# Real Estate Market Report 2009

## Baltic States Capitals

Tallinn, Riga, Vilnius

SORAINEN

OBER HAUS REAL ESTATE ADVISORS

Deloitte.


## Tallinn, Estonia

### *Recession Hits an Overbuilt Market*

#### Economy

The recession began in Estonia in 2008, with GDP dropping -3.5% in 2008 after eight years averaging 7% growth per year. GDP is projected to drop anywhere from -7% to a worst case -10% in 2009.

Inflation peaked at 11% in 2008 but started 2009 at just 7%, and is expected to drop as low as 1% by the end of 2009 as the economy falters. Unemployment meanwhile has doubled to reach 9% at the start of 2009.

The Estonian kroon (EEK) has been pegged to the euro (previously the German mark) since 1992, at a rate of 15.6466 kroons to one euro, through a fixed currency board. The adoption of the euro is now a primary policy goal of Estonia, which hopes to meet Maastricht criteria in either 2010 or 2011.

## Office

### *Bonanza of New Offices Projects in Tallinn Flood a Depressed Market*

#### Supply

More than 100,000 sqm of new office space flooded the Tallinn market in 2008, bringing the total to 250,000 sqm. The total stock of A class and B class office space reached 500,000 sqm by the beginning of 2008.

The largest developments of 2008 include the first phase of Ülemiste City (10,000 already delivered but which plans another 160,000 sqm of office over seven years), Delta Plaza (15,500 sqm delivered) and Tammsaare 49 (22,000 sqm delivered).

Due to the downturn in the economy, however, almost all future developments has been postponed.

• *Tammsaare Business Centre - an innovative new office building on Tammsaare Road.*

#### Recent Developments

For leasing opportunities in these or other properties, contact Ober-Haus on +372 66 59 700.

**Delta Plaza** - an A class, 14-storey office building offering 15,500 sqm on the border of the city centre at the crossing point of Pärnu and Tammsaare Roads. The building opened in 2008 and is 40% occupied, with rents from €9.00 to €11.50 per sqm per month.

**Marienthali Centre** - an A class exclusive multifunctional 8-storey business building with 12,000 sqm in the Kristiine district, five minutes drive from the city centre, near one of the major streets of Tallinn with the most intense traffic. The building opened in 2008 and is 65% occupied, with rents from €9.50 to €13.00 per sqm per month.

**Tammsaare Business Centre** - an A class, 22,000 sqm office building near Delta Plaza and Tondi Selver. The building has 578 parking places, as well as an additional parking lot with 81 places. The building opened in 2008 and is 70% occupied, with rents from €10.50 to €12.00 per sqm per month.

## New Projects

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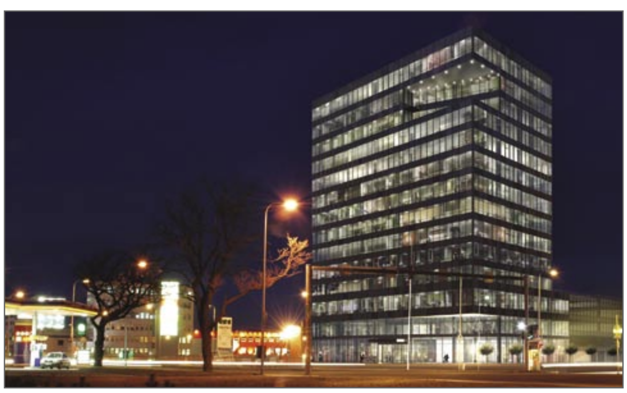
**Petersburg Business Block** - a complex of new office buildings near the city centre with a proposed total area of 75,000 sqm to be built in several phases. The first phase of 10,000 sqm will be completed by June 2009. The building has the highest energy efficiency class according to the standard EN 15232, which enables low maintenance costs of the building. The developer, Kobe Investments, is an investment company operating in Estonia and Latvia.

**Lasnamäe Business House** - the first office building in a rapidly developing area of the Lasnamäe district, will have 7,215 sqm and 163 parking places. The immediate area contains many new retail and industrial developments, such as Lasnamäe Centrum, Mustakivi Selver, Prisma, Mustakivi Centre, as well as the future entertainment and retail centre Tallink City planned on the neighbouring lot.

## Demand

Total take-up in 2008 was 42,000 sqm, which fell 58,000 sqm short of new supply, driving vacancy up from near 1% in 2008 to 22% at the beginning of 2009. Given that another 30,000 sqm will be delivered in 2009, just in time for the recession, we anticipate that vacancy rates will be 25-30% by the end of 2009.



• *Delta Plaza - an A-class office building on Tallinn's busy Pärnu Road.*

## Rents

Rents for A class offices in Tallinn fell 18% in 2008, to €12.70 to €16.00 per sqm, but by the start of 2009, with so many mostly vacant new developments, asking rents for A class buildings were as low as €9 per sqm in some instances. Typical service charges in A class buildings are €2.50 to €3.50 per sqm per month.

B class rents fell as much as 30% in 2008, to €7.60 to €10.00 per sqm per month. We expect rents to fall further in 2009 as take-up diminishes and supply grows.

• *Petersburg Business Block - new office complex, first stage will be completed by June 2009.*

## Investment

**Estonian Police Office** - a sale/leaseback by the state to the Focus Northern Cities fund. The total area of the building is 19,300 sqm, transaction cost €12.8 million, for a yield of 7.5%.

**Marat Office Building** - bought by Baltic Property Trust, total area of 19,500 sqm, the cost of the transaction has not been revealed.

## Legal Notes by Sorainen

Rents are usually payable monthly in advance, in some cases up to the 15th day of the current month. Payment of rent in advance for more than one month is not customary. Tenants generally pay their own utilities, invoiced by the owner after use. 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 in use and normal wear and tear is widely accepted. Quite commonly, payment of rent and costs is secured, e.g. by rent deposit or bank guarantee. Leases survive transfer of property title.

When buildings are sold, lease agreements are generally of low quality. Typically, no standard agreement is used. It is not unusual for buildings to suffer from technical defects with e.g. air-conditioning, humidity system, even ventilation. Often, foreign investors and local sellers have a different understanding of what is considered an A-class or a B-class building. Asset deals and share deals are equally common.

# Retail

## *Solaris Centrum the Last Major Development For Some Time*

### Supply

Perhaps luckily for developers there were no new retail projects brought to market in 2008. The only new construction was an addition of 16,000 sqm to Citycon's Rocca al Mare centre, which at 71,000 sqm is the largest in Estonia.

The year 2009, however, will see 85,000 sqm of additional retail, the largest being the new city centre Solaris Centrum with 43,000 sqm in the very city centre on the location of the old Sakala Centre. In addition to that will be additional car dealers in the Tähesaju City project and one additional Selver supermarket in the Kakumäe suburb.

Due to the economic slowdown, and lack of bank finance, there are no significant new developments or enlargements of retail spaces planned in 2010, other than additions to Citycon's Rocca al Mare Centre. At least four major projects, which had earlier been planned to start in 2009, have been suspended, pending better conditions.


• *Maxima - new shopping centre in Pärnu, built by Häuser-Oberschneider.*

### Recent Developments

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**Tähesaju City** - a commercial complex being developed in several stages in Tallinn's largest living district, Lasnamäe. In 2008 the centre opened with 35,000 sqm, of which 25,000 sqm is retail space, which was 100% leased to Prisma, Opel, Chevrolet, and Toyota dealers. The owner announced two additional phases, with 35,000 to be opened in 2009, and the eventual total size planned is 100,000 sqm.

**Rocca al Mare (extension)** - Finnish Citycon extended the shopping centre they bought two years ago. The extension brought 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.

**Marienthali Centre** - the ground floor of this new office building in Mustamäe brought 4,000 sqm of retail in 2008. Supermarket chain Selver leased 2,100 sqm and the rest was leased by several smaller tenants.

**Pirita Selver** - extension of Selver operating in the suburb with total area 2,500 sqm opened in 2008.

**Asko and Sotka Furniture Centre** - Indoor Group, the owner of the furniture retailers Asko and Sotka, is building a 2,300 square meter furniture department store in Tallinn Haabersti district.

• *Tähesaju City - a commercial complex located in the large Lasnamäe living district.*

### New Projects

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**Solaris Centrum** - a new retail and entertainment centre in the very centre of Tallinn will be opened in Autumn 2009. The total area will be 43,000 sqm, comprising retail and the first 3D cinema complex in Estonia with seven screens, arts film centre with two screens, an art gallery, jazz club, dancing studio and fitness centre. At the beginning of January the project was 80% leased. Asking rents are €10.00 to €20.00 per sqm.

**Kakumäe Selver** - a 7,000 sqm retail centre being constructed in the Haabersti district to be opened in March 2009, with a Selver supermarket as the anchor.

### Demand

New take-up is declining as retails sales fell 8% in Estonia in 2008 and consumer consumption is set to plummet in 2009. Vacancy rates in retail centres have jumped from nearly 0% at the beginning of 2008 to 5% in the beginning of 2009.

One bright spot was new supermarkets. Food chains such as Selver, Rimi and Maxima continued active enlargement throughout Estonia. Selver opened eight shopping centres and is planning to open new ones by the Rannamõisa Road in Tallinn as well as in Haapsalu and Rapla. Finish Prisma is also actively expanding in Estonia.

### Rents

Rents were flat throughout the year due to the weakening retail environment. Retail centres with inflation indexed rental growth leases mostly waived rental increases for 2009, as tenants could not sustain them. At the start of 2009, typical shopping centres charged €18 - €24 per sqm per month for medium sized units (150 - 300 sqm), and up to €29 - €39 per sqm per month for 100 sqm units in prime locations. Food store anchor rents are €8 - €13 per sqm. Service charges range from €2.50 - €5.00 per sqm.

### 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 widely 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 clearly set out.

## Industrial

### *Steady Growth Without Excess Overheating*

### Supply

In 2008, nearly 50,000 sqm of new industrial and warehouses were developed in the Tallinn area, bringing the total stock of modern industrial space and warehouses to 600,000 sqm. More than 80% of newly developed premises are situated out of the city borders.
Nearly all new warehouses and industrial buildings are on the St. Petersburg and Pärnu Roads at Laagri (Tänassilma) and the Tartu Road from the border of Tallinn up to Jüri. Among the mentioned areas, the most developed is the surroundings of St. Petersburg Road, where rents have doubled in recent years. Development of Tänassilma (Pärnu Road) as a warehouse and industrial area is restricted by the congestion on local roads and difficult access to the city.

Build-by-user or built-to-suit projects are predominant type of developments. Today there are no speculative developments.

• *Premia Production - bought by Eften Capital in 2008.*

### New Projects

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**Jüri Technological Park** - local developer AS Kodu Grupp plans to build up to 50,000 sqm of warehouse space on 50 hectares of land, with the first to be ready in 2009. Tenants will include Kinema, Kaeser, Husqvarna, Pharmadule, and Buderus.

**American Corner Business Park** - 10 km from the edge of Tallinn near the Tartu Road, this new business park will be constructed on 85 hectares of land. Individual plots can be purchased in the park for €45 per sqm. Warehouse units will be rented for €5 per sqm. The total volume to be constructed has not been announced.

### Rents

Warehouse market rents decreased slightly to €4.50 to €6.50 by the beginning of 2009. Ober-Haus expects a further 10-15% decrease of rents in 2009 as demand slackens.

### Investment

Two major investment transactions in 2008 included:

**Magnum Medical Logistic Centre** - a sale/leaseback to the Focus Northern Cities Fund, the total area of the building was

11,800 sqm, the cost of the transaction has not been revealed.

**Premia Production and Warehouse** - bought by Eften Capital, the total area of 7,000 sqm, the cost of the transaction has not been revealed.

• *Kroosi Industrial Park - just 4 km from the airport on the main Tartu Road, the biggest tenant will be Bauhof.*

### Legal Notes by Sorainen

Industrial leases are quite simple. Rents are tied to the euro but indexed to local inflation. Nearly all properties are owner-occupied. Good-quality tenants are in short supply, as are sufficiently universal properties to create an investment market. The number of sale-leaseback transactions is low.

## Residential

### *The Tide Goes Out on the Residential Market*

### Prices

Prices in Tallinn hit their peak in April 2007 at €1,614 per sqm average, and have fallen 39% since to reach an average of €984 per sqm in January 2009.

The volume of residential sales transactions in Tallinn in 2008 was €511 million, down 41% from the €876 million residential sales volume in 2007, as recorded by notaries. In the last three months of 2008, the monthly sales volume was €31 million, or just €372 million an annualized basis as mortgage finance for buyers has become increasingly scarce.

Prices for newly developed flats in Tallinn suburbs fell 32% to range from €1,080 to €1,590 per sqm, while outside the city limits there are new flats for sale as cheaply as €760 per sqm. Note that new apartments in Estonia are generally sold fully fit-out, that is completed with everything except a kitchen.
Newly built flats in the city centre fell more than 30%, with most city centre projects now selling for €1,400 to €2,200 per sqm.

Well renovated and maintained flats in the historic old town have done a much better job holding their value. They lost only 5-15% and sell for €2,240 to €4,480 per sqm.

Prices for older flats in the Soviet-era pre-fabricated panel block suburbs fell as much as 40% and now sell for €660 to €1,020 per sqm, as compared to €1,200 to €1,300 one year ago.

### Rents

Rents have fallen 12% in spite of higher demand for rental units by those who no longer quality for mortgages, as the supply of empty units has outpaced demand.

Rental demand has grown as more people have their mortgage loan applications rejected due to the banks' tightening standards. But at the same time rental supply has grown as both speculators and developers with surplus stock have put their properties out for rent.

The monthly rent for a 70 sqm typical three-room new apartment in city centre ranges from €450 up to as high as €750 (if furnished). City centre two-room flats rent for €350 to €520 per month. Based on prices at the start of 2009, residential yields range from 4% to 6%.

In the suburban areas of Tallinn there is the greatest demand for two-room and three-room apartments. Young families look for flats with rents from €200 to €350 per month. In this segment, rental yields at the start of 2009 were from 5% to 7%.

### Legal Notes by Sorainen

New residential leases are not subject to rent control, so 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. These tenants also have a pre-emptive right to buy ahead of you, though are unlikely to be financially able to exercise that option.

### Supply

Only 1,420 newly built units were completed in Tallinn in 2008. That is 59% less than the 3,480 flats delivered in 2007.
Due to decreasing availability of construction finance, cash strapped developers, declining prices, and falling consumer

confidence, Ober-Haus predicts that fewer than 500 units will be completed in 2009, and no large projects will be started.

• *Rootsikula - Scandinavian style living just next to Tallinn, built by Besqab and sold by Ober-Haus.*

## Recent Developments

To buy or rent these or other residential properties, call Ober-Haus on +372 66 59 700.

**Rabaküla** – an ambitious 1,200 apartment project by Finish developer NCC in a popular suburb. The first phase delivered 110 flats in 2008, sized from 53 to 153 sqm.

**Sipelgapesa Quarter** – local developer Koger and Partners is building 300 flats aimed at the middle class. The first two stages sold successfully in 2007 and 2008. The third stage with 70 flats is now selling for prices starting at €1,350 per sqm.

**Mäepealse** – Finish developer YIT built 120 middle class apartments in three buildings in the green area between the Mustamäe and Nõmme districts of Tallinn. The apartments are sized 32 to 82 sqm, and prices with full fit-out today start at €1,000 per sqm. Over 100 units were sold by the start of 2009.

**Noole** – YIT built 53 apartments in Kalamaja, just north of the centre of Tallinn. The apartments are sized 28 to 140 sqm, and prices with full fit-out today start at €1,300 per sqm.

**Vana Kuuli** – a very successful suburban apartment project by NCC, which sold all 84 flats delivered in 2008. An additional 140 flats will be built over the next two years, with prices starting at €1,350 per sqm.

**Sõpruse** – a successful development by Merko Group in the Mustamäe district, 38 flats sized from 39 to 78 sqm, and sold for prices starting at €1,650 per sqm.

**Volta Maja** – a very successful factory loft renovation by Koger and Partners in the Kalamaja district next to the sea just north of the city centre. Loft flats start at €1,000 per sqm, and 85 of the 92 flats were sold by the start of 2009.

**Pirita** – a top class development by Swedish Skanska in the sought after Pirita area next to the sea. Half of the apartments have sea views. Out of the 76 flats, 31 were sold by the start of 2009 and prices on the remaining flats start at €2,400 per sqm.

**Filmi** – part of the new development of Skanska in the Liivaoja area of Kadriorg Gardens, the five storey buildings with 86 flats are almost completely sold out, with remaining flats starting at €1,850 per sqm.

## New Projects

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**Black Swan (Must Luik)** – a luxury three-storey apartment house in the best city centre neighbourhood, Kadriorg Gardens (near the president's palace), with 32 apartments. The economic downturn means prices start at €3,000 per sqm, a rare bargain for this prestigious location.

**Kadaka** – Finish YIT is delivering 95 middle-class apartments sized 44 to 105 sqm in the Mustamäe suburb, starting at €1,000 per sqm.

**Kentmanni 6** – local developer Merko Group is building 120 flats in two 15-storey business and residential towers. The completion date is not yet announced.

**Karsti** – local developer Facio Ehitus is building 32 apartments for young couples and families, at prices from €1,000 to €1,800 per sqm. Prices also include kitchen and parking.

• *Black Swan - 32 luxury apartments in Kadriorg Gardens, sold by Ober-Haus.*

**Reederi Maja** – local developer Tagwerk is building 21 apartments in the port area just five minutes walk from the Old Town, at prices from €2,100 to €3,900 per sqm. Many apartments will have sea views.

### Demand

In 2008 over 600 new apartments were sold in Tallinn. Still, there remains an overhang of more than 1,800 flats built but not sold from previous few years.

The developers which sold most successfully were those which dropped the prices early in 2008 before banks started restricting credit. By the end of 2008, those developers which had not lowered prices had missed a window of opportunity, which closed when mortgage credit tightened and buyers disappeared.

### The Mortgage Market

The real estate market lives or dies by the availability of bank credit, and in 2008 it was the disappearance of mortgage finance that triggered the fall in prices.

Residential loan portfolios of commercial banks in Estonia stopped growing by mid-2008, and 2009 will see no net growth in residential mortgages.

And while euribor declined markedly in 2008, margins charged by banks increased from as low as 0.9% at the beginning of 2008 to 2.5% to 5.0% margin by the beginning of 2009. This means in January 2009 rates for loans in euros ranged from 4.7% to 7.2%, if you were lucky enough to qualify for a loan.

Estonia and Latvia are the most mortgaged countries among the ten new EU-accession countries, with outstanding mortgages totalling 40% of GDP. Clearly any change in the availability of credit had to affect Estonia more than other central European real estate markets.

Still, total mortgages are lower than the EU average of 48% or the levels in similarly high home-ownership countries like the Netherlands, the UK or Ireland, where mortgages exceed 100% of one year's GDP. So while the small Baltic countries will suffer in 2009 and 2010 from the lack of easy credit, in the long run they may still be better positioned than their more indebted Western neighbours.

## Land

### *Prices Collapse as New Projects Halted*

Land prices ended 2008 in freefall, dropping as much as 75% for land without planning, as construction works stopped, banks financing was withdrawn, and speculators went bust.

The supply of land with planning far exceeds the amount of land needed by developers for the next several years. This is the opposite situation of just a few years ago, when developers were eager to start building but nearly no land had planning. This reversal of fortune has sent land prices plummeting.

By the beginning of 2009, asking prices on plots in the city centre suitable for commercial development had fallen to €350 to €700 per gross buildable square metre of commercial space, but no major transactions had been done to test those numbers.

Plots in the suburbs for residential apartment developments tumbled more than half to €50 to €140 per sqm of land, or roughly €50 to €70 per gross buildable square meter of residential space.

### Legal Notes by Sorainen

No restrictions exist on foreign legal or private persons purchasing land, except for agricultural and forestry land over 10 ha. Most land is offered without detailed plans, which means unclear building rights. In rural areas, problems are likely to occur with land use rights if privatization was not finished in time.

Setting a price on development potential (construction rights) is the most difficult point of purchase negotiations. As sellers are often inexperienced, they may have difficulty in assessing development potential, or may base their assessment on optimistic relations with local government in charge for establishing construction rights.

# Legal

## Introduction

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

## Title to Real Estate, Land Register

Ownership of real estate is registered in the Land Register. This is a national register, which includes information about ownership, details of real estate, and related encumbrances. Entries in the Land Register are assumed correct and valid vis-à-vis third persons acting in good faith.
The Land Register is a public register and everyone with a legitimate interest may access registered information. The register is maintained electronically.

## Acquisition of Real Estate

### General

Real estate may consist of land, apartment ownership, or building title. In general, transfer of a building separately from the underlying land is not permissible, except if building title is established and so transferred. In that case, the building forms an essential part of the building title, not of land.
Due to land reform, buildings may be located on land not yet entered in the Land Register, i.e. land not yet privatised or restored. These buildings are considered to be movable property, even though technically they are permanent structures.
As of 2 March 2006, no transactions can be made specifically with respect to buildings as movable property. This restriction does not apply to proceedings for enforcement, bankruptcy, and expropriation, or to wills and succession contracts.

### Letter of Intent and Heads of Terms

In practice LOIs and HOTs are used to bind negotiating parties to a contemplated real estate transaction. However, in Estonia all transactions related to the obligation to buy or sell real estate (including preliminary agreements, LOIs, and HOTs) require notarisation in order to be legally binding. Without notarisation, a buyer can not require the seller to conclude the sales contract and transfer ownership, or to pay contractual penalties.
If an LOI or HOT sets out the parties' obligation not to negotiate with third parties (so-called exclusivity) this is considered valid and binding. Breach of the exclusivity obligation entitles the innocent party to compensation of damage, including payment of specific contractual penalties.
In order for the LOI or HOT to be effective in practice, it is vital to ensure that the exclusivity period is long enough (preferably for the intended negotiating period plus e.g. a further two months).

### Change of Ownership

Title to real estate is considered transferred on registration of ownership in the Land Register, not on signing the agreement. Ownership must be registered within 1-4 weeks as of filing an application with the Land Register along with the signed and notarised agreement.

### Asset Transfer vs Share Transfer

Asset deals and share deals relating to real estate are both commonly used in practice.
Bear the following aspects in mind when considering a share transfer of the company holding target real estate:
• Notarial fees and state duty arising from real estate sales are saved from transaction costs since the sale of shares of a private or public limited company (whose shares are registered with the Estonian Central Register of Securities (ECRS)) is carried out via banks and ECRS;
• Ownership of shares is transferred as agreed in the sales agreement, usually at the time of closing the agreement, or (in the case of transfer via ECRS), on registration, which takes only a few days, whereas in an asset transfer the actual transfer of title takes place in 1-4 weeks;
• Scope of due diligence investigation is extended because a share deal transfers an entire company (with all known and unknown rights and liabilities) as opposed to due diligence of target real estate only;
• LOIs and HOTs for real estate companies are usually binding on the seller;
• Applicability of financial assistance rules (the target company may not secure with its own assets a loan taken by the buyer to finance the acquisition);
• Deferred tax issues.

Asset transfers require consideration of the following aspects:
• Asset transfer is subject to a notarial fee and state duty and, thus, is more expensive than a share transfer;
• Notarial agreements are seldom made in English, and sometimes notaries do not facilitate negotiations;
• Limited scope of due diligence investigation since the review concerns only the target asset unless the transfer amounts to transfer of enterprise (see below);
• Lease contracts survive 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 parties (see above);
• An asset transaction may be considered sale of an enterprise, in which case all obligations associated with the enterprise will be transferred from seller to buyer.

## Form of Agreements

Transfer of title to real estate requires a sale agreement (setting the terms and conditions of sale) and a real right agreement (agreement to transfer title). These 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. The notary verifies authorisation of signatories to the agreement, the content of the agreement, and the will of the parties, who must appear before the notary to conclude the agreement.

## Language Requirements

The sales agreement and real right agreement are drafted and verified by a notary, 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 target real estate before concluding a purchase. Due diligence involves checking e.g. title, encumbrances, planning issues, third party rights, public restrictions, permits. This gives more security or bargaining power to the purchaser. It has become more common to offer compensation of due diligence costs to bidders shortlisted in sale of real estate at auction.

## Pre-emption Rights

Pre-emptive rights may be entered in the Land Register on the basis of a transaction, or may be created by law. For example, a co-owner of real estate has a pre-emptive right on sale of a legal share of the real estate to third persons. Further, the state or local government has a pre-emption right on transfer of real estate located within the boundaries of a shore or shore bank building exclusion zone or if real estate is located in certain nature protection zones, or if a heritage protection object is located on real estate.
Pre-emptive rights may be exercised within two months after receiving notification of a sales agreement.

## Typical Purchase Price Arrangements

The buyer may be required to pay a deposit on the purchase price to a broker's or the seller's account before the real estate purchase agreement is signed.
Often the purchase price is transferred to a notary's deposit account before concluding the sale agreement. The notary releases the purchase price to the seller after registration of ownership in the Land Register or, more commonly, after the agreement is made and filed with the Land Register and no other applications are filed in the Land Register that would hinder transfer of title.

## Related Costs

During purchase of real estate, the following costs may occur depending on services used: brokerage fees, valuation of the real estate (usually carried out by real estate firms), bank fees, fees for legal due diligence and reviewing the sale and security agreements, notarial fees, and state duty.
The notary charges a fee for verifying a transaction. Fees are laid down by law. In sales transactions the fee for notarising the purchase agreement depends on the value of the transaction. For instance, the notarial fee on sale of real estate for €319,000 (EEK 5,000,000) is roughly €973 (EEK 15,220) plus VAT.
Registration of ownership and encumbrances in the Land Register attract state duty. The amount depends on transaction value and is a fixed sum laid down by law. For instance, the state duty for registering a new owner of real estate at a purchase price of €319,000 (EEK 5,000,000) is approximately €372 (EEK 5,800).

## Concentration Control

Transfer of real estate (both asset and share transfers) may be subject to concentration control by the competition authorities if:
• Turnover in Estonia of participants to the concentration (target undertaking and buyer) exceeds 100 MEEK
and
• Turnover in Estonia of at least two participants to the concentration exceeds 30 MEEK each.
Turnover considered in deciding if concentration control applies is turnover of sales in or to Estonia in the last financial year. If the buyer has no business in Estonia (on first purchase), concentration control does not apply.

## Portfolio Deals

We have seen many portfolio deals over recent years. Mainly foreign investors typically enter into portfolio deals because these provide an investor with diversification and volume, thereby reducing overall risk and relative cost. Additionally, some transaction costs are cut due to a cap on notarial fees and state duty if multiple sales are closed simultaneously. Acquisition of a portfolio versus acquisition of many single properties is less time-consuming, so that a single portfolio deal may result in a buyer gaining significant market share.

Considering a portfolio deal requires bearing in mind the following:
• Scope of due diligence investigations is extensive as the high number of properties in the portfolio entails multiple title checks and review of survey materials. Additionally, the seller may insist on full due diligence pre-contractually. This arrangement in an asset deal (due to failure to notarise the pre-contract) thus does not sufficiently assure the buyer that the deal will take place.
• The seller may choose to arrange an auction of the portfolio. If the due diligence costs of shortlisted bidders are not compensated (at least up to a certain cap amount), bidders may be reluctant to take part at all, or to place good bids. The buyer needs to ensure that compensation offers are valid and binding upon the seller.
• Portfolios may include flawed or mismatched (so-called "dog") properties. Here, due diligence is of utmost importance in order to ensure marketability and rapid resale after closing.
• A number of non-real estate assets are often acquired or need to be acquired together with the portfolio. These might include e.g. employment contracts, property-related rights, access arrangements, and management operations.
• In an asset deal, allocation of the purchase price between each property is important as the seller may want to receive at least the book value for each property. This may or may not be the same as the appraised value.
• The seller may seek to limit remedies available to the buyer to compensation of damage only.
• In a multiple jurisdiction portfolio deal, simultaneous closing of the transaction in all countries involved may be difficult to achieve due to differences in local laws and regulations.
• Structuring a portfolio transaction, including a mix of assets and shares, is rather complicated, especially with a view to achieving simultaneous closings.

## Sale-Leasebacks

Increasingly, local companies are using sale-leasebacks as a cost-effective and efficient alternative to traditional debt in funding costs of expansion, acquisition, and construction of new facilities.

Considering this arrangement requires the following checks:
• Existence of solid tenant/guarantor with strong business track record to ensure stable cash-flow during the lease.
• The lease agreement should be tied to the asset purchase agreement as this is the main reason for the deal. Additionally, if the target property is encumbered with a pre-emption right that is subsequently exercised, the lease should transfer to or include the rightholder as well as be binding on the rightholder.
• The long-term nature of the arrangement requires the lease to be "waterproof". Adequate security on both sides that the other party will duly perform is also required (e.g. guarantee, surety, reserves, sinking fund).
• The lease should include a clear split of maintenance responsibilities and cost/service charge break-down between owner and tenant.
• Closing under the asset purchase agreement should coincide with lease commencement date (book-keeping issues, reconciliation of costs) irrespective of the actual title transfer date.

## Restrictions

In general, no restrictions are imposed on foreigners acquiring real estate in Estonia. Exceptions include forestry and agricultural land, plus some island and sea coast and state border areas. Even though Estonia is a member of the EU, some restrictions on EU citizens and companies will exist until 1 May 2011. Acquiring real estate the intended purpose of which is profit-yielding land consisting of 10 or more hectares of agricultural or forestry land is unrestricted only for:
• Estonian citizens.
• Citizens of a state contracting party to the EEA Agreement who have lived in Estonia for the past three financial years and are registered in an Estonian register as sole proprietor in agricultural products production (EU Treaty, appendix 1).
• Estonian legal persons 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 contracting party to the EEA Agreement registered in the Estonian Commercial Register and operating in Estonia for at least the past three financial years in agricultural products production (EU Treaty, appendix 1).
Other persons may own such land but on limited grounds and on approval of the county governor.
Transfer of land on smaller islands and certain border areas is only allowed to non-citizens or legal persons of states not contracting parties to the EEA agreement on permission of the Estonian Government.

## Public Restrictions on the Use of Real Estate

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

## Encumbrances

The following rights, which are entered into the Estonian Land Register, may encumber 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 in the Land Register on notarised agreement to secure the interest of the purchaser or seller, or third persons, or neighbouring real estate.

The Land Register may register notation of a lease agreement, which ensures that on change of ownership the new owner may not terminate the lease agreement within three months of acquiring the premises citing urgent personal need to use the premises.

## Mortgage

Real estate purchase is often financed by a loan. Usually, a mortgage is established on real estate by a notarised agreement as security in favour of a bank financing payment of sale price. The mortgage agreement is concluded at the same time and in the same document as the sales agreement.

If a mortgage already encumbers real estate before sale and the purchaser needs a mortgage for its own financing purposes, the existing mortgage is typically transferred to the bank financing payment of the sale price. This transaction structure is more cost-efficient compared to deleting the existing mortgage and establishing a new one, since it saves on both notary fees and state duty.

## Lease Agreements

**General**

In general, freedom of contract applies as to the content and form of lease agreement. However, as to a residential lease, the law protects the rights of the tenant and provides extensive mandatory regulation. If a residential lease contract with a term exceeding one year is not entered into in writing, the contract is taken to have been entered into for an unspecified term.

On transfer of real estate, lease agreements survive change of ownership. However, an owner who needs the premises urgently for own use may terminate a lease agreement within three months of acquisition. This right may not be exercised if a notation of the lease agreement has been entered in the Land Register.

**Duration and Expiry of Lease Agreement**

Lease agreements may be either for specified or unspecified terms. If the parties have not agreed differently, either party to a lease agreement for an unspecified term may terminate a residential or business premises lease by giving at least three months' notice.

A lease agreement for a specified term expires at the end of the term. Extraordinary termination is allowed for material breach of the agreement, whether for an unspecified or specified term.

If, after expiry of a lease contract, the tenant continues to use the leased premises, the lease is taken 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 of expiry of the lease contract (applies to the tenant) and as of when the owner learns that the tenant is continuing to use the leased premises (applies to the owner).

**Lease Payment and Accessory Expenses**

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

Accessory expenses (utilities) such as electricity and water are considered included in the rent if not otherwise agreed in the lease agreement. Prevailing market practice is that the tenant pays for utilities and other cost items in addition to the rent according to invoices from service providers. There is no clear understanding in the market about "triple net" leases although many professional real estate owners apply triple net principles to cost recovery from tenants.

## PPP & Infrastructure

**Concessions**

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

On granting a construction work concession, the 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**

Increasingly, sale-leaseback agreements are used in Estonia for structuring PPPs. For 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 quality of the agreements. In practice, lease agreements (i.e. PPP agreements) are far from being as comprehensive and detailed as their counterparts in Western Europe and Scandinavia.

## Regulated Real Estate Funds

Laws and regulations have been adopted concerning real estate investment funds.
A real estate fund is a fund whose units or shares are redeemed or repurchased not less six months of a claim being filed by the unit-holder or shareholder and, under the fund rules or articles of association, at least 60% of whose assets are invested in real estate or at least 80% is invested in real estate and real estate-related securities.
Both foreign and domestic investments may be administered through a real estate investment fund. The fund may be formed either as a private limited company or as a contractual investment fund. Fund units may be offered publicly or privately. The fund must be managed by a fund manager.
This investment structure opens up exciting new opportunities for investors for exiting real estate investment or receiving financing without losing control over the investment. Fund management fees may be structured as success fees depending on the performance of the investment portfolio.

## 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 set building rights for land plots as well as to set limits on construction activities in a particular area. After completing a detailed project plan, public hearings and discussion take place. The whole process of approving a detailed plan may take from some 6 months to a few years depending on the area and on the complexity of the project.

**Construction**
Building, modifying, and demolishing 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 work has to be carried out in line with building design documentation and building norms. The building design should be drafted by a professional architect or engineer, and needs approval by the local supervisory authority. Building design documentation must comply with the detailed plan, if established, and must meet 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). If no detailed plan is in place or no detailed plan is required, construction works must be performed in line with design criteria issued by local government.
The local government issues building permits based on building design and application, where these documents comply with the detailed plan or design criteria. Construction without a valid building permit is not allowed. A building permit becomes invalid if construction works do not begin within two years of issue of the building permit.
After completion of construction works, the municipality issues a permit for use of the building if it has been constructed under a valid building permit and in accordance with design documentation. Use of a building is generally not allowed without a permit for use.
Once construction works are finished, the construction company must give a minimum two-year guarantee for construction faults. A manufacturer's guarantee for equipment incorporated in construction works cannot be shorter than six months.

## Insolvency and restructuring

Two court-administered insolvency proceedings in Estonia are regulated by law:

1) Reorganisation proceedings, which can be used if the debtor is likely to become insolvent in the future; and
2) Bankruptcy proceedings, which have to be used if the debtor is permanently insolvent.

If a company does not pay its debts as they fall due and the parties fail to reach an agreement regarding restructuring the debt or the creditor does not have or is unable to satisfy its claim through collateral, then the creditor may sue the debtor in court or issue a bankruptcy notice and file a bankruptcy application. On the other hand, the debtor may decide to file a reorganisation application with the court, establishing an automatic stay on all collection attempts against the debtor until a reorganisation plan is confirmed or the proceedings are terminated. Only the debtor can launch reorganisation proceedings if it is able to show that:

1) It is likely to become insolvent in the future;
2) It requires reorganisation;
3) Sustainable management of its enterprise is likely after the reorganisation.

The consequences of commencing reorganisation proceedings are as follows:

1) The court suspends enforcement proceedings against assets of the undertaking until the reorganisation plan is approved or reorganisation proceedings are terminated;
2) Suspension of accumulating fines for delay or contractual penalties against the undertaking until approval of a reorganisation plan;
3) Termination of court proceedings for a financial claim against the undertaking until approval of the reorganisation plan or

termination of the reorganisation proceedings;
4) Deciding on commencement of bankruptcy proceedings until approval of the reorganisation plan or termination of reorganisation proceedings is suspended.

Reorganisation is also possible in bankruptcy.

If the court declares a debtor permanently insolvent in bankruptcy proceedings, creditors have to decide whether a "settlement of debts" procedure will be used or whether "restructuring" will take place. If the creditors fail to agree on restructuring the company, then all the company's assets, including mortgaged property, are sold through a "bankruptcy procedure". Insolvency proceedings are managed by a court-appointed certified insolvency administrator, who can decide on termination or continuation of the company's business activity in full or limited scope.

After the start of insolvency proceedings, the debtor forfeits the rights to handle its property, including property in its possession but belonging to third parties (the insolvency administrator obtains these rights). Rights of the company's directing bodies are suspended and management is performed by the insolvency administrator. Accumulation of interest on loans, as well as accumulation of interest set by law and late payment interest, are suspended after declaration of insolvency.

After sale of the debtor's property, funds received are used for payment of costs related to the proceedings (e.g. claims related to clawbacks and carveouts from the estate, costs of the proceedings) followed by claims of secured creditors and, finally, unsecured creditors.

Business difficulties require taking all available precautions and matching the solution to the problem:
• If the debtor is in financial difficulties - restructure lease agreement (lower lease payments, ask for additional collateral) or search for substitute tenants.
• If a commercial property is performing poorly - restructure property (hire real estate management company, change or relocate tenants, e.g. some to smaller premises, others to bigger premises).
• If financing is bad – improve cash collection, find a new investor, restructure debt, make a debt-equity swap, or sell non-performing assets;
• If the company is badly managed – change management and/or shareholders.

# 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.

**Fees** - 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.

**Broker fees** - The broker's fee is typically 3% of 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. 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 2009 is 21%. 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 flat rate of personal income tax (21% in 2009).

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.

## 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).


## Riga, Latvia

### *Economic Crisis Slams Demand and Prices*

#### Economy

After GDP growth of 10% in 2007 and 12% in 2006, Latvia plunged into recession in 2008 with GDP falling -4%, and with GDP projected to drop a staggering -10% to -12% in 2009. The recession followed the choking off of foreign credits, leading to collapsing investment, a two-third drop in the number of real estate purchases, and steep declines in private consumption.

Meanwhile inflation dropped from the peak of 18% annualized rate in mid-2008 to 11.5% annually at the start of 2009. Analysts predict inflation to switch to disinflation by the end of 2009, and for CPI to fall -6% in 2010.

The crisis led to the near failure and nationalisation of Latvia's largest domestically owned bank, Parex Bank, and to intervention by the International Monetary Fund (IMF) which spearheaded a 7.5 bln euro bailout of Latvia that included funding by the European Union and the World Bank.

The bailout terms allow Latvia to maintain its currency's peg to the euro at the rate of 0.7028 Latvian lats (LVL) to one euro (1 LVL = 1.4229 EUR), but Latvia has agreed to raise taxes and slash spending to reduce the budget deficit to 3% of GDP by 2011. In the short term, these moves will further dampen demand and exacerbate the recession.

## Office

### *Rents Drop as Companies Slash Costs*

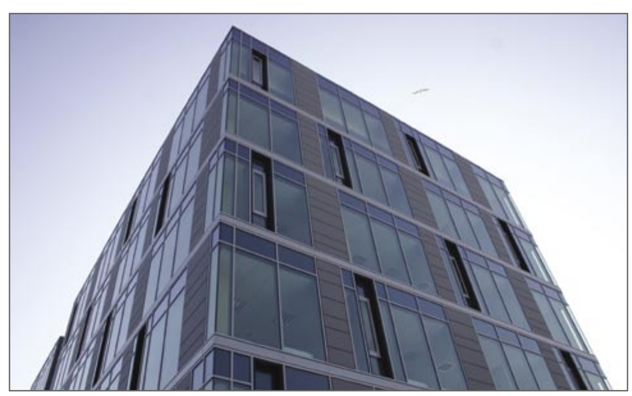
#### Supply

Office construction boomed in 2008, with 108,000 sqm of modern office stock added to Riga last year, boosting the total an enormous 20% to 590,000 sqm. The timing was unfortunate, given the economic train wreck at the end of 2008.

New projects in 2008 included the SWH Business centre (20,000 sqm), Muitas Business centre (7,000 sqm), and Riga Industrial Park (8,600 sqm). Another 99,000 sqm will be brought to market in 2009 if all the projects will be finished.

Office vacancy rates hit 20% by the end of 2008. Due to new supply Ober-Haus sees office vacancy rates hitting 25% by the end of 2009, even though many office projects slated for delivery over the next two years have been halted.

Traffic congestion, building height restrictions and the lack of available development land in the city centre means few new developments are built in the immediate city centre. The new central business district is growing up around Skanstes and Duntes Streets, as well as the beginning of Ganibu Dambis. Over the next ten years this area will develop as the main office area for Riga.
A secondary new office district is developing on the right (south-western) bank of the Daugava River, where Swedbank built its signature landmark headquarters building. Now under development in this district, Pardaugava, is the business centre Mukusala and the upcoming Akropole retail centre.



*• O! class office centre - a modern 8,220 sqm office building, developed by LIG ltd, located on Duntes Street based on VOC (voice of customer) principle.*

### Recent developments

For leasing opportunities in these or other properties, contact Ober-Haus on +371 728 4544.

**SWH Business Centre** - a modern, multifunctional A class business centre, developed by SWH Grupa, located in the district of Skanstes Street. The 20,000 sqm space was delivered at the start of 2008 for lease €14 per sqm. There are 300 surface parking places on the property. The building was 94% leased at the start of 2009.

**Unity Business Centre** - a modern A class office building, developed by Bikstu 7 ltd, located in left side of the river Daugava, on Vienibas Avenue. The 16,500 sqm rentable space was delivered at the start of 2008. There are 400 parking spaces on the property. Rents start from €13 per sqm. The building was 20% leased at the start of 2009.

**Business, Interior & Design Centre InDi** - an historic factory reconstructed into a modern B class office building, the 12,000 sqm space was delivered in the summer of 2008 for lease €9.00 to €10.00 per sqm. There are 200 parking spaces on the property. The building was 70% leased at the start of 2009.

**Muitas Business Centre** - a modern A class office building, developed by Jurmalas Celtnieciba, located on Muitas Street close to the Old Town. The complex consists of two buildings totalling 7,000 sqm. Asking tents range from €19.00 to €20.00 per sqm. The building was 70% leased at the start of 2009.

**Dzimta Seta** - a seven storey, 7,200 sqm modern, B class office building, developed by Dzimta Seta, located in Gunāra Astras Street. Rents start from €12.00 per sqm. The building was 10% leased at the start of 2009.

**Mukusala Business Centre** - a modern A class office building, developed by local developer Berzins Investment Ltd, located at the left bank of the river Daugava on Mukusalas Street. The 12,821 sqm space is due to open in spring 2009 for lease €12 to €20 per sqm. There will be 100 underground parking lots on the property.

**Riga Industrial Park** - a modern B class three storied office building with storage premises, developed by Riga Industrial Park, located in Dzelzavas Street. The premises in the new project shall be both to rent and to sell. The 8,600 sqm space is due to open in the spring 2009. Rents starts from €8 per sqm. The building was 65% pre-leased at the start of 2009.

**TOMO** - a modern 5,000 sqm office complex on Raunas Street. This centre includes a hotel, fitness centre and swimming pool. There will be 60 surface parking places and 110 spaces in and underground car park. Rents start from €11.00 per sqm. The building had not announced any leases by the start of 2009.

*• Europa - a modern 15,400 sqm A class office building, developed by leading Lithuanian developer Hanner.*

### New projects

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**Europa Business Centre** - a modern A class office building, developed by leading Lithuanian developer Hanner, located at the intersection of Brivibas and Vairogu streets. The 15,400 sqm space is due to open in spring of 2009 for lease starting at €12 per sqm. There will be parking for 500 cars on the property.

**O! class* Offices Centre** - a modern office building, developed by LIG ltd, located on Duntes street. The 8,220 sqm space is due to open in first quarter of 2009 for lease € 9-12 per sqm. There will be more than 140 parking lots on the property. The building was 30% pre-leased in the very beginning of 2009.
*O! class is service system based on VOC (voice of customer) principle.

### Demand

Take-up was 95,000 sqm in 2008. While take up was good for modern offices in central areas, where there is still a lack of good office space, it was very poor for new office buildings located in less favourable locations.
In early 2008, with tax revenues still booming, the largest state ministries and state owned companies leased new office space in order to consolidate far flung offices, or upgrade from poor space. That process came to an abrupt halt in the second half of 2008, and many state organs balked at signing leases they had committed to earlier.
By the second half of 2008 most companies were already economising space, trying to reduce their rent or reduce the space used. Tenants on short leases or with break clauses used the opportunity to get rent concessions from property owners. Other offered part of their space to sublet. All these factors put more downward pressure on rents.

### Rents

Rents for A class offices in Riga fell 22% in 2008, to €14 - €19 per sqm, but by the start of 2009, with many new developments coming online, asking rents for A class buildings were as low as €10 per sqm in some instances, and effective rents (taking into account incentives like free rent) were even lower. Typical service charges in A class buildings are €2.50 - €4.00 per sqm per month.

Rents for B class offices dropped 25% to €8 to €12 per sqm. The charge for B class management services is mostly €1.50 to €3.00 per sqm.

We expect rents for B class offices to decrease as supply will continue to exceed take-up, and tenants will take advantage of developers current problems to sign A class leases in 2009 at rents from €10 to €15 per sqm.

### Investment

Scandinavian fund Focus Nordic Cities bought office building Duntes Biroji with total area 16,300 sqm in July 2008 for €33 million and yield reported below 7%.
Canadian based Homburg Invest bought office building Unicentrs, with total area 9,400 sqm in February 2008, for €28 million and yield of 6%, as part of a larger sale/leaseback portfolio sold by SEB, the Scandinavian bank.
By the start of 2009, potential sellers of office buildings started to offer properties at yields of 8-9% for fully leased properties, but still buyers' yield expectations, given the increased economic and market risks, including the perceived risk of a currency devaluation, remain closer to yields of 9-11%.

Given that some property owners may have cash flow problems in 2009-2010, it is likely that 2009 or 2010 will produce transactions at yields of 10% or more.

### Legal Notes by Sorainen

**Rents**
Rents are paid in advance, usually monthly, sometimes quarterly, and are typically tied to the euro but indexed to local inflation. Recent practice shows that an option to index rent according to European inflation is used more commonly. Tenants pay their own utilities, invoiced by the owner or supplier after use. Security deposits for two to three months' rent are generally required. The owner usually pays all applicable real estate taxes.

**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. Lease agreements are binding on the new owner of real estate on transfer of title but only if registered with the Land Book.

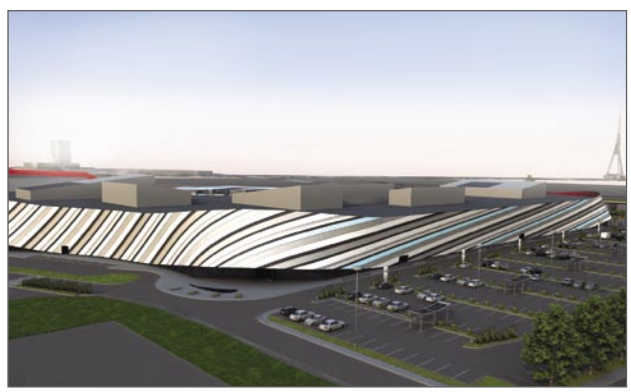
Buildings may suffer from technical defects, or construction works may fail to comply with legal requirements, e.g. construction might have been commenced before obtaining a construction permit, or the building might be higher than specified in the construction permit. Asset deals and share deals are equally common.

## Retail

### *Rents Fall as Retail Sales Slow*

### Supply

Developers brought 9,000 sqm of new retail space to Riga, most of it in two projects: the Alfa extension and Panorama Plaza, both of which were successfully leased. It remains questionable, however, if the same success will be had of the 267,000 sqm of new retail space coming in the next three years, including Riga Plaza, (67,000 sqm - total area), Galleria Patollo (50,000 sqm) and Akropole (150,000 sqm).



• *Riga Plaza – a new 67,000 sqm retail complex next to the busy Salu Bridge. The planned investment is €80 million. The facility will contain over 160 stores.*

### Recent Developments

For leasing opportunities in these or other properties, contact Ober-Haus on +371 728 4544.

**Alfa (extension)** - investment fund Acta added 6,500 sqm to its existing 49,000 sqm retail complex on the northern half of

Riga on the main Brivibas Street. The new extension includes a cinema and large electronics shop.

**Panorama Plaza** - a new multifunctional complex is part of a larger residential complex on the southern side of the Daugava River. The retail space was opened in the summer of 2008, with a total rentable retail area of 2,500 sqm offering 28 trade outlets, including BoConcept, the first franchise salon of Danish-made design furniture and accessories in the Baltics; Montparnasse Paris, dress shop from Renato Nucci, Prestige, Karl Lagerfeld, and other fashion brands.

## New Projects

For leasing opportunities in these or other properties, contact Ober-Haus on +371 728 4544.

**Riga Plaza** - Latvian developer Diksna in a joint venture with Plaza Centers Europe is building Riga Plaza Shopping and Entertainment Centre, a 67,000 sqm complex. The planned investment is €80 million. The facility will contain over 160 stores, a supermarket, cinema complex, bowling, restaurants, cafes and a family entertainment site. The centre is located next to the busy Salu Bridge on the south bank of the River Daugava, three km from the city centre. The centre will be completed in spring of 2009.

**Galleria Patollo** - Norwegian developer Balder Invest is building a 7-floor city centre shopping gallery with a total area of 50,000 sqm, consisting of 220 stores. Galeria Patollo will be the biggest city centre retail complex in Riga, located in the prime shopping area of Riga on Dzirnavu Street, between Tērbatas and Brīvības Streets. Galeria will create opportunities for shopping, recreation and entertainment activities. The centre is planned to be finished in 2010, although the launch of the project has been delayed many times. Total investment of the project will be €50 million.

**Akropole** - Lithuanian developer Vilnaius Prekybas Group is to build one of the largest retail and entertainment centres in the Baltics. Akropole will house the biggest variety of shops in the region and most entertainment in one place. The site, located two km northeast of the centre of Riga will account for more than 150,000 sqm of retail space after completing the first phase, including a Hyper-Maxima hypermarket. Total investment will reach €135 million. The centre is planned to be finished by the end of 2010.

## Demand

Demand has fallen significantly, and the 1% vacancy rate of 2008 has already reached 2-3% in shopping centres. Tenants are falling behind on rents and Ober-Haus projects retail vacancy rates to reach 5% in shopping centres or more by the end of 2009. City centre high street vacancies are nearly 20% today, with a vacant shop visible on every city block.

The shopping centres with the lowest vacancy and the largest demand remain Alfa, Domina, Mols and Spice, and for this reason the rents there are higher. Demand by retailers for city centre street locations has declined, which will also feed through to lower high street rents in 2009.

## Rents

Rents fell 25% in 2008 due to weakening demand, and we expect declines of 40% in 2009. City centre high street rents have declined 40% from their highs down to €25 to €40 per sqm.

In shopping centres rents have softened to €10 per sqm for large units (1,000 sqm), while recent lettings of medium units (150 - 300 sqm) have declined to €15 - €20 per sqm. Smaller units under 100 sqm rent for €25 - €45 per sqm. Anchor tenants, such as supermarkets, typically pay €8 to 12 per sqm. Service charges are from €2.50 to €5.00 per sqm. In suburbs rents are €10 to €20 per sqm.

## Investment

There were no major retail centre sales in 2008. Mid-sized transactiosn included the sale of the Minska shopping center with anchor tenant Rimi, total area of 3,050 sqm, which was bought for €4.1 mln by Apex Investments.

## Legal Notes by Sorainen

Typically, one anchor tenant or a few medium-size tenants lease each property. As a rule, tenants are charged for use of common areas and management of the building. The owner usually pays taxes applicable to the rent and the property. The advertising cost is often fixed and therefore not negotiable. A sinking fund is not used as a separate cost in the retail market, though it might be included in maintenance costs. Turnover rents are commonly used in Latvia. As a rule, the tenant is responsible for finishing and equipping leased premises for use.

When looking at investment properties, keep in mind that lease agreements are generally of low quality. Distribution of maintenance and renovation obligations may not be set out very clearly in lease agreements. 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. Lease agreements survive change of ownership and are binding on the new owner - but only if registered with the Land Book.

## Industrial

### *New Supply Outstrips Demand*

### Supply

In 2008 developers brought more than 250,000 sqm of new warehouse space to market, including built to suit projects. The total modern space available in Riga and the immediate surroundings is now 473,000 sqm. Most are outside of the city located at main highways. Ober-Haus projects supply to grow another 95,000 sqm in 2009.

### Recent Developments

For leasing opportunities in these or other properties, contact Ober-Haus on +371 728 4544.

**Agatex** - a new warehouse and office complex built in 2008 by local developer Agatex Ltd, located in Daugavas Street, Marupe. On a total of 2.5 hectares of land, the complex comprises 4,250 sqm building area. Rents are €5.50 per sqm for warehouses, and €10.00 to €12.00 per sqm for office premises. Lease terms start from five years.

**Parks G31** - a new warehouse complex built in 2008 by local developer Parks G31, located less than 2.5 km from city centre. The complex comprises 6,500 sqm building area. Rents are €6.50 per sqm for warehouses, and €10.00 per sqm for office premises.

**Dominante Park** - built by local developer Dominante Developments, this 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 delivered 35,000 sqm of warehouse space and 3,500 sqm of office premises in 2007. The second and third phase of the park added 43,776 sqm of warehouse space and 10,944 sqm of office premises in 2008. Current rents are €5.30 per sqm.

### New projects

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**Bumani Business Centre** - a new warehouse complex comprising of three phases, located close by Lubana Street seven kilometres from the city centre, developed by Izoterms. The first phase 16,000 sqm warehouse spaces and 6,000 office spaces was delivered in 2008. The second phase 17,000 warehouse spaces and 550 sqm office spaces will be finished in the first quarter of 2009 and the last phase comprising 20,000 sqm warehouse spaces and 3,000 sqm office spaces will be finished in the Spring of 2010. Rents are €5.00 to €5.30 per sqm for warehouses, €3.00 per sqm for non-heated warehouses and €6.50 to €12.00 per sqm for office premises.

**Wellman (extension)** - Estonian developers will add a second phase 11,200 sqm in 2009 to existing 12,193 sqm, in Salaspils suburb of Riga. The building has effective heights under the frames of 9.5 metres. Rents are €5.50 per sqm, and for office premises €8.50 per sqm.

*• Parks G31 - a new warehouse complex built in 2008 by local developer Parks G31, located less than 2.5 km from city centre.*

**Kekava Logistics Park** - a 50,000 sqm project being developed by Scandinavian developers NCC in Kekava just outside Riga. Kekava Logistics Park encompasses high quality, A class logistics building for single and/or multi-user purposes. The entirety encompasses modern office and logistics space with practical and adjustable solutions to meet the specific needs of each client. Altogether the gross volume of the building is 600,000 cubic metres. The building includes 44,000 sqm of leasable warehouse space and up to 3,200 sqm of office space. The warehouse space will have at least 10 meters of net working height. The bearing capacity of the floor will be over 5 tons per sqm. There will be over 100 parking places for cars and 30 places for freight trucks. All parking places are asphalt hardtop. Asking rents are €6.00 per sqm for warehouses and €10.00 per sqm for offices. Lease terms start from 8 years. The construction of the complex is expected to start in 2009.

**Elipse** - to be built by local developers Baltic Logistics Company, the first stage of Elipse logistics and distribution centre will have a total area of 30,538 sqm, of which warehousing premises will be 26,543 sqm. According to the detailed plan of the territory, the buildings can be used for light manufacturing enterprises, warehousing, or wholesale enterprises. Asking rents are €6.00 per sqm for warehouse space and for offices €14.00 per sqm. Tenants will include Sia Pluss Punkts, Greis, Greiss Loģistika.

### Demand

Riga's central location in the three Baltic States has made it an attractive distribution centre.

Warehouse take-up in 2008 was more than 200,000 sqm, although most of that was by owner-occupiers. Take up looks to be less than 50,000 sqm in 2009 due to the recession.

• *Dominante Park - the largest industrial park in the Baltic States, on 65 ha on Riga ring road and the A7 highway.*

### Rents

Due to fast growing supply in warehouse market rents decreased slightly to €4.50 to €6.50 by the beginning of 2009. Ober-Haus expects a further 10-15% decrease of rents in 2009 as demand slackens and more space comes on line.

### 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 pays all maintenance costs. Projects are usually built for owner-occupiers. Sale-lease-back arrangements rarely take place.

## Residential

### *Prices Drop as Easy Credit Dries Up*

### Prices

The withdrawal of virtually all mortgage lending in the Latvian market drove residential prices down 36% in 2008 to an average €1,500 - €4,000 per sqm in the city centre, and €945 per sqm in Soviet-era suburbs.

Prices for newly built apartments in Riga range from €900 - €1,500 per sqm in the suburbs and €1,900 - €2,500 per sqm in the city centre, and although some high-end developments in the old town still ask €3,000 to €5,400, there are few buyers today at that price.

Note that new apartments in Latvia are generally sold fully fit-out, that is completed with everything except a kitchen.

### Rents

Net rents (what the owner receives) for new apartments in the city centre range from €7 to €9 per sqm, while net rents for new apartments in the suburbs range from as low as €4 to €6 per sqm, a drop of nearly 30% over the course of 2008.

To give an example, newly built two-room flats of around 50 sqm rent from €250 to €350 per month, including all common charges, which means the owner receives about €200 to €300 per month net rent. Two-room Soviet era flats rents for a bit less, and the owner generally will get only €175 to €250 net rent as the heating costs are higher for inefficient Soviet-era flats.

### Supply

Less than 3,000 new apartments were completed in Riga in 2008, less than half the 6,780 delivered in 2007. Almost 65% of the new flats built in 2008 remain unsold. There are at least 2,200 unsold new apartments on the market.

In 2009 Ober-Haus estimates that developers will complete 2,200 more new units. There are no new project starts, so these 2,200 new units represent projects already in process. There may be significantly less than 1,000 new units delivered in 2010.

By the beginning of 2009, banks in Latvia already had over 2,000 mortgage loans that were behind on payments. Even if foreclosure actions start against all debtors, it is unlikely that this will significantly increase the supply of flats on the market as all major banks have announced the creation of special companies that will warehouse foreclosed properties to sell when the market recovers, instead of increasing supply today and further dampening prices.

• *NCC is building 322 apartments in Mežciems, Riga.*

## Recent Developments

To buy or rent these or other residential properties, call Ober-Haus on +371 728 4544.

**Purvciems Project** - leading Lithuanian developer Hanner has built four multi-storey apartment buildings, each of nine floors with totally 336 apartments, 236 underground parking spaces and 118 ground parking spaces. Apartment sizes range from 51-152 sqm, with prices starting at €1,100 per sqm for a fully finished apartment. The project was finished in 2008. The first three buildings were all sold out by the end of 2008, and the fourth and last building started selling in 2009.

**Aurora Park Residence** - located in left bank of river Daugava between two parks, on Maza Nometnu Street, developed by Lithuanian developer Ranga IV. This project comprises of 12 three to six storey apartment houses with 391 apartments. The first phase consists of 152 apartments and was finished in autumn of 2008, and is 30% pre-sold. Apartments range from 60 -180 sqm, with average price €2,000 per sqm.

**Skanstes Virsotnes** - located on Skanstes Street just north of the city centre, developed by the Latvian subsidiary of Estonian Merko Construction. This project comprises of four 24 stories buildings with 520 apartments. Apartment sizes range from 50 - 150 sqm, prices starting at €1,700 per sqm. There is an underground parking space for each apartment, at a cost of €15,000 per parking space. The project will be finished in 2010. The first phase consists of two 24 stories buildings with 263 apartments. The first phase was delivered at the end of 2008. By the start of 2009 70% of the apartments were sold.

## New Projects

To buy or rent these or other residential properties, call Ober-Haus on +371 728 4544.

**NCC Houses** - Finnish construction firm NCC is building apartment houses in the Riga district of Mezciems, at Bikernieku Street. The development consists of eight five-storey and ten four-storey buildings with 322 apartments in the area of approximately 3.5 hectares. The project consists of two, three and four room apartments with the total space from 55 to 104 sqm. Each apartment will have a balcony. Apartments are sold with full finishing.
The project includes multi-storey parking for 250 cars, as well as surface parking. There will be a well-organized yard, playgrounds for children and places for having rest in the territory. Project will be finished at first quarter of 2009, prices start at €1,200 per sqm for fully fit-out apartment.

**Tekstiliana** - a conversion and renovation of a historical factory in the Pardaugava area of Riga across the river from the city centre, developed by Latvian Capitolia Group. It comprises three six storey buildings with 257 apartments. Apartments range from 60 to 260 sqm, with an average asking price of €2,100 per sqm. The first phase will be finish in autumn 2010.

**Equilibrium** - located on Brivibas Street 446 by lake Jugla, developed by Latvian developer Brivibas Nams. The development includes a 5,000 sqm park on the territory, and only 23 apartments, ranging in size from 60 to 190 sqm, with price starting at €2,000 per sqm. The project will be finish in 2009.

• *Leading Lithuanian developer Hanner built 336 apartments in Purvciems, Riga.*

## Demand

Less than 1,500 completed units were sold in 2008, leaving close to 50% unsold of new stock. The rate of new apartment sales fell to less than 10 per month by the beginning of 2009.
With the increase in the number of unsold, finished flats available for sale, buyers have almost entirely stopped buying anything off plan, preferring to buy only ready to move into finished units.
The highest demand is for two to three room apartments (50 - 70 sqm) in new projects with full finishing. As anywhere, buyers avoid buildings that are mostly empty, which becomes a self-

perpetuating situation for some continuously empty developments.

• Skanstes Virsotnes - leading Merko Group builds a 75,400 sqm apartment complex near Riga city centre.

### The Mortgage Market

Residential loan portfolios of Latvian banks stopped growing by mid-2008, and 2009 will see no net growth in residential mortgages.

Even though euribor declined markedly in 2008, margins charged by banks increased from as low as 0.9% at the beginning of 2008 to 2.5% to 5.0% margin by the beginning of 2009. This means in January 2009 rates for loans in euros ranged from 4.7% to 7.2%. Clients in theory can borrow up to 80% of the property value, and for length's up to 40 years, but in practice it has become much more difficult to qualify.

The credit crunch hit Latvia hardest of all Central and East European countries because Latvians piled up so much more debt than any other country. The main Swedish banks bought all the main Latvian banks, except Parex Bank, and Swedish banks were getting more than 50% of the total profits just from the Baltic States. Margins were kept low and loan portfolios ballooned as each bank tried to gain more market share. Even without the outside shocks from the US or Europe, the Swedish banks created their very own sub-prime crises right in their own backyard.

### 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, ensure that lease agreements are binding on new owners regardless of whether they are registered in the Land Book.

## Land

*An End to New Developments Spells Doom for Land Prices*

### Supply

Supply of land plots with planning, especially in suburbs, increased rapidly in 2008, just as demand from developers fell off a cliff. The resultant seismic shift in supply vs demand led to 50% to 70% drops in land values outside of Riga city centre.

### Demand

A halt in new developments, combined with the insolvency of many land investors, and refusal of banks to lend on land purchases after many years funding speculators 100% on their purchases, put a complete end to nearly all demand for land.
The only remaining buyers are end-users. Some companies now take advantage of the lower prices to buy land for own use, and private individuals can now buy house plots at knock-down prices.

### Price

Prices fell most for land for residential development, as banks and investors realised that sector had become overbuilt. In residential apartment suburbs, land values fell to €100 to €300 per sqm, which works out to roughly €80 to €250 per gross buildable square metre of residential space.
Raw land in housing districts fell to €25 to €45 for land without any connections, and €50 to €90 for land ready to build on.
Commercial land prices in city centre vary from €400 to €3,500 per sqm of land plot, or roughly €200 to €600 per buildable sqm of final building space.

### Legal Notes by Sorainen

Investments by foreigners are completely unrestricted, except for acquisition of agricultural and forestry land and land plots in border areas and special protection zones.

# Legal

## Introduction

After years of rapid growth in the real estate investment market, Latvia has been experiencing slower demand and activity, starting from the end of 2007. Little buying or development activity is predicted in 2009. Problems are being experienced in all sectors of the real estate market: residential property, commercial property such as office or warehouse facilities, and shopping centres.

## 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 land reform, a land plot and a building situated on it may belong to different owners.
The Land Book stores information regarding the legal status of real estate, including all encumbrances, mortgages, pre-emption rights, and other relevant rights and obligations. The Land Book is a public register; the information it contains is publicly available, and is binding on third persons. It is also available in a database version in Latvian via Internet in return for a fee.
Some properties are not registered with the Land Book but registered with the Cadastral Register. Most of these are privatised apartments and land plots restored to their previous owners. Privatisation of an apartment is completed after it is registered with the Land Book.

## Acquisition of Real Estate

**General**
Real estate may be acquired as a building and land plot beneath (entire or ideal parts) or as a building (if registered with the Land Book as a permanent property object) or land (if registered with the Land Book as a permanent property object) or apartment ownership.
Generally, 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 occur following restitution of 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 a contemplated real estate transaction. According to these agreements, the buyer can require conclusion of a sale contract.
Usually, a LOI sets out the parties' obligation not to negotiate with third parties (so-called exclusivity) and states other obligations of the parties to be followed during a certain period. Breach of the exclusivity obligation under LOI or preliminary agreements entitles the innocent party to compensation of damage, including specific contractual penalties.

**Change of Ownership**
Each transaction with real estate and registration of ownership rights with the Land Book involves a number of formalities. These have to be completed or resolved before title transfer. For instance, any real estate tax debt on a particular property has to be settled – if not, registration of ownership rights with the Land Book is not possible. The period for registration of title to real estate with the Land Book is fifteen days as of filing all necessary documentation with 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 a company holding target real estate, take the following into account:
• Notarial fees and state duty arising from real estate sales are excluded from transaction costs on the sale of shares of a company;
• Ownership of shares is transferred as agreed in the sale agreement, at the time of signing the agreement, or on registration, which takes only a few days;
• The buyer, on completing the transfer of shares, assumes responsibility for the whole company including any matters that occurred before change of ownership;
• Due diligence investigations are more extensive as a share deal transfers the entire company (with all known and unknown rights and liabilities) as opposed to due diligence of target real estate only;
• Applicability of financial assistance rules;
• Deferred tax issues.

Asset transfer involves the following benefits and drawbacks:
• Asset transfer is subject to notarial fees and state duty and is thus more expensive than a share transfer;
• Limited scope of due diligence investigation since the review concerns only the target asset;
• Lease contracts registered with the Land Book still bind 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;
• An asset transaction may in some cases be treated as sale of an enterprise, in which case all obligations associated with the enterprise may be transferred from seller to buyer.

## Form of Agreements

Transactions with real estate require written form, as well as registration with the Land Book. There are no requirements for notarisation of the purchase agreement.

Registration of ownership rights with the Land Book is carried out on the basis of a registration application signed by both seller and purchaser in the presence of a notary public.

In addition to the purchase agreement and registration application, some other documents have to be prepared and filed with the Land Book (e.g. statement confirming payment of real estate tax).

## Language Requirements

There is no specific requirement under Latvian law to use only the official state language (Latvian) in agreements on real estate. Parties may choose the language of the agreement themselves. However, the Land Book must have at least a translation of the 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 is prepared and signed in Latvian.

## Due Diligence

Before carrying out any real estate transaction, it is advisable to research the status of the real estate, e.g. encumbrances, permitted use as set by the local authority, lease agreements affecting the real estate. The results of research may help set the final purchase price reflecting the value of the real estate.

## Pre-emption Rights

Local authorities have 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 may a purchase agreement be registered with the Land Book and ownership 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 a pre-emption right with respect to the land plot, and vice versa. Additionally, co-owners of real estate have pre-emption rights with respect to the ideal part (legal share) of the immovable property being sold.

By law, the state has pre-emption rights on the sale of cultural monuments of state importance and land plots in preservation zones. Generally, pre-emption rights are exercised within two months after the purchase agreement is delivered to the persons entitled to such rights. Local authorities have to decide on using their pre-emption rights within 20 days after receiving the purchase agreement.

Pre-emption rights may be also agreed upon between the parties.

## Typical Purchase Price Arrangements

In complex and long-term projects, it is common that some part of the purchase price (up to 5-10%) is paid by a purchaser to a seller's account as an advance payment on signing the agreement. Normally, the parties agree to use an escrow account with a bank. During registration of the real estate title, neither the seller nor the purchaser has access to the funds transferred to the escrow account. Generally, the parties agree on release of these funds only after registration of the purchaser's real estate title with the Land Book.

## Related Costs

Sharing of costs incurred during purchase is a matter for agreement between the 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, whichever amount is higher. Nevertheless, state duty may not exceed €44,843 (LVL 30,000). Stamp duty for registration and issue of a Land Book certificate is currently €15 (LVL 9).

Preparing and testifying signatures for the application to the Land Book will cost approximately €23 (LVL 15). Signing an agreement in the presence of a notary public and certification of the signatures of the parties costs approximately €15 (LVL 10) for each copy of the agreement and for every page €1.50 (LVL 1). Preparation and certification of an agreement by a notary public amounts to 1% of the purchase price.

## Concentration Control

Transfer of real estate may be subject to prior approval by the Latvian competition authorities. Both concentration participants who have decided to merge in Latvia (either directly or through a subsidiary) and whose combined turnover in Latvia during the previous financial year is at least LVL 25 million must receive prior consent from the Competition Council.

Please note that sale of assets may also be treated as a concentration if the assets are considered to be an enterprise (business) and the turnover in question can be attributed to that enterprise (business).

Turnover comprises products sold and services provided by the undertakings concerned to undertakings or consumers in Latvia during the last financial year. Notification must be made before the share (or asset) transfer completes. Notification must be filed after signing the agreement, since the agreement must be submitted to the Competition Council before it enters into force.

## Portfolio Deals

Portfolio deals have been used more often in practice. Foreign investors enter into portfolio deals because they provide sufficient diversification and volume, a larger market share, and reduce overall risk and relative cost.

At the same time, considering a portfolio deal involves taking into account the following issues:
• Many properties in the portfolio lead to more extensive and time-consuming due diligence investigations.
• Sellers may use auctions as their preferred sales method. Without offering some compensation of due diligence costs to second-round bidders, high participation and placing of good bids is unlikely.
• In the case of an asset deal, allocation of the purchase price between each property is important as the seller may want to receive at least the book value for each property, which may or may not be the same as the market value. At the same time, the difference between purchase and market value could make some properties attractive to pre-emptive right holders.
• Remedies available to the buyer can be limited and the buyer might be excluded from claiming compensation until a certain level of loss is achieved first.
• Portfolios may include less attractive properties. For these properties, due diligence is even more important in order to ensure complete understanding of all risks and preparing for resale of those properties after closing.
• Some non-real estate assets, such as employment contracts, property-related rights, access arrangements, and management operations, are often acquired or need to be acquired together with the portfolio.
• Structuring a portfolio transaction that includes a mix of assets and shares or multiple jurisdictions or both, is rather complicated, especially with a view to achieving simultaneous closings.

## Sale-Leasebacks

Sale-leaseback transactions are becoming increasingly popular in Latvia as cost-effective and efficient alternatives to traditional debt funding, helping to attract other resources to fund expansion, acquisition, and construction of new facilities.

The following points should be reviewed before using this arrangement:
• The lease agreement should be tied to the asset purchase agreement. Additionally, if the target property is encumbered with pre-emption rights that are subsequently exercised, the lease should transfer and be binding on the right holder. Currently, in view of existing case law, in practice the binding nature of lease agreements in these circumstances is not entirely clear.
• Existence of a solid tenant/guarantor with a strong business track record to ensure stable cash-flow during the lease.
• Since the arrangement is usually long-term, the lease should be "waterproof". This includes ensuring sufficient guarantees for performance on both sides (e.g. bank guarantee, surety, reserves, sinking fund).
• The lease should include a clear split of maintenance responsibilities and cost/service charge break-down between owner and tenant.
• Closing under the asset purchase agreement and lease commencement date should coincide (book-keeping issues, reconciliation of costs) irrespective of the actual title transfer date.

## Restrictions

**Restrictions on Acquisition of Real Estate**
Restrictions on real estate acquisition in Latvia apply to land plot purchases. After 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 be aware of several restrictions on acquiring land plots in Latvia. Latvian law does not lay down any particular restrictions or obstacles for foreigners to buy commercial property. Buyers should investigate restrictions on use of real estate. Use may be restricted in e.g. coastal areas, heritage protection zones, protected zones for power lines, railways. These restrictions can also influence e.g. construction area.

**Non–EU Citizens and Legal Entities**
No restrictions are imposed on acquisition of land plots by companies registered in the Latvian Register of Enterprises 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 land acquisition, the shareholder structure of an undertaking is changed so that it no longer corresponds to the requirements of the law, permission from the municipality must be obtained to retain ownership of the land. If the local municipality does not issue permission, the land must be transferred to another person within two years.

Should potential foreign purchasers fail to fulfil the criteria listed above, they must apply for permission from the local municipality, which has the discretion to accept or reject the 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, 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 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 may acquire land on the same conditions as citizens of Latvia. During the transitional period, EU citizens may only acquire agricultural or forestry land if they live permanently in Latvia and have had farmland there within the last three years.

There are no restrictions for EU citizens and legal entities to acquire land plots in cities in Latvia.

## Encumbrances

Real estate might be encumbered with servitudes, pre-emption rights, lease rights registered with the Land Book, mortgages, protection zones, and other encumbrances that should be considered in usage of real estate and construction of 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 real estate, a mortgage agreement should be concluded. An application to register the mortgage with the Land Book must be signed in the presence of a notary public. The Land Book registers the mortgage within 7 days of filing the necessary documentation.

## Property Management

Maintenance of real estate is usually carried out by the owner or by a maintenance company. Apartment owners may establish an apartment owner's association, though this is voluntary.

## Lease Agreements

**General**

General terms for lease and tenancy agreements are laid down in Latvian Civil Law and the Law on Apartment Leases. The contents of lease and tenancy agreement are subject to agreement between the parties. However, the Law on Apartment Leases protects the rights of tenants.

Tenancy agreements on real estate remain valid if registered with the Land Book. Otherwise, a purchaser of real estate may terminate an unregistered agreement. However, the tenant is entitled to compensation from the owner for termination of a lease agreement before expiry.

Lease agreements of apartments are binding on new apartment owners under the Law on Apartment Leases.

**Duration and Expiry of Lease Agreement**

The duration and expiry of lease or tenancy agreements are usually set in the agreement. Latvian law lays down some general rules and these agreements may be for a specified or unspecified term. As for termination, the law lays down only general rules. More specific provisions on termination are regulated by the Law on Apartment Leases, adopted in order to protect the interests of tenants.

**Lease Payment and Accessory Expenses**

Prepayment of lease payments (deposit or guarantee) is usually required by the owner, but Latvian law lays down no specific provisions regarding payment of deposits, or a procedure.

Accessory expenses are payments for maintenance and utilities (e.g. water, gas, electricity). As a rule, these 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 may be procured either under the Public Procurement Law or the Concessions Law (a new PPP law is expected to be adopted in 2009 and will replace the current Concessions Law). Procurement of both construction works and public services is possible under either regime. The difference lies in the definition of a concession, which, according to the draft PPP 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.

## Investment Funds and Real Estate

The Latvian Law on Investment Management Companies regulates real estate-related operations of investment funds. Both foreign and domestic investments may be administered through an investment fund. Fund units may be subject to public or private offering. Only closed-end investment funds may invest in real estate.

Real estate acquired by an investment fund must be registered under the name of an investment management company, and it can be sold or encumbered only with permission of the custodian bank. Assets of a fund may be invested in real estate located in Latvia, the EU, or other countries specified in the prospectus once the real estate has been valued and the valuation has been approved by an expert panel. Real estate owned by the investment fund may not be managed by the investment management company itself, and, therefore, will most likely be managed by a professional real estate management company.

## Planning Requirements and Construction of Buildings

**Planning**

Municipalities (local authorities) have the authority to define usage of real estate in their territory, to set limits on construction activity, and to issue building permissions. If the particular territory has a general territorial plan, a detailed plan can be required. This 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.

## Insolvency and restructuring

If a company is unable to cover its liabilities, then under Latvian law insolvency proceedings may be initiated against a debtor in financial difficulties. After the court declares the company insolvent, the creditors have to decide whether a “settlement of debts” procedure will be used or whether “restructuring” will take place. If the creditors have not reached an agreement on restructuring the company, then all the company’s assets, including mortgaged property, will be sold through a “bankruptcy procedure”. Insolvency proceedings are managed by a certified insolvency administrator appointed by the court, who can decide on termination or continuation of the company’s business activity in full or limited scope.

After of the start of insolvency proceedings, the company (debtor) forfeits the right to handle its property. This includes property in its possession and property belonging to third parties (the insolvency administrator obtains these rights). The operations of the company’s administrative institutions are suspended and management is performed by the insolvency administrator. Accumulation of loan interest is suspended after declaration of insolvency, as well as accumulation of interest set by law and accumulation of contractual penalties and late payment interest.

After sale of property, funds received are used to cover the claims of secured creditors. This is followed by compensation of the costs of the insolvency proceedings, payments to employees and the State (tax claims), and payments to unsecured creditors.

If a company is facing short-term financial difficulties in covering current or upcoming liabilities, it may find a temporary solution through legal protection proceedings, if its assets exceed liabilities. Legal protection proceedings are initiated by the company itself but have to be approved by 2/3 of the non-secured creditors and the court. The proceedings ensure suspension of execution of court judgments in matters regarding recovery of unrecovered sums under a judgment, and suspension of compulsory execution against the company. The proceedings also stop accumulation of contractual penalties, interest exceeding interest limits set by law, increase of interest on late payment penalties, and calculation of interest of delayed tax payments.

In case of business difficulties, one should take all available precautions and match the solution to the problem:

- If the debtor is in financial difficulties - restructure lease agreement (lower lease payments, ask for additional collateral) or search for substitute tenants.
- If a commercial property is performing poorly - restructure property (hire a real estate management company, change or relocate tenants, e.g. some to smaller premises, others to bigger premises).
- If financing is bad - improve cash collection, find a new investor, restructure debt, do a debt-equity swap, or sell non-performing assets.
- If the company is badly managed - change management and/or shareholders.

# Taxes

## Purchase

**VAT** - The purchase any new building or apartment is subject to 21% VAT. The purchase of used real estate is not subject to VAT. The purchase of a renovated building, within one year after renovation, is subject to 21% VAT on the difference between the purchase price of the building and the value of the building before renovation.

The sale of land is not subject to VAT in 2008, however, it is currently planned that as of January 1, 2011, the sale of building land will be subject to VAT. The date when the building land is taxed still can be reviewed.

In order for a corporate buyer to deduct the VAT on the purchase, construction or renovation of a building, the buyer must prove that the building will be used for VAT taxable transactions during the following 10 years.

**Stamp duty** - When purchasing property, the buyer pays a stamp duty of 2% of the transaction value. The maximum stamp duty is €43,000 (30,000 lats). Stamp duty also applies to real estate contributed as an investment.

**Broker fees** - The broker's fee is typically 3% of transaction value.

## Rents

**VAT** - Property leased to a private person is exempt from VAT. Otherwise all property rentals are subject to 21% VAT.

**Corporate Income Tax** - Rents collected by companies is subject to the standard 15% corporate income tax rate. The taxable income of a company may be reduced by the real estate tax paid, as well as by depreciation and all other expenses directly related to the generation of taxable income. Regarding deductibility of interest the special thin capitalization regulations apply. Buildings, constructions and long-term plantations used for business purposes can be depreciated at 10% annual rate. Land is not subject to depreciation.

**Personal Income Tax** - Rents collected by individuals will be taxed at the personal income tax rate of 23%. Individuals have the right to register themselves as a business activity, and take advantage of the lower 15% tax rate. To apply the 15% tax rate the individual has to register as a business activity with the local Tax Authority.

## Sale

**Corporate Income Tax** - Companies pay standard corporate income tax at the current rate of 15% on capital gain from sale of real estate. The capital gain is calculated as the difference between the acquisition value or the value at the moment of development of the real estate, and the sales value.

Residents must withhold tax at 2% from the payments to non-residents for sale of real estate. After amendments to the Corporate Income Tax Act, which are applicable since 12 June 2007, residents must also withhold tax at 2% from the payments to non-residents for sales price of the shares of a real estate company.

The term "real estate company" refers to any entity whose assets consist for at least 50% either directly or indirectly (e.g. through one or several Latvian or foreign entities) of real estate situated in Latvia. The 50% is based on the book value of the assets at the beginning of the year. When the real estate was sold during the preceding tax year and the result on the sale was booked, the reference is the asset value at the date when the real estate was sold.

**Personal Income Tax** - Private persons pay the 23% personal income tax rate on capital gains from the sale of real estate. Capital gains are tax-free only if the real estate belonged to the seller for a period more than 12 months, except if the sale is classified as trading activity.

## Real Estate Tax

Owners of land or buildings are subject to real estate tax. Starting from January 1, 2008 the real estate tax rate is 1% of the cadastral value. This value is set by the State Land Department and is adjusted annually (by the 15th of May of each year) and may lead to increase of tax base. However, the increase of tax amount may not exceed 25% of the previous year tax during the next 3 years (2008 - 2010).


## Vilnius, Lithuania

### *Rough Patch Ahead for Lithuanian Real Estate Developers*

#### Economy

Lithuanian GDP growth cooled to just 3.2% in 2008, after seven years of better than 7% growth. Lithuania is no exception to the worldwide slump, and the consensus forecasts call for a -4.8% drop in GDP in 2009.

Inflation was 11% in 2008, after peaking at 12.5% in the 3Q. As credit tightens, demand plunges, taxes rise, and spending drops off, economists expect Lithuanian CPI to be 5-7% in 2009.

Officially reported salaries grew 20% in Lithuania in 2008, to €672 per month, according to the Department of Statistics, but the main bank analysts report only 11% salary growth. The difference is that the official statistics include the increase in tax rolls coming from grey economy salaries being shifted to official salary payments, while independent analysts projections of 11% show the truer overall picture. Most analysts project salaries to stay flat at best, or even decline by 3-4% per year in both 2009 and 2010.

Unemployment jumped from 4.5% in mid-2008 to 7.9% by the beginning of 2009.

The Lithuanian currency, the litas (LTL), remains pegged to the euro at a rate of 3.4528 litas to one euro. The adoption of the euro is a key economic goal for Lithuania, but it is unlikely to be achieved before 2012, at the earliest. In the meantime, the exchange rate remains fixed through a currency board system.

As of October 2008, direct foreign investment totalled €9.7 billion, which is €2,896 per capita.

Construction costs are heading down in 2009. After rising in the first half of 2008 but falling in the second half, they ended 2008 up less than 0.5%. But the downward trend is now expected to continue as labour costs decline, construction companies bid lower to capture a shrinking pool of clients, and materials costs get cheaper worldwide.

## Office

### *Record-level Supply at the End of the Cycle*

#### Supply

In 2008 developers completed 85,700 sqm of new office space, even more than the 54,000 sqm delivered in 2007. By the beginning of 2009, the total area of modern office premises in Vilnius equalled 354,500 sqm (including both A class and B office premises). Of the total of the modern office supply 58% was B class.

The rapidly growing economy of previous years led developers to start an all time high number of new projects, just as the economic cycle is ending. There are 14 new office buildings planned in 2009, which will increase the modern office premises market by a record-level 100,000 sqm of lettable area.

However, it is likely that developers will meet already-present financing problems, forecasted economic recession in Lithuania, worsening company results, and increasing availability of vacant premises. Although all projects are currently being constructed, it is likely that some of the projects will be stopped or postponed to later dates.

#### Recent Developments

To lease space in these or other properties, call Ober-Haus on +370 5210 9700.

**Vilnius Business Harbour** - local company Nekilnojamojo Turto Gama completed construction of the largest A class business centre in Lvovo Street in the new centre of Vilnius. The project is the largest office premises complex in Lithuania with an area of 62,000 sqm, of which over 30,000 sqm constitutes lettable area. The 24-storey and 17-storey towers and the 6-storey additional building already host well-known local and international companies such as Nokia, Puma, LG, Verdispar, City Service, Lindorff, DnB Nord, Raidla Lejins & Norcous, Eurovaistine, and the Vilnius branch of the State Enterprise Centre of Registers. At the start of 2009, asking rents were €16.00 to €18.00 per sqm.

**Vilniaus/Islandijos Street** - for those who want office space with some history, this renovated 19th century building in the Old Town should suit. The four storey building with 7,600 sqm offers retail and office premises for rent. The building has a glass covered internal courtyard atrium, with two panoramic lifts. Furthermore, almost all authentic decorations, facades, interiors with 16 unique tile stoves, mouldings, wall paintings, terraced staircases, and encrusted inlaid parquet have been restored and reconstructed. Asking rents are €13.00 to €19.00 per sqm.

**NVC 3** - local company Vilbra completed the third stage of the Naujamiestis Business Centre in the city centre at the end of 2008. This stage comprised a 10-storey B class office building with a total area of over 5,000 sqm. At present, over 50% of the premises have been leased. Rents are from €11.60 to €13.00 per sqm.

**Perkunkiemis Business Centre** - a three building suburban office centre built in the Pasilaiciai district on Ukmerges Street by Local developer Ranga IV. The 12,000 sqm complex already houses local and foreign companies such as Swedbank, Ranga Group, General Financing, Pieno Zvaigzdes, and Vilniaus Duona (Vaasan & Vaasan Group). At the start of 2009 asking rents started at €11.60 per sqm.

## New Projects

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**Swedbank HQ** - Swedbank is building its new headquarters building on the right bank of the Neris River, on Konstitucijos Avenue. The project comprises 14-storey and 16-storey interconnected buildings with an underground parking facility. The total area of the buildings is 23,700 sqm, plus 600 spaces underground for parking. The entire building will be used by Swedbank. The building will be opened in Spring 2009.

**Leandra & Partners** - opening of a B class business centre in Ukmerges Street in the Seskine district planned in early 2009. The project is a 10-storey office building with a total area of over 6,000 sqm and underground and outdoor parking lots developed by Leandra & Partners. Asking rents are from €10.00 to €12.00 per sqm.

**Green Hall** - aiming to satisfy the ecologically conscious, developer SBA Concern is building what they claim to be Vilnius's first "green" A class office building on the right bank of the Neris River. The project comprises a 12-storey business centre with over 10,000 sqm of lettable area, which was designed by the Danish architectural company PLH Arkitekter and which will stand out by its environmentally-friendly solutions such as a double-glass façade, the use of solar energy, and a green business park nearby. The estimated opening date is at the end of 2009.

**Embassy House** - a unique commercial and residential project being built on Kalinausko Street in the city centre. The bottom floors will be occupied by the embassies of Finland and Norway, while the 4th and 5th floors offer office space for rent. Apartments on the 6th floor will be offered for sale. The building will have a two-level underground parking lot.

**North Star** - Lithuanian developer MG Valda finishing construction of an office building in Ulonu Street just north of the CBD. The building will consist of two blocks (5 storey and 7 storey) totalling 10,000 sqm, with 390 parking places. The building will be completed in early 2009, and is offered now for rent from €13.00 per sqm.

**Alfa & Beta** - Realco, another local company, has completed construction of Alfa office building (9,000 sqm) in the territory of Ozo Park, near Siemens Arena and Vichy Aquapark. Second office building Beta will bring another 20,000 sqm in the end of 2009. Office space is available at rents of €11.50 - 14.50 per sqm.

*• Vilnius Business Harbour – the largest A class office building in Vilnius's new central business area.*

## Demand

Declining GDP and worsening company results have led to cost cutting at most companies, and pessimistic economic forecasts don't promise a bright future for this market. The vacancy rate jumped in 2008 from 1% to 10%. Given that the total vacancy rate for new projects in 2009 may be as high as 40-50%, Ober-Haus projects the overall vacancy rate in modern office stock to reach 15-20% by the end of 2009.

If the most pessimistic economic development forecasts come true, many companies will take further steps to cut costs and will lower their workplace quality standards. Therefore, many companies may want to move from A class premises to B class premises, from B class to C class premises. For this reason, in 2009 the situation will be most favourable for those premises owners who will be able to offer the lowest prices in already completed and operating buildings.

• *NVC 3 – the third stage of the Naujamiestis Business Centre in Vilnius city centre.*

## Rents

After remaining unchanged in the first half of 2008, A class office rents fell 7% in the second half of 2008, and asking rents started 2009 at €14.00 to €19.00 per sqm.

