



TRAVEL GUIDE TO REAL ESTATE

How to get from Tallinn to Bucharest in 15 years?

- Ⓜ EE Kuidas jõuda 15 aastaga Tallinnast Bukaresti?
- Ⓜ LV Kā nokļūt no Tallinas līdz Bukarestei 15 gados?
- Ⓜ LT Kaip iš Talino patekti į Buchareštą per 15 metų?
- Ⓜ UA Як подолати шлях з Таллінна до Бухареста за 15 років?
- Ⓜ BG Как се стига от Талин до Букорещ за 15 години?
- Ⓜ RO Cum sa ajungi din Tallinn in Bucusresti in 15 ani?

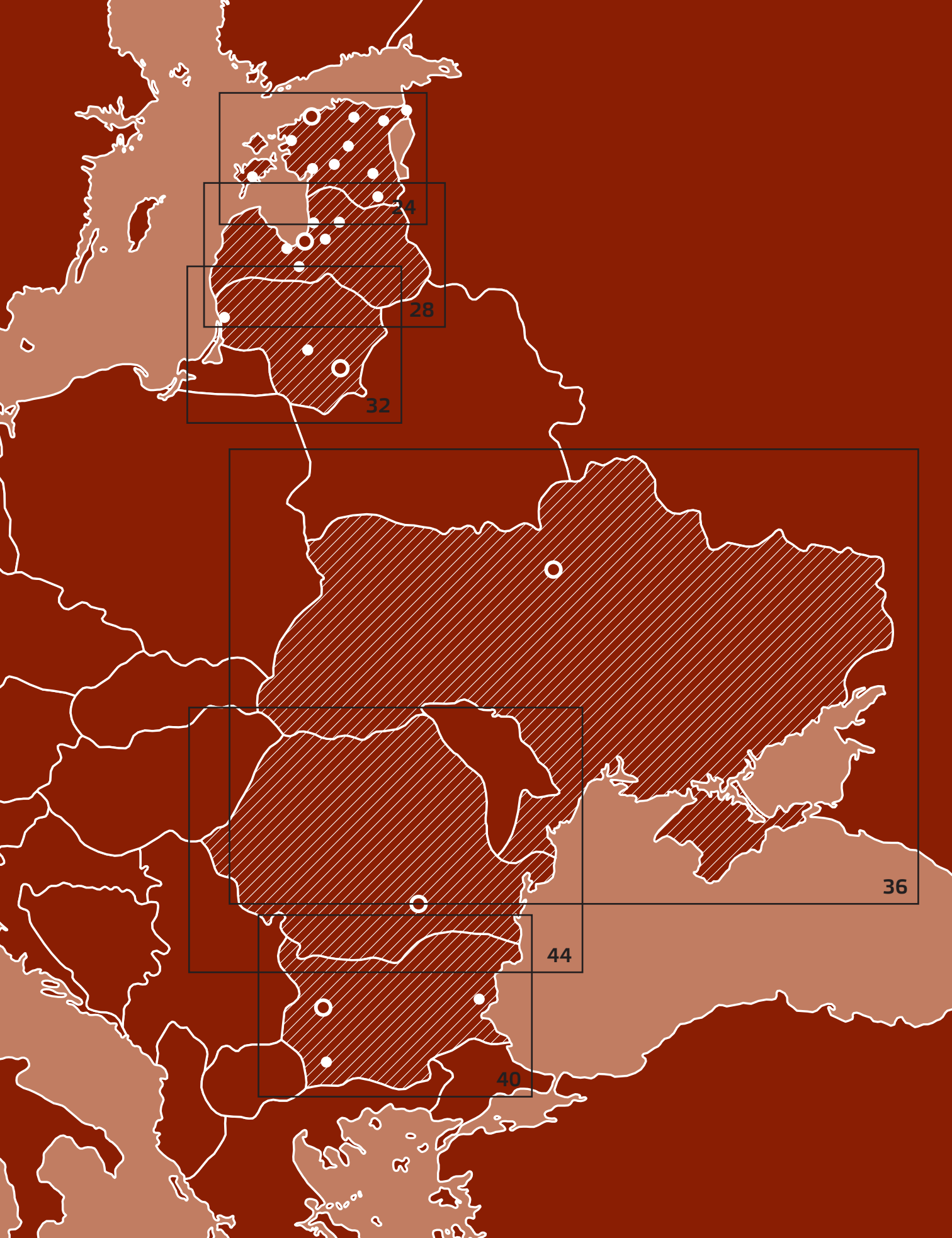
Arco Real Estate Annual Report 2006



ARCO REAL ESTATE

Arco Real Estate Annual Report 2006





Contents

Mission, vision and main values of Arco Real Estate	4
The structure of Arco Real Estate group	5
Address by the chairman of the supervisory board	6
Address by the chairman of the management board	8
Service Division	12
Development Division	14
Construction Division	18
Macroeconomic background	22
Estonia	24
Latvia	28
Lithuania	32
Ukraine	36
Bulgaria	40
Romania	44
Arco Real Estate group 15	52
Sponsorship projects	54
Comments to Consolidated Annual Report	56
Consolidated Annual Report	60

The mission of Arco Real Estate is to be a comprehensive and appreciated provider of real estate solutions.

The vision of Arco Real Estate is to become the symbol of real estate.

Our main values:

Partnership

our clients are our partners

Reliability

we are reliable, open and honest

Professionalism

we guarantee quality service

Respect

we respect our client's personality

Responsibility

we keep our promises

Chronology – 1992 key events

> Arti Arakas founds AS Arco Vara.

1993

> Arco Vara's Saare office is founded, which represents an expansion of activity beyond Tallinn.

> Arco Vara is responsible for conducting what to its knowledge was the first real estate transaction in independent Estonia.





1994

- > The Estonian Association of Real Estate Companies is founded, with Arco Vara as a founding member.
- > The Arco Vara Pärnu Office is founded.
- > The first contract for the right of superficies in Tallinn is concluded involving a piece of real estate owned by the Republic of Estonia.

1995

- > A real estate development subsidiary, Arco Investeeringute AS, was founded.
- > In cooperation with partners, 2.1 hectares of commercial land is purchased in Tallinn passenger port, where today a large-scale project is proceeding.
- > Activity is expanded to southern Estonia.

1996

- > One of the largest real estate development projects in the Baltics – Veskimöldre – is launched.
