FEST – FOREST NEWS

ESTONIAN AND LATVIAN FOREST INVESTMENT MANAGEMENT

Estonian property news from

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Following the windblow of 9 January 2005, the timber market has returned to pre-windblow prices except for the conifer pulpwood. This market remains difficult. For example, in Estonia, the price for pulpwood in a standing sale was 300 kr/m3 before the windblow, compared with 100kr/m3 now. We have been concentrating on crops with little pulpwood content in the hope that prices would improve, but there is little sign of that.

The bulk of the pulpwood is exported to Finland and Sweden as there is very little processing capacity in the Baltics. Recently a new pulpmill for aspen has started production in Estonia (www.estoniancell.ee) and this should have a significant effect on the market for aspen. At present, aspen is often left standing on clear-fell sites because, if felled, a few thousand new plants appear from root-suckers. However, with a hungry local aspen mill, this may be manageable. The mill requires 400 000m3 of aspen logs per annum. RKM, the Estonian state forest company is contracted to supply 60%.

One of the reasons for the low conifer pulp prices may be the continued harvesting of windblow in Sweden. Trees which still had some of their roots in the ground remained fresh enough for harvesting this season. However, that should have come to an end now, as any remaining windblow will deteriorate too much this summer.

Not surprisingly, Sweden exported the largest volume of timber ever last year. Sawmills must be concerned about supplies now the windblow is cleared.

There remains a considerable shortage of sawlogs for the Baltic mills and imports from Russia are more expensive than local timber. There is also an increasing capacity to mill timber in Russia and much of that timber goes to China. However, the spring is traditionally a time for clearing timber yards and essential mill maintenance. Harvesting should start up again after the summer breaks.

It is also a time for nesting birds and harvesting is much reduced to give nature a chance.

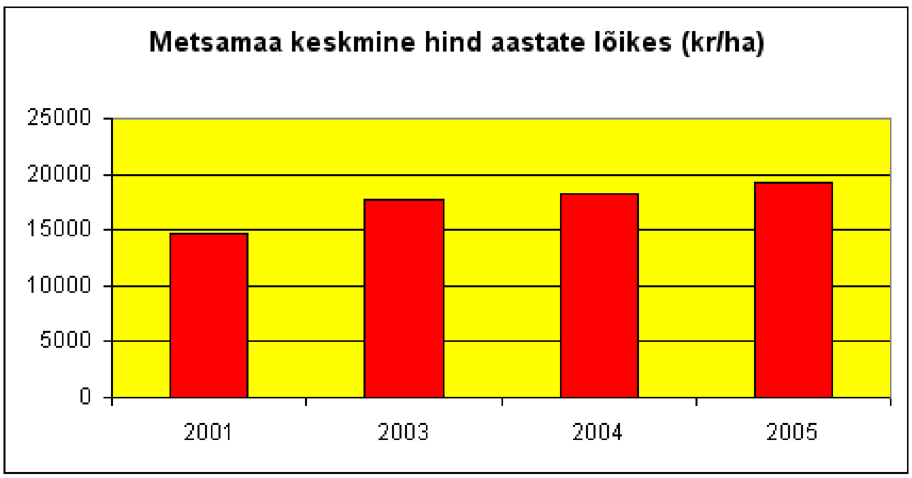
The May issue of Timber Trades Journal had some interesting statistics. Timber production in Estonia is dropping from a high of 12.7m m3 in 2000 to 8.5 m3 in 2004. (Some suggest that it may be as low as 5m m3 in 2006. *ed*)

Forest properties

In Estonia, we have been offered quite a lot of forests for sale and we have successfully bid for some larger groups on behalf of clients. We have bought our first forests in Saaremaa, the popular tourist island off the west coast.

