DTZ Research

Investment Market Update
Baltic Q3 2011
Positive prospects will boost the activity

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Contents

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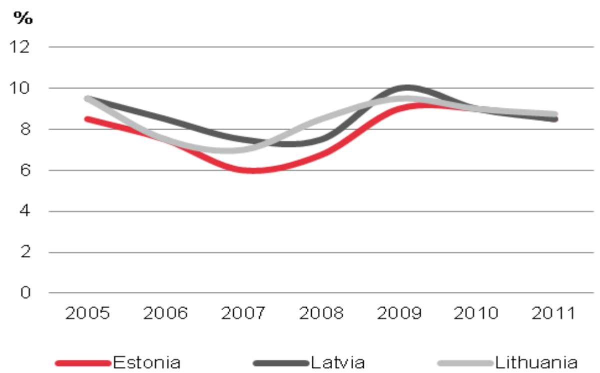
- Recession in Baltic countries is over and although the recovery has been uneven across different economic sectors, turnaround is evident
- Overall situation in the Baltic countries is enlightening. From investment point of view, crisis in economy and real estate market have made all three countries – ESTONIA, LATVIA and LITHUANIA - attractive as prices of real estate have significantly decreased, yields increased and the variety of different properties on offer is wide.
- Serious obstacle to investment activity has been the weakness of economies which took a high speed in recovery process however it will slow down further.
- In short term, yields will have a slight tendency to decrease, especially in Estonia and Lithuania and mainly in retail and office sector or properties with very good perspective and strong rental agreements. Yields in Latvia will remain stable at least during current year.
- Baltic countries separately are small in size, but together make a considerable region for trade and investing. All three countries are effective in speed of decision making with country-wide importance, making them in long term more stable and trustworthy partners

Figure 1

Dynamics of office prime yields in Baltic States



Source: DTZ Research

Macro economic trends

General trends

Recession in Baltic countries is over and although the recovery has been uneven across different economic sectors, turnaround is evident. In 2010-2011, the biggest contributor to growth was the recovering export sector. Stabilisation in household consumption, driven by stronger consumer confidence and more positive outlook towards future, supported the overall economic activity. However, global uncertainty has risen, and global growth is now expected to slow down more sharply than previously forecast.

ESTONIA

The economic situation in Estonia has mainly improved by support of export, but the domestic demand is playing continuously larger role in overall growth. After joining the Euro zone in the beginning of 2011, the Estonian reliability has increased in the eyes of foreign investors and in international scene as whole. The amount of investment transactions in real estate sector has increased throughout the year 2011.

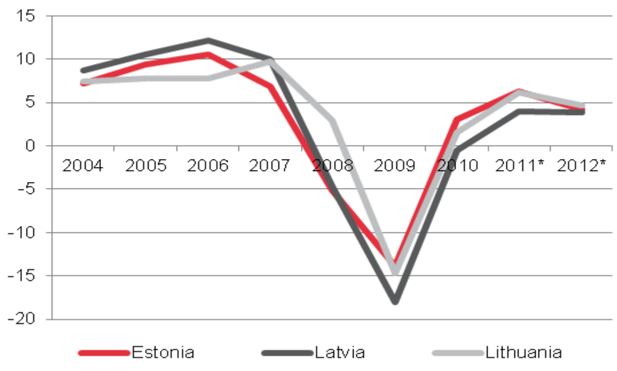
Based on the information from Statistics Estonia, GDP decreased by 13,9% in 2009, and was followed by 3,1% increase in 2010. Based on the prognoses of Estonian Bank (from June 2011) the growth of GDP will be 6,3% in 2011 and 4,2% in both 2012 and 2013. The growth of GDP was 8,4% in the Q2 Y2011 compared to the same period in 2010. In the comparison with 1st quarter of 2011, the growth was 1,8%.

Based on the information from Bank of Estonia and Statistics Estonia, the CPI was 0,2% in 2009 and 2,7% in 2010. Such fast inflation is mainly caused by price increase in food and fuel sector. Based on the prognoses of Estonian Bank, the CPI will be 4,7% in 2011 and after the inflation in food market has stabilized, 2,5% in 2012 and 2,9% in 2013.

There average registered unemployment rate was 12.3% in 2010. The same figure has continuously decreased, being averagely 7.4% in Q3 2011 and after three quarters of 2011 8.8% on annual base.