- > Arco Vara begins offering land surveying services.





Arco Real Estate group is in its athletic prime

Arti Arakas
Chairman of Supervisory Board

1997

- > Arco Vara begins expansion to other Baltic States. The first step is the establishment of Arco Real Estate in Riga. Today, Arco Real Estate is one of Latvia's most successful real estate firms.
- > Arco Vara Halduse OÜ is established as a provider of real estate management services.
- > Cooperation with the developer and builder AS TTP begins for the sales of a

large real estate development project in Pirita.

1998

- > Establishment of a second large-scale residential community (40 hectares), Merivälja2, is launched.

1999

- > Arco Vara Tartu Office acquires the Ristiku shopping centre in Tartu, then in poor financial state. It is the first sanitization of a real estate firm in Arco Vara history. The centre is sold successfully in 2002.
- > Arco Vara Pärnu Office acquires and renovates a historical building in Pärnu on Aia 8. In addition to a number of tenants, Arco Vara Pärnu Office is based here.

I would like to begin by talking about an ostensibly different field – the athletic field. I have always admired the fortitude and willpower of professional athletes. As a skiing enthusiast, I have kept an eye out for things that could be learned, for example, from the results posted by Estonia's successful Nordic ski teams. Let us be honest – the results have been good ones. I am sure that their success is based on a number of principles which can also be applied to the business world: precise planning, fortitude and perseverance, teamwork and attention to details.

To continue our parallel to the world of sport, I can say that for Arco Real Estate, 2006 was a year of hard training, resulting in a good level of preparation for the effective, broad-based and balanced future growth of the entire Group and in the longer term as well.

Above all, this has to do with our people – I would assert that, figuratively speaking, Arco Real Estate has the best ski waxers, coaches, physicians and caretakers in the business. Thanks to their aptitude and dedication, there is reason for self-confidence. We have a very strong group of leaders. Yet "Team Arco" is actually made up of almost 500 people in six countries. Amid a shortage of good specialists, especially in Estonia and Latvia, people have expressed a desire to join us, and this is very noteworthy.