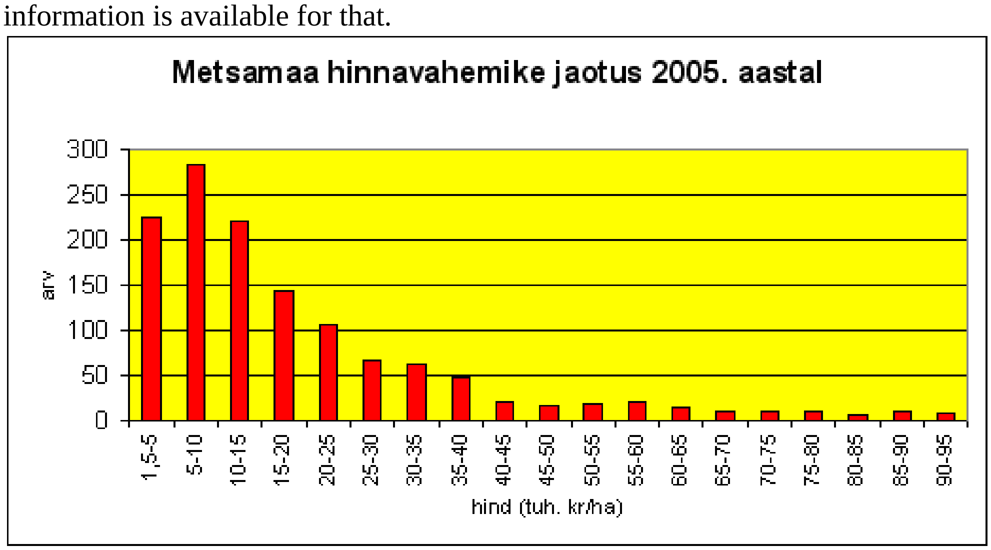
Information from the Estonian Land Board for 2005

A total of 1 294 forests, with an area of 13 149 ha were sold for 235 million kr (€15m).
The average was 10ha for 18 100kr/ha (€1 160/ha).



Average prices per hectare in kr (€1 = 15.6kr)

The trend, however, is increasingly for properties to have more bare ground or younger trees. The increase in value per cubic metre for forests sold is much higher, but no independent information is available for that.



Number of forests sold per price class ('000 kr)

In Latvia, we are finding it very difficult to find properties which have a reasonable rate of return. Prices are 30% or more than in Estonia. It is a mystery to us why this is. There has been very aggressive purchasing from abroad, but this would not explain such a price increase, as harvesting companies cannot purchase at these values and it is quite difficult to borrow from banks on the strength of woodlands.

The statistics for Latvia tell a confusing story. No information is available on the amount of land sold, nor the average size.

	In Lats		In Euros	
	2004	2005	2004	2005
No of deals	2 379	1 637	2 379	1 637
min value/ha	31	31	45	45
max value/ha	6585	6800	9614	9928
average value/ha	638	689	931	1005

Thus, the average price per hectare is about 10% lower than Estonia, which contradicts our experience.

In Latvia, income from timber is no longer taxed now, as it is in the UK. However, foreign investors cannot benefit from this, as only Latvian entities can own forests. Foreigners can only achieve this by owning a Latvian company and then corporation tax applies (15%). The tax change means, that sawmills and timber merchants who play by the rules and do not buy timber with cash in the black-market are no longer disadvantaged.

Forest ownership of large blocks in Latvia is dominated by overseas investors. The total holdings are still relatively small, compared with those of many European countries. We have no recent figures from Estonia, but the largest single ownership (22 000 hectares) is still in Estonian hands.

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The biggest Latvian Forest land owners - companies, 2005

Areas in hectares

Company name	Owner	Total	Forest	Agriculture	Water	bought in 2005
Myrtillus	USA Phemus Corporation	14475	11161	2320	151	4600
Fragaria	USA Phemus Corporation	6187	4742	926	104	2300
Ruda	Swedish Rattviks Sagverks AB	5591	3769	1395	80	0
Metsaliitto Latvija	Finnish comp.(SILVA)	4492	3673	437	79	500
Foran Real Estate	Swedish Korsna AB, Foran	4500	3534	628	66	0
Kursa MRU	Latvian	3014	2348	398	47	300
Latvijas meži	Latvian	2694	1952	520	36	
Danamežs	Randan, Danish	2200	1836	188	25	70
Latvijas Finieris	Latvian	3437	1582	1457	81	1582
Skogssallskapet Latvia	Swedish Skogssallskapet AB	5160	1432	2865	140	-200
EV Mežs	Danish, Ejendomsselskabet Viborg	2669	1309	1160	26	180
RPK Grupa	Latvian	1972	1218	582	39	
Saldus mežrūpnieks	Latvian	1635	1214	2731	26	350
Projektu konsultaciju tehnologijas	unkonwn offshore comp.	5747	1200	3700	94	140
Ošukalns	Latvian	1596	1177	270	33	100
Rundaiņi	Swedish	3307	1066	1634	42	
Mežinvests	Palsgaard, Danish	1432	1033	302	10	20
Natre	USA, New century Holding & Netherland Nocturnal Holding B.V.	1250	992	182	20	
Egļu mežnieciba	Latvian	1132	991	46	15	0
AMG Eksports	Latvian	1362	927	334	20	400
		73852	47156	22075	1133	10342

Better regulation

In the UK, a new drive for “Better Regulation” is being promoted to reduce bureaucracy. A few EU member states are following the lead from the Netherlands and hope to influence decisions at the EU source. New regulations are supposed to be subjected to a “regulatory impact assessment”. Existing regulations are subject to consultation and review. This is good news, although it puts yet another burden on the over-stretched lobbying sector.

In Estonia and Latvia, bureaucratic control of forestry is impressive. When I recently visited our Estonian office, three legally-trained auditors came to inspect our record-keeping to ensure compliance with forest law. All three were dressed in black, very smart, but definitely dressed to kill. Two problems were identified. Firstly, we do not keep our records together per forest. We keep them per department: forestry, accounts, etc. That was not acceptable, because if they wanted to do a “dawn raid”, they would be unable to find all the records.

We managed to deflect that one by asking "where in the forest law does it specify that the records are kept together?" Secondly, one of our contracts with a harvesting company did not list the contract details between Fest-Forest and the client, therefore, "how could the harvesting company be sure we had permission to fell?" Unfortunately, we were guilty as charged, but got away with a scolding.
They came back to follow all the paperwork of a specific harvesting operation, but no further failures were identified.

In Latvia, the state forest service maintains a database of all the forestry compartments in the country. Maintenance is compulsory, whether needed or not. Sites are regularly inspected by officials. If maintenance is not carried out, fines are frequently imposed and/or felling permission refused, unless the authorities can be convinced that remedial action will take place. It does not seem conceivable that this level of official supervision can be maintained.

Our record keeping is very detailed and sophisticated. Many small harvesting companies must really struggle to cope with these demands of record keeping and forest maintenance.

It is not all negative, efforts are also made to reward good forest owners. In Latvia, one of our clients was given a large world wildlife encyclopaedia (in Latvian), plus a thank you card for good management. In Estonia, clients sometimes receive "Thank You" (Tänu kiri) certificates from local authorities in recognition of good maintenance. Now, woodland owners are also invited to special wildlife seminars so they can better appreciate their forests.

EU subsidies
Forest properties often have abandoned farmland and, as part of the EU, the land can qualify for subsidies.

The type of land which is likely to attract subsidy is neglected agricultural grassland. Often this is colonising with trees. Much of this is too small and some of this was planted this spring using subsidy, which covered the cost of the planting.

However, where it is of sufficient size and in an area where it may be used, it should probably be retained in agriculture, as the capital value will be higher than forest land and future subsidies may leave a profit.

European agricultural subsidies are at present being changed. Here only the grants available for the grassland are discussed, which is typically part of non-tenanted land in our clients' possession.

The present arrangements will stand until 2009, when "decoupling" comes in. This intends to remove the tie between subsidy and production (paying farmers depending on the amount of land they have, rather than what they produce).

However, the individual member countries have a fair amount of flexibility, and it is thought the Baltic countries will tie as much of the subsidy to production as they are allowed. Every sector of the agricultural industry is fighting its corner hard at present.

As in the UK, the bureaucracy is quite daunting. Applications had to be in by mid-May.

Present payments are based on an agreed area of farmland between the Baltic countries and the EU, and this cannot be changed. However, as it is not known how many applications there will be, the payment per hectare is not yet exactly known.

Single Area Payment (SAP)
At present, there is a basic grant available for keeping the land in use for agriculture. Anyone can apply for this and the grant is about €38/ha in Estonia and €32/ha in Latvia. This subsidy will increase every year, but it is not known by how much.

It will be required to cut and remove the grass and any bushes/trees, as well as clearing the side of drains from trees.

In addition to the Single Area Payment there are:

Complimentary National Direct Payments (CNDP)
It is not clear yet, whether all CNDP's are subject to a 5 year commitment. However, that would seem difficult, as the whole system is to be replaced by 2009.

The relevant ones for us are:

- **Less Favoured Area (LFA) payments**
  LFA status is designated by local authority area and only applies if the land is in a designated authority. It is a matter of checking a map.

  The payments are: Estonia €25/ha
  Latvia 3 categories €33 - €46 - €64/ha

  Latvia has in addition decided that a single owner can only apply for LFA payment on areas over 30ha if there are cattle on the land.

  No additional work is required to receive this payment.

- **Preservation of Biodiversity in Grassland (Designated under Natura 2000)**
  The payment is: Estonia € 32/ha Latvia €138/ha
  A commitment of 5 years is required.

- **Improved Grassland**
  If land has been sown with certain productive grasses, an additional payment may be applicable. However, improved grassland only lasts for about 3 years, after which it has to be reseeded. It may apply to small areas of newly purchased woodlands which have improved grassland.

  The payments are: Estonia not known Latvia €12.64/ha

It looks as if the authorities in both countries are going to implement this with their usual bureaucratic enthusiasm.

We have got through the first hurdle, applying where relevant. The second hurdle, carrying out the work, is about to start. In both countries, we have found an agency which applies for and carries out the work.

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The property market in Estonia is very buoyant and competitive. In Tallinn, the office market has a vacancy of only 4% and there is not much on the market, hence, yields are low, typically between 6% and 7%.

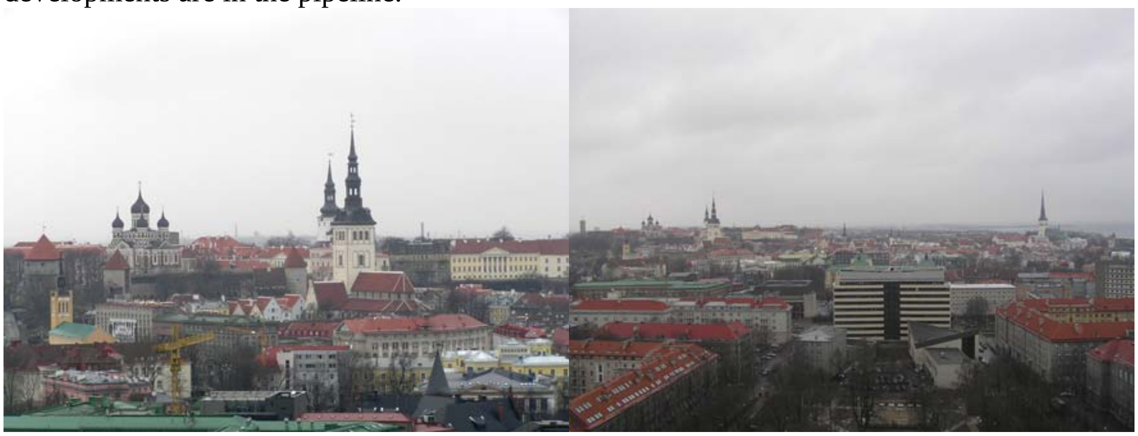
Recently, the car park in front of the Olümpia Hotell, well known to most of our clients, was sold for 70 000 kr (€4 500) per m2, a record and obviously will require a tall building to produce a return.

Office block under construction in Tallinn
ESTKinnisvara clients have the top 3 floors

Last month, the building of the environment ministry was put on the market by the state. Built in stages between 1965 and 1980, it was designed by a well known architect and designated a heritage building. However, it is badly in need of renovation. However, bidders will have to make a guess as to how much the building can be increased upwards. At present there are 3 buildings of 3, 4 and 11 floors. The area plan allows for buildings of up to 8 floors. Some are also optimistic that they can make a case for knocking down the building and building a new one in its place.

The asking price is 315m kr (€20m), however, this will certainly be exceeded. By how much will depend on one's confidence to increase or replace the building. Some estimate the successful bid will be double.

The development of Tallinn is only in its early stages. The “Old Town”, or mediaeval centre is pretty well renovated. However, now there is a huge new development by the airport, dominated by the conversion of a huge pulpmill being converted to flats. Other large focused developments are in the pipeline.



The changing face of Tallinn

Riga, about twice the size of Tallinn, also has an old town, but more recent than Tallinn. However, the areas around the centre have some magnificent buildings, comparable to many other European cities. In Tallinn, the offices outside the old town are mainly Soviet era. Development is also planned. There is a huge amount of development going on, but again, it is in an early stage.

Riga - The old town and the new Hansabanka building on the island which is to be developed for business.

There are various investment opportunities. If you are interested, please get in touch we us.

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Fest-Forest Party

Every year, all the staff and their families get together for the Fest-Forest party. Last year it was at Leigo, Estonia. Leigo is an enterprising development, specialising in open-air concerts, but also catering for visitors in slightly DIY buildings (www.leigo.ee). It is an excellent example of successful farm diversification on a shoestring. At the same time it is clear the owner played out a dream in his project. In the morning, before the guests arrive for breakfast, he can be found welcoming the new day by playing the piano. We were lucky with the weather, early September, but like mid summer.

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Sandra, Latvian book-keeper in full flight

Singing – a Baltic passion

Smoke sauna, the smoke leaves the building via the windows. I am still not clear why there is no chimney.

Small or large, everybody enjoyed themselves

This year we are going to www.rancho.lv in Latvia, which appears much more commercial, but will no doubt reflect the Latvian spirit of good food, good beers and good company.

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