Figure 2

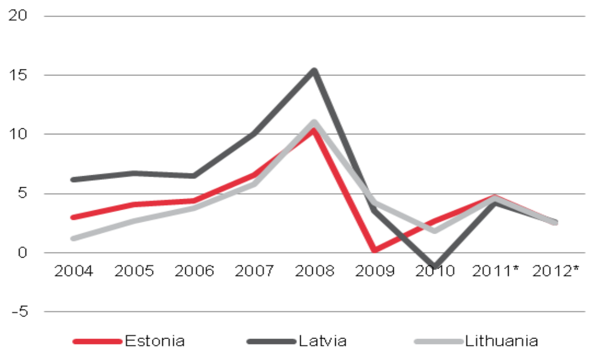
Real growth rate of GDP in Estonia, Latvia, Lithuania



Source: Statistics Estonia, Bank of Estonia, Statistics Latvia, Statistics Lithuania, Lithuanian Ministry of Finance

Figure 3

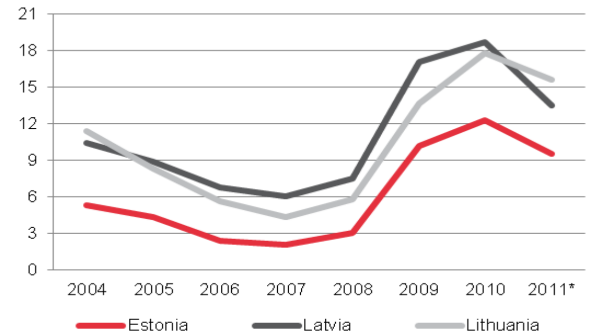
Growth rate of CPI in Estonia, Latvia and Lithuania



Source: Statistics Estonia, Bank of Estonia, Statistics Latvia, Statistics Lithuania, Lithuanian Ministry of Finance

Figure 4

Unemployment rate in Estonia, Latvia and Lithuania



Source: Statistics Estonia, Bank of Estonia, Statistics Latvia, Statistics Lithuania, Lithuanian Ministry of Finance

Macro economic trends

LATVIA

Economic growth picked up strongly in the first two quarters of 2011; however slowdown was experienced in the Q3 Y2011 because of growing import. In July 2011 the most significant share in Latvia’s export had export to the countries of the European Union (74.5%), followed by export to the CIS countries – 14.1%. The main trading partners were Lithuania (18.0% of total export), Estonia (14.1%), Russia (9.7%), Germany (8.1%) and Poland (6.9%).

Compared to the second quarter of 2010, the GDP in the second quarter of 2011 has increased by 5.6%. Historically, from 1996 until 2011, Latvia's average annual GDP growth was 4.54 % reaching an historical high of 13.90 % in March of 1996 and a record low of -19.10 % in September of 2009 according to the data of the Central Statistical Bureau of Latvia. Stronger export and restocking has stimulated investments and, thus, import in 2011. Activity gains are still weak, especially in the public sector, and adjustment should continue.

The labour market situation continues to improve. In Q3 Y2011 there were 11.6% unemployed of the active population in Latvia. However, unemployment rate will remain high for years to come. Further developments will depend on productivity and wages growth.

LITHUANIA

GDP as compared to corresponding period of previous year, seasonally adjusted, in the end of September 2009 was –decreased 14.5%, and in September 2010 GDP decreased by 1.6%. In the end of June 2011 compared with preview half-yearly GDP increased by 0.4 %. The Lithuanian Ministry of Finance forecasts 5.8% and 4.7% economic growth in 2011 and 2012, respectively. The recovery of Lithuanian economy is stimulated by the growth of domestic demand, whereas the influence of foreign demand ceased to increase.

Average annual inflation was at 3.4%in the end of August 2011 and increased by 4.2%, compared with the August 2010. According to the forecast by Ministry of Finance of Lithuania, the average annual harmonized index of consumer prices was positive in 2010 and climb to 3.3% in 2011.

According to the estimates of the Labor Force Survey conducted by Statistics Lithuania, the unemployment rate in the country in Q2 Y2011 stood at 15.6 %. Over the year, the unemployment rate decreased by 2.7 percentage points. On the July 2011, there were 255.6 thousand registered unemployed, which is 15.6 % of the country's working age population. The average annual unemployment level is assumed to stand at 14.9% in 2011, and should be followed by a mild drop to 11.5% in 2012. The more positive changes are expected in 2013-2014, when according to the forecast by Ministry of Finance of Lithuania, the unemployment level will fall to 9.3% and 7.8%, respectively.

ESTONIA

Land reform started in November 1991, with the objective to transform relations based on state ownership of land into relations primarily based on private ownership of land. The Western European style system of Land Register was introduced and enforced with a great success. During the years 1993-1995, the main legislative acts regulating the real estate transactions were evolved: Law of Property Act, General Principles of the Civil Code Act and Commercial Code. Hardly had the national law been created, was Estonia in situation where it was necessary to bring the regulations into line with EU requirements. The transposition of the EU Aquis Communautaire started. Estonian Government started also developing the information society, where the priority was evolvement of digital state registers that could make different administrative procedures easier and more timesaving for private entities and public institutions. For transforming the economy more attractive for foreign investments, clear and advantageous tax-system was also established.

In Estonia information related to all real estate is registered in a Land Book kept by County Court real estate registration departments. Land Book shows for each property the owner, mortgages, servitudes and other information registered in the relevant portion of the registry. Land Book data is public and any interested party may have the information. Real estate units are registered in Cadastral Register which is publicly accessible via internet.

Table 1

Property registration systems

	Estonia	**Latvia**	**Lithuania**
Land plots (physical parameters)	Cadastre	Cadastre	Cadastre
Buildings	Building Register	Cadastre	Cadastre
Mortgages	Title Book	Land Book	Mortgage Register
Ownership etc. rights	Title Book	Land Book	Cadastre

Source: DTZ Research

Retail market

LATVIA

Transactions with real estate are regulated by Civil Code, which along with Land Register law dated from 1937, were approved by Latvian parliament in 1993.

In Latvia there is a trustworthy and effective real estate registration system that is comparable with systems in Western Europe (Land Book registry). Usually a purchase agreement is submitted to Land Book along with the corroboration request, a notarization by a notary and other information in addition to registering title or leasehold estates under the Land Book registry system. As a difference to many other countries, it is possible for land and buildings to be owned by different persons. The relationship between the different owners is regulated on the level of reform law.

Land registration is regulated with corresponding law. Real estate units are registered in Cadastral Register. It is possible to get information about all cadastral units, buildings and the value of land. Some properties are registered only in Cadastral Register. Most of these are privatized apartments and land plots restored by their previous owners.

The Land Book forms one of the underlying preconditions for the transfer of title. It is the presumption of law that the person (natural person, legal entity, state or municipality) registered with the Land Book as the owner of real estate is considered it's lawful owner having full control of the property. In any transaction involving transfer of title, it is of utmost importance to have the property registered in the name of the purchaser as soon as possible to enable the purchaser to obtain all rights of the owner with respect to third parties.

LITHUANIA

In the beginning of 1990s shortly after becoming independent, land and ownership reforms was executed. Compared to Estonia and Latvia, the reform was less radical, combining all registers (no separate Land Book was formed).

Harmonisation of the legislative acts with those of the European Union and the reform of the administrative system in Lithuania has contributed to the protection of ownership, legal occupancy and investments.
The real estate market in Lithuania is regulated following the generally accepted principles of ownership immunity and protection of rights of a just acquirer (possessor). In addition, the principles of equal treatment and equal protection are the main principles of the investment law, meaning that both Lithuanian and foreign investors are subject to equal business conditions, and their rights and lawful interests are equally protected by law.

The Real Property Register contains all actual information of buildings and land plots, rights to real estate and encumbrances thereof. One can receive information from the Real Property Register on changes in real estate, mortgages on buildings or land plots including pledges of land lease rights, imposed attachments, civil cases brought to the court regarding real estate as well as registered agreements or decisions made regarding the legal status of real estate, such as concluded lease agreements and equivalent, regarding any particular piece of property.

In Lithuania commercial land is mainly state-owned, meaning rental relations are dominant. From the institutional point of view, Lithuania has a separate mortgage institution, while in Latvia and Estonia it is included in the Title Book system.

Investment market

In previous years the interest of international investors was involved with the Baltic region as a whole. After Estonia joined with the EURO-zone, the interest is little bit higher towards Estonia, but also towards Lithuania and Latvia.

The most active investors in the Baltics have historically been the Baltic Property Trust, East Capital, Evli, Boultbee, Citycon, AVEC Baltic Property Fund, EEREIF, Catella Real Estate, Deka Immobilien, Verdispar, Triangle Group, EEREIT and Explorer Property Fund – Baltic States.

ESTONIA

General overview

Within Estonia, the most favourable region is still Tallinn and the areas around Tallinn. Pärnu, Tartu and also Jõhvi and Narva are also attractive, but clearly secondary. The rest of Estonia even in larger settlements is from investment point of view less valued, having among comparable locations yields of all sectors on lower level.

In general, the most active part of investment market is involved with retail as the more stable market sector in market slow down situation. Office sector has been more active within last year, being affected by low vacancies and moderate increase in rental levels. There have been no larger investment transactions in industrial sector during the last year.

Transactions

Many companies have gone to bankruptcy, leaving the sale of collateral on banks shoulders. Collateral is sold on public auctions, resulting in low sales prices.

Driven from low sales prices, all the main banks in Estonia have formed investment companies that bid on public auctions to buy real estate with good perspective. If transactions through public auctions today are made with market level sales prices or not is a matter of discussion and depends on auction course.

For example in June 2011 SEB's Estectus bought Scala City office building located in close edge of CBD in Tallinn. It was bought in the auction by €5.76m.

Activity in investment market enlivened from second half of 2009, and even more from Q2 2010. If in 2009 office properties were sold with the yield approximately 10% and higher, then properties sold during 2010 had yields around 9%. Deals with warehouses were made at yield around 10-11%.

The biggest transaction in investment market was made in May 2011, when Citycon bought Kristiine shopping centre from Pro Kapital with €105m, estimated yield of the transaction was 8.0%.

The other big transaction was made by BPT, buying Lincona office complex in city centre of Tallinn in Q2 2011. It was first investment made in their newest – Baltic Opportunity Fund. There is altogether 11,000 sq m of rentable area and 400 car parking places. There are also retail and service premises in the complex beside office. The anchor tenant is Swedbank's IT-department. The price of the transaction was €15.4m, yield level 8.5%.

Outside of Tallinn one of the biggest transactions was made in Tartu in Q2 2011, where Estonian fund EfTEN bought office building sized 3,524 sq m located in city heart (Tartu Kapitali building) with €2.25m. The anchor tenant is Sampo Bank.

There have been different smaller investment transactions made throughout the year.

Yields

Compared to Northern and Western European countries, market yields in Estonia have been relatively high for a long time. During the years 2006-2007, the yields fell dramatically, almost to the level of Northern and Western European countries and close to interest rates. During the years 2008/09, yields rose again - during 2008, the increase was 150-250 basis points and during 2009, 50-100 basis points in addition. In 2010 the yields remained quite stable. In the 2011, the first signs of decrease are in retail and office sector, maximum by 50 bpt.

The "low end" of yields in industrial and logistics sector starts from 10.0% presuming good quality, a long term rental agreement (usually sale & lease-back deals), a trustworthy lessee and a guarantee from a bank or from mother company. The lowest yield for retail is 7.5% and for office properties 8.0%.

Yields in Pärnu and Tartu are 1-3% higher, depending on quality and perspective of the property. The rest of Estonia even in bigger settlements is not comparable, yields being significantly higher.

Investment market

LATVIA

General overview

Investment demand remains rather low in Latvia.

Due to previous information and macroeconomic and real estate sector recession, investors tend to wait for stabilization. Economic slowdown affected the quality of investment products as vacancy rates rose, in the same time rental fees and property prices fell.

Transactions

2009-2010 is noted for no investment transactions. Some formal transactions were enclosed in the beginning of 2011. The bank building in Old town was sold for 12 million EUR for Snoras Bank. Estonian company bought industrial/ administrative buildings at Katlakalna 9 for more than 5,94 million EUR. The lates transaction was enclosed between Rimi and Baltic Property Trust; Hypermarket Rimi Valdemars was sold in October 2011, although transaction price is not disclosed. Nevertheless, Riga still remains attractive due to its geographical location.

On the 1 July 2010, the amendments to the immigration law of Latvia came into effect, which allows foreign investors to obtain the residence permit in Latvia. This legislative change is expected to have serious impact on Latvian investment market.

Purpose of investment transactions: Speculation or for own use, but no commercial reasoning is the purpose of enclosing deals. Typical properties on sale are assets with short term or easy to terminated agreements, high vacancy rate or even close to empty, unsuccessful tenant mix. Type of deals is mostly speculative or distressed with low deal size eg: 2-10 € mn.

Mostly only secondary assets on sale, eg small retail properties and some office buildings. Investors tend to wait. Some transactions are foreseen in the Q4 2011.

Yields

Market yields in Latvia have historically been relatively high compared to Northern and Western European countries. During the years 2006/07 the yields fell sharply, however, during the years 2008/09 - 2009/10 yields quickly increased again. The first signs of commercial market stabilization in 2010 were noticed, rental rates have evened out and stopped falling, a positive effect on investors' confidence has resulted in lower yields.

The lowest level of yields in the industrial and logistics sector starts at 10.0% presuming good condition, a long term rental agreement (usually sale & lease-back deals), a strong tenant and a guarantee from a bank or from mother company. The prime yields for retail and office objects are 7.5% and 8.0%, respectively. As there haven't been large transactions, then presented levels are rather assumable.

Investment market

LITHUANIA

General overview

In Lithuania, the most favourable region for international investors is Vilnius, followed by Kaunas, Klaipeda, Panevezys, and Siauliai, the rest of Lithuania even in bigger settlements is from investment point of view less valued.

The most active part of investment market was involved with retail as the more stable market sector also in the market slow down situation. The last large investment transaction was recorded in 2008, when Akropolis shopping centre in Kaunas was acquired by German fund DEKA Immobilien. Few and much smaller investment transactions were made also in 2009 and 2010, but the activity is still rather low.

Yields

As there were no evidence of significant investment transactions in 2011, and only one office property was acquired as investment in 2010, the yields are rather assumable and represent the overall expectations.

The expected yield level currently stands at 8.0-11.0% for office properties, whereas for those of the best quality located in the Vilnius CBD the yield level is estimated to be in the range of 8.0-8.5%. The yield of prime retail properties is 7.5-8.0%, while that of industrial and logistics is estimated to be 10.0%.

Transactions

Despite the significantly increased supply of new investment opportunities during the economic downturn, there were no investment transactions of larger scale in 2011 and only one transaction in 2010. The office building (8,000 sq m), developed by local developer Vilmesta, was acquired by Lords LB Baltic Fund I. The building is anchored by Danske Bank. This is the first acquisition of the Lithuania based property fund.

The main factor determining such low activity is a tremendous gap between buyer's and seller's property price expectations. Other reasons for low activity include upswing in borrowing cost and the price of capital as a result of the global financial turmoil in 2008; challenges caused by economic downturn in Lithuania; short-term risks related to commercial property market (high vacancies and dramatic decline in rentals); uncertainty of the further market development in the future.

Many local property owners and developers found it difficult to acknowledge the sharp drop in their property values, but those under financial pressure were forced to consider disposing some of their assets in order to strengthen their short-term financial liquidity position. Thus, a number of prime investment properties were offered for sale. However, a mismatch of the yield level expectations between sellers and buyers lead to only one investment transaction in 2010.

The market remained illiquid in September 2011. Yet the lack of transactions made it more difficult to estimate the actual drop of property values. The more frequent expectations of potential investors to get double-digit yields have widened the gap between the sellers' and buyers' anticipation of the property price. Developers and property owners were not in a hurry to sell their properties, as the current market price often does not satisfy their previous investments.

Investment market

Comparison between Estonia, Latvia and Lithuania

Overall situation in the Baltic countries is enlightening. From investment point of view, crisis in economy and real estate market have made all three countries attractive as prices of real estate have significantly decreased, yields increased and the variety of different properties on offer is wide. Serious obstacle to investment activity has been the weakness of economies which took a high speed in recovery process however it will slow down further.

First to exit the recession period are Estonia and Lithuania which are to investors also more attractive. Investors mainly come from Scandinavian countries, but also from Russia. Latvia is currently still less attractive, but the situation will improve along with stronger recovery in economy and in real estate market.

In Estonia, first national capital based investment funds was founded in 2005 – Eastern European Real Estate Investment Fund (EEREIF) and the second in 2008 - Eften Capital. Eften Capital portfolio contains seven commercial real estate properties in Tallinn and in other larger cities in Estonia. Eften Capital also operates the Baltic real estate portfolio which contains eleven commercial properties all over Estonia. EEREIF portfolio contains different typed objects (commercial properties and development projects) in all 3 Baltic countries and also in Poland and Bulgaria.

This kind of a national investment fund is also created in Lithuania, however, slightly later. All three funds, in Estonia and in Lithuania, were created to invest in real estate with great perspective, steady rental flow and attractive price.

Investment market

In short term, yields will have a slight tendency to decrease, especially in Estonia and Lithuania and mainly in retail and office sector or properties with very good perspective and strong rental agreements. Yields in Latvia will remain stable at least during current year.

Baltic countries separately are small in size, but together make a considerable region for trade and investing. All three countries are effective in speed of decision making with country-wide importance, making them in long term more stable and trustworthy partners. Due to low wage level, the countries are attractive to international industries in order to increase the efficiency of their operation. In addition, the Baltic countries have strong growth potential in terms of real estate market and participating in global transit and industry.

Table 2

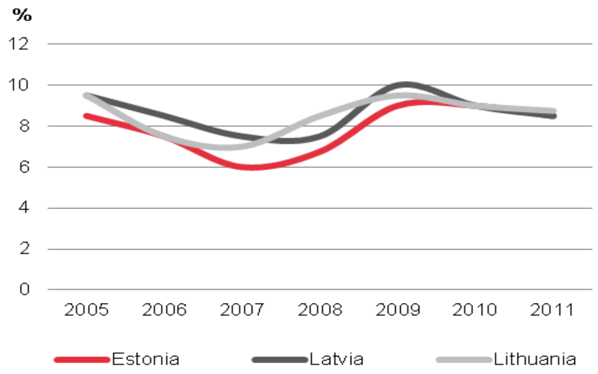
Prime yields

	Retail	Office	Industrial and warehouse
Baltic countries	7.5-8.0	8.0-9.0	10.0-13.0
Central and Eastern Europe	4.0-6.5	5.0-7.0	7.5-8.5
Western and Northern Europe	5.0-6.0	4.5-6.0	6.0-7.5

Source: DTZ Research

Figure 5

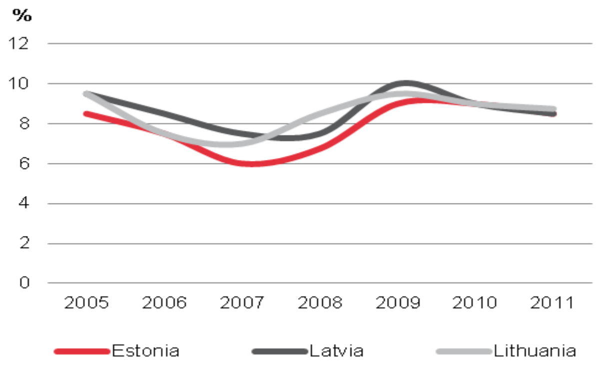
Dynamics of office prime yields in Baltic States



Source: Statistics Estonia

Figure 6

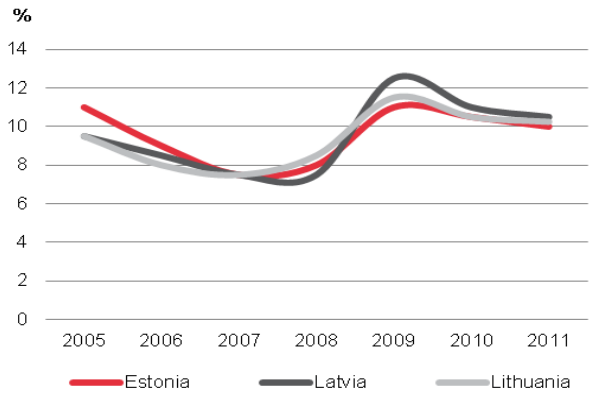
Dynamics of retail prime yields in Baltic States



Source: Statistics Estonia

Figure 7

Dynamics of industrial/ logistics prime yields in Baltic States



Source: Statistics Estonia

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