B class office premises rents fell 12% in 2008 to reach €11.00 to €14.00 per sqm. In general maintenance and public utilities cost an additional €1.50 to €3.00 per sqm.

In 2007-2008, despite higher rents, office owners also started to impose full triple net leases on new tenants, adding all charges for common-use areas, and the tenant's pro-rata portion of the real estate/land tax and insurance fees, as well as fees for additional parking spaces, which could add up to an additional 10-20% of the base rent price.

Furthermore the practice of indexing rents by pegging them to the local Lithuanian inflation rate (LCPI) became the default practice.

Already in 2009, as supply has increased much faster than demand, tenants have considerably more power to negotiate both the base rent price (at least 10% less than asking rents) and even some free rental period when negotiating a new lease.

## Investment

No major transactions were registered in Vilnius in 2008. Investors steered clear of the Baltic States in 2008 as news went from bad to worse. On the other side, sellers had not yet adjusted their own selling price expectations to meet the increased yield demands of buyers.

By the start of 2009, potential sellers of office buildings started to offer properties at yields of 8-9% for fully leased Vilnius properties, but still buyers' yield expectations, given their increased perception of the risk of lowering rents, increasing vacancy, and high costs of funds, remain closer to 9-11%.

Given that some sellers may have cash requirements in 2009-2010, it is likely that the next two years will produce double-digit yields of 10-11%, which haven't been seen since 2004.

In any case, even with the cooling-down of the Lithuanian commercial market, this market is likely to remain attractive for both local and foreign investors who believe in long-term real estate perspectives.

For companies buying their own space for use, sale prices dropped by 10-20% in 2008, to €1,400 - €2,800 per sqm, because at present there are few companies with available funds and able to afford to purchase premises. Furthermore, demand to buy space has been depressed by the more stringent policies of banks with regard to granting loans for real estate.

## Legal Notes by Sorainen

Rent is usually paid in advance, generally monthly, sometimes quarterly. Rent is typically tied to the euro and indexed-based on local or European Union inflation. In addition to rent, tenants usually pay for utility services and a service charge for maintenance of the property. Security deposits are common. Triple net leases are not universally used. Double net leases are more common. As a rule, the owner is responsible for finishing leased premises. Typically, standard lease agreements are used in larger properties.

Lease agreements must be registered with the Register of Real Estate if they are to be invoked against third persons. The tenant may terminate the lease agreement on change of ownership of the premises. In practice, such issue is attempted to be solved by obtaining estoppels (upfront waivers of such rights) from tenants.

# Retail

## *Competition Between Shopping Centres Becoming Fiercer*

### Supply

The city centre three storey shopping centre Panorama, at 52,000 sqm, was the largest new retail offering in Vilnius last year. Besides that, just 20,000 sqm was built in three smaller hypermarket schemes, increasing the total lettable area of modern retail premises in Vilnius by 16% to 510,000 sqm by year end.

Looking to 2009-2010, we see three more major retail centres to come: Ozas, which will have 62,000 sqm of retail and another 30,000 of entertainment and mixed-use, and Olinda (30,000 sqm) and DomusPro (18,400 sqm). If these projects are successfully completed, in the next two years the Vilnius retail market will be supplemented by 110,000 sqm of lettable area.

• *Panorama - the second largest shopping centre in Vilnius, opened in 2008 by Merko Group.*

### Recent Developments

To lease space in these or other properties, call Ober-Haus on +370 5210 9700.

**Panorama** - the second largest shopping centre in Vilnius, in the Zverynas district, was opened at the end of 2008 by ELL Real Estate (part of the Merko Group). The 3-storey building (with two levels of  underground parking) with a lettable area of 52,000 sqm hosts 170 tenants, including Rimi Hypermarket, BMS Megapolis, Apranga, Sportland, Imitz, Baltman, Reserved, Douglas, and others. Total investment into the project totalled €78 million.

**Pupa** - a shopping centre with the total area of 6,300 sqm in the Pilaite district, built by local developer Eika. This shopping centre is primarily intended for residents of this part of the city and for future residents of the apartment buildings being constructed in the vicinity. Forty tenants occupy the shopping centre.

### New Projects

To lease space in these or other properties, call Ober-Haus on +370 5210 9700.

**Ozas** - will be one of the largest shopping and entertainment centres in Vilnius, next to Siemens Arena and Vichy Aqua Park. The German company ECE Projektmanagement will open the shopping centre with a lettable area of 62,000 sqm in autumn 2009. Ozas expects to have 180 shops. Total project investments exceed €170 million. 90% percent of the premises have already been leased.

**Olinda** - Finnish real estate development and investment company Vicus and its Lithuanian partner GB Projektai are investing €49 million in this shopping centre with the total area of 40,000 sqm in the Pasilaiciai district. The shopping centre will house a Prisma supermarket (belonging to the Finnish retail trade group SOK), which will occupy an area of 11,000 sqm and will become the major tenant in Olinda. The centre is scheduled to open in 2010.

**DomusPro** - TK Development, an international real estate development company, plans to construct a 20,000 sqm shopping park in Pasilaiciai district, near Ukmergės Street. DomusPro will house a foodstuffs retail outlet, as well as specialised furniture, interior finishing, leisure, and household goods shops, all of which will have separate entrances. The centre is scheduled to open in 2010.

### Demand

Due to increasing supply and recession hampered demand, Ober-Haus expects that the vacancy rate in shopping centres will increase from 2-3% at the end of 2008 up to 4-5% by the end of 2009.

Retailers feel decreasing consumer consumption, which dropped 9% in 2008 and is likely to decrease at least another 10% in 2009.

Whereas in the there were long waiting lists for free lettable premises, today it is considerably more difficult to find a stable tenant for any free premises.

### Rents

Retail sales fell 9% in 2008, leading to reduced demand for space and downward pressure on rents. While rents in the best shopping centres did not decrease in 2008, rents on new leases in second tier retail centres were down 12% in 2008, with rents for a medium sized (150-300 sqm) unit in a major retail centre running from €12.50 - €25.00 per sqm. Rents for anchor tenants (like hypermarkets) remained stable at €8.50 - €14.50 per sqm.

Asking rents on the high street (such as Gedimino or old town centre) were down 13% on the year, to €19 - €49 per sqm.

• *Olinda – a 40,000 sqm shopping centre for residents of the rapidly growing Pasilaiciai residential area.*

### Investment

The Norwegian investment company Verdispar acquired nine retail shops from Maxima, the owner of the largest supermarket chain in Lithuania. The properties are in the largest cities of Lithuania: Vilnius, Kaunas, Klaipeda, Alytus, Siauliai, Ukmerge and Plunge. Verdispar paid over €46.6 million for the 26,500 sqm of property and 6.2 ha land. Yields have not been disclosed.

### Legal Notes by Sorainen

Typically, 3-5 year lease agreements are common. Triple net leases are not universally used. Double net leases are more common. The advertising cost are either fixed or a part of the service charge. As a rule, a sinking fund is not used in the retail market, while step rents and turnover rents are practiced but not common. As a rule, the tenant is responsible for finishing the premises.

Lease agreements may be invoked against third persons only if registered with the Register of Real Estate. The tenant may terminate the lease agreement on change of ownership of the leased premises. In practice, such issue is attempted to be solved by obtaining estoppels (upfront waivers of such rights) from tenants.

## Industrial

### *Rents Steady, No Oversupply Seen in Logistics Market*

### Supply

In 2008 developers brought 16,300 sqm of new warehouse space to the market. The total modern space available in Vilnius and the immediate surroundings is now 281,000 sqm.
More than 75% of this space is located in the industrial zones of Vilnius (Kirtimai, Vilkpede, Aukstieji and Zemieji Paneriai), with the remainder within the city limits. Also, they are constructed in the vicinity of strategic highways such as Vilnius–Kaunas and Vilnius-Minsk.
Developers have plans to build 46,900 sqm of lettable space over the years 2009-2010. However, the actual supply will depend on the market situation, and developers are unlikely to commence the implementation of any projects in the absence of any preliminary lease or sale contracts.

### New Projects

To lease space in these or other properties, call Ober-Haus on +370 5210 9700.

**Airport Business Park** – Lithuanian developer Ogmios Group is building a logistics park with the total area of 30,000 sqm in Dariaus and Gireno Streets, near Vilnius Airport. The first stage was completed in 2008, during which 5,400 sqm of warehousing space and 1,600 sqm of office space were constructed. Companies such as DHL, Adictus, and Arijus have already occupied their premises. At present the second stage of the project is being implemented, which in 2009 will offer 8,500 sqm of warehousing premises and 3,500 sqm of office premises. Upon successful completion of the first project stages, plans are to continue developing this territory. Rental prices for the warehouses begin at €5.80 per sqm, and office space for €8.70 per sqm.

**GLC Logistics Centre** - this logistics centre with the total area of 21,000 sqm will be located in the vicinity of Minsko Highway, 7 km from Vilnius city centre. The complex will comprise two buildings. One of the buildings has already been leased to the Lithuanian subsidiary of the Finnish company Elektroskandia Oy. The building was designed and will be built in accordance with the company's specific requirements based on the built-to-suit principle. Another warehousing building with an area of 16,500 sqm with office premises will be offered for lease in Q2 2009. At present, over 70% of premises have been leased.

### Demand

Warehouse take-up in 2008 passed 11,500 sqm, which was 70% of the new supply brought to the market.

As the largest tenants on the market do not need any more new space, and no new large tenants are likely to come to market in the year ahead, it is now very difficult to find a tenant for premises exceeding 5,000 sqm.

The greatest demand is for premises of up to 1,000 sqm, which are needed by small and medium-size companies which upgrade from old premises that do not satisfy their current needs. Such small tenants are not desirable or practical for large space owners.

Some previously fast growing tenants are now forced to downsize or trade down the quality of their warehouse space with cheaper space, thus adding to the vacancy rate of modern warehouses. In the mid-2008, the vacancy rate of modern warehouses was 3%, but by the start of 2009 the vacancy rate increased to 6%. Ober-Haus predicts the rate will continue to climb to 7-9% by the end of 2009.

• *GLC - part of a new 21,000 sqm logistics complex built-to-suit for its customers.*

### Rents

2008 was neutral for industrial rents. New modern warehouses near the city centre rent for €5.20 - €6.90 per sqm, depending on the size. Near or outside the city limits, rents range from €4.00 - €5.50 per sqm. Renovated older premises are being offered at prices from €2.80 - €5.20 per sqm. Average and poor quality premises rent from €1.70 - €3.50 per sqm.

Owing to growing supply and poorer economic perspectives in Lithuania, we expect lease rates for modern warehouses to soften 5-10% in 2009.

### Investment

In 2008, investment company NOR Property Investment AS controlled by Norwegian real estate fund Orkla Finanse purchased 100% of shares of Megarenta, which owns a logistics centre with an area of 30,000 sqm in Vilnius. The value of the transaction equals €22.6 million. Yields have not been disclosed.

### Legal Notes by Sorainen

The industrial real estate market has developed over the past few years and leases have become of better quality than used to be the case. Rents are usually tied to the euro and indexed on the basis of local or European Union inflation. Triple net leases are not universally used. Sale-leaseback arrangements have occurred. The market is rather mixed and comprises brand new buildings and renovated Soviet-era premises.

## Residential

### *Prices Fall as New Supply Outpaces Local Borrowing Power*

### Prices

The party ended for residential developers in Vilnius, with prices for newly built units slumping 21% to as low as €1,070 per sqm in some new suburban schemes. The average price range for a new suburban flat at the beginning of 2009 was €1,070 - €1,950 per sqm.

In the city centre, secondary market flat prices fell 15% to €1,600 - €3,200 per sqm.

Those developers who cut prices early in 2008 did the best. They managed to drop prices 10-15% and sell out their units. Developers who waited to cut prices are now scrambling to sell in 2009 at prices 20-30% lower than the start of 2008. The biggest developers can now count on one hand the number of flats sold per month.

As would also be expected, the price of larger flats have dropped the most, as local mortgage financing has become more difficult to obtain and with home maintenance costs like heating increasing, people are looking for cheaper homes.

On the secondary market, at the beginning of 2009, a standard two-room apartment (45-55 sqm) in a Soviet-era concrete block building located in a satellite district was priced from €60,000 to €75,000. The same size new apartment, fully fitout, sells for

€70,000 to €90,000, which is not a reasonable difference, considering that the Soviet-era flats are much poorer quality and cost more to heat and maintain.

Prices of newly built apartments in the suburbs range from €1,000 to €2,000 per sqm. In more prestigious districts (Antakalnis, Zverynas, Valakampiai), prices range from €1,800 to €2,900 per sqm.

Note that while new apartments in Estonia and Latvia are generally sold fully fit-out, in Lithuania new developments are generally sold shell, which is without any fit-out at all. Apartments sold shell require a minimum of €150 to €200 to fit-out with floors, painting, lights, bathrooms and kitchen to a bare economy standard.

Similar trends are seen on the detached houses market: prices for larger-area/luxury houses with a price exceeding €500,000 have dropped the most. It is becoming more difficult to find a potential buyer who can afford a house for such a price. However, negative changes in prices have also occurred on the cheaper house market. In the course of 2008, the prices of detached and semi-detached houses in the city of Vilnius and in the immediate Vilnius surroundings have gone down by an average of 20%.

Individual houses (about 200 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 €160,000 to €230,000. Full final fit out generally costs €150-200 per sqm more.

The average price for the same type of fully finished house within the city limits (suburbs or city residential districts) averages between €250,000 and €450,000, and from €480,000 to €900,000 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.

## Supply

Delivery of new apartments in 2008 dropped for the first time in years, with only 5,809 flats built versus 6,289 in 2007. Ober-Haus forecasts that only 2,000 to 2,500 new units will be delivered in 2009, the lowest level in six years. And as no new major projects will be started, the level of new units delivered in 2010 may be as low as from 800 to 1,400 units.

The greatest number of new apartments was built in the most rapidly developing Pasilaiciai district. Only 11% of apartments were built in the central part of the city, in the Old Town, Uzupis and prestigious districts. The average area of a newly constructed apartment is 61.4 sqm, a figure that has decreases each year as the market demands smaller-sized apartments.

The detached and semi-detached segment also sees a drop in supply, with supply dropping 20% in 2008 to 360 new units, and a further drop to less than 300 units projected in 2009.

## Recent Developments

To buy or rent in these or other residential properties, call Ober-Haus on +370 5210 9700.

**Perkunkiemis** – with over 4,000 apartments planned, Perkunkiemis is the largest residential development from Lithuania's largest residential developer, Ranga IV. Already over 1,750 apartments have been built as of the start 2009, but new buildings starts will be delayed at least until 2010. Prices for remaining units start at €1,050 per sqm for units delivered shell (without final fit-out).

**Veikme Perkunkiemis** – local developer Veikme has finished 300 apartments in two buildings in Perkunkiemis, the most active development area of the Pasilaiciai district in northern Vilnius. The apartments are sized from 38 to 80 sqm and offered for sale shell starting at €1,000 per sqm, and with turn-key finishing starting at €1,400 per sqm.

**Linksmasis** – developer Luidas has finished over 450 apartments in their second stage development in the Perkunkiemis area. The apartments vary from 35 to 90 sqm, and sell as shell for €1,000 to €1,250 per sqm. Over 70% apartments have already been sold or reserved.

**Bajoru Kalvos** - local developer Hanner is adding another 170 apartments in 2009 in a third stage to its already successfully sold 580 new apartments which were delivered in 2008 in its residential housing project on Mokslininku Street in Visoriai. All apartments were successfully sold. One-room to three-room apartments sold shell sell for €1,450 to 1,800 per sqm, and 50% of the third stage apartments have already been sold or reserved.

**Eika Pilaite** – local developer Eika finished 380 apartments in seven apartment buildings in the Pilaite district. The apartments, sized from 34 to 86 sqm, sell shell for €1,200 to €1,600 per sqm. Nearly 85% of apartments had been sold by the start of 2009. There are plans to develop a second stage in the same area in the future.

**Taurakalnio Namai** - local developer Sklypas built a luxury apartment building on Tauro Hill in the city centre. The fully completed 5-storey residential building comprises 47 apartments with sizes from 37 to 138 sqm. 65% of apartments have been sold.

**Verkiai Residence** – local developer Perspektyvios Idejos built its third stage of the Verkiai Residence project in the Santariškės section of the city, next to Verkiai Regional Park. Two three storey apartment buildings with 57 apartments sized from 40 to 117 sqm. By the start of 2009 85% of the apartments had been sold at prices of €1,100 to €1,600 per sqm for shell.

**Pavilnių Park** – in the city limits of Vilnius, in Zemasis Pavilnys 7 km from the city centre, 12 already finished semidetached houses of 75-137 sqm with land plots of 120 to 350 sqm are being sold at the price of €100,000-152,000. 75% are already sold.

• *Sand Houses - MG Valda will build 52 flats in the prestigious Antakalnis district.*

## New Projects

To buy or rent in these or other residential properties, call Ober-Haus on +370 5210 9700.

**Ozo Park** – just five to ten minutes from the city centre near the Siemens Arena and Vichy Aquapark, Realco is building a projected 1,400 apartments for middle-class buyers. The first stage in 2008 delivered 119 units, and the second stage will bring 159 more apartments in 2009. The price of apartments sold shell ranges from €1,600 to €2,200 per sqm.

**Evita** – developer MEI Baltija is building 10 and 11 storey mixed use towers in the city centre on Savanoriu Avenue. The residential buildings will offer 59 apartments for sale, at prices of €1,900 to €2,200 per sqm. Over 45% of the apartments had been sold by the start of 2009. Construction is scheduled for completion in Summer 2009.

**North Star** – is another commercial and residential complex by MG Valda in the Siaures Miestelis district. The complex will comprise two separate buildings: a residential building and a commercial building. The 7-storey residential building will comprise 124 apartments. Prices of the remaining apartments sold shell are €1,650 to €2,200 per sqm. The announced completion date is Spring 2009.

**Sand Houses (Smėlio Namai)** – local developer MG Valda will build 52 flats in the prestigious Antakalnis district. The flats will be sized 38 to 99 sqm in 6 and 8-storey buildings, and will sell as shell for €2,000 to €2,800 per sqm. By the start of 2009 60% of the apartments had been sold. The project will be completed in Spring 2009.

**Step Nine** – nine blocks comprising 116 apartments being built by local developer Statybų Aprūpinimas next to their already successful project near the Old Town on St. Steponas Street. Apartments sized from 37 to 100 sqm will be sold shell for €1,700 to €2,200 per sqm. The anticipated completion of the entire project is in 2009.

## Demand

According to Ober-Haus data, 69% of the new apartments built in 2008 were purchased by the end of the year. This result is much worse than the 89% rate achieved in 2007. The number of new apartments purchased in Vilnius fell 28% in 2008, to 4,037 units, and in all of Lithuania new apartment purchases fell 35%.

There still exists enormous pent-up demand for apartments, due to the dearth of living space per capita, the disintegration of Soviet-era housing stock, and the high level of people per flat (2.6, compared to the EU average of 1.8) and conversely low level of flats per capita. However, the short-term drivers of demand, namely GDP growth, wage growth, and mortgage liquidity growth have all abruptly been thrown in to reverse.

The greatest demand today remains for small and cheap apartments and houses, either one or two room apartments or houses with an area of 100–160 sqm. This trend is likely to continue for the next few years.

## The Mortgage Market

The volume of new mortgage loans issued fell 25% in 2008, compared to 2007, and look to fall further as many analysts predict no net loan growth in 2009.

Currently in Lithuania, the value of housing loans equals just over 18% of GDP, which is twice as low as the 40% rate of mortgage loans to GDP in neighbouring Latvia and Estonia. Overall Lithuanians are much less indebted than their Baltic neighbours.

The majority of home loans are taken in euros, and the average interest rate on new mortgage loans at the beginning of 2009 was 4.6%, which worked out to about 2.3% margin over euribor. While most analysts expect euribor to fall during 2009, the average margin will not.

Interest rates in the local currency, the litas, start at 11%, making them far less attractive. And while most analysts expect the Lithuanian currency peg to hold, making borrowing in euros a safe bet, even the smallest chance of a devaluation has made homebuyers scared of borrowing in euros.

Banks are still willing to lend up to 90% of the property value, especially if the loan is made on a new property where the bank is already the lender to the developer.

### Rents

2008 saw an average 10% decrease in apartment rents, after rising 15% in 2007. Although there is still great demand for residential property, and the inability of most people to get mortgage loans today forces them into the rental market increasing demand for rental units, rents have still failed to rise due to the overhanging supply in the market, especially of new apartments built and bought by investors with the intention to rent them out.

Additionally, the cost of maintaining a flat (from heating to electricity to maintenance) has risen by 26% in 2008, cutting into the net amount received by landlords.

Ober-Haus expects residential rents to now remain flat in 2009, as the overhang in the market starts to get taken up, supply drops and demand continues to increase for housing by people who have no access to mortgage loans.

The most popular units to rent are one and two room apartments at prices ranging from 700 to 1,500 litas (€200 to €430) per month. The number of rental contracts signed in more expensive apartments with rents exceeding €600 were down 10% in 2008. In this sector, it is very hard to find a long-term tenant, so the owners are forced to drop rents.

Fully equipped 65-75 sqm apartments in the centre or Old Town are offered at €500 to €1,000 per month, depending on location and quality. Individual homes are usually offered for rent at €1,000 to €3,000 per month however, the number of potential clients of this sector is very limited. The most expensive homes offered for rent are in Valakampiai, Antakalnis, and Zverynas districts, which is close to the centre, quiet, and surrounded by forests. A limited number of very prestigious houses can even exceed €4,000 per month.

### Legal Notes by Sorainen

Residential leases are regulated by Lithuanian law more strictly than commercial leases. Lithuanian legislation establishes specific rules related to the condition of leased residential premises, the right of family members to reside with the lessee, termination of the lease agreement, and eviction of the lessee. However, rents may be agreed freely. Institutional investors usually do not lease residential premises in the local market.

## Land

*The Liquidity of Land Parcels Has Reached the Lowest Point*

### Prices

Lithuanian land prices tumbled in 2008, just as they did throughout the region, as developers stopped developing, lenders stopped lending, and buyers stopped buying. As new project starts stopped, the price for land fell anywhere from 20-80% depending on location. Most land is now completely illiquid and cannot be sold for any price.

The greatest decrease in prices was seen in suburban land without planning (typically agricultural) intended to be rezoned for large-scale residential developments. Such plots have fallen by at least 70%, but even that figure is only a paper figure as no large plots of this kind were transacted at any price in the last half of 2008.

Plots in the city centre suitable for commercial development or luxury apartments dropped by 25% in 2008, to €600 to €2,200 per sqm of land, or roughly €450 to €900 per gross buildable square metre of commercial space.

Plots in the suburbs already zoned for residential apartment developments dropped by 40% in 2008 and now range from €100 to €300 per sqm, which works out to €80 to €250 per gross buildable square metre of residential space.

Plots for private homes dropped the least, falling 20% in 2008, to a range of €25 to €45 per sqm in the cheaper suburbs, to €70 to €100 per sqm in the more sought after suburbs of Riešė, Bajorai, Kalnėnai, Gulbinai.

### Supply

The supply of land in Vilnius in 2008 continued to grow. The current pessimistic moods on the real estate market and the difficult financial situation of project developers and individual investors led to the cancelling of most development plans. Therefore, the supply of various-purpose land has increased, which concerns agricultural land, fully prepared land plots for the development of various-purpose projects, and smaller land plots intended for the construction of detached houses.

Many developers with cash flow problems have lost their collateralised land to the bank that granted the loans. All the major commercial banks have expanded their bad loan departments -probably the only growth segment in banking today.

The number of seized properties will continue to rise, providing opportunities to those with cash on hand.

## Demand

The shrinking real estate market has made land the least liquid asset today, and are difficult to sell. There is no demand for plots to start commercial or residential developments, and banks nearly always refuse to finance land purchase, or the offered terms are so onerous as to make the buyer change his mind.

Greater activity is seen for smaller land parcels from 600 to 1200 sqm, intended for individual houses. With land and construction costs going down, today is a good time to start building a private house.

## Investment

No major land investment transactions were registered in Vilnius in 2008.

## News

As of 2008, the general plan of the Vilnius District has not been approved yet, although the draft plan is available.

One of the largest infrastructure projects - the Vilnius southern ring road - was opened at the end of 2008, the development cost reaching €78 million. The Vilnius southern ring road constitutes part of the international IXB transport corridor which connects Zirniu Street and the Lazdynu Bridge.

## 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 land beneath a building (e.g. ownership, lease right) must be transferred to buyers along with the building.

Investments by non-Lithuanian citizens are not restricted except direct acquisition of agricultural and forestry land to 1 May 2011.

# Legal

## Introduction

The real estate market in Lithuania is based on principles of private ownership and ownership immunity, prudence, fairness, justice, and protection of the rights of those legitimately acquiring real estate. The Lithuanian legal environment has proven to be tailored not only to prosperous economic times, but also to complicated market circumstances.

## Title to Real Estate, Register of Real Estate

Real estate and related rights are registered with the Real Estate Register. Title to real estate passes as of the moment the real estate is transferred. An agreement on acquisition of real estate is valid and binding on the parties irrespective of registration with the Real Estate Register. However, it may only be invoked against a third party after registration with the Real Estate Register.

Real estate must be registered with the public register in order to be transferred, mortgaged, or otherwise disposed of. Failure to register rights to real estate results in restrictions on invoking those rights against third parties. The purpose of the public register is to provide official information about registered real estate, its owners, the rights of owners and other persons to the real estate, and restrictions on those rights.

## Acquisition of Real Estate

**General**

A real estate transaction involves real estate registered with the Real Estate Register. Relevant information must appear correctly in the title transfer document, i.e. the unique number, area, purpose of use, address, description of the land plot where the building is located, location of the building on the land plot, and location of the premises under transfer in the building. These details are required for attestation by a notary, which is also required for a transaction to be valid.

Generally, the seller must transfer to the purchaser the title to the building, the right to the land plot occupied by the building and necessary for use of the building for its purpose.

If the seller owns the land plot on which the building stands, the buyer must receive transfer of ownership of the land plot, the right to lease or develop or otherwise use the land for theist proper purpose.

If the seller does not own the land plot on which the building stands, the seller may sell the building only with prior consent of the land owner, while the buyer must acquire the right to use the land on which the building stands under the same conditions as the seller. An 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**

Ordinarily, a letter of intent (LOI), heads of terms (HOT), or preliminary agreement details what the parties have to do before entering into the main agreement for acquisition of real estate, the main terms and conditions, and any liability for not entering into the main agreement.

The LOI, HOT, or preliminary agreement should be in writing. There is no legal requirement to notarise the LOI, HOT, or preliminary agreement.

**Change of Ownership**

Title to real estate passes as from the moment of transfer to the acquirer. The transfer must be recorded by a signed transfer-acceptance deed. This may be structured as a separate document or incorporated into the agreement on real estate acquisition.

**Legal structures of real estate investment transactions**

The Lithuanian legal environment has proven flexible in meeting investment practices introduced to the local market by foreign investors. Complex business structures are tailored to the needs of investors. These structures range from incorporation of a special purpose vehicle (SPV) to other contractual instruments.

Principal legal structures

The following are common in real estate investment (REI) transactions in the local market by foreign investors:

1) Share deal

The trend towards share deals in the market has grown strongly as an increasing number of SPVs meeting the criteria of institutional investors have been offered by developers. Acquisition of a target holding real estate may be performed either via an SPV incorporated in Lithuania or elsewhere by a foreign investor.

The share sale-purchase agreement need not be notarised or publicly registered, unlike an agreement on sale-purchase of real property.

Issues usually to be tackled while structuring the REI transaction as a share deal include, e.g.: target company history, employees, unnecessary assets, subsidiary operations, transferability of loan facilities, deferred taxes, and financial assistance.

2) Asset deal

Asset deals are still rather popular in the local market. Asset deals usually require a narrower scope of due diligence review than share deals, and are more tax-transparent.

An agreement on sale-purchase of real estate must be certified by a notary public. Transfer of title to real estate must also be registered with the public register. Notarization and registration increase transaction costs.

While structuring a transaction, the parties may also be required to perform particular procedures in order to obtain a permit for the transaction if the land where the target property stands is not owned by the seller of the target.

Another bottleneck of an asset deal is the statutory right of a tenant to terminate the tenancy agreement on change of ownership of the leased property. In practice, this issue is tackled by collecting estoppels from tenants.

Asset deals may involve recharacterization risk, i.e. a REI transaction structured as an asset deal may be recharacterized as a sale of business. As a result, investors may be exposed to additional risks, related to transaction validity and liability to creditors and employees of the former owner of the target.

3) Sale-leaseback
Sale-leaseback transactions have become more frequent over recent years, particularly in the industrial and office sectors.

The structure of a sale and leaseback transaction should ensure tying the sale of the property with a lease agreement. Various security instruments (e.g. guarantees, deposits) are commonly used in such REI transactions in order to secure the flow of sustainable income from the target and proper performance of long-term obligations of the parties.

4) Forward purchase
Projects under development have been more often structured as forward purchase transactions. In these cases the investor undertakes a forward commitment to purchase the property. The developer usually acts as a developer until completion of the project or may act as project developer under a development contract while title to the target property on construction goes directly to the investor.

These REI investment structures are rather complex, may involve particular elements of share and asset deals, and usually involve other arrangements related to project development (e.g. development agreements, escrow arrangements).

5) Joint venture
Joint ventures are quite commonly formed for project development purposes both by local developers and foreign investors.

In joint venture, various contractual instruments are used in order to define e.g. project goals, responsibilities of the parties, terms for profit-sharing between partners, terms related to project management, project exit mechanisms. Commonly the partners establish an SPV to develop the project. The internal relationship between the partners is usually agreed in a shareholder agreement and related documentation. Commonly, the scope of such transactions includes execution of asset management, project management, and property management agreements + other related transaction documentation.

**Other legal structures**
In addition to REI transaction structures discussed above, other structures are used, though not so commonly:
Portfolio deals. These facilitate acquisition of a large market share at a relatively lower cost and in a shorter time, and are usually arranged by foreign investors with high financial capability.
Initial public offering. This has not yet become a popular investment instrument in the local real estate market.
Public-private-partnership projects (PPP). These are not commonly exploited in the local market, due to involvement of the public sector, broad transaction scope, and specific areas where this legal structure could be used.

## Form of Agreements

Share transfer transactions must be in written form. Real estate sale-purchase agreements (asset transfer transactions) must be in written form and certified by a notary. Failure to notarise an asset transfer agreement makes it ineffective.

## Language Requirements

Transactions by Lithuanian legal and natural persons must be in Lithuanian, however, failure to do so does not make such transactions invalid.. Translations into one or more languages may be attached. Transactions with foreign natural and legal persons may be in a language acceptable for both contracting parties. However, all transactions to be confirmed by a notary must be in Lithuanian.

## Due Diligence

Legal due diligence of target real estate is strongly advisable before investment or disinvestment. From the perspective of both seller and buyer, due diligence forms a basis for contract negotiations, risk distribution, and verification of purchase price. Due diligence checks on e.g. ownership title, encumbrances, permitted land use, third party rights, public restrictions, lease agreements, agreements for supply of utility services.

## Pre-emption Rights

Pre-emption rights may exist on a statutory or contractual basis. For instance, a co-owner of real estate has a pre-emption right while selling a legal share of the real estate to third persons, with the exception of cases when the sale takes the form of a public auction. Additionally, the state has a pre-emption right to acquire land in state parks, and in ecological and other protection zones.
As a general principle, if the seller of private real estate fails to comply with the pre-emption right requirement, the person who had the pre-emption right may, within the statutory limitation, request the court to transfer to him the rights and obligations of the buyer of that real estate.

## Typical Purchase Price Arrangements

Purchase price payment arrangements may differ according to agreement between contracting parties. If no credit or third party financing is involved, purchase price payment is usually divided into two parts: part-payment is made on the day of signing a preliminary agreement or signing and confirming the real estate transaction before the notary, with the remaining part paid after certain conditions precedent are met, e.g. signing the transfer-acceptance deed. Title to real estate may be transferred irrespective of settlement between seller and buyer. In order to secure the interests of seller or buyer, title to real estate may be transferred before or after payment of the entire real estate purchase price.

## Related Costs

Agreements concluded before a notary and registration of title with the Real Estate Register involve a notarial fee and state duty. Purchasing real estate may also incur further costs depending on services used, e.g.: brokerage and valuation fees, bank fees, due diligence fees, costs of environmental and technical reviews.

## Concentration Control

Structuring a real estate investment transaction should take into account merger control regulation, since applicable thresholds are rather low and a real estate investment transaction might require notification of concentration.

An anticipated concentration must be notified to the Lithuanian Competition Council, whose consent to a concentration is required where the combined total income of the undertakings concerned (received from the Lithuanian market) is over ~ EUR 8,688,600 for the financial year preceding the concentration and the aggregate income of each of at least two undertakings concerned (received from the Lithuanian market) is over ~ EUR 1,448,100 for the financial year preceding concentration.

## Restrictions

**Restrictions on Acquiring Real Estate**
Buildings and other constructions may be acquired by Lithuanian or foreign natural or legal persons without restrictions.
Under the Lithuanian Constitution, the Lithuanian state is the exclusive owner of the subsoil, internal waters, forests, parks, roads, historical, archaeological, and cultural objects of national significance. In other cases Lithuanian citizens and legal persons with offices registered in Lithuania may acquire title to land and forest unrestrictedly.
Foreign legal and natural persons may acquire title to land if they comply with European and Transatlantic criteria. Foreign legal entities are assumed to comply with these criteria, if they are established in:
• Member States of the European Union or states 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 parties to the North Atlantic Treaty Organisation (NATO), or the European Economic Area Agreement (EEA).

Foreign natural persons are assumed to comply with European and Transatlantic criteria, if they are:
• Citizens or permanent residents of any of the states specified above; and/or
• Permanent residents of Lithuania holding no Lithuanian citizenship.
However, even foreign natural and legal persons complying with the European and Transatlantic criteria may not acquire agricultural and forestry land for a transitional period of 7 years as from 1st May 2004, except:
• Foreign natural persons who permanently reside and are engaged in agricultural business in Lithuania for at least 3 years; and
• Foreign legal persons and other foreign organizations with established representative or branch offices in Lithuania.

**Public Restrictions on Use of Real Estate**
Real estate must be used in accordance with its purpose, following zoning and planning requirements, conditions of encumbrances (e.g. easements, protection zones). Further, the law establishes specific requirements on the use of real estate objects of cultural heritage. For instance, the owner or manager of an object of cultural heritage must e.g. promptly eliminate defects discovered, and protect structures against adverse environmental impact.
Transfer of title or rights of management of properties registered as cultural heritage objects requires one month's advance

notice to the heritage protection authority. Within this period, the authority must verify whether the condition of such property corresponds to the condition specified in the certificate of immovable cultural property. A transferor of such property may be held liable if it appears that the condition established at the time of verification does not correspond to the condition specified in the certificate of the immovable cultural property.

## Property Management

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

## Lease Agreements

**General**
General terms and conditions of lease agreements are regulated by the Civil Code. However, parties to lease agreements may freely agree on most aspects. In order to secure the interests of a natural person as tenant, residential leases are regulated more strictly than commercial leases by setting specific rules related to the condition of leased residential premises, the right of family members to live with the tenant, termination of 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. Under Lithuanian law, the tenant may terminate the lease agreement following change of real estate owner.

**Duration and Expiry of Lease Agreement**
Lease agreements may be for a fixed or indefinite term. The term is agreed by the parties, but the maximum term in any case is one hundred years. If the term is not determined, the lease agreement is taken to be for an indefinite term. If the tenant continues to use leased property for more than ten days after expiry of the term and the owner does not object, the lease agreement is taken to be for an indefinite term.
Generally, either party may terminate a lease for an indefinite term by giving three months prior notice, unless the parties agree on another notification period. A tenant who has duly performed obligations under the lease agreement has a right of first refusal to renew the lease agreement on its expiry.

**Lease Payment and Accessory Expenses (Utilities and Service Charge)**
Rent payments for a lease of commercial premises are subject to agreement by both parties. Generally, the tenant pays the rent monthly in advance. Utility services, such as electricity, heating, water, are charged additionally according to the meters or proportionately to the area of the leased premises if individual meters are not installed. The tenant is also obligated to compensate expenses of the owner for maintaining the leased premises. Guarantee, deposit or other similar securities ensuring payment of rent and costs may also be required.
As to leases of residential premises, the law explicitly states that an owner may not demand payment of rent in advance, with the exception of the rental for the first month. Rent must be paid monthly for the current month not later than by the 20th calendar day of the next month.

## Real Estate Funds

Novel investment possibilities are introduced to the market by new legislation as of 1 March 2008. It became possible to establish real estate collective investment undertakings (both closed-end and open-end) in Lithuania.

Generally, both retail and professional investors may invest in real estate collective investment undertakings.

As this investment vehicle is a novelty in the local market, some procedural and taxation issues related to acquisition, development, and disposal of real estate are not yet clearly resolved. In practice, these uncertainties are usually tackled by structuring investment vehicles and investments themselves.

## Planning Requirements and Construction of Buildings

**Planning**
Approval of detailed plans lies within the competence of local authorities. As a rule, detailed plans are established for city areas and rural municipality areas where construction is intended. A new detailed plan must be approved in case of change of purpose of the land. Establishing detailed plans involves evaluating the results of detailed planning, as well as public hearings and discussions. The process of approving detailed plans 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.

Construction must comply with building norms set by legal acts. Construction works must be in line with the design documentation of the building. The contractor, the architect, and the technical supervisor of the construction are liable for collapse of the object or defects, if the object collapses, or defects are discovered within 5 years, or 10 years in case of hidden structural elements (e.g. internal structure, pipes) and 20 years in case of intentionally concealed defects. These time-limits begin on the day of handing over the result of the work.

Construction may be carried out only based on a building design drafted by a professional architect or engineer and approved by the local supervisory authority. Building design documentation must comply with the relevant detailed plan, if it exists, and meet official building norms.

In order to begin construction, a building permit should be issued by the State Territorial Planning and Construction Inspectorate. The validity period is stated in the permit but may not exceed ten years.

After completion of construction, the state authorities inspect the building to check whether it 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 as fit for use. A building may not be used without this occupancy permit.

## Insolvency and restructuring

If a company is unable to cover its liabilities, then bankruptcy or restructuring proceedings may ensue.

Restructuring proceedings may be run if realistically the company may overcome its temporary financial problems. Restructuring of the company may not exceed 5 years (4+1 year). Company restructuring is a tool that allows creditors to restructure their claims and provides better opportunities for the company to survive. The operations of the company's administrative institutions are not suspended during restructuring proceedings. During restructuring proceedings, creditors are ranked with first priority given to claims secured by mortgaged/pledged property.

Generally, if the company is insolvent bankruptcy proceedings may be commenced. The operations of the company's administrative institutions are suspended and management is performed by the insolvency administrator. Declaration of bankruptcy triggers suspension of accumulation of loan interest, interest set by law, and contractual penalties, and late payment interest. Creditors are ranked, with first priority given to claims secured by mortgaged/pledged property.

# Taxes

## Purchase

**VAT** – The purchase of any new building or apartment is subject to 19% VAT. The building is considered as new for a period of 24 months from the date it was put into use or materially improved. Old buildings are exempt from VAT with an option for taxation in case the customer is a VAT registered taxable person. In case the option to tax is used, it must be maintained for at least 24 months.
The purchase of plots of land generally is VAT exempt except if land is with new buildings or for construction purposes. Tax payers have an option to sell land with VAT under the same conditions as mentioned above (customer is a VAT registered taxable person).

**Fees** – Notary fees depend on the value of the transaction, and are calculated as 0.45% of the real estate value, but not less than approx. € 29 (100 litas) and not more than approx. € 5,800 (20,000 litas). If a few transactions are confirmed by one notary action, the total notary fee may not exceed €14,500 (50,000 litas).

**Broker fees** – The broker's fee is typically 3% of transaction value.

## Rents

**VAT** – Although the rent of real estate is considered to be a VAT exempt supply, owners of commercial property have the option to charge VAT on rent, for example, if they wish to recoup any VAT paid for development of the property, provided the customer is a VAT registered taxable person. Once the owner chooses to charge VAT on rent, such option must be maintained for at least 24 months for all analogous transactions.

**Corporate Income Tax** – Final profit after all costs is subject to standard 20% corporate income tax. Buildings and improvements are subject to tax depreciation.

**Withholding Tax** – Income from the lease of property immovable by nature located in Lithuania is subject to withholding tax at the rate of 20%, if this income is paid to non-resident legal entities. Such income paid to individuals is subject to withholding tax at the rate of 15%.

**Personal Income Tax** – Rents collected by individuals are subject to personal income tax at the rate of 15%. In addition, Lithuanian residents must pay 6% health insurance contributions on the income from rent.
Alternatively, rents to individuals may be subject to a low one-off yearly tax under a special permit system.

## Sale

**Corporate Income Tax** – Companies which sell real estate book the capital gains as profit and pay standard corporate income tax at the current rate which is 20%. 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.

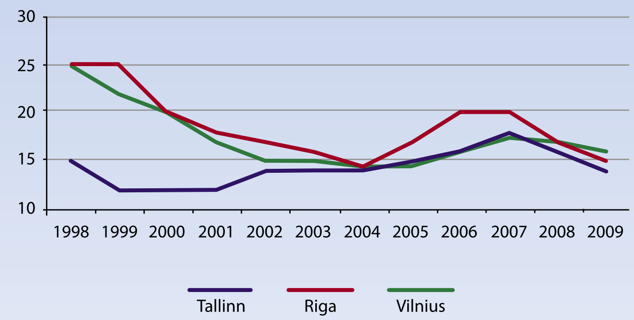
**Withholding Tax** – Income from the sale or other transfer into ownership of property immovable by nature located in Lithuania is subject to withholding tax at the rate of 20%, if this income is paid to non-resident legal entities. Provided the income from the sale or other transfer into ownership of property immovable by nature located in Lithuania is paid to individuals, such income is subject to 15% withholding tax. However, a foreign company or an individual who received income from the sale or other transfer into ownership of property immovable by nature located in Lithuania may recalculate the withholding tax paid for the above income so that only the difference between the sales price and the acquisition price would be subject to income tax.

**Personal Income Tax** – Capital gains earned by private persons on the sale of property (except for residential premises) are not taxable if that real estate was owned for at least 3 years. In case of transfer of residential premises, the income is not taxable provided that the domicile has been declared in those residential premises for at least 2 years or when less than 2 years - when the income from the sale is used (within one year) to obtain other residential premises where the domicile will be declared. Otherwise, the capital gains earned by private persons on the sale of property are subject to personal income tax at the rate of 15%. In addition, Lithuanian residents must pay health insurance contributions at the rate of 6%.

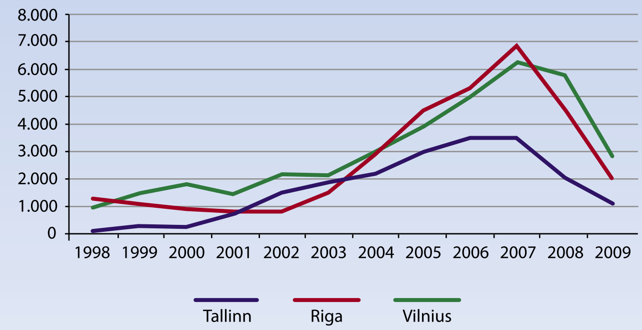
## Real Estate Tax

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 %, depending on the decision of the municipality where the building is located. Exemptions apply to individuals for residential premises and certain other personal property. Depending on the type and purpose of buildings, the tax base is assessed either based on fair market value or the recoverable value (costs) method. If the taxpayer disagrees with the assessment, he may get a valuation done and challenge the assessment.
Land is subject to 1.5 % Land Tax. The tax base (typically, the average market value determined by the State Enterprise Centre of Registers) and tax payable is calculated and reported to the taxpayer by the tax authorities.

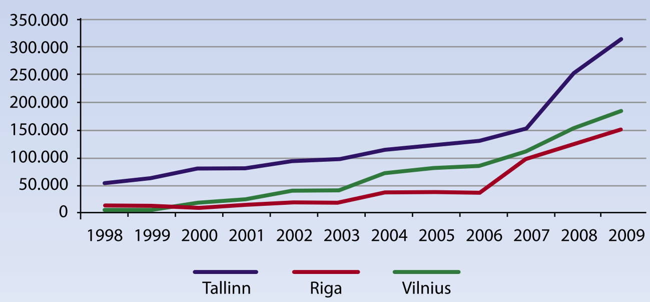
Avg class A office rents (EUR)



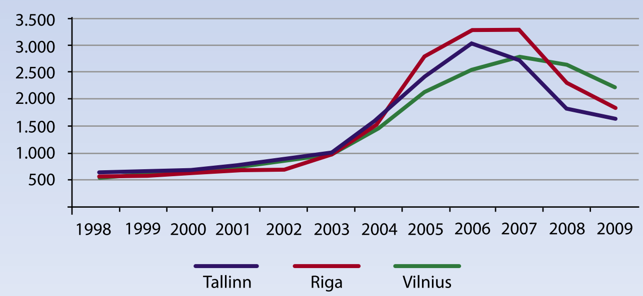

Completed residential units



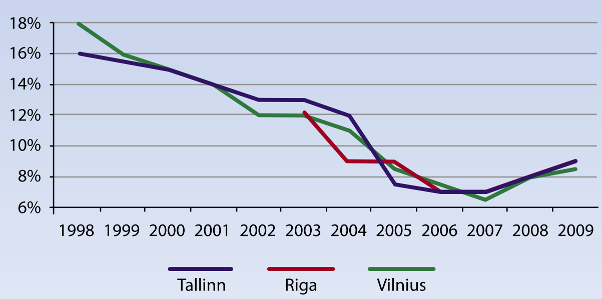

Total class A office space (sqm)



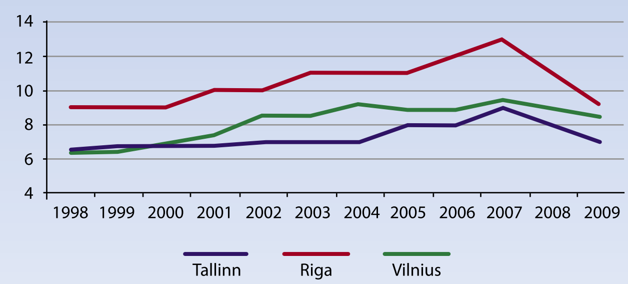

Average city centre residential prices (EUR/sqm)



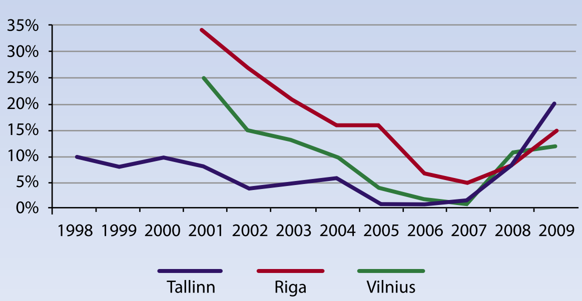

Class A office investment yields



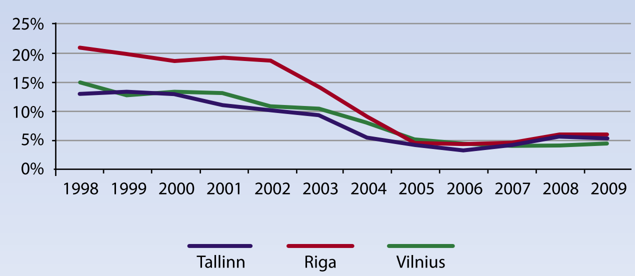

Average residential rents (EUR/sqm/month)



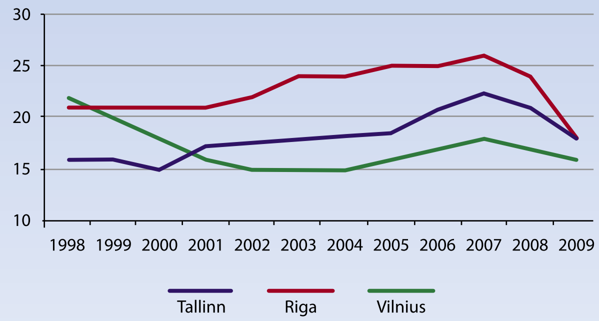

Class A office vacancy rates



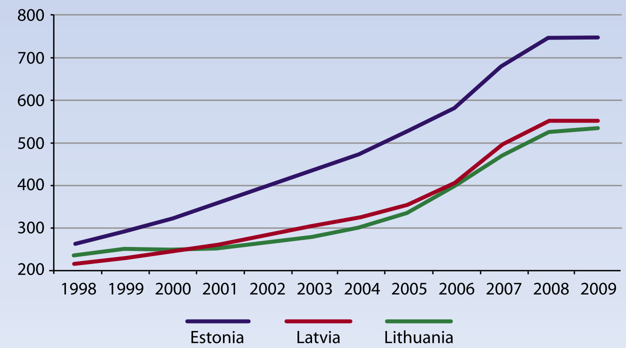

Residential investment yields



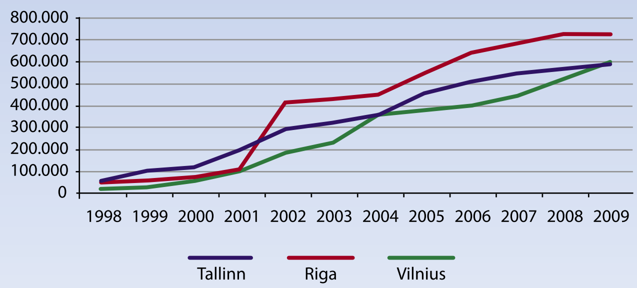
Avg mall rents (EUR)



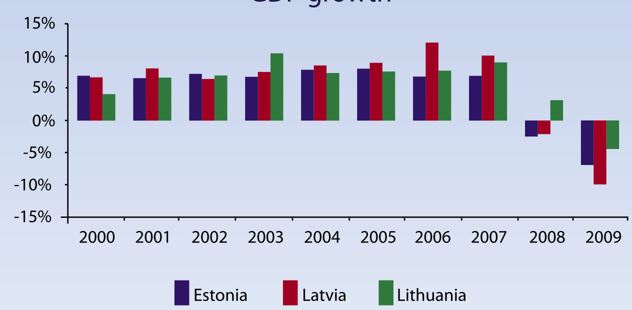

Avg salary per month (EUR)



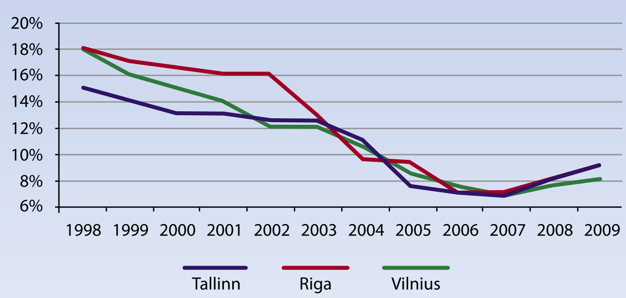

Total mall space (sqm)



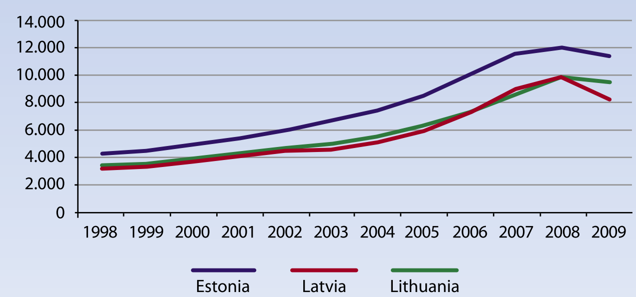

GDP growth



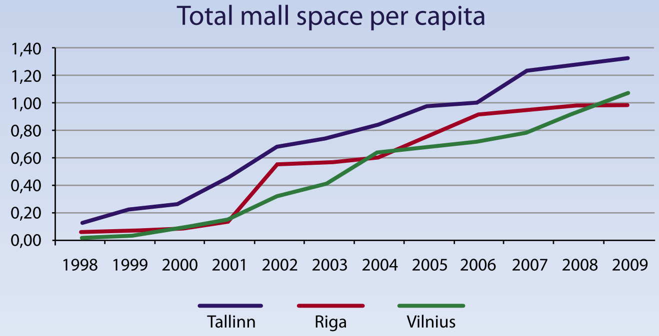

Retail investment yields



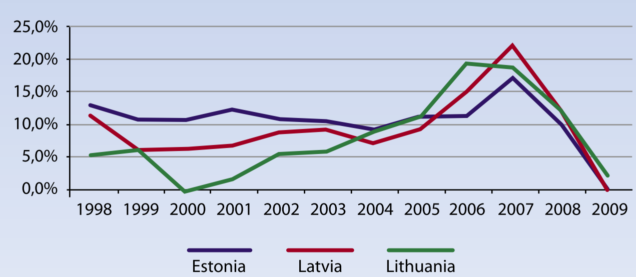

GDP per capita (EUR)




Total mall space per capita




Avg salary growth

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