The hard-working people of the Arco Real Estate Service Division's team provide our eyes and ears in the market, ensuring the best sales solutions for our development projects. Arco's Construction Division includes construction teams in Estonia as well as Latvia. This makes it possible for us to complete our projects ourselves, from start to finish, producing the best possible quality. Our competitors have nothing on such an all-inclusive, integral development scale.

I consider the other major underpinning of our success to be risk diversification and the readiness for broad-based and sustainable growth. The founding of Arco Real Estate subsidiaries in Bulgaria and Romania last year plays a major role in this regard. Constant flow of information and a good overview of developments in this very high-prospect market allow us to make the necessary action at the right moment.

The company has completed structuring the Group on three pillars - Service, Development and Construction - which ensures clarity and efficiency. Important innovations have also been introduced in company financial management, the budget process and organization of accounting and reporting.

As a result of all of these training sessions, Arco Real Estate is in top physical condition. The entire team, partners and clients all deserve recognition for this accomplishment. And we would like to thank our fans!

At the same time, there are inevitably some spectators who hint that much of the Estonian and Latvian real estate boom is history. Stabilization will affect speculative investors the most, but the cyclical nature of the market means that a correction and cooling was overdue. The situation was not a normal one and actually the proliferation of what can be termed „one-man development booths“ reduced the competitiveness of the serious players. Now that we are seeing consolidation in the market, Arco Real Estate can really reveal its polished form with pride.

We recently marked Arco Real Estate's 15th birthday. We should be in our athletic prime for several more decades. The company has already set Baltic records, by becoming the leading real estate company, but our aims are even more distant – and so we have focused on endurance events and longer distances. Keep on rooting for us!

2000

- > Arco Maadehalduse OÜ, a forestland and land management and brokerage company, is founded.
- > An Arco Real Estate office is founded in Vilnius, Lithuania.

2001

- > One of Estonia's largest construction supervision companies, Tallinna Linnaehituse AS, is acquired in a public tender.
- > Arco Kapitalijuhtimise AS is founded with the aim of managing real estate investment programmes to be launched and of offering various investment opportunities.

2002

- > Arco Vara buys the Tallinn Olympic Sailing Centre from the Ministry of Culture.
- > Arco Real Estate Latvia launches the first large-scale residential development in Baltezers near Riga – the Marsili residential community.

A year of revolutionary changes

Viljar Arakas
Chairman of the Management board



Last year Arco Real Estate group's turnover stood at 483 million kroons and net profit reached 217 million kroons. These figures, coupled with the knowledge that the net profit grew 87% in a year, surely gives us reason to be satisfied. In this background of good macroeconomic figures there is however no time to rest on our laurels but rather time for scrutinizing our strengths and weaknesses bearing in mind the longer term. Indeed, this is what we did last year at Arco Real Estate, focusing on the challenges for the future and areas where we saw the need for development.

In 2006, many different signals were received regarding the situation of the Baltic real estate market. As always, some were pessimistic and others were optimistic. The pessimists predicted a market crash, while the optimists talked about prices continuing to rise unabated. I believe that the truth lies somewhere in between; we will probably see prices stabilize, as well as corrections in a few overvalued sectors.

2003

- > A forest auction system, www.metsaoksjon.ee, is created and Arco Vara Puukooli OÜ is founded as a nursery, seedling sale centre and forestry renewal company.
- > Cooperation begins with a leading German real estate group, DEC.
- > A majority stake is acquired in the construction firm Deena Ehituse OÜ.
- > First Arco Real Estate managed funds are launched on the market.
- > Arco Vara becomes the personal main sponsor of a top Estonian skier, Jaak Mae.

2004

- > The final implementation of Arco Real Estate group managerial unit is completed.
- > Successful development activity is launched in Latvia through Arco Development SIA.
- > Developments in group's construction activities.

I believe that releasing some pressure will undoubtedly bring us back to reality amid the hitherto overoptimistic expectations. The rapid price rise we have seen in the last three years will certainly not last for ever. Sooner or later it must end. Certainly a market slowdown will mean less speculative interest and mark an orderly settling process on the market, from which the largest players will stand to gain the most.

Last year, Arco Real Estate continued to diversify its geographical risk and we founded subsidiaries in Bulgaria and Romania.

I was glad to see that that the Arco Real Estate model for entering new markets is becoming more and more refined. Thanks to the experience gained from Estonia, Latvia, Lithuania and Ukraine, it is possible to learn from past examples and avoid mistakes each time Arco enters a new country.

As Bulgaria and Romania proved, subsequent expansions are coming more easily. This provides us with the certainty that when the next country meets the criteria of Arco Real Estate's experts, we will be able to continue expansion effectively.

An important step in the development of Arco Real Estate is the reinforcement and consolidation of our Construction Division. We merged our construction companies into one firm – Arco Ehitus – and bought a construction enterprise in Latvia. The special attention this sector received helped complete Arco Real Estate's development project production chain. The brokerage offices provide information on the needs and means of the market, and on the basis of that information, a development project is created. The Construction Division brings the project to life and the brokerage markets the end product. There should be no more weak links – especially

considering that we have no competitors with such a chain.

We see the same thing when we look at the quality of our land and the nature of the development projects in progress. I am glad that we purchased land and invested in projects at the right time – we began creating our inventory of long-term properties back when land was still undervalued. We have launched our development projects in locations which guarantee profitability even if a certain market correction were to occur. Take for example the former fairground property in the Kadriorg district of Tallinn, the Kolde residential community near Stroomi beach, the TOP complex in the Pirita district of Tallinn, the Bišemuiza residential community in Riga or the lush, verdant Baltezers residential community on the shores of a picturesque lake near Riga.

Looking at last year, it is also worth mentioning that we managed to get a detailed plan approved for Ahtri 3 in the centre of Tallinn. In a situation where initial plans to build a spa hotel had to be scrapped upon agreement with the operator due to a rise in construction costs, we were able to come up with an alternative vision for the property, beginning the planning process for an all-encompassing commercial building on one of Tallinn's more promising pieces of real estate. We also carefully revised our land portfolio, disposing of land with lesser potential to focus on larger projects.

The good economic properties of our land inventory and development projects, our integral development project production chain, geographic range, ability to enter new markets with our functional know-how, and our trustworthiness – these are five aspects which received much attention last year within the Group. Precisely this helps ensure risk diversification and long-term success. This conviction allows all of our partners and clients and, above all, the 500 employees of our Group, to face each new day head, boldly and optimistically. Thank you for creating the opportunity to do so!

2005

- > The investment policy is established and developed. A new real estate fund, Explorer Baltic Property Fund – Baltic States makes its market debut in cooperation with East Capital.
- > Development activity is expanded throughout the Baltics.
- > The Ukrainian office is opened in Kyiv.
- > Successful merger of Estonian regional real estate offices takes place.
- > Arco Vara increases its share capital, involving Hansabank with a 10.5% holding.

2006

- > The Arco Real Estate group strategy for each division is developed for 2007-2009, using the Balanced Scorecard model.
- > Expansion and opening of representations in Bulgaria and Romania.
- > An international service organization based on a single set of standards takes shape.
- > Rapid development and increase in the number of employees in all locations.

Fruitful year of 2006 for Arco Real Estate group divisions



Focus on quality

Ivar Siimar
Head of group's Service Division

Arco Real Estate's Service Division provides real estate brokerage and appraisal services, real estate management and real estate fund management. This is Arco Real Estate's largest division, employing 332 people (69 percent of all the people working for Arco Real Estate group as at the end of 2006). In addition to eleven offices in Estonia (in Tallinn, Tartu, Pärnu, Haapsalu, Paide, Viljandi, Rakvere, Narva, Jõhvi, Kuressaare, Otepää), Arco Real Estate has opened offices in eight cities in Latvia, two cities in Lithuania and one each in Ukraine, Bulgaria and Romania.

Why do I work for Arco Real Estate?

The largest real estate enterprise in the Baltic countries, Arco Real Estate employs five hundred people. The core values of the firm are partnership, trustworthiness, professionalism, caring and responsibility. Those values are the basis for how the company treats not only its clients, but its employees as well. We asked some of our co-workers to tell us why they like working for Arco Real Estate.

„I like working for Arco because here I found what I was looking for: professionalism, fair play and last but not least clarity.”

Loredana Marinica, Romania

„The company's work principles correspond to my personal principles.” Anna, