

BALTIC PROPERTY OUTLOOK

2020-2021

W A L L E S S

Luminor

NEWSEC

Business centre "Uptown Park"
in Vilnius

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Moody office in Vilnius
Credit: Leonas Garbačas

BALTIC ECONOMIC OUTLOOK

THE BALTIC ECONOMIES HAVE JOINED THE NORDIC LEAGUE

The United Nations classified the Baltic States as Northern European countries back in 2017. Three years later, the Baltic States have proved their right to the title by demonstrating Nordic-style resilience to the Covid-19 recession. Indeed, the Baltic economies, like the other Nordic economies, were among the least affected in the EU. The European Commission forecasts that the EU economy will shrink by 7.4% in 2020, but the Nordic and Baltic economies will contract by a mere 3.8% and 3.3%, respectively. Hence, unlike the 2008-2009 economic crisis when Baltic economies were among the hardest hit in the EU, this time the economic contraction will be among the lowest in the EU and similar to that in the Nordic countries. The Baltic economies underwent severe adjustments of external and internal balances in the aftermath of the 2008-2009 global economic crisis, which increased their resilience to any external or internal adverse shocks. Moreover, the economies' structure has changed, with rapid expansion of high value-added service and high-tech manufacturing (machinery, electronics, chemicals and pharma) constituting an increasingly larger share of exports. At the same time, dependency on Russia and other CIS countries significantly decreased after the Russian economic crisis of 2014-2015, which motivated Baltic companies to

GDP forecast table (annual change, %) Source: Luminor

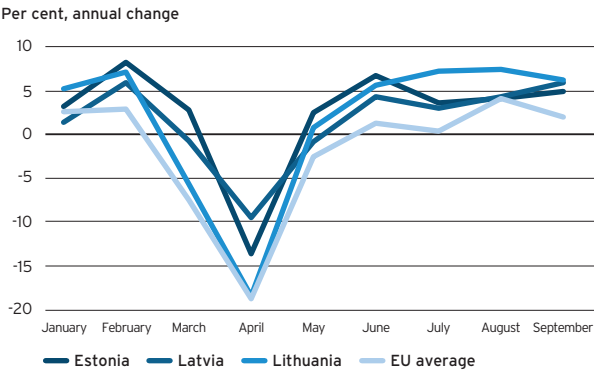
	2018	2019	2020	2021	2022
Estonia	4.8	4.3	-4.0	3.7	4.8
Latvia	4.3	2.2	-4.3	3.2	5.3
Lithuania	3.6	3.9	-1.7	2.7	4.5

strengthen their focus on Scandinavian and Western European markets. Finally, rigorous macro-prudential policies have helped avoid real estate price bubbles and thus increased resilience against the Covid-19 recession.

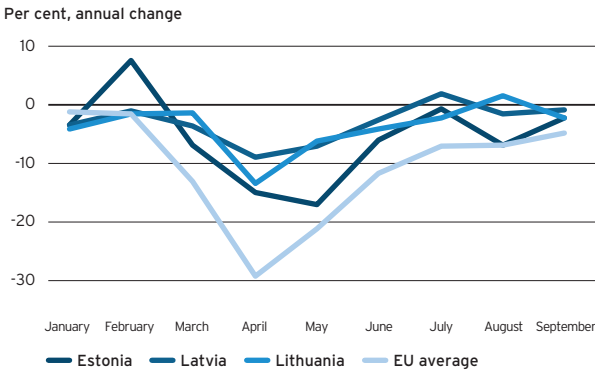
“V-SHAPED” RECOVERY IN THE BALTICS
Retail trade and manufacturing production data indicate a “V-shaped” economic recovery in all three Baltic States, i.e. a sharp but short drop followed by a robust and balanced recovery. The second wave of the Covid-19 pandemic will temporarily slow economic activity at the end of 2020 and possibly the beginning of 2021, but will have a smaller negative effect on economic activity compared to the first wave due to less strict lockdowns and fading Covid-19 pandemic fears. Moreover, the Baltic economies will get a boost from ongoing economic stimulus and a record-high influx of EU funds. In other words, pandemics come and go, but economic stimulus stays, hence we expect

economic growth to accelerate to 3.2% in 2021 and 4.9% in 2022. Open and small, the Baltic economies remain exposed to the risks which could negatively affect the EU recovery. The biggest risk by far is an uneven multi-speed “K-shaped” recovery, which may increase the European North-South economic and political divide. The existing threat of the Covid-19 pandemic should not be disregarded either as it will take some time for mass vaccination to be implemented. Hence, the activity of some sectors, such as international travel and leisure activities, will remain depressed for some time to come. Domestic challenges still include elevated unemployment levels and uneven sectoral recovery, which could take years to resolve. Yet, at the same time, there are great opportunities coming with a record-high influx of EU money, which, if invested wisely, could facilitate economic transformation towards more digital and greener economies.

Retail trade dynamics in 2020 Source: Luminor



Manufacturing production dynamics in 2020 Source: Luminor



THE LITHUANIAN ECONOMIC OUTLOOK

SPECTACULAR RESILIENCE TO COVID-19 CRISIS

The Lithuanian economy has demonstrated spectacular resilience to the Covid-19 crisis. During the first three quarters of the year GDP declined by a mere 0.8% and is forecast to drop by as little as 1.7% in 2020 as a whole, which is likely to be the lowest GDP drop in the EU. Lithuania's post-crisis recovery has been not only fast, but also balanced, with both domestic consumption and exports contributing positively. Retail trade and manufacturing production data indicate that economic recovery in Lithuania is "V-shaped", i.e. a sharp but short drop followed by robust and balanced recovery.

Retail trade figures have been particularly strong, running well (6-7%) above last year's levels throughout the summer and well into the autumn. Indeed, it could be said to be a "C-shaped" recover, for "Christmas", since retail activity in the summer was reminiscent of the pre-Christmas peak period. Manufacturing output is somewhat lagging but is also gradually recovering and has almost reached pre-crisis levels. Given that major export partners (Scandinavian countries, Germany and Poland) are doing relatively well, one could expect manufacturing production to reach pre-crisis levels in the first half of 2021.

Interesting trends in Lithuanian economy in 2020:

LITHUANIA BECAME THE LEADING EXPORTER OF ICT SERVICES IN THE BALTICS

Lithuanian exports of ICT services increased by an impressive 50% in the first half of 2020, making it the number one ICT service exporter in the Baltics. Lithuania also became the leading exporter of financial services thanks to its fast-growing Fintech service industry. More generally, Lithuanian high-tech

Pandemics come and go, but economic stimulus remains. Hence, there is an increasing risk of the economy overheating in 2021 and 2022. In some cases even building concepts, and if possible, to reconsider new office development plans outside the central part of the city.

service exports (ICT, financial, insurance, intellectual property and other business services) have more than tripled during in last five years, going from EUR 800 million to EUR 2.5 billion euros annually. Exports of high-tech services have also been fuelled by the emergence of Kaunas as a regional centre for high-tech services.

LITHUANIA IS EXPERIENCING RECORD-HIGH IMMIGRATION

Unlike in the 2008-2009 financial crisis, Lithuania has avoided an emigration wave and instead is experiencing record-high immigration, fuelled both by returning Lithuanian nationals and continued immigration from third countries (primarily Ukraine and Belarus). The majority of immigrants settle in the largest cities of Lithuania, resulting in rapid population growth. The population of Vilnius in 2020 (mid-year, incl.

surrounding municipality) increased by 10,700, which makes it among the fastest growing cities in the EU. Other major Lithuanian cities have also experienced population growth, with Kaunas, Klaipeda and Siauliai increasing by 5,400, 2,500 and 1,000, respectively, in 2020.

LITHUANIAN CONSUMER CONFIDENCE

Lithuanian consumer confidence remains among the highest in the EU, which supports domestic consumption and the housing market recovery. Lithuanian consumer confidence in October 2020 was the third-highest in the EU (just behind Sweden and Denmark and ahead of Finland and Germany), which is a big contrast to the 2009 crisis. Consumer confidence is supported by continued wage growth, a stabilizing labour market and generous government support.

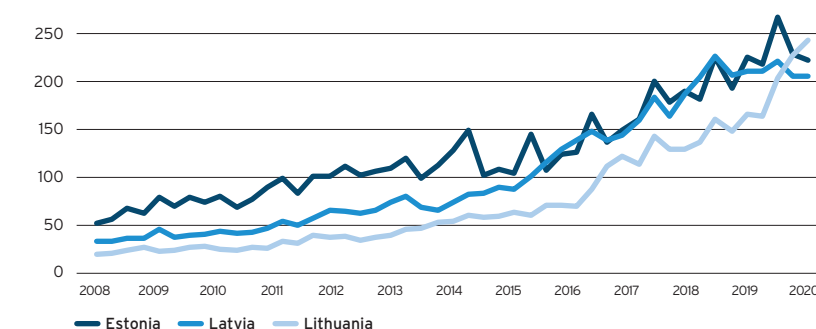


LITHUANIA'S BUDGET DEFICIT IS EXPECTED TO BE THE HIGHEST AMONG THE BALTIC STATES

Lithuania is forecast to have a budget deficit of 8.8% in 2020 and 6.0% in 2021. That would increase the public debt level to 51% of GDP by 2022, which would still, however, be among the lowest in the EU. The budget deficit has increased faster in Lithuania than in the other Baltic countries due to generous handouts by the government in 2020 and increased public investment expenditure expected in 2021.

Exports of ICT Services

mEUR, quarterly



THE LITHUANIAN PROPERTY MARKET

RESULTS SHATTER PESSIMISTIC ECONOMIC FORECASTS

Despite the circumstances, there has been no slowdown on the Lithuanian real estate market. Developers have continued to complete planned projects and proceed with new construction. The rental market was also more active than expected in the first half of the year. The most notable office lease transactions were signed by Western Union for 15,000 sqm, Telia for

7,000 sqm and Devbridge for 5,000 sqm of office space. These were the biggest office signings in Vilnius and in all the Baltic countries in 2020, consisting of active expansion of service centres and IT companies that are already operating on the market. Transaction volume remained quite high in H1 2020. Total investment in Lithuania made up one-third of the total

Baltic transaction volume, at just over EUR 115 million. This is only 9% less than in the same period of 2019. Another EUR 43 million of investment volume was added in Q3 2020. The office segment was the most active, accounting for nearly 85% of total volume in Lithuania. The total annual volume of investment transactions in the Baltic region, including Lithuania, will decrease in 2020. As most investment transactions tend to be concluded in the second half of the year, the reduced activity may reduce total investments to a level below EUR 700 million in the Baltic region, and close to EUR 200 million in Lithuania.

Total investment in Lithuania in three quarters of 2020, at just over EUR 160 million, accounted for one-third of the total Baltic transaction volume.



Moody office in Vilnius
Credit: Leonas Garbačas



VINTED office in Vilnius
Credit: VINTED

Interesting trends on the Lithuanian investment market in 2020:

TWO LARGE OFFICE INVESTMENT TRANSACTIONS

At the beginning of 2020, Lithuania-based Lords LB Asset Management purchased the IBC Business Centre in Vilnius, with a total area of 22,700 sqm, from INVIL Real Estate for EUR 33 million. Meanwhile, following the lifting of the lockdown restrictions, Zenith AM acquired the second phase of the Park Town business centre from the Lithuanian developer Darnu Group. The first stage was acquired in 2018 and the second was closed after the completion of construction and achievement of full occupancy. High-quality prime offices are on investors' wish lists and the sale of the Park Town is one of the first post-lockdown transactions on the Baltic real estate investment market.

NEWLY CONSTRUCTED OFFICES AND LOGISTICS CENTRES REMAIN ATTRACTIVE TO INVESTORS

As a result of the pandemic, banks are hesitant and financing volumes have fallen sharply. Therefore, equity investors are in the most favourable position. Such investors typically buy so-called core or prime products, that is, new construction or very good offices in a city's central business district or old town. The logistics segment is attractive as well and is seen as second on the list of assets most in demand.



OFFICE SEGMENT YIELDS REMAIN UNAFFECTED

So far, sale prices in the most attractive office segment have not been significantly affected. Yields have remained just below 6% for prime office properties and stand at 7.25% for the retail and industrial segment.

LITHUANIA REMAINS A STABLE INVESTMENT LOCATION

Internationally, Lithuania is considered a reliable country. With many countries downgraded in the face of the pandemic, the international credit rating agency Fitch Ratings affirmed Lithuania's A long-term debt rating in January 2020 and kept a stable outlook. Government debt had been relatively stable until the economic downturn caused by Covid-19. Now it is likely to reach 50% of GDP shortly. Nevertheless, Lithuania continues to borrow on both domestic and foreign markets at the lowest pricing levels in history.

