Real Estate Market Report 2007

Baltic States Capitals

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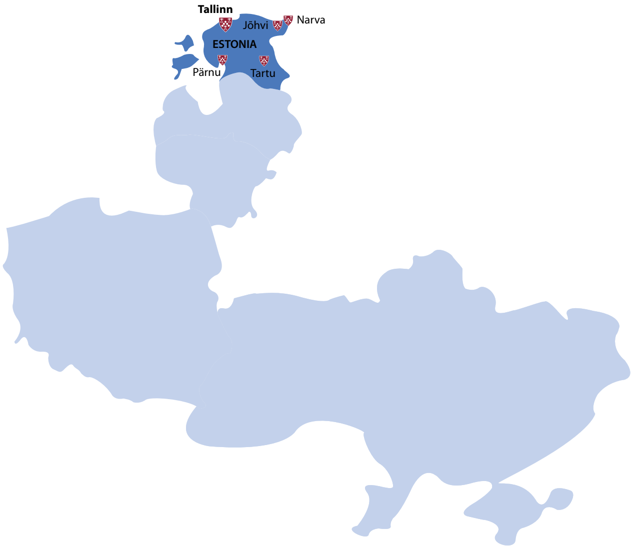

Tallinn, Estonia

Supply of New Developments Limited by Construction Capacity

Economy

Estonia's GDP grew 11.8% in 2006, following 10.5% growth in 2005. Average GDP growth has been 9.1% for the last seven years. Growth is projected to be over 8% in 2007. The contribution of domestic demand to growth has increased markedly since 2005, as consumption has been fuelled by wages growing over 10% per year, strong consumer confidence and large increases in private debt. Unemployment is at historical lows at 5.4% in 2006.

Retail sales grew 19.7% in 2006. Consumption may slow in the years ahead as wages decelerate, and the increased loan burden and increasing interest rates slow spending patterns.

Prices still have room to rise to fully converge with Western Europe - thus inflation remained, as expected, above EU norms at 4.4% in 2006. Inflation is expected to remain around 4%, as it has for many years. Rising prices of production inputs, like salaries and indirect effects of energy price changes have an upward impact on inflation as well.

Like the currency, mortgage rates are linked to the Euro, and are therefore now tightening slightly. Average mortgage rates were 4.6% at the end of 2006. However, with CPI at 4.4%, and property price growth in double digits, real lending rates are, for all purposes, zero or even negative.

Sound and liberal economic policies and excellent business climate has ensured a continuous growth of foreign direct investment (FDI) in Estonia. FDI per capita in 2005 was € 1,740 and € 510 in the first half of 2006.

Office

Growing Supply Yet to Satisfy Demand

Supply

Only 19,000 sqm of class A office stock was added to Tallinn in 2006, bringing the total to 144,000 sqm. The total stock of class A and B office space has reached about 300,000 sqm by the end of 2006.
The low supply is due to the higher profitability of developing residential units in this low-interest rate environment, and the limited availability of construction labour and resources in the Baltic States today. However, the development of office premises is increasing steadily in Tallinn.

Recent Developments

Rävala 4 – located next to City Plaza in the CBD, this 8,000 sqm building was opened in Spring 2006. The project was 100% pre-leased and rents were € 13-16 per sqm. Most of the tenants are local companies.
Twin Towers – completed in November 2006 by local construction company Merko, these two buildings offer 7,300 sqm office space. Rents are €14-16 per sqm. 80% pre-leased. The demand is high but the owner prefers bigger clients and preferably well-known international companies and smaller and local companies have to wait in cue.
Foorum Building – a 2,400 sqm building in the centre of the city, completed in December 2006. Rents are €14-16 per sqm. 85% pre-leased for the same reason that in Twin Towers (demand is higher).

New Projects

Ülemiste City - The first phase of a new business district called Ülemiste City will be developed near the airport at Lõõtsa 2. Over the next seven years the project will deliver 160,000 sqm of new office space plus 70,000 sqm of light industrial premises for high tech companies. The first phase, to be delivered in 2007, will consist of 20,000 sqm of class A office space in two 10-storey towers. More than 50% of the space was pre-leased at the beginning of 2007.

Sõpruse 145 - E.L.L. Kinnisvara (a subsidiary of Merko Group) is developing a 12,500 sqm modern office building in Mustamäe area in an excellent location only five minutes drive from the city centre. The five-storey building will also have some retail, service and catering places on the ground floor. Development is scheduled to be completed by autumn 2007.

Mustamäe 16 - Norwegian investors Gildhall are building a new 8-storey office building on Mustamäe Street near the city centre. The building will have 10,000 sqm of office and 4,000 sqm of retail, located a 5-minute car drive from the city centre. The ground floor will be taken by the supermarket chain Selver, with the rest of the space remaining to lease out.

• *Tallinn city centre: CityPlaza and SEB office buildings*

Demand

Total take-up in 2006 absorbed all 19,000 sqm of Class A space to be delivered, with no overhanging space remaining. There is no vacancy remaining, other than small 100 sqm units. Due to the shortage of office space, vacancy has dropped below 1% and pre-leases take up over 70% of new supply. Demand is strong due to GDP growth averaging 9.1% over the last seven years.

Rents

Class A office rents in Tallinn rose 15% in 2006, to €15.00 - €18.50. Typical service charges in class A buildings are €2.50 to €3.50 per sqm per month.
Rents for class B office space range from €8.00 to €12.00 per sqm per month. Class B rents rose by 10% in 2006. We expect rents to rise a further 10-15% in 2007 as take-up will continue to exceed supply.

Investment

No class A or investment grade office building transaction was recorded last year. Offering yields are not lower than 7.0% and the asking range is 6.5-7.0%. With the indicators such as GDP, CPI, and rents converging with core markets - and thus rising faster - investors believe there will be much more rental growth to come, increasing their yields on investment cost.

The only large office transaction in 2006 was the sale of a large Soviet-era office building in prime location in CBD at Rävala Street 8, which was sold by the Estonian government. Local investor Wipestrex Grupp paid €24.3 million for the 16,700 sqm class B office building. The main tenants are the Ministry of the Environment and several state institutions. IT is unlikely the property was bought for the yield, but rather with the intension to redevelop this choice location some time in the future.

The largest portfolio to come to market will be a sell-off by SEB of its 14 properties in Estonia. The buildings will be sold in the first half of 2007.

Legal Notes by Sorainen

Rents are usually payable monthly in advance, in some cases up to 15th day of current month. Payment of rent in advance for more than one month is not customary. Tenants generally pay their own utilities, invoiced after use by the owner. Rents are typically tied to the euro but indexed to local inflation. Triple net leases may be found but are not universally used. However, the concept of sinking fund is not used and normal wear and tear is widely accepted. Use of securities ensuring the payment of the rent and costs, such as rent deposit or bank guarantee, are quite common. Leases survive the transfer of property title. When buildings are sold, the lease agreements are generally of low quality. Typically no standard agreement is used, or even if it is used, many standards have been used based on their development during the years. It is not unusual for buildings to have technical defects, such as with air-conditioning, humidity system, even ventilation. Often foreign investors and local sellers have a different understanding of what is deemed as an A-class or a B-class building. Asset deals and share deals are equally common.

Retail

Rapid Spending Growth Drives New Supply

Supply

Total retail stock is currently 500,000 sqm (1.25 sqm GLA per capita) in Tallinn. Rapid growth in retail supply in 2004 caused some over-supply which reduced investments in 2005-2006. There were few new projects completed in 2006. As the development of new concept shopping centres has been successful, several existing centres like Rocca al Mare, Kristiine, Järve, Magistraal have plans in near future to add ca 40,000 more retail space to the market. The main target for future developments is the eastern suburb Lasnamäe, where one third of the capital's population lives, yet retail space per capita is 50% lower than Tallinn's average today. Tallinn's first large retail park is planned there as an area for groceries, DIY retail and car sale centres.

Recent Developments

Foorum Centre – a 5,000 sqm retail space in central city next to Viru Keskus developed by local construction company KMG Ehitus was opened at the end of 2006, and was fully leased.

Mustakivi Prisma – second large retail development by Häuser-Oberschneider in Lasnamäe Retail Park. A 11,000 sqm hypermarket was opened in October, 2006, and was fully leased.

New Projects

Rocca al Mare (extension) – Finnish Citycon will extend the shopping centre they bought two years ago. The first extension will bring 16,000 sqm more retail space to the property at the beginning of 2008. Citycon plans a second and third extension of equal size by 2010.

Magistral (extension) - The owners of Magistral centre in the Mustamäe suburb will add another 13,000 sqm of retail and additional parking.

Mustakivi Retail Park – Regional developer Häuser-Oberschneider will add 25,000 sqm of new retail, including a large DIY-store, next to the already existing Lasnamäe Centrum and Prisma.

Demand

The competition between well-operating retail centres is high and demand for retail space in good locations exceeds supply. Vacancy rates are virtually 0% during 2006. Several shopping centres have a waiting list of potential new tenants. The market situation has encouraged several centres to plan expansions in the future.

• *Tallinn, Lasnamäe Retail Park: Lasnamäe Centrum and Prisma*

Mall Rents

Rents on new leases grew 14% in 2006, as demand outstripped supply. New shopping centres charge €15-24 per sqm per month for 100 sqm units in prime locations. Food store anchor tenants' rents are €9-10 per sqm. Maximum rents for tenants occupying small spaces reach to €48 per sqm. Service charges range from €3-5 per sqm (depending on the centre) with a tendency to grow. Rents for a prime located main street units and old city shopping areas range from €20-50 per sqm per month.

Investment

The only significant transaction was the purchase of the 1,600 sqm De La Gardie retail building in the Old Town by EVLI Property Investments Fund for €4.9 million. The yield was estimated at about 7%. Owners are reluctant to sell, and those that offer their property are asking in the range of 6-7%.

Legal Notes by Sorainen

When looking at investment properties, keep in mind that there is no standard approach to the set-up and use of marketing funds. Turnover-based rent is not used. Rents are typically tied to the euro but indexed to local inflation. Lease agreements are often of low quality, e.g. distribution of maintenance and renovation obligations may not be set out very clearly in lease agreements.

Industrial

Nearly all Projects Built for Owner Occupiers

Supply

Rapid economic growth and increasing foreign capital flows drove increased development in 2006. In 2006 140,000 sqm of new industrial and warehouses were developed in the Tallinn area, bringing the total stock of modern industrial space to 440,000 sqm. More than 80% of newly developed premises are situated out of the city borders. Built-to-suit projects are predominant type of developments. Speculative developments are very limited. The majority of new warehouses and industrial buildings are located along the St. Petersburg and Tartu Road from the border of Tallinn up to Jüri as well as along Pärnu Road up to Saue.

Recent Developments

Jüri Technology Park – The largest industrial park in Tallinn area covering a total territory of 37 ha and includes 42 land parcels of between 2,700 – 16,000 sqm. The developers offering both land to sale as well as built-to-suit for tenants.

Smarten Logistics Centre – 1st phase of logistics centre with 26,000 sqm situated in Assaku near Tallinn. Owner occupied.
Via3L Logistics Complex – 20,200 sqm area logistics centre developed by Loginvest LLC in Rae Parish, Harju County. Owner occupied.

Balti Logistics Complex – a warehouse complex with 15,200 sqm developed by Balti Logistica Haldus in Lasnamäe Industrial Park. Owner occupied.

Demand

There is demand for quality (renovated or newly built) rental premises in almost all districts of Tallinn. Requirements for new rental warehouses and industrial spaces have remained constant:
- Location in industrial region near highways and logistic terminals.
- Good accessibility.
- Insulated and heated.
- Flooring with sufficient carrying capacity.
- Infrastructures with sufficient capacity.
- Availability of sufficient office space.
- Availability of public transit in direct vicinity.

Most demand for warehouses and industrial premises has come from different logistic companies and companies that operate in distribution and manufacturing fields.
Trend: the demand for modern warehouses and industrial spaces remains high. The development activities will be buoyant alongside the main highways (Tartu Road, St. Petersburg Road, and Pärnu Road) within 30 km from Tallinn.

• *Tanassilma Industrial Park: modern industrial and office buildings in Tallinn suburb, next to Pärnu Road*

Rents

Rental rates for new warehouses and industrial premises located in the most demanded regions remain €4.50 to €6.40 per sqm per month. Rental rates for secondary market premises at prime locations range from €3.90 to €5.50 per sqm per month and less demanded location vary from €3.00 to €4.50 sqm per month. Some increase in rents is foreseeable due to rapid growth of both land prices and construction costs during last year, and the lack of new developments for rent.

Investment

Yields are 8% in the case of sale/leaseback transactions. Continually high interest for industrial premises and deficit of quality investment objects will push yields lower.

Legal Notes by Sorainen

Industrial leases are quite simple, finance and construction opportunities are readily available. Rents are tied to the euro but indexed to local inflation. Nearly all properties are owner occupied. There is a lack of good-quality tenants and sufficiently universal properties to create an investment market. The number of sale-leaseback transactions is low.

Land

Commercial Land Prices Climbing

Supply

There are very few large sites remaining in the city centre, only those in the harbour area, the former TVMK plant site ("Luther Quarter"), and Juhkentali Quarter. For commercial development, there are sites on the junction of the Tartu and St. Petersburg Roads. Land for industrial development exists in the city on the St. Petersburg Road, as well as on the Tartu and Pärnu roads outside of the city limits, and on the ring road. For any large residential project, developers have to look for plots outside the city limits.

The procedure of changing a land site purpose is long-lasting and complicated process, which can take from six months up to three years.

Prices

As anywhere, prices for land depend on allowable building volumes. The price of land for residential development range from €600-800 per sqm of net sellable area in Tallinn city centre and from €320-400 per sqm of net sellable area in suburbs and adjacent to the city borders.

Prices of commercial land near the city limits on main roads range from €35-220 per sqm. Land plots for industrial premises in technology parks are sold for €40-125 per sqm. Prices of commercial land plots in prime locations on main traffic roads with extensive building rights start from €250 per sqm.

Strong economic growth is pushing demand for space, and therefore land prices have grown more than 40% in the suburbs and more than 60% in the city centre in 2006.

Demand

There are number of enterprises who want to move their existing production and distribution facilities situated inside the city to better locations and others who need space for extensions. The biggest demand is for properties outside of Tallinn on main highways to St. Petersburg, Tartu, and Pärnu and alongside the Tallinn roundabout connecting the highways. Residential land divided to appropriate land plots for houses as far as 20-30 km outside of Tallinn in good location is also in need.
The most attractive properties for investment are land sites in city centre for apartment and office development and also the commercial land in good locations outside the city borders. These are still good investments considering the growing demand.

Investment

One of the biggest land deals in Tallinn in 2006 was the purchase of a land plot near Hotel Olümpia by a local investor. The 7384 sqm plot was sold at auction for a total price of €38.1m, which was €5,160 per sqm of land, but €560 per sqm of net buildable area according to detail plan.

News

The reconstruction of several main roads has begun, such as the expansion of the Tartu Road, reconstruction of Merivälja Road, construction of Mustakivi Road extension and connection between Smuuli and Suur-Sõjamäe Roads. The planned reconstruction of the Ring Road to four-lanes with multi-level intersections means that some of the existing off-ramps will be closed in the future, which might leave some land plots without access to traffic.

Legal Notes by Sorainen

There are no restrictions on foreigners purchasing land except for agricultural and forestry land over 10 ha. Most land is offered without detail plans, which means unclear building rights. In rural areas, one may expect problems with the right of use of the land if privatization was not finished in time.
The pricing of development potential (construction rights) is the most difficult point of purchase negotiations. As sellers are often inexperienced, they have difficulties in evaluating the development potential or the development potential is based on the sellers' optimistic relations with local governments.

Residential

Price Growth to Continue, but not at Heady Pace of the Past

Prices

Prices continue to grow, with residential prices rising 24% in 2006. Price rises are fuelled by an imbalance of supply and demand, by easy credit from banks, and by speculators betting on further rises.

Prices of newly built apartments in suburbs vary from €1,800-2,200 per sqm in the largest districts (Lasnamäe and Mustamäe) and up to €2,500 per sqm in new developments near the sea in Kakumäe and Pirita. These prices are for fully fitted units. In the Old Town prices for flats in newly renovated buildings are €3,800-5,100 per sqm.

In the Soviet-era, pre-fabricated concrete suburbs, prices for unrenovated apartments are between €1,200-1,300. As a result of more of these flats being sold, the average selling period has lengthened and prices have dropped by over 10% in 2006.

Supply

More than 3,400 newly built units were completed in Tallinn and surrounding areas in 2006. That is 20% more than in year 2005. There were more than 1,000 new units for sale in Tallinn at the end of the year 2006. Most of the new residential developments are in the suburbs. The only large city centre development is the 180-unit Luther Quarter and another large development of more than 1,500 apartments over the next 5-6 years on an adjacent 11 ha site.
There are very strong bottlenecks in the supply side – most of all in construction capacity - which limits future supply growth.

• *Tartu, South-Estonia, new living area Jõekääru, developer SRV Kinnisvara AS.*

New Projects

SUBURBS

Kolde pst 67 - Developed by local construction company and developer Merko the project is located in Pelgulinn in Northern Tallinn 10 minutes drive from city centre. There are total 54 apartments. The project will be completed at the beginning of 2007. 95% of the apartments are sold by today with average price €2,300 per sqm. With apartments the buyers received additionally a voucher (€6,410) for interior equipment.

Räägu/ Kännu 27 - Developed by Merko and located in Mustamäe suburb in 10 minutes drive from city centre. The project has a total 64 apartments of which 75% has been sold. The project will be completed in winter 2007. Average sales price has been €2,435 per sqm. but the buyers have received the vouchers for interior equipment in amount of €6,400.

Sipelga 7 - The project is located in Mustamäe area and developed by local developer Koger & Partnerid. The 1st phase of the project – total number of 97 apartments ranging from 47 – 70 sqm will be completed in April 2007. Sales prices in 1st phase have been from €1,800 to €2,000 per sqm for fully equipped (except kitchen) apartments. 70% of the apartments have been sold. Another 291 apartments will come to market during next stage.

Padriku Street - This is a large integral development of total area of more than 80 hectares in Pirita which is one of the most prestigious suburban living areas in Tallinn. The project is developed by local developer TTP and includes development of more than 60 single family houses, 10 semi-detached houses and 38 apartment buildings as well as network of new streets together with necessary communications over several years. More than 300 dwellings have been completed and sold during last 4 years. Currently there are about 30 apartments for sale with average price of €2,500 per sqm. Apartments are fully equipped, storage room and parking place are included in price. About 100 more apartments will be constructed during the last phase. The total project will be completed at the beginning of 2009.

Astangu Street 21 - Developed by local developer Noran and situated in Haabersti suburb. There are total 176 apartments planned from 37 – 77 sqm. The project will be completed at the beginning of 2007 with average price €1,600 per sqm. The price includes a parking place and storage room. 85% of apartments are already sold.

CITY CENTRE

Luther - Developed by local developer Grove Invest and located in the city centre on Vana-Lõuna Street. There are 180 apartments planned from 28 – 185 sqm. The project will be completed in October 2007 with prices from €2,300 to €2,600 per sqm. 50% of apartments have been sold.

Filmi 6 - Developed by Skanska EMV and located in Kadriorg next to the city centre, this project has a planned 86 apartments ranging from 31-126 sqm. The project will be completed in November 2007 with prices from €2,300 to €2,700 per sqm. 80% of the apartments are already sold.

Demand

Demand is fuelled by easy credit, growing wages, zero real interest rates, and an increasing number of households per capita. At the end of 2006, more than 92% of all flats available had been sold. While these trends will continue for many years ahead, the overall effect will not be as strong as in the past.

• *Tartu, South-Estonia, Kroonuaia - new apartment houses next to city centre. Developer Eleven EST OÜ.*

The Mortgage Market

The rapid development of mortgage lending is driven by cheap foreign money flowing into local banks. Strong competition for market share lead banks to slash margins. At the beginning of 2006, the average mortgage loan (issued in Euros) carried interest of only 3.6%. By the end of 2006 rates rose - due to ECB rate rises, not margin increases - to 4.6%. Still, with CPI growth at 4.4%, and property price growth in double digits, real lending rates are, for all purposes, zero or negative.
The maximum lending period is 40 years. Credit may be granted for up to 90% of the property value.
Estonians, like Latvians, are far more leveraged than their Central European counterparts: total mortgage lending equalled 32% of GDP at the end of 2006. Total loan volumes grew 64% in 2006, after growing 55% on average for the last five years.
Although there is still some room for continuing liquidity through convergence with the Western EU (where mortgages average 48% of GDP) in the medium term mortgage market growth rates are expected to slow down to fit better with actual income growth.

Rents

Monthly rent for a 70 sqm typical three-room new apartment in city centre ranges from €575 (unfurnished) up to €765 (furnished). There has been a 20% jump in rental rates during 2006 and demand is much higher than it has been for the last three years.
In mostly suburban areas of Tallinn there is the greatest demand for two- and three-room apartments. Mostly young families are looking for flats with rental rates between €260-€380 per month. In the city centre area there is a highest demand for two-room flats which price range is between €380-€520 per month. The upturn in rents is driven by the recent increase in property prices, rising interest rates, and stricter bank terms - all of which have made renting - rather than buying - a more reasonable option for some people.

Legal Notes by Sorainen

New residential leases are not subject to rent control, and rent may be agreed freely. However, when buying a property with tenants, take care that you have checked whether any Soviet-era tenants are subject to rent control. Such tenants also have the pre-emptive right to buy ahead of you, but are not likely to be financially able to exercise that option.

Legal

Introduction

After Estonia regained its independence, restitution of land and privatisation of buildings and land started in the beginning of 1990s in order to re-establish private ownership. Most of the land has been privatised by now and the title to the land has been entered into the Estonian Land Register, with some exemptions.

Title to Real Estate, Land Register

The ownership of real estate is registered in the Land Register. This is a national register, which includes information about the ownership and details about the real estate and related encumbrances. It is assumed that each and every entry in the Land Register is correct and valid vis-à-vis third persons acting in good faith.
The Land Register is a public register and everyone with legitimate interest is entitled to access the registered information. As of 1 January 2006, the register is maintained electronically.

Acquisition of Real Estate

General

Real estate may be land, apartment ownership or building title. In general, a transfer of a building separately from the underlying land is not permissible, except if a building title is established and so transferred. In such case the building is an essential part of the building title and not of land.
Due to the land reform, buildings may be located on land, which has not yet been entered into the Land Register, i.e. not yet privatised or restituted land. Said buildings – though technically permanent structures – are considered to be movable property.
As of 2 March 2006, no transactions can be made specifically with respect to buildings as movable property. This restriction is not applicable in enforcement, bankruptcy and expropriation proceedings as well as to wills and succession contracts.

Letter of Intent and Heads of Terms

In practice LOIs and HOTs are used to bind negotiating parties to the contemplated real estate transaction. However, in Estonia all transactions related to the obligation to sell and purchase real estate (including preliminary agreements, LOIs and HOTs) require notarisation in order to be legally binding. Without notarisation of said agreements the buyer can neither demand conclusion of the sales contract and transfer of ownership from the seller nor payment of contractual penalties.
If an LOI or HOT sets out the parties' obligation not to negotiate with third parties (so-called exclusivity) this is deemed as valid and binding. Breach of the exclusivity obligation entitles the aggrieved party to compensation of damage, including to payment of specific contractual penalties.
In order for the LOI or HOT to be effective in practice, one must make sure that the exclusivity period is sufficiently long (preferably for intended period of negotiations and e.g. two months thereafter).

Change of Ownership

The title to real estate is considered as transferred upon the registration of the ownership in the Land Register, not upon signing the agreement. The registration of ownership shall be made within one month as of submission of the application along with the signed and notarised agreement to the Land Register.

Asset Transfer vs Share Transfer

Asset deals and share deals relating to real estate are both commonly used in practice.
The following aspects should be taken into account when considering a share transfer of the company holding the target real estate:
• notary fees and state duty arising from real estate sales are saved from transaction costs as the sale of shares of a private or public limited company (the shares of which are registered with the Estonian Central Register of the Securities (ECRS)) is carried out via banks and the ECRS;
• the ownership of shares is transferred as agreed in the sales agreement, usually at the time of closing the agreement, or in case of transfer via ECRS, upon the making of registration in the register, which takes only a few days, whereas in asset transfer the actual transfer of title takes place in one month's time;
• scope of due diligence investigation is extended due to the fact that the share deal transfers an entire company (with all known and unknown rights and liabilities) as opposed to due diligence of the target real estate only;
• LOIs and HOTs for real estate companies are usually binding on the seller;
• deferred tax issues.

For an asset transfer, one should consider the following aspects:
• the asset transfer is subject to a notary fee and state duty and, therefore, is more expensive than a share transfer;
• notary agreements are seldom made in English and sometimes notaries do not facilitate the negotiations;
• limited scope of due diligence investigation due to the fact that the review concerns only the target asset unless the transfer amounts to transfer of enterprise (see below);
• lease contracts survive the change of ownership of the target asset;
• agreements on supply of utilities and other services must be

assigned or concluded anew;
• LOIs and HOTs are not binding on the seller (see above);
• the asset transaction may be deemed as the sale of an enterprise in which case all the obligations associated with the enterprise will be transferred from the seller to the buyer.

Form of Agreements

For transferring title to the real estate, a sales agreement (determining the terms and conditions of sale) and real right agreement (agreement to transfer title) must be concluded. These two agreements are usually contained in one document.
All transactions related to the obligation to sell and purchase real estate require notarisation in order to create legally binding obligations to sell and purchase the real estate. The notary does not only verify the authorisation of the person signing the agreement but also the content of and the will of the parties to the agreement. Parties to the agreement must appear in front of the notary in order to conclude the agreement.

Language Requirements

The sales agreement and real right agreement are drafted and verified by a notary, usually in the Estonian language. At the request of parties, a notary may prepare the agreements in another language provided that the notary is sufficiently proficient in this language. If the agreements are verified in Estonian, foreigners may ask for a written translation or use the assistance of an interpreter before signing.
As the Land Register is maintained in Estonian, any documents in foreign languages must be submitted to the Land Register together with a notarised translation thereof into Estonian.

Due Diligence

It is advisable to carry out legal due diligence of the target real estate before the purchase has been concluded. In the course of the due diligence, title, encumbrances, planning issues, third persons' rights, public restrictions, permits etc. shall be checked, which give more security or bargaining power to the purchaser.

Pre-emption Rights

Pre-emptive rights may be entered into the Land Register on the basis of transaction or may be created by law. For example, a co-owner of real estate has the pre-emptive right upon the sale of a legal share of the real estate to third persons. Also, the state has the pre-emption right upon transfer of a real estate located within the boundaries of a shore or shore bank building exclusion zone.
Pre-emptive rights may be used within two months after receiving the notification of conclusion of the sales agreement by the person holding the pre-emption right.

Typical Purchase Price Arrangements

It is common that 5-10% of the purchase price is paid by a buyer to a broker's or seller's account as a deposit before an agreement is made.
Often the purchase price is transferred to a notary deposit account prior to the conclusion of the sales agreement. The notary releases the purchase price to the seller after registration of the ownership in the Land Register or more commonly, after the agreement has been made and filed with the Land Register and there are no other applications in the Land Register that would hinder the transfer of title.

Related Costs

In the purchasing process of the real estate, the following costs may occur depending on which services are used: brokerage fees, evaluation of the real estate (usually carried out by real estate firms), bank fees, legal fees for carrying out a legal due diligence and reviewing the sales and security agreements, notary fees and state duty.
The notary charges a fee for verifying a transaction. The fees are provided for by law. In sales transactions the notary fee for notarisation of the purchase agreement depends on the value of the transaction. For instance, the notary fee for the sale of real estate at purchase price of €319,000 (EEK 5,000,000) is approximately €973 (EEK 15,220) plus VAT.
Registration of ownership and encumbrances in the Land Register is subject to state duty, the amount of which depends on the value of the transaction and is a fixed sum set forth in the law. A new State Fees Act is expected to enter into force in 2007, according to which the state fees for Land Register operations will be significantly decreased. For instance, in 2006 the state duty for registration of a new owner of real estate with purchase price of €319,000 (EEK 5,000,000) was approximately €926 (EEK 14,500), whereas pursuant to the draft State Fees Act this duty will be approximately €372 (EEK 5,800).

Concentration Control

Transfer of real estate (both in asset or share transfer) may be subject to concentration control by the competition authorities if:
• the turnover in Estonia of the participants to the concentration (the target undertaking and its buyer) exceeds 100 MEEK and
• the turnover in Estonia of at least two participants to the concentration exceeds 30 MEEK each.

The turnover, which is considered in the process of determining whether concentration control is applicable, is the turnover of sales in or directed to Estonia in the last financial year. If the buyer does not have any business in Estonia (upon the first purchase), concentration control is not applicable.

Restrictions

Restrictions on Acquiring Real Estate
In general, there are no restrictions for foreigners to acquire real estate in Estonia, except forestry and agricultural land, plus some island and sea coast and borderline areas of the state.
Even though Estonia is a member of the EU some restrictions for EU citizens and companies will exist until 1 May 2011. Acquiring of real estate the intended purpose of which is profit yielding land and that consists of 10 or more hectares of agricultural or forestry land is unrestricted only for:
• Estonian citizens;
• Citizens of the state which is a contracting party to the EEA Agreement who have lived in Estonia for the past three financial years and have been registered in an Estonian register as sole proprietor in the area of production of agricultural products (forest management for forestry land);
• Estonian legal persons that have been registered in the Estonian Commercial Register or in the Register of Non-profit Associations and Foundations register and a branch of a legal person of a state that is a contracting Party to the EEA Agreement, that is registered in Estonian Commercial Register and that have been operating in Estonia for at least 3 past financial years in the area of production of agricultural products (forest management or production of agricultural products for forestry land).

Other persons may become owners of the respective land on rather limited grounds and only upon approval of the county governor.
The transfer of land on smaller islands and certain border areas is permitted to non-citizens or legal persons of the states which are not a contracting party to the EEA agreement only upon the permission of the Government of the Republic of Estonia.

Public Restrictions on the Use of Real Estate

It is important to be aware of the restrictions on certain types of use of real estate. For example, the use of real estate may be restricted in the sea coast area, heritage protection zones, protected zones of power lines, railways etc. The restrictions may mean that part of real estate may not be used for buildings or the owner has to avoid activity in the protected zones, etc.

Encumbrances

The following rights, which are entered into the Estonian Land Register, may encumber the real estate: usufruct, encumbrances, building title, pre-emptive rights, and mortgages. In general, these rights may be used in real estate transactions and are entered into the Land Register upon the notarised agreement to secure the interest of the purchaser or seller or third persons or the neighbouring real estate.
The Land Register may register a notation of a lease agreement, which ensures that upon change of ownership of the real estate encumbered with a lease the new owner may not terminate the lease agreement within three months as of acquisition of the premises with reference to urgent personal need for use of the premises.

Mortgage

The real estate purchase is often financed by a loan. Usually a mortgage as security in favour of a bank financing the payment of sales price is established on the real estate by a notarised agreement. A mortgage agreement is concluded at the same time and in the same document as the sales agreement.
In case a mortgage is already encumbering a real estate prior to the sale and the purchaser needs a mortgage to be established for its own financing purposes, the existing mortgage is typically transferred to the bank financing the payment of sales price. This transaction structure is more cost efficient compared to deletion of the existing mortgage and establishment of a new one as it saves on the notary fees as well as the state duty.

Lease Agreements

General
In general the freedom of contract applies as to the content and form of the lease agreement. However, as to the residential lease, the law protects the rights of the tenant and provides many mandatory rules. If a residential lease contract with a term exceeding one year is not entered into in writing, the contract is deemed to have been entered into for an unspecified term.
Upon the transfer of the real estate, the lease agreements shall survive the change of ownership. However, the owner may terminate the lease agreement within three months as of acquisition if the owner needs the premises urgently for its own use. This right may not be exercised if a notation about the lease agreement has been made in the Land Register.

Duration and Expiry of Lease Agreement
Lease agreements may be concluded either for specified or unspecified terms. If the parties have not agreed differently, either party of the lease agreement entered into for an unspecified term may terminate the residential or business premises lease by giving at least three months' notice.
The lease agreement entered into for a specified term expires

upon expiry of the term. Extraordinary termination is allowed upon the material breach of agreement (for both agreements entered into for unspecified or specified term).

If, after expiry of the term of a lease contract, the tenant continues to use the leased premises, the lease is deemed to have become a lease agreement entered into for an unspecified term unless the owner or tenant expresses some other intention to the other party within two weeks as of expiry of the lease contract (applicable to the tenant) and as of the time when the owner learns that the tenant is continuing to use the thing (applicable to the owner).

Lease Payment and Accessory Expenses

Rent is usually paid once a month to a bank account of the owner. The amount of rent is subject to changes based on the index determined by parties (e.g. changes in CPI). It is common to pay a deposit in the amount of one to three months' rent payment.

Accessory expenses (utilities) such as electricity and water are deemed as included in the rent if not otherwise agreed in the lease agreement. It is quite common that the tenant pays for the utilities extra according to the invoices of the service providers.

PPP & Infrastructure

Concessions

The only type of concessions the granting of which is regulated in the Estonian legislation are construction work concessions. Said concessions may be granted in compliance with the Public Procurement Code. Construction work concession means the exclusive right to exploit a structure, which is granted either for a charge or without charge for the performance of construction work.

Upon granting a construction work concession, a contracting authority may use a negotiated tendering procedure with prior publication of a tender notice.

In Estonian practice, SPVs holding concessions have not been used as an investment object.

Sale-Leasebacks

Conclusion of sale-leaseback agreements for structuring PPPs is increasingly used in Estonia. For the lease-back agreements the parties usually first establish a building title, which separates the title of the building sold to and leased back from the private partner. Thereafter the building title is transferred to the new owner and leased back to the tenant (public partner).

These properties may be of investment quality depending on the quality of the agreements. In practice, the lease agreements (i.e. PPP agreements) are far from being as comprehensive and detailed as their counterparties in Western Europe and Scandinavia.

Planning Requirements and Construction of Buildings

Planning

Local governments have the authority to approve detailed plans. Detailed plans are established for city areas and some rural municipality areas to regulate zoning and to determine building rights for plots as well as to set limits for construction activities in the particular area. After the completion of the project of detailed plan, there are public hearings and discussion. The whole process of approving the detailed plan may take approximately from 6 months to a few years depending on the area and complexity of the project.

Construction

The erection, modification and demolition of buildings and other structures, as well as their subsequent use, require a building permit and permit for use issued by the local government construction supervisory authority.

Construction works have to be performed pursuant to building design documentation and building norms. The building design should be drafted by a professional architect or an engineer as well as be approved by the local supervisory authority. The building design documentation must comply with the relevant detailed plan, if such plan has been established, and meet the official building norms. The intended purpose of the building cannot differ from the intended purpose of the land plot (e.g. it is not possible to build residential buildings on commercial land). In case there is no detailed plan in place or no detailed plan required, any construction works have to be performed based on design criteria issued by local government.

The local government issues building permits based on the building design and respective application, in case the said documents are in compliance with detailed plan or design criteria. Construction without a valid building permit is not allowed. A building permit becomes invalid if construction works are not commenced within two years as of the date of issue of the building permit.

After completion of the construction works, the municipality issues a permit for the use of the building if it has been erected on the basis of a building permit and in accordance with the design documentation. Use of a building is generally not allowed without a permit of use.

Once the constructions works are finished, the construction company must give a guarantee for any faults in the construction works for at least two years after the construction works are finished. The guarantee granted by the manufacturer for equipment incorporated in the construction works cannot be shorter than six months.

Taxes

Purchase

VAT - The purchase any new building or apartment, a significantly renovated building, or a plot of land without a building is subject to 18% VAT. Supply of new buildings, the construction of which began before 1 May 2004, plots of land purchased before 1 May 2004, and used buildings are VAT exempt. A person may opt for adding VAT to the latter supply, unless it is a dwelling. In case of VAT exempt supply of immovable, the adjustment period for input VAT is ten calendar years.

State Duty on Real Estate Transfer – There is no real estate transfer tax in Estonia. Real estate transfer brings about an obligation to pay a state duty, which depends on the value of the transaction (ca 0.2% - 0.4% of the transaction value). Notary fees are also due.

Rents

VAT – Although the rent of real estate is considered a VAT exempt supply, owners of commercial property have the option to charge VAT on rent. Nearly all owners choose to charge VAT on commercial rents, as owners want to recoup the VAT paid for development of the property. All residential property is rented without VAT.

Income tax – The personal and corporate income tax rate in 2007 is 22%. The specificity of the Estonian income tax system is in the fact that corporate profit is not taxed at the moment it is earned, but rather at the moment it is distributed in the form of a dividend. Non-resident companies which do not have a permanent establishment in Estonia are subject to income tax on business income (which includes lease of immovable property located in Estonia) derived from Estonian sources. Documented business related costs as well as real estate repairs and maintenance expenses may be treated as deductible business expenses in the year they occurred.
Natural persons and sole proprietors pay income tax on rental income. Natural persons not registered as sole proprietors may not deduct any expenses from rental income for tax purposes - the total rental income is taxed at the prevailing rate of personal income tax (22% in 2007).
Registered sole proprietors may deduct documented business related costs, such as loan interest, repairs, commissions, etc, from their taxable income, and the net income is then taxed. However, sole proprietors must pay both and social tax and income tax on their net rental income, as if it were salary.
An investor should calculate to see which system works best for him. For all practical purposes, investing through a company (which allows both the deduction of expenses and the indefinite deferral of tax) is usually the most tax efficient method.

Sale

Capital gains derived by resident companies on the sale of the real estate property are not taxable until distributed in the form of a dividend. In case of non-resident companies or private persons, income tax is levied on the difference between the sales price and the acquisition cost. The acquisition cost includes all documented expenses a person makes in order to buy, improve or supplement property, including any commissions and fees. If property was acquired by way of finance lease, interest is excluded from the acquisition cost. Transfer costs are also deductible. Losses from the sale of real estate may be offset against profits from the sale of real estate occurring in the same calendar year.

Real Estate Tax

There is no real estate tax in Estonia. However, there is a land tax for real estate located in Estonia. The tax rate varies between 0.1% and 2.5% of the taxable value of the real estate, which depends on its location and is determined by the local municipality (not to be confused with market value).

SORAINEN
LAW OFFICES

Established in 1995 in Tallinn, today Sorainen Law Offices is one of the largest business law firms in the Baltics, having more than 80 lawyers who specialise in all areas of law related to commercial activities. The firm's offices in Estonia, Latvia and Lithuania form a fully integrated pan-Baltic law firm, which is ISO 9001:2000 certified since 2006.

Sorainen Law Offices provides high-quality legal services to the world's leading companies, financial institutions and private investors on their most demanding transactions and assignments. Sorainen Law Offices recently has assisted:

SEB Advising on a landmark transaction involving the sale and lease-back of the real estate property portfolio of SEB Baltics Legal Adviser	**Rigas dome** PPP project of Northern crossing **1 billion EUR** Legal Adviser in cooperation with Lovells	**Citycon Oyj** Acquisition of the shopping centres "Rocca al Mare" in Tallinn and "Mandarinas" in Vilnius **62 and 14.6 MEUR** Buyer's Legal Adviser	**Valdemara centrs SIA** Sale of a major A-class office building in the centre of Riga Seller's Legal Adviser	**Merks SIA** Sale of the multinational hall "Arena Riga" **17.6 MEUR** Seller's Legal Adviser
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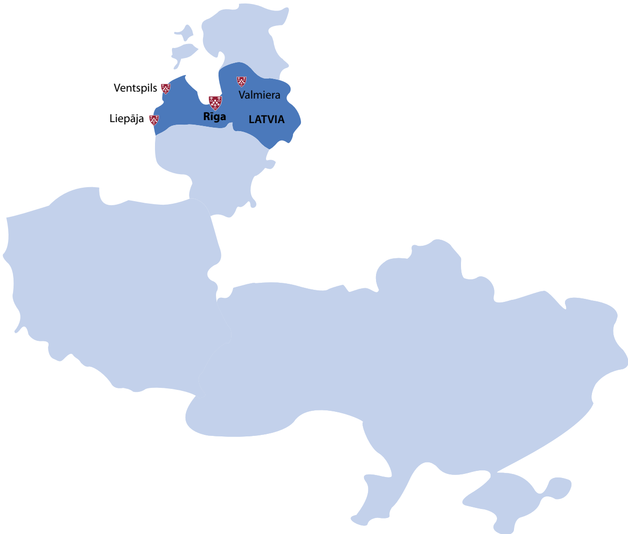

Riga, Latvia

Demand Exceeds Supply in All Sectors

Economy

Latvia's economic growth is among the fastest in the world, with GDP growing 11% in 2006, and consensus estimates of a further 9% growth in 2007. Consumer price inflation – at 6.8% in 2006 – is projected to fall to 5.2% in 2007. Since prices are still significantly lower than Western Europe, price and wage convergence with the West should keep inflation above core European levels for many years to come. Unemployment has dropped to 6.6%, lower than Western Europe, and mortgage rates are low, with euro denominated home loans ranging from 4.0 to 6.5% per annum. FDI per capita in 2006 was €297, and the construction price index was up 17.2% in 2006.

Office

Rents Jump as Take-up Outstrips Supply

Supply

Modern A and B class office stock in Riga grew to 338,000 sqm by the end of 2006. This represents nearly 80,000 sqm of new office stock in 2006. Ober-Haus projects supply to grow another 110,000 sqm in 2007. A class stock remains meagre, however, at 33,800 sqm with no new additions in 2006. Although we expect this figure to double in 2007 to 66,800 sqm, the supply will still not meet demand.

Recent Developments

Barons Square – a new B class office centre, developed by Ivo Zonne, located near CBD and Brivibas Street. The 28,700 sqm office space opened at the end of 2006 for lease at €12-17 per sqm. The centre was 60% leased on opening day.

GMP – a new B class office centre located in Krasta Street near the Daugava River, near CBD. The 6,000 sqm office space opened at the end of 2006 for lease at €15-16 per sqm. Among the building's features is a façade fashioned in aluminium and glass that provides natural lighting throughout the structure. The centre was 85 % leased on opening day.

Astras Street office centre – developed by "Baltijas ofiss", located on G. Astras Street, near A. Deglava Street. This modern B class office building offers 7500 sqm for rent at €13 per sqm, delivered in June 2006.

New Projects

Duntes Business Office – a modern B class office building, developed by Merks, located at the corner of Duntes and Upes Streets. The 12,000 sqm space is due to open in 2007 for lease at €13-17 per sqm as a two-part building of seven stories with a glass atrium. Car parks for the new office building will be located on the property and in the underground stories of the building. The building was 20% pre-leased at the end of 2006.

Duntes House – a modern A class business centre, developed by Duntes nami, located at the intersection of Duntes and Skanstes Streets. The 7,800 sqm office space is due to open early in 2007 for lease at €18-23 per sqm. There will be 75 surface parking places on the property, 110 spaces in an underground car park and 22 spaces reserved for clients. The building was 25% pre-leased at the end of 2006.

Magnat business centre - a modern B class business centre, developed by "Magnat Group", located in Pardaugava at 83/89 Daugavgrivas Street. The 4,000 sqm office space is due to open in July 2007 for lease at €10 per sqm. The office centre will have convenient access and a car park for 100 cars. Leasing begins in 2007.

Rietumu Capital Centre – a modern A class business centre, developed by Rietumu Banka, located on Vesetas Street. The project, with total area of 16,500 sqm and 3,600 sqm for rent, is due to open in end 2007 for lease at €20 per sqm. There will be a five-storey parking garage for 290 vehicles. The building was 50% pre-leased at the end of 2006.

RBS Skals Office Centre – a modern A class business centre, developed by RBS Skals, close to the Riga city centre in Kipsala, one of the city's most scenic districts. There will be underground parking for 104 vehicles. The 9,000 sqm business centre is due to open in March 2007 for lease at €20 per sqm, but it was 100% pre-leased by the end of 2006.

Panorama Plaza – a new complex of four skyline residential towers, with 7,700 sqm of commercial space, located on Ventspils Street. The complex is set to open at the end of 2007 for lease from €20 per sqm or sale from €2,800 per sqm. The building was 60% pre-leased by the end of 2006.

Krajbankas house – developed by Merks, located in a square between Skanstes, Eveles and Grostonas Streets. There will be 6,000 sqm of B class office space for rent by Krajbanka, a local Latvian commercial bank. The office building will be completed in 2007.

• *Panorama Plaza – a new complex of four skyline residential towers, with 7,700 sqm of commercial space.*

Demand

Take-up was nearly 90,000 sqm in 2006, exceeding new supply. The vacancy rate for A class office space dropped from 11% to 0% by end of 2006, while available B class office space decreased from 24% to 16%.
Demand will continue to outpace supply for the near future. The tendency to move offices away from the city centre still continues. We predict with confidence that in the next few years problems like increasingly heavy traffic and insufficient parking places in city centre will become acute. Combined with growing companies and the constant effort to decrease expenses, this will drive the need for enlarged office projects outside of the city centre.
The demand for B class offices in the suburbs is also high, as shown by the fact that the 7500 sqm B class office centre Astras biroji with was fully leased at €13 per sqm, the major tenants include GE Money and Roche.

Rents

The shortage of office space drove A class rents up 28% in 2006, from €14-17 per sqm to €17-23 per sqm, while B class rents increased 50%, from €6-11 per sqm to €12-16 per sqm. Service charges average €2-3 per sqm for A class and €1-2 per sqm for B class. We expect rents to continue to rise in next year as construction is slow and demand continues to exceed supply.

Investment

No significant office building investment transactions were recorded last year. Small office buildings are offered for sale at yields of 6.5%.

Legal Notes by Sorainen

Rents
Rents are usually paid on a monthly basis in advance. However, in some cases the rent is payable in advance on a quarterly basis. Rents are typically tied to the euro but indexed to local inflation. Tenants pay their own utilities, invoiced after use by the owner or the supplier. Security deposits for two to three months' rent are generally required. The owner usually pays all the taxes applicable to the real estate.

Investments
Lease agreements of business centres are of rather good quality, other lease agreements for office space are generally of low quality. Typically the owner prepares standard lease agreements, which are mostly one-sided and in favour of the owner. The lease agreements are binding to the new owner of the real estate upon transfer of the title provided such agreements are registered with the Land Book.
The buildings might have technical defects or the construction works do not comply with the legal requirements, e.g. the construction might have been commenced before obtaining the construction permit or the building might be higher than specified in the construction permit, etc. Asset deals and share deals are equally common.

Retail

Strong Demand Takes Up All New Supply

Supply

Total retail space grew 33% in 2006 to 715,000 sqm. The main developments in 2006 included the opening of two new shopping centres – Galerija Azur and Zoom – and the expansion of the existing Galerija Centrs (Phase II). New brands like Marks & Spencer, New Yorker and Lindex invigorated the retail market. Ober-Haus foresees another 250,000 sqm of retail space coming to market in the next two years.

• *Galleria Patollo - will be Riga's largest city centre retail complex.*

Recent Developments

Galerija Centrs (Phase II) - Linstow added 10,000 sqm to its popular Galerija Centrs bringing the total area to 32,000 sqm with more than 140 shops. The centre has a glass-covered passage, covering Rīdzenes Street and connecting Vaļņu, Teātra, Kalēju and Audēju Streets. The function of the centre has also expanded, a multifunctional trade, restaurant, sport, recreation and leisure complex. The anchor tenant is Rimi, new brands include Accessorize, Marco Polo, Gant, Swarovski, Oasis, La Senza, Peggy Sage, La Femme.

Galerija Azur – a new shopping centre developed by TK Development, opened in August with total area of 25,000 sqm in the Plavnieki suburb of Riga, close to the planned southern bridge. The total investment of the centre is 24,5 million lats. The shopping centre has a Caribbean style interior, 80 shops, food court and anchor tenants, the biggest being Rimi Hypermarket, New Yorker, Lindex, new brands are: Takko Fashion, Pierre Cavallo, Novalux, Elektromarket, BMS Megapolis, Gestuz.

Zoom - a new shopping centre owned by Latoneks-A opened in August this year. The 7500 sqm space is located close to a main road leading to Ogre, Jekabpils and Daugavpils. Investments in the centre total 4 million lats. The shopping centre has 26 tenants; the anchor tenant is Rimi.

New Projects

Spice (Phase III) – Merks is adding 28,000 sqm to its 50,000 sqm retail complex on Ulmana Avenue. The new phase will add a wide selection of furniture and interior goods to its existing shopping mall. The main tenants will include several leading Baltic and Scandinavian furniture retailers. Total investment will be €17 million and the complex is scheduled for completion in autumn 2007.

Riga Plaza - in a joint venture with Plaza Centres Europe, Latvian developer SIA "Diksna" is to build the Riga Plaza Shopping and Entertainment Centre, a 67,000 sqm complex, with investment expected to reach €70 million. The facility will contain more than 160 stores, a supermarket, cinema complex, bowling, restaurants, cafes and a family entertainment site. The centre – next to the busy Salu Bridge on the south bank of the River Daugava, three km from the city centre – is planned to be finished by the end of 2008.

Akropole – Lithuanian developer Vilnaius Prekybas Group is to build one of the largest retail and entertainment centres in the Baltics. Akropole will house the widest variety of shops in the region and most entertainment in one place. The site, two km northeast of the centre of Riga, will include more than 150,000 sqm of retail space including a "Hyper-Maxima" hypermarket when the first phase is complete. Total investment will reach €135 million. The centre is planned to be finished by the end of 2008.

Galleria Patollo - Norwegian developer Balder Invest is to build a seven-floor shopping centre with a total area of 50,000 sqm and 220 stores. Galeria Patollo will be Riga's largest city centre retail complex, located in the prime shopping area on Dzirnavu Street, between Tērbatas and Brīvības. Galeria will create opportunities for shopping, recreation and entertainment activities. The centre is planned to be finished by the end of 2008, although launch of the project has been delayed many times.

Sky & More - a new shopping centre on Duntes Street will open its doors in Spring 2007. Total area of 16,000 sqm. Along with the anchor supermarket, Sky, which will occupy 3500 sqm, the centre will include 70 shops and a 1,200 sqm food court.

Demand

Mid-market retailers still like to be present in the city centre, but as is the trend worldwide it is shopping centres which guarantee good foot flow. The most successful shopping centres are Alfa, Domina, Origo, Mols and Spice. Shopping centres in their turn favour large international brands. Demand still surpass the supply. There is no vacancy, as retailers are queuing to have a space. For larger retailers such as building material companies, car dealers, home appliances, furniture, garden stores, the most attractive Streets are busy roads going out of town, as the parking is provided.
In top demand remain the city centre with pedestrian flow and Old Town retail high Streets (Kalku, Valnu, Audeju, Terbatas, and

Barona), especially among the most exclusive brands who can pay the top rent price. International brands usually seek a location first in the city centre and then in shopping centres. The biggest demand is for 50-100 sqm units.

Rents

Rents in new leases grew 9% in 2006 due to demand. In the city centre rents are €30-55 per sqm and around €15 per sqm further out of the city centre, the same as the previous year. Retail space in the prestigious Old Town rents for €35-55 per sqm, though in prices prime locations have reached as high as €60 per sqm. Rent prices in shopping centres start from €15 per sqm for large units, €30 for medium units and €50 for small units. Anchor tenants, such as supermarkets, typically pay €8-12 per sqm. Service charges range from €3 to €5 per sqm. In the suburbs, rents range from €5 to €20 per sqm for 100 sqm premises.

Investment

No significant office investment transactions were recorded last year. Sellers are asking for yields of 6.5%.

Legal Notes by Sorainen

Typically one anchor tenant or a few medium-size tenants lease each property. As a rule, the tenants are charged for the use of common areas and management of the building. The owner usually pays the taxes applicable to the rent and the property. The advertising cost is often fixed and therefore not negotiable. Sinking fund is not used as a separate cost in retail market but it might be included in the maintenance costs. Turnover rents are commonly used in Latvia. As a rule, the tenant is responsible for finishing and furnishing with equipment of leased premises for its usage purposes.
When looking at investment properties, keep in mind that lease agreements are generally of low quality. There is no standard approach to the set-up and use of marketing funds. Rents are typically tied to the euro but indexed to local inflation. Distribution of maintenance and renovation obligations may not be set out very clearly in lease agreements. The lease agreements survive the change of ownership and are binding to the new owner of property provided such agreements are registered with the Land Book.

Industrial

Sector Dominated by Owner Occupiers, Few Speculative Developments

Supply

Most available warehouse and industrial premises are leftover from the Soviet Union. Few modern speculative projects have been introduced so far, and most retail companies (Rimi, VP Market, DHL Logistics and others) build for their own use, and these projects do not show up in the rental market. However, there are now at least 10 major projects under construction with total building area of more than 200,000 sqm. Most are outside of the city, and the biggest (Dominante business park, Dommo business park, Wellman, etc.) are on the ring road around the city. This location is good for companies servicing all three Baltic States' markets, which need to transport goods to Lithuania and Estonia as well.

• *Wellman logistic center*

Recent Developments

Nordic Technology Park (NIP) is a full service industrial park situated in the industrial zone of Riga city – not far from the international airport, the site is located on 7,5 ha of land and has a total floor space of 41,500 sqm, including 32,500 sqm of industrial premises and 9,000 sqm of office space in a separate office building. Rental price: €4.50 per sqm with taxes and public utilities excluded.

New Projects

Dominante Park is the largest industrial project in the Baltic Region. The site is on 65 ha of grasslands on the outskirts of Riga, near the crossroads of the Riga ring road and the A7 highway. The first phase of the park development will deliver 35,000 sqm of warehouse space and 3,500 sqm of office premises by

April 2007. Eventually the project will total 250,000 sqm of warehouse premises and 10,000 sqm of office premises. Asking rents for warehouse space is €5.00 per sqm.

Dommo Park is a new warehouse and production center located 13 km from Riga, next to A5 and A8 road junction – Gaismas, Olaine parish, Riga district. On a total of 54 hectares of land, the complex may comprise up to 200,000 sqm building area. The first stage consists of 91,399 sqm of warehouses, light manufacturing and office premises on 25 hectares. Construction began with an 11,000 sqm warehouse in September 2006 and is due to be completed in September 2007. Asking rent for warehouse space is €5 to €6 per sqm.

Demand

Demand in the industrial segment continues to strengthen due to the rapidly growing retail and import sectors pressuring developers to bring new premises to the market after a long period of inactivity.

Legal Notes by Sorainen

Industrial leases are quite simple, finance and construction opportunities are readily available. Rents are tied to the euro but indexed to local inflation. Usually the parties conclude triple net lease agreements where the tenant shall pay all maintenance costs. Projects are usually built for owner occupiers. Sale-lease-back arrangements rarely take place.

Land

Master Plan Brought Standards, and Price Rises

Supply

Riga has developed as a dense urban area. Destruction during the Second World War was minor. Today the historical centre of Riga is under UNESCO world cultural and natural heritage protection.
Riga master plan was approved in 2005, so it is clear what can be built on suburban plots.

Prices

The price of land grew over 60% on average in 2006. The most expensive land plots for private houses in Riga are located in Mezaparks, Teika, Vecaki and Kipsala, where supply is restricted.

The prices of land plots located in the city centre for constructing commercial projects and apartment houses range from €400 to €3500 per sqm, but in suburbs the lands of the same purpose range from €100 to €600 per sqm, depending from possible construction intensity.

Planning

The master plan of Riga is valid from 2006 to 2018. The master plan dictates the allowable use of land and possible number of storeys.

Residential

50% Jump in Prices as Cheap Lending Fuels Demand

Prices

The price of secondary market apartments in Soviet-era suburban prefabricated concrete panel flats increased nearly 50% in 2006, to €1,350-1,650 per sqm. The greatest price growth was in Teika, where prices jumped 56%. In Vecmilgravis, Bolderaja and Imanta saw prices rise 46%, and in Purvciems and Plavnieki (which had experienced faster growth earlier), prices grew another 37% and 34% respectively.
Prices for newly built apartment grew more than 30% in 2006, with prices for new apartments in the city centre at between €2,700 and €5,100 per sqm, and prices in the historic Old Town from 3,500 to 6,000 per sqm. New apartments outside the city centre range from economy class at €1,300 to luxury levels at €3,500 per sqm. New apartments in the suburbs are typically sold shell in Latvia, meaning the buyer will have to pay about €200 per sqm more to finish out flooring, painting, lights, bathrooms and kitchen.

Supply

New apartment construction is growing at a record pace, with more than 6,000 new units delivered in 2006. More than 95% were sold quickly, and only badly planned or overpriced units remained on the market long. In 2007, Ober-Haus predicts that more 8,000 new units will be delivered to the market, although construction companies are currently facing a severe labour shortage.

The average size of a new apartment has increased from 65 to 77 sqm. As has long been the case, the most prestigious and expensive offerings are still found in the city centre, as well as in the seaside satellite suburb of Jurmala. The largest number of new flats are being built in the Ziepniekkalns, Purvciems, Plavnieki and Jugla regions.

• *Hanner project – near from VEF bridge.*

New Projects

Skanstes Virsotnes – an enormous 2,500 apartment project located between Ganibu Dambis and Kristjana Valdemara Streets, on both sides Skanstes Street, is being developed by Merks. The project will take seven years to complete. The first phase has started, scheduled to bring 508 apartments to market in 2008 in four 24-storey buildings. The selling price is expected to be €2,500 per sqm for an apartment (sold shell without flooring, bath, kitchen etc); the project is 25% pre-sold.

Purvciems Project – located on Puces Street, developed by Hanner. This project comprises 336 apartments in four buildings. Apartments range from 51 to 152 square metres, with prices starting at €1,422 per sqm (sold shell). Two buildings will be finished in February 2007, and two in June. The project is nearly 100% pre-sold.

Dienvidu Pakavs II – A 147-apartment project to be developed by Urban Art, on Vienibas Gatve in Ziepniekkalns. These apartments range from 52 to 170 square metres, with prices starting at €1,750 per sqm for fully finished apartments. The building will be finished in December 2007, and is 50% pre-sold.

M. Park – 189 apartments in three buildings to be developed by M.Pasaule, located on Ulbrokas Street in Plavnieki. These apartments range from 42 to 144 square metres, with prices starting at €1,400 EUR per sqm (apartment shell, without final interior fittings). The project will be completed in spring 2007, and is 85% pre-sold.

In the single family residential housing sector, the highest demand is for houses with a total area of 150 to 200 square metres. The favourite districts are Marupe, Babite, Kekava, Adazi and Lici. House prices average €200,000 to €300,000, (about €1,000 to €1,500 per sqm). Prices for individual houses in the suburbs have increased 25% due to higher construction, labour and land costs.

Demand

Demand is increasing due to fast economic growth, strong consumer confidence and improved mortgage offers from banks. The highest demand is for apartments of 50 to 100 square metres.

The Mortgage Market

Mortgage loan rates start at 4.3% for loans in Euros, with a maximum term of 40 years. Clients can borrow 100% of the property value in several banks. With CPI growth at 6.8%, and property price growth in double digits, real lending rates are, for all purposes, negative.
Latvia now has the most mortgaged homeowners in Europe, with outstanding mortgage loans in Latvia totalling 35% of annual GDP. Although there is still some room for continuing liquidity through convergence with the Western EU (where mortgages average 48% of GDP) in the medium term mortgage market growth rates are expected to slow down to fit better with actual income growth.

Rents

Residential rents remained stable in 2006. Typical monthly rent for a newly built, 70 sqm, 3-room flat in the city centre ranges from €8-12 per sqm; rent for exclusive apartments have reached as high as €12-14 per sqm.
The greatest demand is for renovated apartments in higher quality city centre buildings. The quality standards for these apartments are invariable – good quality, contemporary decorations, comfortable planning, good views, renovated buildings in attractive locations. The favourite streets for rentals are Terbatas, Barona, Skolas, Baznicas, Blaumana, Dzirnavu and Lacplesa in city centre.

Legal Notes by Sorainen

Residential leases are regulated by Latvian law more strictly than commercial leases. However, rents may be agreed upon freely.
When purchasing a leased property, mind that lease agreements are binding on new owners regardless of whether they are registered in the Land Book. Special attention should also be given to the Soviet-era tenants for whom the rent and term provisions of law are applicable.

Legal

Introduction

Restitution to original owners of property that was expropriated in the Soviet period was completed in Latvia by the end of 1990s. Privatisation of the state-owned land, land owned by the municipalities and state businesses also began and should be finished in the next few years.

Title to Real Estate, Land Book

Title to real estate is transferable subject to registration with the Land Book. Buildings are also registered with the Land Book. In general, buildings are considered to be a part of the land beneath them. However, as a result of the land reform, a land plot and a building situated thereon may belong to different owners.

The Land Book stores information regarding to the legal status of real estate, including all encumbrances, mortgages, preemption rights and any other relevant rights and obligations. The Land Book is a public register and information contained therein is publicly available and also binding to third persons. It is also available in a database version in Latvian via Internet in return for a fee.

There are a number of real estates not registered with the Land Book but registered with the Cadastral Register. Most of them are privatised apartments and land plots restored to the previous landowners. The privatisation of an apartment is completed after its registration with the Land Book.

Acquisition of Real Estate

General

Real estate may be acquired as buildings and land plot beneath the building (entire or ideal parts) or as building (if the building is registered with the Land Book as permanent property object) or land (if the land is registered with the Land Book as permanent property object) or apartment ownership.

Generally a transfer of a building or land separately from each other is not possible, unless the land plot and the building are registered with the Land Book separately as permanent property objects. This situation might be derived due to the restitution of the ownership rights.

Letter of Intent and Heads of Terms

In practice letters of intent (LOI) and preliminary agreements are used in order to bind negotiating parties to the contemplated real estate transaction. According to said agreements the buyer can demand the conclusion of the sales contract.

Usually an LOI sets out the parties' obligation not to negotiate with third parties (so-called exclusivity) and stipulates other obligations of the parties to be followed during certain time period. Breach of the exclusivity obligation according to LOI or preliminary agreements entitles the aggrieved party to compensation of damage, including to payment of specific contractual penalties.

Change of Ownership

Each transaction with real estate and registration of the ownership rights with the Land Book involves a number of formalities, which have to be completed or solved before the title transfer. For instance, one is the real estate tax debt on the particular property, which has to be settled. Otherwise the registration of the ownership rights with the Land Book is not possible. The period of time for the registration of the title to a real estate with the Land Book usually varies from fifteen days to one month after as of submission of all necessary documentation to the Land Book.

Asset Transfer vs Share Transfer

Asset deals and share deals relating to real estate are both commonly used in practice.

When considering a share transfer of the company holding the target real estate, the following should be taken into account:

- notary fees and state duty arising from real estate sales are excluded from transaction costs as the sale of shares of a companies;
- the ownership of shares is transferred as agreed in the sales agreement, at the time of signing the agreement, or upon the making of registration in the register, which takes only a few days;
- once the buyer completes the transfer of shares the buyer assumes responsibility for the whole company including any actions that have occurred before the change of ownership;
- due diligence investigations are more extensive as the share deal transfers an entire company (with all known and unknown rights and liabilities) as opposed to due diligence of the target real estate only;
- deferred tax issues.

Asset transfer involves the following benefits and drawbacks:

- the asset transfer is subject to notary fee and state duty and is therefore more expensive than a share transfer;
- limited scope of due diligence investigation due to the fact that the review concerns only the target asset;
- lease contracts registered with the Land Book are still binding for the new owner after purchase of the target asset;
- agreements on supply of utilities and other services must be assigned to the buyer or new agreements signed with service providers;
- the asset transaction in some cases may be deemed as the sale of an enterprise in which case all the obligations associated with the enterprise might be transferred from the seller to the buyer.

Form of Agreements

Transactions with real estate require a written form, as well as registration with the Land Book. There are no requirements for the notarisation of the purchase agreement.
The registration of the ownership rights with the Land Book is carried out on the basis of a registration application signed by the seller and the purchaser in the presence of a notary public. In addition to both the purchase agreement and registration application to the Land Book, a number of other documents have to be prepared and submitted to the Land Book (the statement on the paid real estate tax, statements on the cadastral value of the real estate, etc.).

Language Requirements

There is no specific requirement to use only the official state language (Latvian) in conclusion of agreements relating to real estate under Latvian law. Parties may choose the language of agreement themselves. However, the Land Book shall have at least a translation of purchase agreement and one copy of the original agreement.
In practice the Land Book does sometimes refuse to register the title if the prevailing language is not Latvian. The registration application to the Land Book shall be prepared and signed in Latvian.

Due Diligence

Before carrying out any real estate transaction it is advisable to research the status of real estate, encumbrances, usage purpose of the land plot stated by the municipality, lease agreements of the real estate, etc. The results of such research may serve as the basis for defining the final purchase price reflecting the value of real estate.

Pre-emption Rights

The municipalities have the pre-emption rights in respect of acquisition of real estate (land and buildings) located in their territory. Only after the municipality has decided not to exercise its pre-emption rights, the purchase agreement may be registered with the Land Book and the ownership may be transferred to the purchaser.
Should the building and the land plot have different owners, the owner of the building situated on the to-be-sold land plot has the pre-emption right with respect to land plot and vice versa. Also co-owners of real estate have pre-emption rights with respect to the ideal part (legal share) of the immovable property being sold.
According to law, the state has pre-emption rights upon the sale of cultural monuments of state importance and land plots in preservation zones. According to Latvian laws there are further pre-emption rights of legal entities upon the sale of the land in ports and special economic zones.
Generally the pre-emption rights are exercised within 2 months after the purchase agreement is submitted to the persons entitled to such rights. The municipalities shall decide on using its pre-emption rights within 20 days after the purchase agreement is submitted to the municipality.
Pre-emption rights may be agreed upon between the parties and are in force based on their agreement.

Typical Purchase Price Arrangements

Normally the parties agree on the use of an escrow account with a bank. During the registration procedure of the real estate title, neither the seller nor the purchaser has access to the funds transferred into the escrow account. Generally parties agree on the release of such funds only after the registration of the real estate title with the Land Book in favour of the purchaser.

Related Costs

Sharing of costs incurred during the course of purchase is subject to agreement between parties. Usually the purchaser pays for state and stamp duties, whilst notary fees are shared equally between the parties.
State duty amounts to 2% of either the real estate purchase price or the cadastral value of the real estate – whatever amount is higher. Nevertheless, the state duty shall not exceed €44,843 (LVL 30,000). The stamp duty for the registration and issuing of Land Book certificate is currently €15 (LVL 9).
Preparation and testifying of signatures for the application to the Land Book will cost approximately €23 (LVL 15). Signing of an agreement in presence of a notary public and certification of the signatures of the parties – approximately €15 (LVL 10) for each copy of the agreement and for every page €1.50 (LVL 1). Preparation and certification of agreement by notary public amounts to 1% of purchase price of the real estate.

Concentration Control

Transfer of real estate can be subject to prior approval by Latvian competition authorities where:
• Both concentration participants are engaged in the economic activities in the territory of Latvia (either directly or through a subsidiary); and
• Either of the below criteria is met if:
- the combined turnover of the concentration participants, gained in the territory of Latvia during the previous financial year was at least LVL 25 million; or
- the combined market share of the concentration participants

on any of the relevant markets (in Latvia) exceeds 40%.
Please note that the sale of assets may also be considered as concentration if the assets are deemed to be an enterprise (business) and the turnover in question can be attributed to such enterprise (business).
The turnover comprises products sold and services provided by undertakings concerned to undertakings or consumers in the territory of Latvia during the last financial year. The notification shall be made before the share (or asset) transfer completes. The notification shall be submitted after the signature of the agreement since the agreement will have to be submitted to the Competition Council and before the said agreement enters into force.

Restrictions

Restrictions on Acquisition of Real Estate

The restrictions regarding real estate acquisition in Latvia refer to land plot purchases. After the accession to the EU as of 1 May 2004, land plot acquisition in Latvia is more liberalised for EU citizens and legal entities. Foreigners from non – EU states should consider that there are many restrictions to acquire land plots in Latvia. Latvian law does not stipulate any particular restrictions or obstacles for foreigners to buy commercial property.

Non–EU Citizens and Legal Entities

There are no restrictions imposed on the acquisition of land plot by companies registered in the Register of Enterprises of the Republic of Latvia in the following cases:
• If more than 50% of the company's share capital is owned by Latvian citizens, the state or a municipality; or
• If more than 50% of the capital is owned by foreign natural persons or undertakings, and Latvia and the relevant foreign country have concluded agreements on mutual promotion and protection of investments (Latvia has signed such agreements with most European countries, Canada and the USA); or
• If the company is a public limited liability company, the shares of which are listed on the Riga Stock Exchange.
If after the land acquisition, the shareholder's structure of an undertaking is changed so that it does not correspond to the requirements of the law anymore, permission from the municipality must be obtained to retain the particular land in ownership. If the local municipality does not issue the permission, the land must be transferred to another person within two years.
Should the potential foreign purchasers fail to fulfil the criteria listed above, they must apply for the permission from the local municipality, which has the discretion to accept or reject such application. Permission is necessary, regardless of the size of the land plot to be purchased.
However, permission is required only for acquisition of land. Therefore, apartments or buildings may be acquired without further restrictions and limitations, unless the land beneath such apartments or buildings is included in the deal. In most cases an apartment ownership also comprises a certain ideal part of the land plot, the land plot being in the co-ownership of all apartment owners in the house.
Certain restrictions are applicable to foreigners, if the land is located in the state border territories and special protection zones.

EU Citizens and Legal Entities

As of 1 May 2011 (expiry of transitional period), EU citizens and legal entities domiciled in EU Member States are permitted to acquire land on the same conditions as citizens of Latvia. During the transitional period, EU citizens may only acquire agricultural land or forestry if they live permanently in Latvia and have farmland there within the last three years.
There are no restrictions for EU citizens and legal entities to acquire land plots in the cities of Latvia.

Encumbrances

Real estate might be encumbered with servitudes, rights of the first refusal, lease rights registered with the Land Book, mortgages, protection zones and other encumbrances that should be considered in usage of the real estate and construction of the buildings.

Mortgage

Usually, purchase of real estate is financed by bank loans. Therefore, the bank requires security in the form of a mortgage.
In order to register a mortgage on the real estate, a mortgage agreement should be concluded. An application to register the mortgage with the Land Book shall be signed in presence of a notary public. The Land Book registers the mortgage within 3 days after the submission of necessary documentation.

Property Management

Maintenance of real estate is usually carried out by the owner himself or by the maintenance company. The apartment owners may establish an apartment owner's association. The establishment of such association is voluntary.

Lease Agreements

General

The general terms of the concluding lease and tenancy agreements are stipulated in Latvian Civil Law and Law on Apartment Lease. The content of the lease and tenancy agreement is subject to agreement of the parties. However, the Law on Apartment Lease protects the rights of the apartment tenant.

The tenancy agreements concerning real estate remain valid if they are registered with the Land Book. Otherwise the purchaser of the particular real estate may terminate the unregistered agreement; however, the tenant is entitled to receive compensation from the owner for the termination of the lease agreement before its expiry.
The lease agreements of apartments are binding to the new apartment owners under the Law on Apartment Lease.

Duration and Expiry of Lease Agreement
The duration and expiry of lease or tenancy agreements are usually determined in the agreement. Latvian law stipulates some general rules and such agreements might be concluded for specified or unspecified term. As for termination, the law stipulates only general rules. More specified provisions on termination are regulated by the Law on Apartment Lease, adopted in order to protect the interests of the tenants.

Lease Payment and Accessory Expenses
Prepayment of lease payments (deposit or guarantee) is usually required by the owner, but Latvian law stipulates no specific provisions regarding payment of deposits or its procedure.
Accessory expenses are payments for maintenance and utilities (water, gas, electricity etc.) and as a rule are usually paid by the tenant in addition to lease payments.

PPP & Infrastructure

Concessions
In the light of the guidance of EU law, under Latvian law a PPP project could be procured either pursuant to the provisions of the Public Procurement Law or the Concession Law (most likely a new Concession Law is going to be adopted by the Parliament in 2007). Procurement of both construction works and public services is possible under either of the regimes. The difference lies in the definition of a concession, which, according to the draft Concession Law, is a contract of the same type as a public contract except for the fact that the consideration for the works to be carried out or the services to be provided consists either solely in the right to exploit the construction or service, or in this right together with payment.
The draft Concession Law establishes a specific procedure for the award of concessions, which slightly differs from the open competition procedure known under the EU law and the Public Procurement Law.

Sale-Leaseback
Sale-leaseback agreements for structuring PPPs are used in Latvia as additional instrument in some of the PPP projects. After a certain period of time the owner (private partner) transfers the building back to the tenant (public partner).
However, the PPP projects are under development in Latvia and are planned to be used also in other areas (for example, road construction).

Planning Requirements and Construction of Buildings

Planning
The municipalities have the authority to define the usage purpose of particular real estate in their territory, to set the limits of construction activities and to issue the building permissions. If the particular territory has no detailed plan, the completion of the detailed plan may take approximately from six months to over one year.

Construction
A construction design must be approved by the local Construction Board. Permission is issued if the project complies with the detailed plan of the administrative territory. The Construction Board determines the technical requirements for the particular construction project.
The municipality will require public hearing only in territories that do not have a valid detail plan and:
• If the construction significantly makes worse the living conditions of the inhabitants;
• If the construction significantly lessens the value of the real estate;
• If the construction significantly affects the environment, but it does not need the evaluation of the effect on the environment pursuant to the Law "On the Environmental Impact Assessment";
• In other cases provided by the construction regulations approved by the respective municipality.
The initiator of the construction has to prepare information for a public hearing, including the design project. The real estate owners and population of the particular administrative territory, experts invited have the right to argue against the construction concept and submit their own proposals as to the construction concept.
Changes to the project require additional approval from the Construction Board. The project is valid for two years after the Construction Board approves the project. Construction works require construction permission from the Construction Board.
The newly erected buildings have to be put into operation by a special commission formed by the municipality.

Taxes

Purchase

VAT – The purchase any new building or apartment or plot of land without a building is subject to 18% VAT. Renovated buildings which are sold within one year of completing the renovation will have VAT applied to the difference between the selling price of the building and the value of the building immediately prior to renovation. For the sale of real estate currently in use, no VAT is charged.

Fees - In purchasing property, the buyer pays a stamp duty of 2% of the transaction value, plus court and notary fees. The broker's fee is typically 3%.

Rents

VAT - An individual's lease of residential apartments is exempt from VAT. There is 18% VAT on the rental of property located in Latvia and rented to any entity other than an individual.

Income Tax - Rents collected by companies will be subject to standard 15% income taxation. The taxable income of a company may be reduced by the real estate tax paid, as well as by depreciation write-offs, and all other expenses directly related to the generation of taxable income, however in case of the interest payments the special thin capitalization regulations may apply. Buildings, constructions and long-term plantations used for business purposes can be depreciated at 10% annual rate. Land is not subject to depreciation. Rents collected by individuals will be taxed with a flat 25% tax rate.

Sale

Companies which sell real estate book the capital gains as profit, and pay standard corporate income tax at the current rate of 15%.The capital gain is calculated as the margin between the acquisition value or the value at the moment of development of the real estate, and the sales value.
Capital gains earned by private persons on the sale of one's personal property owned for more than 12 months is exempt from tax. Capital gains on real estate owned for less than 12 months is taxed at the rate of personal income tax which is currently 25%.

Real Estate Tax

The ownership of plots of land and buildings is subject to real estate tax, which consists of land tax and tax on buildings. The land tax of 1.5% is imposed on plots of land entered in the State Land Register and is payable by the owner or user. The basis is the cadastral value of the land. Building tax at 1.5% is calculated on the average balance sheet value of the building or property's inventory value.

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Vilnius, Lithuania

Real Estate Values Grow in Step with Economy

Economy

The Lithuanian economy continues to roar along, growing 7.4% in 2006. Growth is projected to remain above 6.5% in 2007-2008. Meanwhile, Lithuania's unemployment level dropped to 5.7% by the end of 2006, and CPI reached 3.8%. Lithuania barely missed the Maastricht criteria – inflation exceeded the parameters by 0.1% – and so will join the Eurozone no sooner than 2009-2010. At the end of 2006, the average interest rate of new mortgage loans for business and households (in litas) was 5.25%. By the third quarter of 2006, Foreign Direct Investment (FDI) per capita reached €2,012 for the year. The construction price index rose 10.6% in 2006.

Office

Vacancy Under 2%, New Supply Set to Grow

Supply

Although the supply of modern office space in Vilnius rose to nearly 214,000 sqm of useful total floor space by the end of the year, the amount of new construction continued a three-year decline: 47,000 sqm in 2004, 37,000 sqm in 2005 and 23,000 sqm in 2006. With developers shifting to more profitable sectors (especially housing construction), the office space market has been set aside and the supply of free office space is currently minimal. However, Ober-Haus sees this as a temporary condition; we expect the trend to reverse in 2007 with 70,000 sqm being brought to the market. The majority of this new construction will be small office centres (1,500 – 5,000 sqm), with a few larger projects of more than 10,000 sqm.

New Projects

Administrative building complex - Local company Vetruna is developing new administrative buildings complex next to the Europe business centre on Lvovo street. When completed, the complex will comprise 62,000 sqm of floor space. Of this, two office towers (24 and 16 floors) with about 30,000 sqm A-class area will be for lease. Next to them a 6-floor building with about 5,000 sqm is being built for State Enterprise Centre of Registers (former State Land Cadastre and Register). Other areas are planned for underground and above-ground parking. Construction is scheduled to be completed in late 2007, resulting in a complex that will complement the new city business centre along Konstitucijos Ave. Other companies – including TEO, Hansabankas, Merko, Vyrokas and MEI – also have plans to develop large projects in this area in the near future.

Vilnius Gates - the largest commercial and residential block in the city centre on Gyneju Street, with a total area exceeding 60,000 sqm. The developer, Ranga IV, is now completing work on the project, and approximately 12,500 sqm of class A office space should be available to the market early in 2007. At the end of 2006, more than 70% of the office space had been leased or sold.

Saltoniskiu Street - local developer, Vilmestos projektai, is finishing the construction of a new office building next to Hanner's second office building at the intersection of Saltoniskiu and Gelezinio Vilko streets. More than 6,500 sqm of class A office space will be delivered by the first half of 2007. Approximately 90% of the space had been pre-leased at the start of 2007.

Skraidenis (first stage) – the construction of a 9,000 sqm complex of class B offices and trading spaces is planned next to the reconstructed business centre Skraidenis on Paneriu Street, Naujamiestis. A building with 3,700 sqm of office and 550 sqm of trading spaces is planned during the first stage, which is scheduled for completion in the second half of 2007.

Demand

Although the supply of modern office space has increased steadily every year, demand was strong and vacancy rates dropped below 2% by the end of 2006. Development of local companies continues to fuel this high demand.

Rents

Rents on new leases rose 15% in 2006, as take-up outpaced new supply and construction costs contend to rise. Current rents for class A office space are €14.50-19.00 per sqm, and €11.00-14.00 per sqm for class B offices. Lack of sufficient parking space near office buildings is becoming more acute. Thus, the rent rates in buildings that are in good locations and can offer sufficient parking spaces for their tenants and their customers have grown by even 20% over the period of one year. As this problem continues to intensify, developers will have to invest more into car parking lots in order to let their office spaces for the market price.

• *Biggest new administrative building complex in Vilnius – next to Europa business centre will offer about 30,000 sqm of A-class office space for lease.*

Investment

No significant office building investment transactions were recorded last year. Offering yields are not lower than 7% and the asking range is 6.5-7.0%.

Legal Notes by Sorainen

Rent is usually paid on a monthly basis in advance. However, in some cases the rent is payable in advance on a quarterly basis. Rent is typically tied to euro and indexed based on local or European Union inflation. In addition to rent tenants usually pay for the utility services consumed. Security deposits are not common, however, may be required in case of lease of substantial areas. Triple net leases can be found, but are not universally used. Double net leases are more common. As a rule, the owner is responsible for finish and equipment of the leased premises. Lease agreements are of rather poor quality. Typically standard lease agreements are used.
Lease agreements may be invoked against third persons only if they are registered with the Register of Real Estate. The tenant is entitled to terminate the lease agreement due to change of the owner of the leased premises. There are attempts to solve the referred issue by obtaining waivers from the tenants concerning termination of the lease agreement due to title transfer of the leased premises. Asset deals prevail in the office market.
The buildings might have technical defects or may be constructed not complying with the legal requirements, e.g. the construction might be started before obtaining the construction permit, the building might be higher than specified in the construction permit, etc.

Retail

Three Major Retail Centres to Open in 2007-2008

Supply

Only one large retail centre opened its doors in Vilnius in 2006. The shopping centre BIG, with a total area of 17,000 sqm, was opened in Ukmergės Street, next to an apartment buildings complex under construction. With several projects failing to open this year, 2006 was not characterised by a large increases in trading space in Vilnius; at year's end the total rentable area of such premises amounted to 458,000 sqm. However, considering the projects planned for 2007 and 2008 – including three shopping and entertainment centres (Gedimino 9, Panorama, and Ozas) with a total rentable area of almost 130,000 sqm – a significant jump in the available supply of retail premises is expected. If we add a few other multifunctional projects (Vilnius Gates and Helios City, for example), the increase in supply in the upcoming two years could easily amount to nearly 146,000 sqm.

New Projects

Vilnius Gates - the largest commercial and residential block in the city centre on Gyneju Street, with a total area exceeding 60,000 sqm. Developed by Ranga IV, the project will add almost 11,000 sqm of retail and entertainment space to the market. The project is unique because of the planned two-storey boutique style shops with separate entrances from the street. A wide range of well known brands – Frette, Christofle, Baccarat, Bernaurdaud, Sonia Rykiel, Nina Ricci, Lanvin, Celine – will be present in the luxurious "Fashion Gates" shopping gallery.

Gedimino 9 - The former city municipal building was bought by the Irish real estate company "Duke House Asset Managers" and the construction company "Constructus" for €13 million in 2004. The building will be turned into a retail and leisure shopping centre offering 13,500 sqm of retail and entertainment space. Renowned fashion brands Marks & Spencer and Lindex have already leased space, with the property scheduled for completion in spring 2007.

Panorama - In a deserted area purchased by E.L.L. Real Estate in the district of Zverynas, the development of a 65,000 sqm shopping and entertainment centre is now underway. The developers plan to invest about €67 million in the project, which they expect to open at the end of 2007 or early 2008.

• *Ozas – one of the largest shopping centres in Vilnius - will open in 2008.*

Future Projects

Ozas - There are plans to develop a shopping and entertainment centre – Ozas – near the city centre as a part of the Vilnius Entertainment Park. The total area of Ozas will reach 93,000 sqm, of which 62,300 sqm will be retail space. A 2008 opening is planned.

Demand

Premises in shopping centres are nearly constantly leased, with tenants queued up to occupy vacated space. As competition among shopping centres increases, however, the centres try ever harder to attract new brands in order to distinguish themselves from others. Demand for retail space on Vilnius' most prestigious streets also remains high, but more and more tenants express a preference to lease premises in shopping centres.

Rents

There were no significant changes in new lease rates in 2006. Rental prices for shops with window displays on Gedimino Avenue and other prestigious Old Town streets vary from €23 to €50 per sqm. Rental of a 150–250 sqm unit in a prestigious retail centre ranges from €12 to €26 per sqm, with the price going as high as €23 to €45 per sqm for units under 100 sqm. Retail centres located a bit further from the city centre are fetching rents of €8.70 to 17.40 per sqm.

Investment

At the end of 2005, the shopping centre Grand Duke Palace was acquired for €23 million by a property fund launched by the Finish Investment Bank EVLI. The shopping centre, with a total area of 5,800 sqm, is located in a reconstructed building on Gedimino Avenue.

In 2006 suburban shopping centre Mandarinas was sold by ELL Real Estate to the Finnish retail real estate group Citycon Oyj. The 10,000 sqm Mandarinas opened in 2005, and sold for €14,6 million with a yield of 7.3%.

Legal Notes by Sorainen

Typically one anchor tenant or a few medium-size tenants lease the property. However, retail buildings with 30 or more tenants may be seen as well. Lease agreements are of rather poor quality. As a rule, the tenants are not charged for the use of common use areas and for management of the building. The advertising cost is usually fixed and usually not negotiable. Sinking fund is not used in retail market, step rents and turnover rents are not common. As a rule, the tenant is responsible for finishing the premises.

Lease agreements may be invoked against third persons only if they are registered with the Register of Real Estate. The tenant is entitled to terminate the lease agreement due to change of the owner of the leased premises. There are attempts to solve the referred issue by obtaining waivers from the tenants concerning termination of the lease agreement due to title transfer of the leased premises.

Industrial

Higher Demand for Quality Warehouses

Supply

During the year 2006, modern warehouse space increased by 43,000 sqm, bringing the for-lease total to almost 168,000 sqm by year's end. More than 80% of the warehouses are located in the industrial zones of Vilnius (Kirtimai, Vilkpede, Aukstieji ir Zemieji Paneriai), with the remainder within the city limits. Compared to 2005, 2006 was characterised by a large number of developments, but the projects that were realised were quite large, amounting to more than 10,000 sqm of warehouse space. Considering the growing interest in modern warehouse space, this segment of the market should continue to grow rapidly. For the 2007-2008 period, Ober-Haus expects to see no less than 60,000 sqm of new modern warehouse space, in spite of the fact that developers generally do not build without at least pre-leasing 50% of the total area.

Dobrovoles Logistics Centre (stage II) – Investment company MEI Baltija launched stage I with 15,000 sqm of office and warehouse space in 2005, and delivered another approximately 10,000 sqm to market in 2006. A total of 35,000 sqm more will be delivered in stages in 2007 and 2008. Rents for warehouse space are €4.30 to €5 per sqm.

Zariju Logistic Centre – freight-forwarding and warehousing company TT Logistic in 2006 opened its new logistics centre in Paneriai, with 12,000 sqm of warehouse space and 2,000 sqm of office space. The Paneriai complex comprises a total of 16,200 sqm of warehouse and 2,200 of office space.

New warehouse in Paneriai – Autoverslas also opened a new warehouse in Aukstieji Paneriai in 2006. The complete warehouse space – 6,500 sqm plus 520 sqm of office space – has been leased to a local company.

• *Zariju Logistic Centre – TT Logistic offering modern warehouses and office space with wide range of services.*

Demand

Demand for modern warehouse floorspace and facilities remains high. Most warehouses are leased; most, in fact, are pre-leased prior to construction. Because warehouse premises and logistics centres must meet very specific tenant requirements (location, space, technical characteristics, communications, etc), existing but unoccupied premises that thoroughly saisfy the needs can only rarely be located. This results in more construction of build-to-suit warehouse premises and an upsurge in warehouse renovation.

Rents

Warehouse rents were mostly unchanged in 2006. For new modern warehouses near the city centre, rent prices vary from €4.5 to €5.8 per sqm, depending on the size. Near or outside the city border, rents range from €3.7 to €4.6 per sqm. Newly renovated premises are on offer at price from €3 to €4 per sqm. Owing to fast-growing demand and rising construction costs, we expect lease rates for modern warehouses to rise this year.

Investment

At the end of 2006, Norway's Verdispar group purchased the Vinges terminal logistics centre on a long-term lease. Located near the Vilnius-Minskas road, the Vinges terminal comprises a total combined warehouse and office space of 18,500 sqm.

Legal Notes by Sorainen

Industrial leases are quite simple, finance and construction opportunities are readily available. Rents are usually tied to the euro and indexed on the basis of local or European Union inflation. Triple net lease agreements are rarely seen. Sale-leaseback arrangements have been seen as well. As a rule, most premises are still Soviet-era, so the technical conditions of the premises are poor, not complying with standard norms.

Residential

After an Early Jump, Prices Growth Moderates

Prices

After rising 10% in the first quarter of 2006, residential property prices levelled off and remained steady for the remainder of the year. The fast rises in 2005 and early 2006 were fuelled by easy credit from banks, and speculators taking advantage of developers offering units for only 10% pre-payments, with 90% due on delivery. This developer-financed leverage allowed developers to push prices higher. Now speculators are unwinding those positions by selling into the market as delivery of the units (and the 90% payment due date) nears.

After the second quarter, only higher quality apartments showed a further price increase – between 5% and 10% – while prices for mass-market units remained stable.

Prices of secondary market apartments in Soviet-era, prefabricated concrete buildings became 5–10% cheaper. Ober-Haus expects the price gap between old and new dwellings to continue to increase. At the end of 2006, a standard two-room apartment (approximately 50 sqm) in an older apartment building located in a bedroom community was priced from €55,000–€75,000. The same size new apartment, fully finished, was fetching €65,000–€95,000.

Prices of new apartments in the suburbs range from €1,050 to €2,000 per sqm. In more prestigious districts (Antakalnis, Žvėrynas, Valakampiai), prices range from €1,800 to €3,500 per sqm. In the city centre and Old Town, prices can be as high as €5,500 per sqm. New apartments are sold shell in Lithuania, meaning the buyer will have to pay about €200 per sqm more to finish out flooring, painting, lights, bathrooms and kitchen.

Individual houses (of 150–250 sqm with land plots of 500–1000 sqm) located in a new housing area with full infrastructure in Vilnius district (typically 14–20 km from the city centre) are sold as shell (that is, without interior fit-out) at prices ranging from €170,000 to €290,000. Full final fitout generally costs €200 per sqm more.

The average price for the same type of partially finished house within the city limits (suburbs or city residential districts) averages between €300,000 and €450,000, and from €600,000 to €2,000,000 in the city's more prestigious neighbourhoods where a considerable share of the house price is represented by the high price of land in these districts.

• *Bajoru kalvos — the largest residential project of Hanner in Vilnius.*

Supply

In 2006, more than 4,900 new apartments were constructed in Vilnius – 25% more than the 3,850 units built in 2005. The majority (approximately 84%) were built in the suburbs primarily in the Žirmūnai, Pašilaičiai and Fabijoniškės districts. The share of apartments constructed in the Old Town and the centre amounted to only 7% of the entire supply, due mostly to complex development procedures in these areas. The average area of a newly constructed apartment is around 62 sqm, a figure that has decreased somewhat over the past few years owing to the market demand for smaller-sized and average-sized apartments.

There are plans to build 7,000 new apartment units in Vilnius in 2007, but the lack of construction resources almost guarantees not all will be built. Ober-Haus works with all major developers and estimates that slightly more than 6,000 new apartments will be realised in 2007. The geographical distribution of apartments in Vilnius remains the same; once the largest projects are implemented, the majority of apartments will be constructed in Pašilaičiai, Žirmūnai, Pilaitė and Verkiai.

The market for individual houses continues growing at a rapid pace. Both the number of those building houses for themselves, as well as those building houses for sale in individual housing quarters is increasing. In the city of Vilnius and nearby, around 260 individual houses in various housing quarters were constructed for sale in 2006, and plans indicate that the supply of such houses will increase to 400–500 units in 2007.

New Projects

In 2007 the Helios City multifunctional complex on Savanorių Avenue in Naujamiestis will be supplemented by an additional nine-storey residential tower currently under construction. The entire complex – a 25-storey and the new nine-storey residential tower – will feature shopping and office premises on the lower storeys, with approximately 110 apartments above. Prices for partially finished apartments in the complex: €1,900–€2,300 per sqm in the nine-storey building and €2,400–€3,200 per sqm in the 25-storey building; exclusive apartments on the 25th floor are priced at €5,000 per sqm). Approximately 65% of the apartments in the complex have been sold or reserved.

The developer Hanner has begun developing a modern residential housing quarter on Mokslininkų Street in Santariškės. Plans call for the construction of 1,100 apartments on a land plot of 8.5 hectares over three years. Three-storey to 11-storey buildings with one-room to five-room apartments of between 40 and 129 sqm have been designed. In the first stage, three apartment houses (approximately 240 apartments) will be constructed, with completion scheduled for autumn 2007. The sale prices of partially finished apartments range from €1,100 to €1,500 per sqm, and 70% of first stage apartments have already been sold or reserved.

The settlement of individual houses in Bendorėliai is being further expanded, with 23 new houses of 153 to 309 sqm to be constructed in the neighbourhood. The homes are being built on land plots of 5-13 ares, about 4 km from the city limits and 13 km from the city centre. It is expected that construction work will be finalised in the second half of 2007. The sale price of partially finished houses ranges from €190,000 to €315,000, and 45% of the houses have already been sold or reserved.

Demand

Although the market has become less active, new apartment sales remain fairly good. At the end of the year, 90% of all apartments constructed in Vilnius in 2006 were already sold. Buyers are choosing new dwellings more carefully, and because a rapid growth in prices is not expected in the future, the purchase of a dwelling is becoming more rational and more time is devoted to the purchase process than in the past.

Although the income of residents is increasing rapidly each year, the increase in housing prices over the past few years was even more rapid. The housing affordability index (taking into consideration only official data) has therefore been decreasing for the last few years. This prompts residents who wish to reside in new dwellings to purchase smaller dwellings. As a result, one- and two-room apartments (40-50 sqm), or compact individual or attached houses of 100 to 200 sqm, are currently the most popular. It is probable that this trend will continue over the next few years.

The Mortgage Market

Mortgage loan rates start at 4.2% for loans in Euros, with a maximum term of 40 years. Clients can borrow 100% of the property value using guarantees from the government backed housing loan insurance company.

Rising interest rates in 2006 caused a slight slow down in growth in the volume of housing loans, but total lending was still more than 50% higher than in 2005. Banks foresee lending to grow for many years. Today outstanding mortgage loans in Lithuania total just 11% of annual GDP. Compared to the EU average of 48% of GDP - and even compared to neighbouring Latvia's 35% of GDP - mortgage lending still has a long way to grow in Lithuania, bringing more liquidity to the market.

Rents

The residential rental segment, which was not very active in the preceding few years, became markedly stronger in 2006 when we saw increases both in rental prices and in demand for rental accommodation. The strengthening of the medium-priced rental segment was particularly noticeable. Both the cheapest and the most expensive housing segments have always had their own circle of tenants, but the demand for housing with rental prices ranging from €300 to €500/month increased considerably. Such housing is more and more often rented by local dwellers who, for the time being, are unwilling or unable to purchase property. Stable housing prices and the unpredictability of further rapid growth encourage rentals. Because no sudden growth in housing prices is expected in the future, because there is an increasingly large variety of new construction projects from which to choose, and because dwellers expect to have higher incomes in the future, more and more often they delay the purchase of housing and opt for rental.

In the suburbs, where monthly rents range up to €250 per month, rents increased about 10-15%. The lowest-priced segment is also popular among people who work in Vilnius but reside in other towns. It is therefore not surprising that this segment has the highest demand. As the number of foreigners who once came to Lithuania for business and rent housing for an extended period of time has decreased considerably, it has become more difficult to lease large, expensive apartments. Owners are forced either to reduce rental prices for such apartments or to invest additional money in the apartments. Rental prices for new apartments range from €300 to €800 per month depending on the location. The rental prices of apartments located in the Centre and the Old Town range from €350 to €1,100 per month.

Legal Notes by Sorainen

Residential leases are regulated by Lithuanian law more strictly than commercial leases. However, rents may be agreed upon freely.
Residential buildings situated in the old town are of high value. However, legal restrictions applicable in respect of the objects situated in the old town area and objects included into the List of Cultural Heritage must be followed. The depreciation or amortisation of long-term assets included into the List of Cultural Heritage is not calculated, except for the depreciation of renovations completed in buildings included into the List of Cultural Heritage.

Land

New General Plan Opens Development of New Areas

Supply

There is still a lack of land plots on which the construction of residential or commercial objects is permissible, i.e. land plots located in convenient areas of the city, with all necessary infrastructure, and connections with main city roads (especially in the case of construction of commercial or storage facilities). There are still many sites in Vilnius where manufacturing once took place, but currently these places, usually located in attractive areas, do not use their full potential. Most often such properties are quite large (10 to 20 hectares), however, and their development requires huge investments amounting to tens of millions of euros.

The supply of land plots appropriate for construction of individual houses in Vilnius is very low. Those who wish to reside in private houses encounter difficulties in finding an appropriate land plot for a reasonable market price. The total land area of the Vilnius district is about 213,000 hectares. It is expected that once the General Plan of Vilnius district is approved in early 2007 the supply of land for construction of individual houses will increase considerably.

Changing the purpose of land plots remains one of the most complex procedures in the real estate market. Currently, this is extremely important for those who have purchased land that is designated for agricultural use in the Vilnius district. Until the General Plan of Vilnius district is finalised, there exist only theoretical opportunities to change the purpose of land plots and to develop various projects. The municipality currently gives those who wish to prepare a master plan of a land plot for a specific project in the city of Vilnius project terms on the basis of the old General Plan, but the master plan must ultimately be in line with the new one. In the best-case scenario, these procedures would last approximately six months, but most often it takes from nine months to several years, depending upon the location and complexity of the project. The biggest related expenses are allocated to the architect who drafts and coordinates the designs with the city government, and these expenses can vary from a few thousand to a hundred thousand euros.

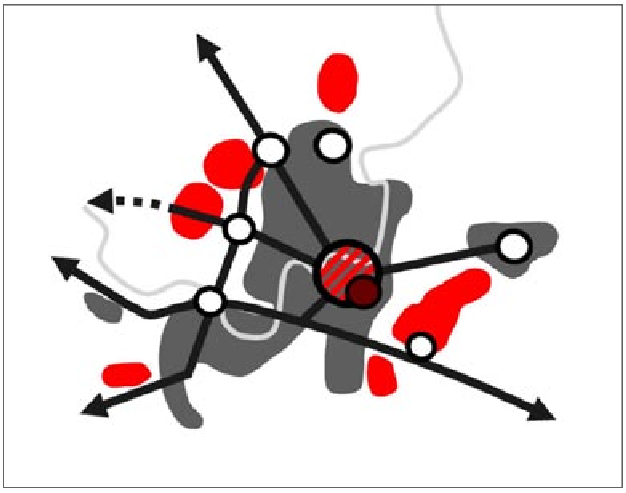
Prices

Unlike the period of 2003-2005, when property with any designated use in Vilnius and its surrounding areas was becoming more expensive and land prices were rising even faster (50-100% each year), the increase in prices for land in 2006 was smaller and more rational. Once Vilnius development plans were introduced to the general public, it finally became evident which direction further city development would follow, and this affected the various changes in the prices of land plots. As a result, in 2006, prices for land plots designated for agricultural use and located in developing territories in the city of Vilnius or surrounding areas increased an average of 30-40%; in more slowly developing territories, prices went up approximately 10-20%. The increase in land prices in the Vilnius district slowed in 2006. The prices of land plots that were designated for agricultural use and located in territories with no prospects (far away from main roads, settlements, or bodies of water) or of land plots located outside possible future development zones increased insignificantly, and in certain cases, such land plots even became cheaper. During the accounting year, the prices of land plots suitable for construction of both commercial and residential buildings in Vilnius and surrounding areas increased an average 50-100%.

Prices for land plots in the central part of the city, the Old Town and other prestigious districts and suitable for construction of apartment houses and commercial projects currently range from €700 to €3,000 per sqm. The prices of similar land plots in the suburbs range from €150 to €600 per sqm, and land plots near the city limits cost from €120 to €200 per sqm.

The main parameters affecting the price of land plots are the location of the land plot and the size of the building allowed to be built on the land. The price of building land may vary depending on the final price of one constructed square meter.

For example, building land in the suburbs may sell for €100 to €400 per buildable square metre of housing, while land in more prestigious districts will sell for €900 to €1,500 per buildable square metre of housing.



• *Approved concept of the General Plan for the Municipality of Vilnius until 2025, which specifies decentralized concentration.*

Demand

One can still sense a large amount of interest in land where construction of residential or commercial objects is permitted. Buyers are most interested in those land plots that are already fully prepared for construction of commercial or residential premises. The buyers are ready to pay a bigger price for such land plots because it allows them to save a lot of time and plan the project development process precisely.

Land plots of 800 - 1,200 sqm located in garden communities or settlements in the city of Vilnius, as well as plots located up to 10 km from the city limits, have the highest demand for individual home construction. People are willing to reside further away from the city because such land plots are two to three times cheaper than those located within the city limits.

Land continues to be the highest-demand product in the real estate market. The biggest hopes of investors relate to opportunities to change the purpose of land plots in the future, thus increasing the value of the property. This was especially noticeable in the Vilnius district where land now designated for agricultural use is purchased with the expectation that the purpose will be changed when the General Plan of Vilnius district is approved. Plots in the city centre and other prestigious districts continue to be the most attractive investments, as property in these locations is widely believed to be "the safest" and the most resistant to negative market changes.

Investment

Lithuanian construction company Kamintras bought a land plot on Linkmenų Street (in the Snipiskes district near the city centre) for €11.8 million, on which 42,000 sqm of residential premises are planned, making the cost €280 per sqm of residential space.

News

In 2006, the Vilnius City Council approved the concept of the General Plan for the Municipality of Vilnius until 2025, which specifies decentralized concentration as the city's strategic development trend, and the optimal option for city development was chosen. According to this concept, external development in the city's most favourable areas will be combined with the conversion of areas that are being used ineffectively. This provides opportunities to invest in both the city centre and the periphery in the direction of Pilaitė, Pavilionys, Gulbinai, Lentvaris, and the Pavilnys area.

In accordance with the approved version of the concept, the General Plan for the Municipality of Vilnius until 2015 was approved in February of 2007.

Approximately 68% of the total land area to which citizens have requested their right of ownership be restored has currently been restored in Vilnius district of Vilnius County. In accordance with the Programme of the Government of the Republic of Lithuania 2006-2008, plans are to restore the land to its legitimate owners by the end of 2007. Until the land is restored to all legitimate owners, the municipality of Vilnius practically may not hold any auctions of land from the stock of unoccupied state land.

Legal Notes by Sorainen

Lease of privately owned land is not widely used in Lithuania. Lease of state owned land is more common. Land in free economic zones may be subleased. The right to use the land under a building (ownership, lease right, etc) must be transferred to buyers along with the building.
Investments for foreigners are not restricted except acquisition of agricultural and forestry land until 1 May 2011.

Legal

Introduction

Over the past few years the real estate market of Lithuania has experienced significant growth driven by rapid economic development and local demand, as well as ability to attract foreign investments by offering friendly legal environment, favourable lending opportunities and an advantageous tax system. The real estate market in Lithuania is based on the principles of private ownership and ownership immunity, prudence, fairness, justice and protection of rights of legitimate acquirer of real estate.

Title to Real Estate, Register of Real Estate

Title to real estate is registered with the Register of Real Estate. Registration of the agreement on acquisition of real estate and consequently - the title to real estate with the Register of Real Estate - is not mandatory pursuant to the Lithuanian legislation. The agreement on acquisition of real estate is valid and binding on its parties irrespective of its registration with the Register of Real Estate. However, the agreement on real estate acquisition may be used against any third parties only if it is registered with the Register of Real Estate. In addition to title, real rights, encumbrances, restrictions, rights of third parties to real estate, etc are also registered with the Register of Real Estate.
As of the moment the data is registered with the register such data is considered true and comprehensive, until contested to the contrary following the procedure established by the laws. The information stored in the Register of Real Estate is publicly available.

Acquisition of Real Estate

General
According to the general rule the seller must transfer to the purchaser, together with the title to the building, the right to the land plot (a part thereof) which is occupied by the building and which is necessary for the use of the building in accordance with its purpose.
Should the seller be the owner of the land plot on which the building under sale is situated, the buyer must be transferred the right of ownership to the land plot, the right of land lease, the right of development (superficies) or any other right entitling the buyer to use the land for the purpose of proper use of the building.
If the seller is not the owner of the land plot on which the building is situated, the seller is entitled to sell the building only upon prior consent of the land owner and the buyer must acquire the right to use the land on which the building is situated under the same conditions as the seller. Agreement in which the rights of the buyer to the land plot are not contemplated may not be certified by a notary and if certified, is null and void.

Letter of Intent and Heads of Terms
It is customary to conclude a letter of intent (LOI), head of terms (HOT) or preliminary agreement detailing the actions required by the parties prior to entering into the main agreement on acquisition of real estate, main terms and conditions of the agreement, as well as liability of the parties, if agreed, for not entering into the main agreement on acquisition of real estate.
It is advisable to conclude the letter of intent, head of terms and the preliminary agreement in writing. There is no legal requirement to notarise the LOI, HOT or the preliminary agreement.

Change of Ownership
A person acquires the title to real estate as from the moment such real estate is transferred into its possession. Such transfer must be recorded by signing a transfer-acceptance deed that may be either structured as a separate document or incorporated into the agreement on real estate acquisition.

Asset Transfer vs Share Transfer
Real estate transaction may be executed either by purchasing shares in a company holding the target real estate (share transfer) or by purchasing the particular real estate (asset transfer).
When choosing the share transfer the following circumstances must be considered:
• increased volume of due diligence investigation, as more extended review of corporate documents, financial, employment issues and other fields of the targeted company is required;
• the investor may face the risk of historical issues of the targeted company in respect of its foundation, previous shareholders, activity, taxation;
• deferred taxes issues;
• share transfer implies a problem relating to existing contracts, since, as a rule, the change of shareholders has no impact on contractual relations of the targeted company;
• management structure of the company, employees selected by the previous owner, contractual obligations undertaken on behalf of the company not always meet expectations of the new investor;
• the investor is not a "fair third party" with respect to transactions entered into by the company;
• by acquiring the targeted real estate the investor also "acquires" all rights and obligations of the company assigned to the company on legal and contractual basis, including payment of debts, if any, performance of contractual obligations towards the third parties, etc.
Asset transfer involves the following risks and issues:
• the asset transfer is subject to a notary fee and state duty and, therefore, is more expensive than a share transfer. The notary fee is calculated by summing LTL 790 and 0.5% of the real es-

tate value exceeding LTL 100,000. The state duty related to registration of the real estate title with the Register of Real Estate depends on the real estate value and varies from LTL 100 to LTL 10,000;

• Lithuanian legislation entitles tenants to terminate lease agreements due to change of the owner of the leased properties;

• in case the seller of the building is not the owner of the land plot on which the building is situated, the referred building may be sold only upon prior written consent of the land owner. Should the building be located on the state-owned land plot, the consent of a respective county governor concerning transfer of the lease right to the buyer together with the building must be obtained;

• agreements on supply of utilities and other services, as well as any other agreements related to the real estate under sale, except the lease agreements registered with the Register of Real Estate, must be assigned or re-concluded;

• since Lithuanian legislation provides for/ the sale of an enterprise as the transfer of an enterprise as a property complex or a material part thereof, there is always a risk that an asset transfer will be recognized as an enterprise transfer. If the transaction is recognised as the sale of an enterprise, additional mandatory legal requirements apply (specific content of the agreement, notification of the creditors, etc).

Form of Agreements

Share transfer transactions must be concluded in a written form. Real estate sale-purchase agreements (asset transfer transactions) must be concluded in a written form and certified by a notary. Failure to notarise the asset transfer agreement makes the referred agreement null and void.

Language Requirements

Transactions of legal and natural persons of the Republic of Lithuania must be conducted in the Lithuanian language. Translations into one or more languages may be attached to them. Transactions with natural and legal persons of foreign states may be conducted in the language acceptable for both contracting parties. However, if such transaction must be confirmed by a notary, it is required that Lithuanian would be the prevailing language of the agreement.

Due Diligence

It is strongly advised that a legal due diligence of the target real estate be carried out before the purchase is concluded. In the course of due diligence the ownership title, encumbrances, the land purpose, third persons' rights, public restrictions, lease agreements, agreement on supply of utility services, etc. are checked, providing more security and bargaining power to the purchaser.

Pre-emption Rights

Pre-emption rights may be established on the statutory or contractual basis. For instance, the law provides that a co-owner of real estate has the pre-emption right while selling a legal share of the real estate to third persons, with the exception of cases when the sale takes form of a public auction. Also, the state has a pre-emption right to acquire the land in state parks, zones of ecological protection and other protection zones.

As a general principle, if the seller of the private real estate fails to comply with the requirement on the pre-emption right, the person who had the pre-emption right may, within the statutory limitation, request the court to transfer him the rights and obligations of the buyer of that real estate.

Typical Purchase Price Arrangements

Purchase price payment arrangements may differ subject to agreement reached by contracting parties. If no credit or third party financing is involved, the purchase price payment is usually divided into two parts: partial payment is made on the day of signing a preliminary agreement or signing and confirming the real estate transaction at the notary, and the remaining part is paid after certain conditions precedent have been met, e.g. signing the transfer-acceptance deed. The title to real estate may be transferred irrespective of settlement between the seller and the buyer for the acquired real estate. For the purpose of securing the interests of the seller or the buyer, the title to real estate may be transferred before or after payment of the entire real estate purchase price.

Related Costs

Conclusion of agreements at the notary and registration of title with the Register of Real Estate involves a notary fee and a state duty. The purchasing process of real estate may bring about also further costs depending on services used: brokerage and valuation fees, bank fees, legal fees for carrying out a legal due diligence and reviewing the purchase agreements, costs of environmental and technical reviews etc.

Value added tax at the rate of 18% is imposed on sales of new buildings.

Concentration Control

In real estate transactions one should check whether the transaction is subject to concentration control.

The intended concentration must be notified to the Competition Council and its permission is required where combined aggregate income of the undertakings concerned (received from Lithuanian market) is more than LTL 30,000,000 for the financial year preceding concentration and the aggregate income of each of at least two undertakings concerned (received from Lithuanian market) is more than LTL 5,000,000 for the financial year preceding concentration.

Restrictions

Restrictions on Acquiring the Real Estate
Buildings and other constructions may be acquired into the ownership of Lithuanian or foreign natural or legal persons without any restrictions.
Constitution of the Republic of Lithuania determines that entrails of the earth, internal waters, forests, parks, roads, historical, archaeological and cultural objects of national significance are owned by the state of the Republic of Lithuania exclusively. In other cases Lithuanian citizens and legal persons with their offices registered in the Republic of Lithuania are allowed to acquire the title to land and forest unrestrictedly.
Foreign legal and natural persons are entitled to acquire the title to the land provided they comply with the European and Transatlantic criteria. It is considered that foreign legal entities are in compliance with the European and Transatlantic criteria, if they are established in:
• Member States of the European Union or the states that are parties to the European Treaty with the European Communities and their Member States; or
• Member Countries of the Organisation for Economic Cooperation and Development (OECD), states that are parties to the North Atlantic Treaty Organisation (NATO) or the European Economic Area Agreement.

Foreign natural persons are deemed to be in compliance with the European and Transatlantic criteria, provided they are:
• citizens or permanent residents of any of the states specified above; and/or
• permanent residents of Lithuania holding no Lithuanian citizenship.
However, foreign natural and legal persons even complying with the European and Transatlantic criteria referred to above are not entitled to acquire agricultural and forestry land for the transitional period of 7 (seven) years, which commenced on 1st May 2004, except:
• foreign natural persons, who permanently reside and are engaged in agricultural business in Lithuania for at least three years; and
• foreign legal persons and other foreign organizations, which have established representative or branch offices in Lithuania.

Public Restrictions on the Use of Real Estate
Real estate must be used in accordance with its purpose, following zoning and planning requirements, conditions of encumbrances (easements, protections zones, etc). Further, the law establishes specific requirements on the use of the real estate objects of cultural heritage. For instance, the owner or the manager of the object of cultural heritage must timely eliminate discovered defects and protect structures against adverse environmental impact, etc.
When transferring title or rights of management, the seller or the manager of an object of cultural heritage must give at least a one-month notice of his intention to conclude a transaction to the heritage protection subdivision of a municipality. Within this period, the municipality must verify whether the condition of the said object and valuable properties thereof correspond to the condition specified in the certificate of the immovable cultural property. The rights, duties and liability of the transferor of an object of cultural heritage shall, upon the verification of the condition of the object, be transferred to the new manager (acquirer) from the signing of a statement of acceptance. Where the condition established at the time of the verification does not correspond to the condition specified in the certificate of the immovable cultural property, the transferor is held liable therefore.

Property Management

For maintenance of real estate the property management companies or associations may be used. In multi-apartment houses owners of the apartments may establish an association of owners. The status, rights and obligations of such associations are regulated by the Law on Association of Multi-Apartment House Owners.

Lease Agreements

General
General terms and conditions of the lease agreement are regulated by the Civil Code. However, the parties to lease agreements may freely agree on most of the lease issues. For the purpose of securing the interests of a natural person as the tenant, residential leases are regulated more strictly than commercial leases by determining specific rules related to the condition of the leased residential premises, right of the family members to reside together with the tenant, termination of the lease agreement and eviction of the tenant.
Lease agreements may be invoked against third persons only if they are registered with the Register of Real Estate prior to title transfer. The Laws of the Republic of Lithuania entitle the tenant to terminate the lease agreement due to the change of the owner of real estate.

Duration and Expiry of Lease Agreement

Lease agreements may be concluded for a fixed-term or for an indefinite period. In all cases the lease term may not exceed one hundred years. Lease term must be determined by the agreement of the parties. In case the term of the lease agreement is not determined in the lease agreement, it is considered that the lease agreement is concluded for an indefinite period. Should the tenant continue to use the leased property for more than ten days after the expiry of the lease term and the owner does not object to such use, the lease agreement is considered to become concluded for an indefinite period of time.

Either party is entitled to terminate the lease agreement concluded for an indefinite period of time by giving a three-month prior notice, unless the parties agree on other notification period. Lease agreements of residential premises may be terminated by either party by giving a six-month prior notice, unless longer notice periods are established by the parties to the lease agreement. The tenant who has duly performed his duties accepted according to the lease agreement has a pre-emption right against other persons to renew the lease agreement upon expiry of the period thereof.

Lease Payment and Accessory Expenses

The terms of rent payment for the lease of commercial premises are subject to the agreement by both parties. Generally, the tenant pays the rent on a monthly basis in advance for the forthcoming month. Provision of utility services, such as electricity, heating, water, etc are charged additionally according to the meters of measurement devices or proportionally to the area of the leased premises in case individual metering devices are not installed. The tenant may also be obligated to compensate the expenses of the owner related to maintenance of the leased real estate object. Guarantee, surety or other similar securities ensuring payment of rent and costs may also be required.

As to the lease of residential premises, the law explicitly states that a owner is not entitled to demand the payment of rent in advance, with the exception of the rent payment for the first month. The rent must be paid on a monthly basis for the current month not later than by 20th calendar day of the next month.

PPP & Infrastructure

Concessions

The Law on Concessions determines concession as an authorisation granted by the awarding authority to the concessionaire to engage in the economic and commercial activity related to the design, construction, development, renovation, transformation, repairs, management, use and/or maintenance of infrastructure objects, to provide public services, manage and/or use state-owned, municipal property. The concessionaire assumes under the concession contract all or part of the operating risk and undertakes the relevant rights and duties. The consideration of the concessionaire for the activity mainly consists solely of the granting of the right to engage in the relevant activity and income from the activity.

Pursuant to the concession contract the concessionaire may be granted an authorisation to engage in the economic and commercial activity in the areas of energy, railway lines and systems, water economy, waste water, roads, bridges, tunnels, parking and other infrastructure of road transport, health care system, telecommunications infrastructure, educational system, airport infrastructure, etc.

The term of a concession agreement may not exceed 25 years.

Sale-Leasebacks

Sale-leaseback model is not commonly used in Lithuania in structuring PPP. However, long term leases are used as one of the PPP models. The advantage of long term lease is that the infrastructure objects are modernized and maintained using private funds. Further, the rent is paid by the private investor (tenant) to the public owner of the respective infrastructure object. After the expiry of the lease term the renewed and profitable infrastructure objects are transferred back to the public owner.

Planning Requirements and Construction of Buildings

Planning

The approval of a detailed plan lies within the competence of the local authorities. As a rule, detailed plans are established for city areas and rural municipality areas where constructions are intended to be performed. The new detailed plan must be approved in case of change of the purpose of the land. The process of establishment of detailed plans involves evaluation of the results of the detailed planning, as well as public hearings and discussions. The process of approving the detailed plan may take approximately from six months to one year.

Construction

Erection, modification and demolition of buildings and other structures, as well as their subsequent use, require a permit issued by the construction supervisory authority.

The construction must comply with building norms that are set forth by the legal acts. Construction works have to be performed pursuant to the design documentation of the building. The contractor, the architect and the technical supervisor of the construction are liable for the collapse of the object or the defects, if the object collapsed or the defects were discovered within a period of 5 years, 10 years – in case of hidden elements of the structure (structures of construction works, pipelines, etc.) and 20 years in case of intentionally concealed defects. These time-limits commence on the day of handing over the result of the work.

Construction may be carried out only based on a building design that is drafted by a professional architect or an engineer and approved by the local supervisory authority. The building design documentation must comply with the relevant detailed plan, if such plan has been established, and meet the official building norms.

In order to commence construction, a building permit should be issued by the State Territorial Planning and Construction Inspectorate. The validity period is provided for in the permit, however, it may not exceed ten years.

After completion of the construction work, the state authorities inspect the completed building for the purpose of attesting whether the building is fit for use. If the building complies with the building design, building standards, engineering and utility networks and traffic routes are tested, and geodetic pictures have been taken, the state authorities issue an act recognizing the building fit for use. Use of a building is not allowed without such an act. Buildings, which are accepted as fit for use, are registered with the Register of Real Estate.

Taxes

Purchase

VAT – The purchase any new building or apartment is subject to 18% VAT. The building is considered as new for a period of 24 months from the date it was put into use. Old buildings are exempt from VAT with an option for taxation in case the customer is a VAT payer. In case the option to tax is used, it must be maintained for at least 24 months. The purchase of plots of land from a legal entity is subject to 18% VAT.

Fees - Notary fees depend on the value of the transaction, and are approximately 0.5% of the transaction value.

Rents

VAT – Although the rent of real estate is considered a VAT exempt supply, owners of commercial property have the option to charge VAT on rent, for example it if they wish to recoup any VAT paid for development of the property. Once the owner chooses to charge VAT on rent, that option must be maintained for at least 24 months.

Corporate Income Tax – Final profit after all costs is subject to standard 15% Corporate Income Tax and an additional Temporary Social Tax of 4% in 2006 and 3% 2007. Buildings and improvements are subject to tax depreciation.

Personal Income Tax – Rents collected by individuals are subject to Personal Income Tax at rates 15% or 27%. An individual may choose to pay a 15% flat rate on gross rental income without cost deductions, or pay 27% on final income after all costs. Rents to individuals may be subject to a low one-off yearly tax under a special permit system.

Sale

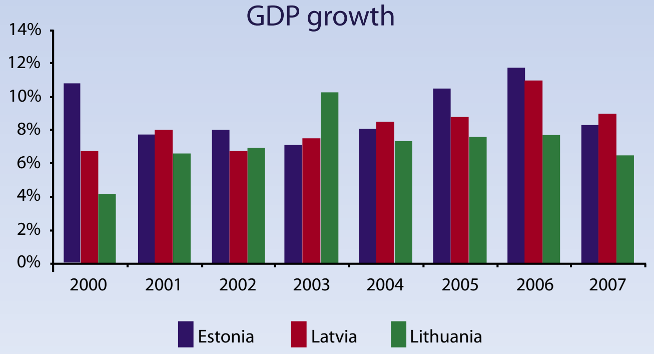
Corporate Income Tax - There is no separate capital gains tax in Lithuania on the sale of immovable property. Any capital gain realised by a Lithuanian resident company on the sale of property is taxed on a yearly basis as part of the company's annual profits at the prevailing rate, which in 2007 is 15% corporate income tax and an additional social tax at a rate of 3% on corporate profits. Any income received by a non-resident company from the sale of immovable property located in Lithuania is subject a withholding tax of 10% of sales price with no deductions applied. The non-resident company must then apply to the Lithuanian tax authorities to recover that part of the tax withheld that corresponds to the acquisition price of the property.

Personal Income Tax - When a resident or non-resident individual acts in his private capacity and sells immovable property that falls outside the scope of individual economic activities (e.g. the sale of own dwelling or summer house), the capital gains received from the sale of immovable property located in Lithuania is subject to personal income tax at 15%. If the immovable property (located in Lithuania or in the European Economic Area) was acquired more than three years prior to the sale, then gain is exempt from personal income tax. A special taxation regime is applicable in Lithuania to individuals who act as entrepreneurs, i.e. when these individuals engage into habitual economic activities for the purpose of receiving income. When filling in the annual income tax return, the individual has the option of choosing either of the two formulas for taxation of income from the sale of immovable property:
a) All revenue is taxed at a flat rate of 15% with no deductions allowed;
b) Capital gains (profits) are taxed at a rate of 27%. This rate is effective from 1 July 2006. Capital gains are calculated as the difference between the sales price and acquisition price (and deductible expenses). The same rules on taxation of individual activities apply to non-resident individuals who sell immovable property through a fixed base in Lithuania.

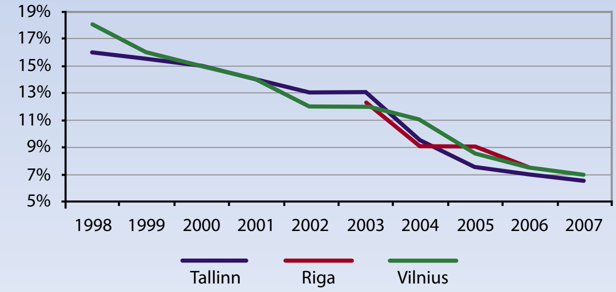
Real Estate Tax

Individuals and companies are subject to Real Estate Tax and Land Tax.
Buildings are subject to Real Estate Tax at a rate of 0.3-1.0%, depending on the municipality where the building is located. Exemptions apply to individuals for own dwelling and certain other personal property. Depending on the type and purpose of buildings, the tax base is either based on fair market value or reconstruction costs.
Land is subject to 1.5% Land Tax. The tax base (typically, lower than fair market value) and tax payable is calculated and reported to the taxpayer by the tax authorities. If the taxpayer disagrees with the assessment, he may get a valuation done and challenge the assessment.

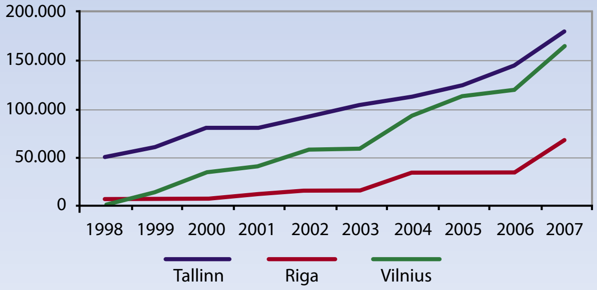
GDP growth



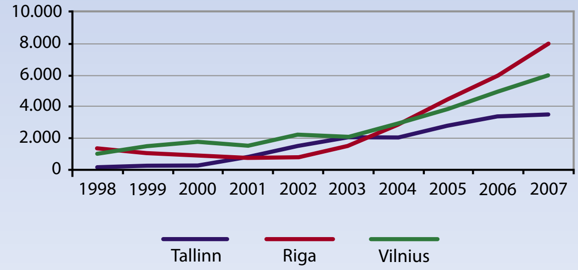
Class A office investment yields



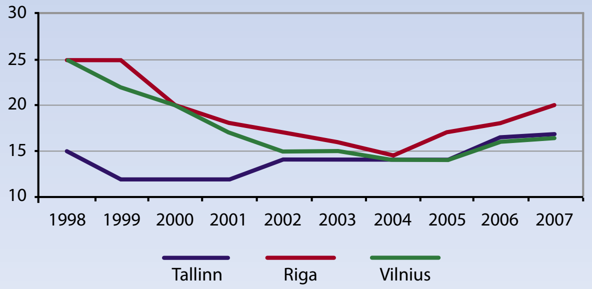
Total class A office space (sqm)



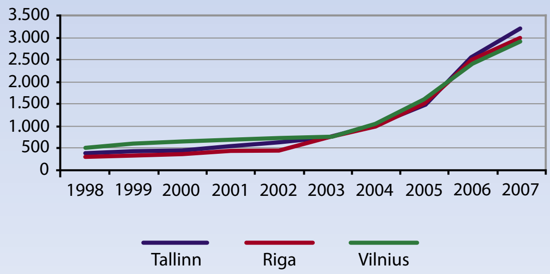
Completed residential units



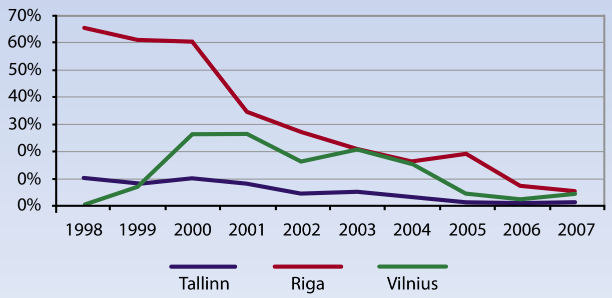
Avg class A office rents (EUR)



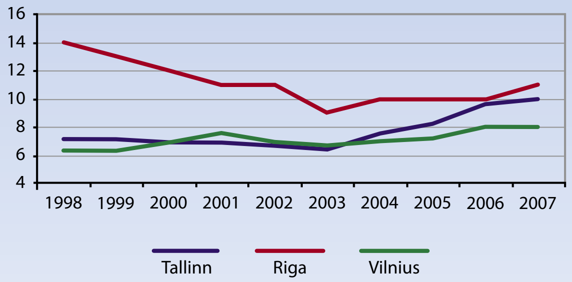
Average city centre residential prices (EUR/sqm)

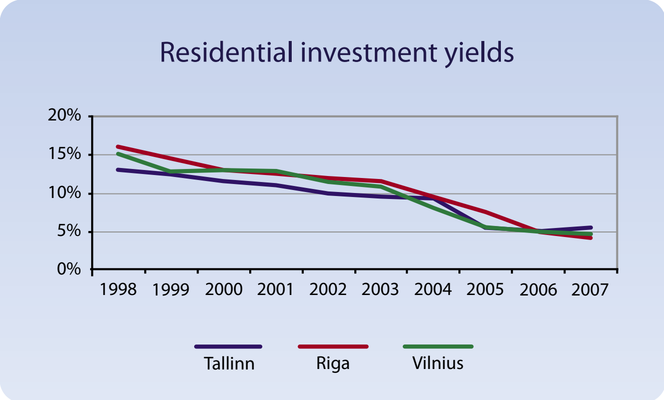


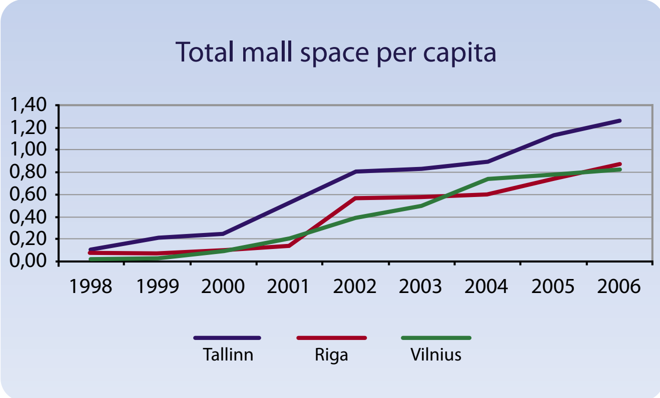
Class A office vacancy rates

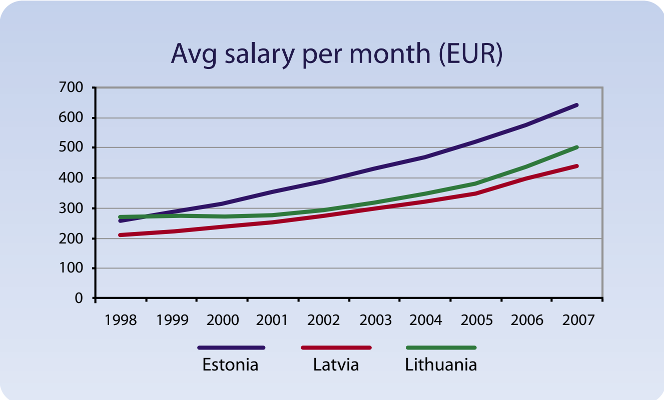


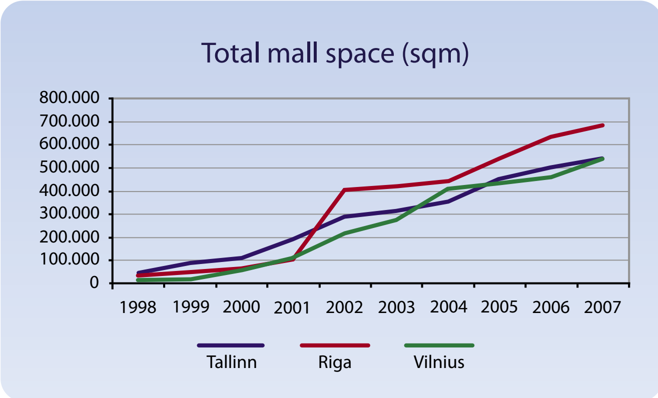
Average residential rents (EUR/sqm/month)

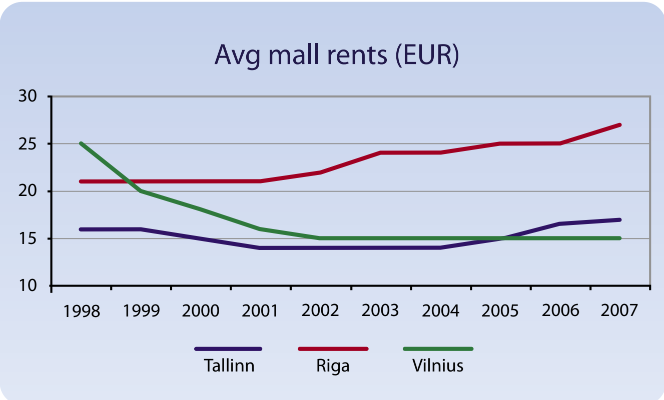


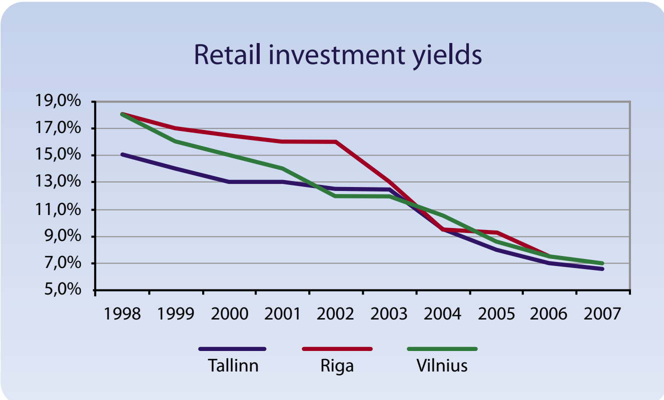

Residential investment yields
20%
15%
10%
5%
0%
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Tallinn
Riga
Vilnius


Total mall space per capita
1,40
1,20
1,00
0,80
0,60
0,40
0,20
0,00
1998 1999 2000 2001 2002 2003 2004 2005 2006
Tallinn
Riga
Vilnius


Avg salary per month (EUR)
700
600
500
400
300
200
100
0
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Estonia
Latvia
Lithuania


Total mall space (sqm)
800.000
700.000
600.000
500.000
400.000
300.000
200.000
100.000
0
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Tallinn
Riga
Vilnius


Avg mall rents (EUR)
30
25
20
15
10
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Tallinn
Riga
Vilnius


Retail investment yields
19,0%
17,0%
15,0%
13,0%
11,0%
9,0%
7,0%
5,0%
1998 1999 2000 2001 2002 2003 2004 2005 2006 2007
Tallinn
Riga
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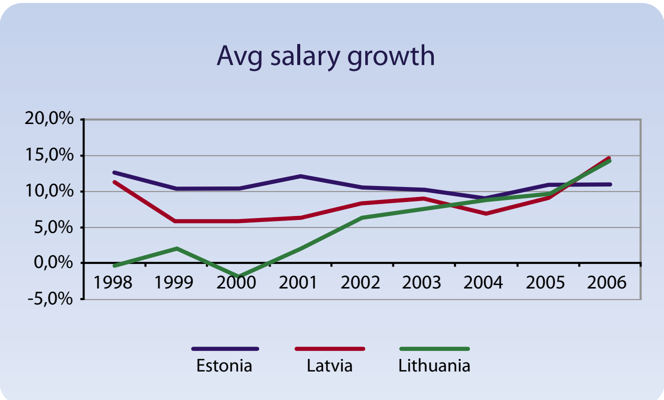
Avg salary growth
20,0%
15,0%
10,0%
5,0%
0,0%
-5,0%
1998 1999 2000 2001 2002 2003 2004 2005 2006
Estonia
Latvia
Lithuania

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