OFFICE CONSTRUCTION AT RECORD LEVELS

Upon the completion of all planned 2020 projects, space in the Vilnius office market will increase by 115,300 sqm or 16%, and the vacancy rate may grow to 7-10%. 2020 will set a record year for new office space supply in a single year - by comparison, over the last five years, an average of 65,000 sqm of new space was completed per year. In any case, increased supply on the office market will create new opportunities for both tenants and investors.

LITHUANIA. LEGAL.

REAL ESTATE INVESTMENTS AT A GLANCE

MAIN RESTRICTIONS

Generally there are no restrictions (except for some special purpose territories and limitation on agricultural and forest land) to acquire land in Lithuania if a foreign investor is established in countries which are (i) not part of a political, military, economic or other unions or alliances of states established on the basis of the former Union of Soviet Socialist Republics and (ii) members of at least one of the EU / NATO / EEA or OECD countries. Reliable title registration system ensures smooth tracking of title records.

MAIN CLEARANCES

Merger clearance may be required. Investors (both foreign and local) are obliged to notify of and/or may be asked to pass particular screening procedures by the Commission for Coordination of Security of Objects Important to the National Security of Lithuania. Such screening is normally not needed in major cases of real estate cashflow investments. AML/KYC is necessary if a local bank is used.

MAIN ACQUISITION COSTS

Notary cost for certification of the sale-purchase agreement – up to €13,000 net of VAT. For a share deal, notary-certification can be avoided, though €3,000 net of VAT

will be due to the securities intermediary for share accounting services. Notary costs for certification of a mortgage bond and for real estate registration are insignificant.

MAIN TAXES

No real estate transaction taxes or stamp duties (except for notary fees and title registration which are insignificant). 15% corporate income tax with flexible depreciation/amortisation rules. Generous participation exemption on share deals (for packages bigger than 10% held for at least 2 years). No withholding tax on share income of non-residents, applies for shares in real estate rich companies. Flexible possibilities to settle input VAT in a cashless manner (transfer of VAT payment duty from the seller).

NEW LAW: CORPORATE TAX EXEMPTION FOR LARGE-SCALE PROJECTS

Large-scale projects that meet the requirements of investing €20 million CAPEX (in Vilnius €30 million) or €100 million and creating 150 new full-time work-places (in Vilnius 200), where income is generated mainly from manufacturing or data centre operations, may enjoy 0% corporate income tax for up to 20 years.

Investing in such projects streamlines processes in acquiring rights to land, zoning and planning, migration, and administrative procedures. Subject to EU state aid regulation.

NEW LAW: MUNICIPALITY INFRASTRUCTURE DEVELOPMENT LAW WAS ADOPTED

The zones in municipalities shall be designed as priority and non-priority infrastructure development zones. The city shall invest in the development of infrastructure in the priority zones. And developers shall pay certain infrastructure-development fees for using such infrastructure. Meanwhile, in the non-priority zones infrastructure shall be constructed by developers. The first developer shall be compensated by other developers that wish to use such infrastructure in the zone. Specific rates to be established by the municipalities.

NEW LAW: UNDERWAY ENACTMENT ON DEVELOPMENT ON STATE-OWNED LAND

For many years construction on state-owned land has been exposed to legal uncertainty. The legislature shall soon establish regulation on when the use of state-land may be converted into a use suitable for development subject to payment of an extra “conversion” fee. Also, construction on state-owned land will become subject to a fee. On 11 November 2020 the fee estimate was 5-50% of the average land market value. This law is still a draft, yet very widely discussed.

The Government has ambitious agenda in modernizing the real estate development regulation and supporting the investments.



Vilnius, Lithuania



VINTED office in Vilnius
Credit: VINTED

THE LATVIAN ECONOMIC OUTLOOK

A LITTLE PATIENCE, PLEASE

Latvia can be proud of how it has overcome the challenges of 2020. The decline of the Latvian economy has been less than the European average, and the performance of some industries, given the circumstances, is truly spectacular. At the same time, however, it must be acknowledged that the other Baltic states have developed faster. There is a risk that Latvia will continue to lag behind, but that is possible to avoid. Hence, it is of the utmost importance for Latvia to effectively use the EU Recovery and Sustainability Plan and Latvia's own public funding as well as the money for the next EU financial period to facilitate economic transformation towards more

digital and greener economies.

For several months now, assessments of the possible trajectory of economic development in the near future have been relatively stable, and it is hoped that this stability will continue. We forecast that the Latvian economy will shrink by 4.3% in 2020 followed by moderate growth of 3.2% in 2021 and quite impressive growth of 5.3% in 2022. Our forecast for 2022 is relatively optimistic, though we consider it justified in view of the unique opportunities of the Next Generation EU fund, RailBaltica funding, the global economic recovery from the Covid-19 pandemic crisis, and

the possibly emergence of the housing market from a long period of stagnation. True, we expected the latter more than once before, but the timing for a housing market recovery could not be better than 2021-2022.

Interesting trends in the Latvian economy in 2020:

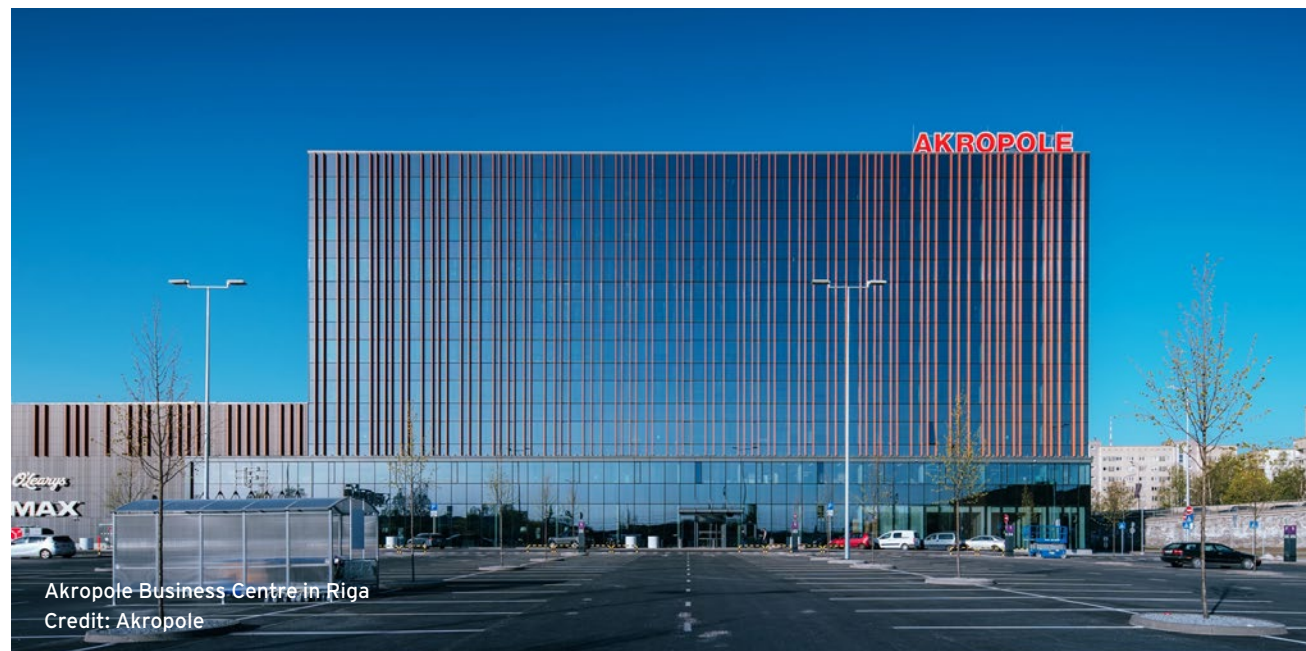
THE HOUSING LOAN TO GDP RATIO IN LATVIA IS THE LOWEST IN THE EUROZONE

As a result of ongoing deleveraging, the housing loan to GDP ratio in Latvia fell from 40% to 15% during the last decade and is now the lowest in the eurozone. The main reason for the drop is very low activity in the housing market, which, unlike in neighbouring Estonia and Lithuania, has failed to recover in recent years. However, it is expected that a post-crisis boom in economic activity will eventually reinvigorate it.

LATVIAN EXPORTS OF GOODS REMAIN SURPRISINGLY STRONG

Latvian exports of goods have

Efforts must be made to keep up with Estonia and Lithuania. The two big opportunities for Latvia are a public sector investment boom and improvement in the governance of municipalities.



demonstrated great resilience to the Covid-19 pandemic crisis and managed to recover fast. In January-September 2020, exports of goods were already higher than in the same period of 2019. Specifically, the Latvian food industry benefited from increased demand for non-perishable food products, the wood industry benefited from increased demand for furniture and other household items, and the chemical and electronics industries also achieved double-digit growth. Metalworking was a weak spot, with producers of car parts suffering the most.

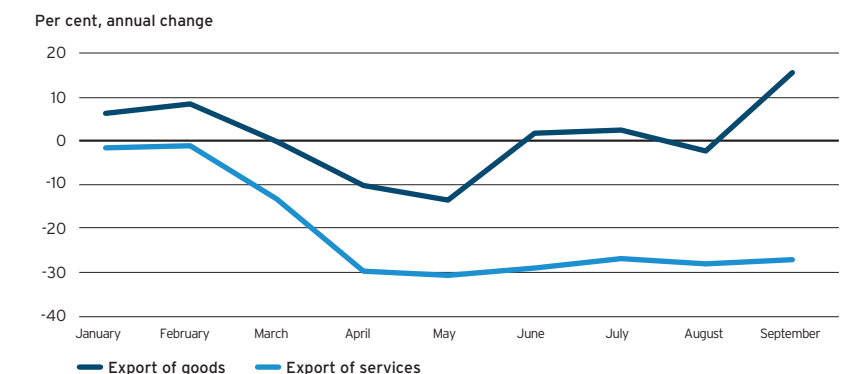
LATVIAN EXPORTS OF SERVICES STRUGGLE TO RECOVER

Exports of ITC and other high value added services continue remarkably well during the pandemic, but tourism and

the transport sector dragged the overall figures down. Latvia is still feeling the effects of the diversion of Russian transit cargo away from Latvian ports.

Exports Dynamics in Latvia 2020

Source: Luminor



THE LATVIAN PROPERTY MARKET

LATVIA'S PROPERTY MARKET MOVES FULL STEAM AHEAD

In terms of commercial real estate, the Latvian property development market remains active. New properties across the office and retail segments will create new supply for tenants and potential investors. Investment market volume in H1 has been relatively slow, however. The transaction market saw limited activity in Q2, and the lion's share of investment in the first half-year was completed at the beginning of 2020, with a total invested amount of just over EUR 40 million. Among others, EfTEN Capital acquired one office building and two logistics centres in the first

quarter. The second half of the year has been more active, as expected, with close to EUR 70 million total volume in Q3 2020. Interest is expected to grow in the retail and logistics sectors. Total investment

volume in 2020 may be close to the previous year's level, with a volume of over EUR 230 million expected.

Interest is expected to grow in the retail and logistics segments, with investment volume seen exceeding EUR 230 million this year.



Multifunctional project "Z-Towers" in Riga
Credit: Z-Towers



Shopping centre "Galerija Centrs" in Riga
Credit: Galerija Centrs

Interesting trends on the Latvian investment market in 2020:

INSTITUTIONAL INVESTORS' TRUST IN THE LATVIAN REAL ESTATE MARKET RETURNS

In early 2020, AirBaltic's HQ, with a total area of 6,560 sqm, was purchased by EfTEN Capital. In late 2019, the Vienna Insurance Group's VIG Fund acquired three office buildings with a total leasable area of 20,000 sqm in Riga from the Baltic RE Group. That company's entry onto the market was the first purchase in the Riga office sector by a Western European investor and one of the biggest investments in Latvian commercial property in several years. One of the latest largest deals in 2020 was Lords LB's acquisition of Citadele's HQ, with a leasable area of over 17,000 sqm, from Citadele Bank. At the end of Q3 2020, EfTEN Capital signed an agreement to acquire the 50,000-sqm size Bergi Logistics Centre from Lords LB. Interest remains strong and more such deals could be completed in the next year.

NEW PROJECTS ON THE LATVIAN OFFICE MARKET

Experienced Baltic property developers are continuing with project development and construction works. A 14% growth in supply is forecast by the end of 2022. Over 115,000 sqm of space is being brought to market as at least seven new office projects are set to be completed one after another. The Riga office market is seeing changes it has not seen in the last decade, a time when new office projects have been rare and the new office space market has stagnated. Intense development of new projects boosted leasable space by 6% in the first half of this

year and by nearly 11% in 2019. The biggest office projects of the first half of 2020 included the Z-Towers and Origo One business centres, offering tenants 25,000 sqm and 11,500 sqm of class A office space, respectively. It is forecasted that new projects will be put on pause next year, since the office space that is on offer will need to be absorbed, and completion of new projects is set for 2022.

RETAIL MARKET DEVELOPMENT IN RIGA REMAINS ACTIVE

The new retail part of the Origo shopping centre was opened in the city centre and total reconstruction of the old part is scheduled at the end of 2020. With the opening of the new Origo One

-4.3%
GDP growth expected in 2020

EUR 230 MILLION
Total investment volume expected in 2020

14 %
growth in office supply is forecast until the end of 2022

business centre and expansion of the retail area, Linstow is adhering to its mixed urban use development strategy. Two more new shopping centres with formats not yet seen on the market are set to open in 2020: recently opened Via Jurmala Outlet Village and the Saga family-focused shopping and entertainment centre, which is in development next to the Riga IKEA. Riga's retail market is continuing to grow, with strong availability of quality investment projects.

YIELD CORRECTIONS TO COME?

After years of compression, the prime Riga office yield stands at 6.10%, with retail and logistics yields at 7.25%. Whether yield corrections will be seen in the market will depend on forthcoming transactions. The office segment remains the least impacted by the Covid-19 pandemic, and as the supply of modern office space grows, the market will remain attractive to both local investment funds and international players seeking new opportunities.

SMALL SCALE RETAIL PROPERTIES REMAIN ATTRACTIVE IN TURBULENT TIMES

A shopping centre in Liepaja, Latvia, was sold by Lords LB to a private investor. The shopping centre has 25 tenants, the largest of which is the Rimi retail chain and the Jysk household goods store, with a total leasable area of approximately 6,300 sqm. The transaction was completed despite Covid-19, which serves as proof of high motivation among all parties and the resilience of the retail sector. A transaction of such a scale in a secondary city underlines the continued liquidity of high-quality, well-located assets.

LATVIA. LEGAL.

REAL ESTATE INVESTMENTS AT A GLANCE

MAIN RESTRICTIONS

Generally no restrictions (except for some special purpose territories and limitation on agricultural land) to acquire land in Latvia if a foreign investor is established in the EU, the EEA or Switzerland. Other cases should be checked case by case, yet regulation is liberal. A reliable title registration system ensures smooth tracking of roots of title.

MAIN CLEARANCES

Merger clearance may be required. The local municipality has the right of first refusal if the real estate under sale is located in its administrative territory. Such right is rarely used. Yet this influences the transaction timeline. AML/KYC is necessary if a local bank is used.

MAIN ACQUISITION COSTS

Registration of mortgage: 0.1% of loan value. Real estate title registration cost: 2% of the value of the property. No significant registration cost in case of share deals.

MAIN TAXES

No real estate transaction taxes (except for a 2% title registration fee and 1% fee for contribution in kind of real estate to share capital). 20% corporate income tax (except for withholding). 3% withholding tax for non-residents on alienation of real estate in Latvia / real estate rich

companies. No participation exemptions for shares of investment funds or alternative investment funds or for shares more than 50% of the asset value of which consists of real estate located in Latvia.

NEW LAW: "GREEN CORRIDOR" INTRODUCED IN RIGA

Very recently a "green corridor" was introduced by the Riga city construction authority in order to develop a more attractive environment for investments and real estate development in the capital city of Latvia and allow for faster coordination of construction initiatives. The construction authority has significantly facilitated the coordination procedure for the construction of new Group 3 buildings (the largest and most complicated types of buildings, e.g. buildings with at least five floors; a public building designated for at least 100 visitors; a storage building with total area exceeding 2000m²) and Group 2 apartment buildings with more than 100 apartments. Developers will be able to obtain a construction permit in

significantly shorter time than foreseen by regulatory enactments.

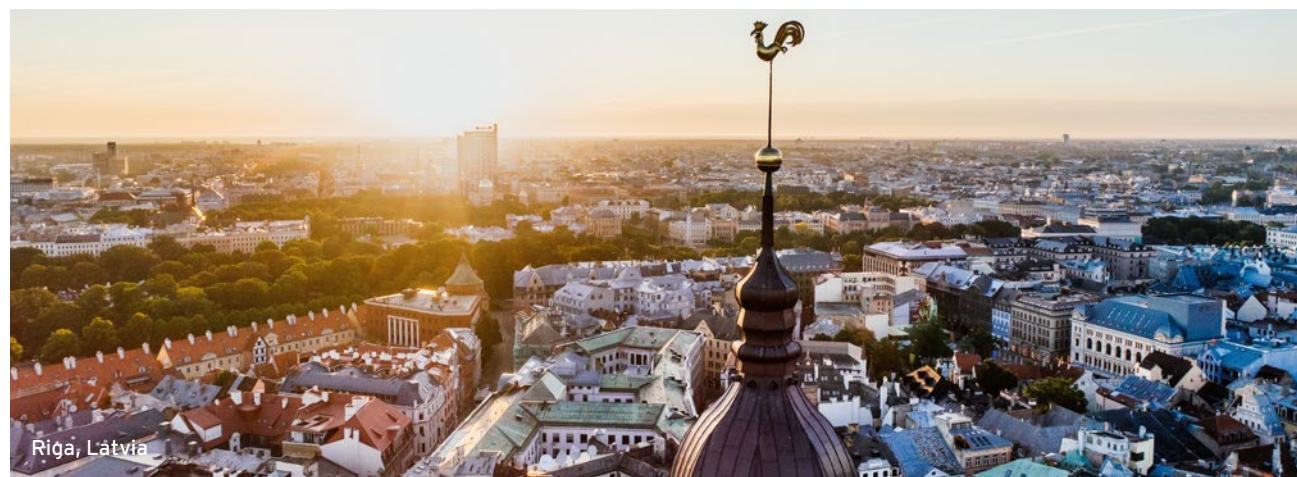
NEW LAW: DIGITAL REGISTRATION OF COMPLETED CONSTRUCTION.

Recently initiated changes (subject to adoption by the parliament) will simplify the process of registration of a commissioned building or a newly constructed building in the Land Registry. It will be possible to transfer the data necessary for such registration digitally from the Construction Information System to the Land Registry without any certification by a notary public (which is currently needed).

NEW LAW: RENT OF RESIDENTIAL PREMISES

An entirely new law regarding rent of residential premises is currently in the final stage of adoption in the parliament. The new law will foresee broader protection of landlords' interests. This legislation is important for resi-for-lease and mixed-use projects.

Riga city construction authority introduces green corridor as a measure for facilitating coordination of construction processes to support real estate developers.



Riga, Latvia



Multifunctional project "Z-Towers" in Riga
Credit: Z-Towers

THE ESTONIAN ECONOMIC OUTLOOK

STRONG ECONOMIC RECOVERY DRIVEN BY CONSUMERS

Like in the period of the euro debt crisis in 2012-2013, the Estonian economy and other northern EU economies again showed greater stability and flexibility at the height of the Covid-19 pandemic. The impact of the coronavirus on Estonia's open economy was not as strong as feared – economic decline in Estonia is forecast to be roughly half the EU average. The quick recovery of the Estonian economy has been primarily driven by extremely strong consumption this time. It is an outstanding achievement that retail sales in Estonia as of May this year already exceeded last year's level. Export and investment growth remain in negative territory, but strong support measures for the economy, fading fear of the Covid-19 pandemic and newly emerging foreign demand mean recovery of the economy, now driven by export and industry, will become more broad-based when bouncing back next year and in the future.

Estonia will see a turnaround from this year's contraction of 4.0% to strong growth of 3.7% in 2021. The speed of the economic recovery will be fast in the first stage but remain uneven across economic sectors for the time being. Some economic sectors are facing "a new normal", which means a permanent change in the number of jobs at least during the forecast period. The distancing requirements established to restrict the spread of Covid-19 have boosted digitalisation of the economy and technological transformations, the impact of which on business models and the labour market will last for years. The best examples of this are the e-commerce boom and the rapid growth of the data communication traffic in the digital economy. Estonia has the opportunity to steer smart development by investing such large sums in the smart economy.

Interesting trends in the Estonian economy in 2020:

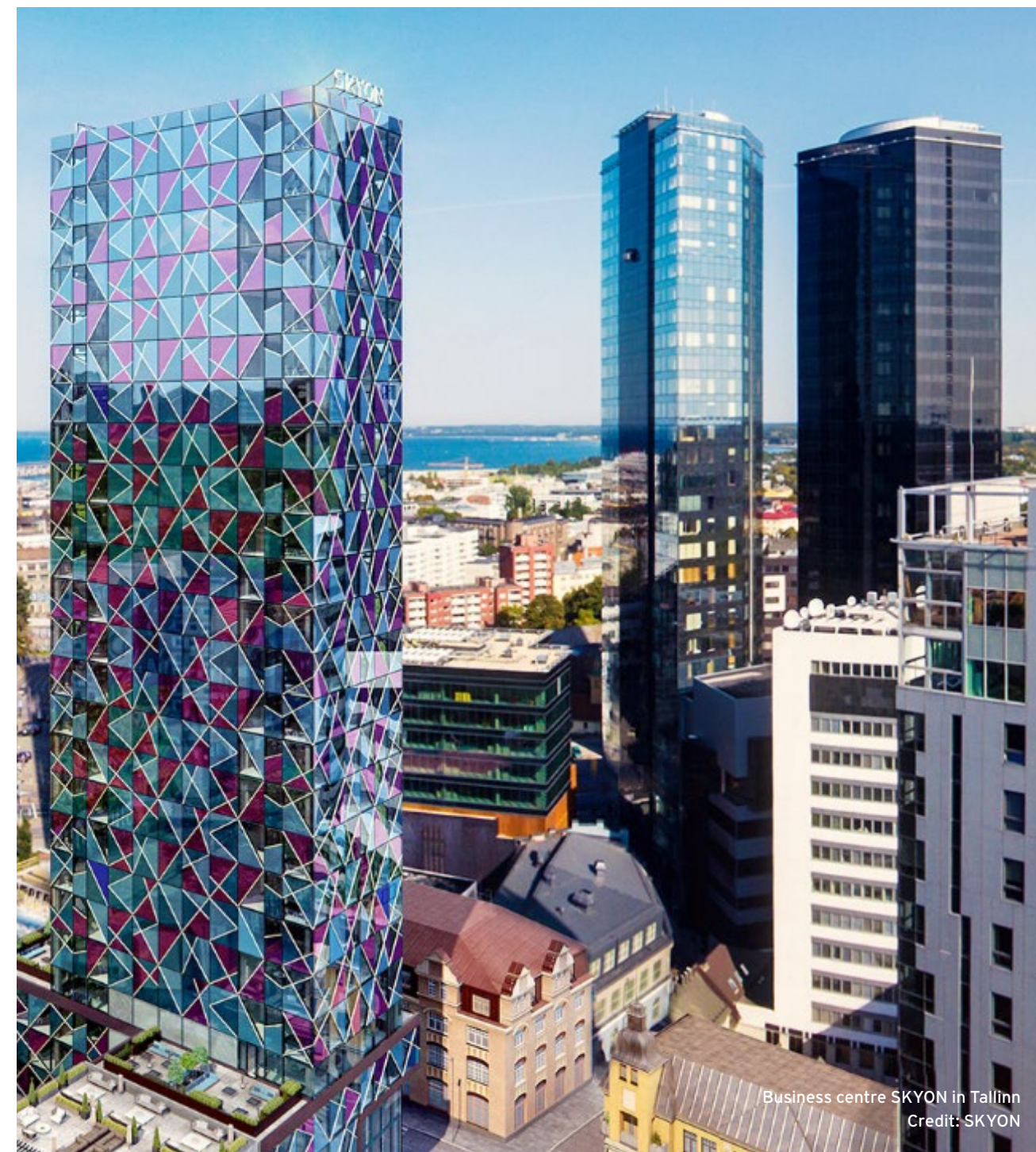
ESTONIAN ECONOMIC RECOVERY HAS BEEN DRIVEN BY DOMESTIC CONSUMPTION

Retail sales already exceeded last year's level in May, with continued robust growth during the summer as well as in September and October. During the first three quarters of the year, retail sales increased as much as 2.6% y/y despite the free-fall of foreign tourism. Retail trade experienced a V-shaped growth bounce, which cannot be said for the whole economy.

UNPRECEDENTED BOOM IN ESTONIAN E-COMMERCE AT THE HEIGHT OF THE CRISIS

Turnover increased by more than 40% (y/y) on average in March and April, compared to the EU average of 32%. The surge in e-commerce activity reflects an acceleration of the digitalisation trend, which allows people to shop without leaving their homes. E-commerce is just the tip of the iceberg for what new technology has to offer potentially as we merge 5G with the power of AI, big data analysis and quantum computing. Estonian e-solutions allowed the economy to function as much as possible during the quarantine period (even real-estate transactions were digitally signed, though in limited number).

As in the period of the euro debt crisis, Estonia, like other northern EU economies, demonstrated higher stability and flexibility at the height of the Covid-19 pandemic.

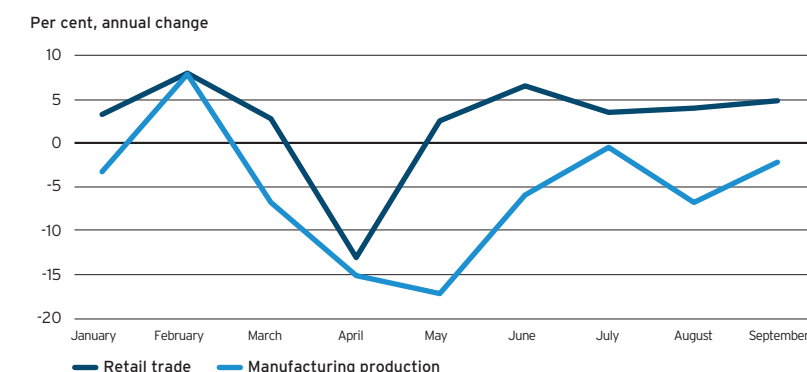


RECOVERY OF EXPORTS WILL TAKE TIME AS THE GLOBAL ECONOMY AND INVESTMENT APPETITE SUFFERS FROM UNCERTAINTY AND SPARE CAPACITY

Estonian exports have dropped relatively more than those of the other Baltic countries due to higher reliance on exports of travel services and capital goods. Hence, it will take more time for exports to recover to pre-crisis levels. That is expected to take place in mid-2021.

Retail Trade and Manufacturing Production Growth in Estonia

Source: Luminor



THE ESTONIAN PROPERTY MARKET

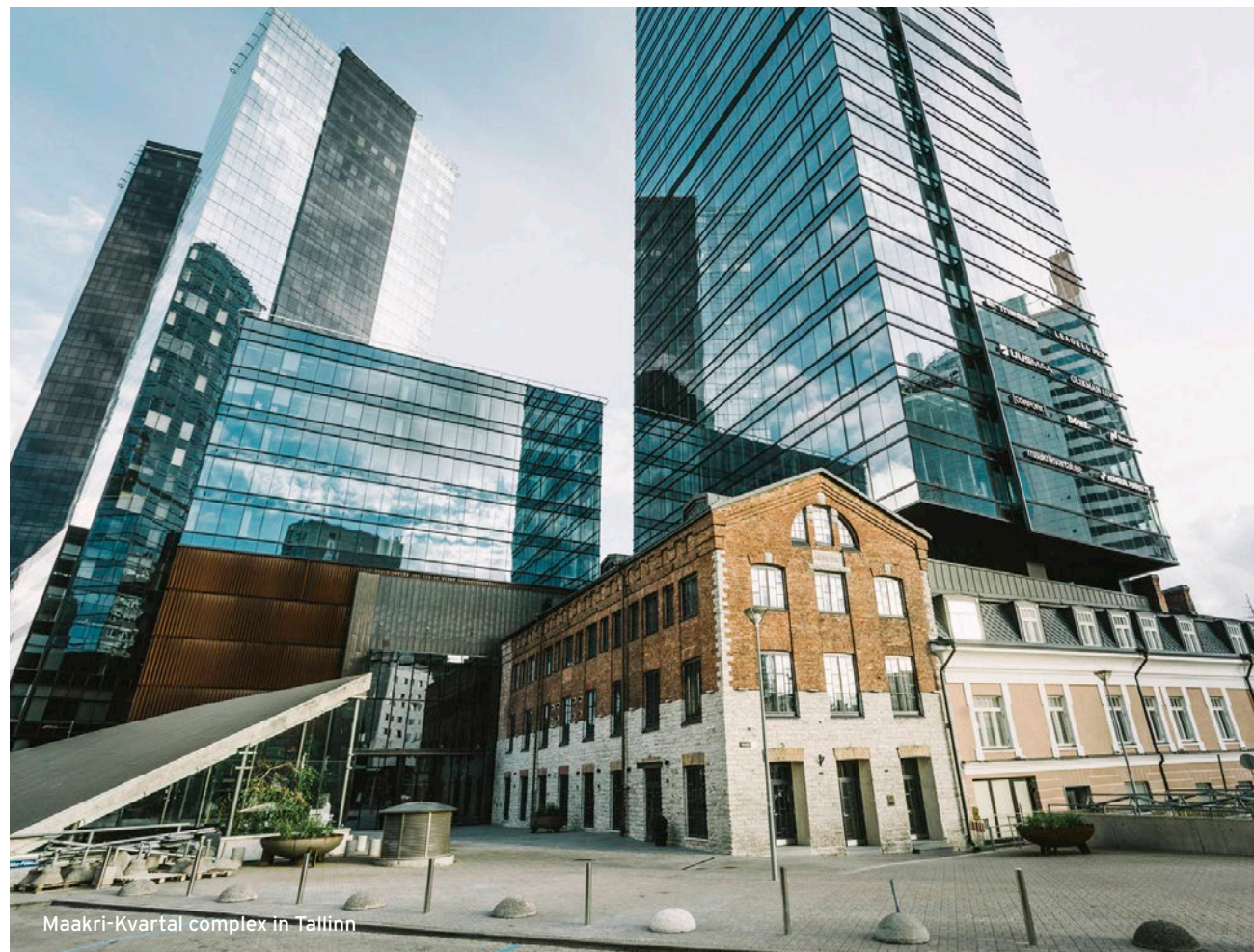
ESTONIA REMAINS ATTRACTIVE TO INVESTORS EVEN IN TIMES OF UNCERTAINTY

The commercial real estate market remains very strong in Estonia. Total office supply increased by 21,300 sqm, or almost 3%, to 827,300 sqm in 2019. Further modern office space is under development, although vacancy rates are slowly increasing. At least 100,000 sqm of new supply may arrive in 2020 and the coming year. The office segment in Tallinn remains the largest and most balanced among the Baltic capitals. Prime office yields feel pressure from the market uncertainty and remain compressed at 6.0%, while retail and industrial yields are at 7.25% in both segments. The first half of the year saw a transaction volume of nearly EUR 200 million, including

two record-breaking deals on the Tallinn market, one of which was the largest investment transaction in the market's history. In H1, more than 55% of the total Baltic volume was transacted in Estonia,

and investment volume is expected to more than double in 2020 compared to 2019, reaching EUR 220 million.

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Maakri-Kvartal complex in Tallinn



"Tallink" office building in Tallinn
Credit: Tallink

Interesting trends on the Estonian investment property market in 2020:

RESIDENTIAL PORTFOLIO IN TALLINN FINDS NEW OWNERS

At the beginning of 2020, Estonia's capital of Tallinn witnessed the largest investment transaction in the country's history. US private equity firm LCN Capital Partners sold a portfolio of about 1,200 apartments for EUR 144 million to ICG, which is listed in the United Kingdom. The apartments, which are rented to the municipality of Tallinn, were purchased by LCN in 2015. They comprise 108,000 sqm across nine blocks and were completed in three stages, starting in 2006.

THE LARGEST OFFICE INVESTMENT TRANSACTION ON RECORD

At the end of May 2020, Sweden-based East Capital acquired the SEB HQ office building from the Laurus fund, which is managed by Partners Group and Northern Horizon. The transaction's value was EUR 45.75 million. The building has a total leasable area of approx. 16,000 sqm. The property is the first acquisition of the East Capital Real Estate IV fund, which has a target size of EUR 400-500 million of assets under management.

-4 %
GDP growth expected in 2020

EUR 220 MILLION
Total investment volume expected in 2020

100,000 sqm
of new office space seen on the Tallinn office market in 2020 and 2021

PENSION FUNDS SLOWED DOWN

A few years ago, the state eased investment restrictions for pension funds. As a result, investments in Estonia have almost doubled. Altogether more than EUR 600 million has been placed in the Estonian economy, accounting for 15% of

the total assets of pension funds. Among Estonian pension funds, the LHV funds are the most active in terms of investing in Estonia. LHV have been continually increasing their investments in the Estonian real estate market, and especially in residential real estate. As of July 2020, Estonia stopped state payments into the second pillar of the pension system until September 2021, primarily as a result of the economic impact of the Covid-19 pandemic. Some EUR 350 million is to be reimbursed in 2023-2024.

RETAIL STRUGGLES

Retail sales in the first half-year and especially the second quarter of 2020 in Estonia were affected by the pandemic. As the Covid-19 virus spread, shopping centres were closed for a period of almost two months. All shopping centres saw a significant decrease in footfall and turnover, but that was expected to be temporary, with a gradual recovery already underway. The delicate situation on Tallinn's shopping centre market accelerated the reorganization plans of the T1 Mall owner company. Despite uncertainty on the market, Tallinn is expecting a further increase in retail supply. The Porto Franco shopping centre is under development as part of a mixed-use project. Completion, expected in 2021, will add 32,000 sqm of retail space.

ESTONIA. LEGAL.

REAL ESTATE INVESTMENTS AT A GLANCE

MAIN RESTRICTIONS

Generally no restrictions, except that the acquisition of certain immovables may be restricted or forbidden for foreign persons (natural or legal) on grounds of the public interest (concerns immovables used as profit yielding land, mostly agricultural/forestry) or for reasons of national security/defence (concerns certain strategic areas). Reliable title registration system ensures smooth tracking of roots of title.

MAIN CLEARANCES

Merger clearance may be required. AML/KYC, if a local bank is used (especially relevant in share deals where the shares mostly are held with intermediaries and the depository is located in Estonia, thus a local bank and security account may be required).

MAIN ACQUISITION COSTS (NET OF VAT)

Notary cost for the certification of real estate transactions depends on the value of the transaction, may be up to 0.7% of the value. Real estate title registration cost is insignificant.

MAIN TAXES

No real estate transaction tax (except for insignificant stamp duties and notary fees based on the value of transaction). 20% corporate income tax for resident

companies on distribution of profits. Capital gains of non-resident companies from the sale of Estonian real estate property, rental income, etc., is subject to a 20% income tax. No participation exemption on share deals by resident companies. Non-residents' capital gains from share deals are taxable if the target is real estate in Estonia and the non-resident owns at least a 10% stake in the target entity at the time of the transaction.

NEW LAW: REMOTE AUTHENTICATION

The law amendments enabling the remote authentication of notarial transactions were adopted already in 2019 and by a lucky coincidence entered into force just before the pandemic in February 2020. That enables performing notarial acts and authenticating agreements remotely. Remote performance of notarial acts requires a video connection to be established, which a person can do from anywhere, including their homes. Remote notarial authentication has the same legal force as in-person authentication.

With the help of digital signatures, this means that all real estate transactions can be made without the need for physical contact of the other party or a public notary.

NEW LAW: OK TO PLAN LESS PARKING SPACES IN TALLINN CITY CENTER

In mid-September 2020, the Tallinn City Council adopted new rules on the required number of parking spaces to be planned for residential projects in the city. The new rules are driven by a need to reduce traffic in and through the city centre. Accordingly, the new rules would reduce the required number of parking spaces per apartment in the centre. At the same time, the rules would require more parking spaces to be planned for the intermediate zone between the city centre and suburbs. This is explained by the need to reduce parking on the city streets in that zone, which has been common around some new residential areas. The new rules also push for more underground or closed parking spaces.

Digital signatures and remote authentication enable to execute Estonian real estate transactions from anywhere in the world.



Tallinn, Estonia



Business centre SKYON in Tallinn
Credit: SKYON

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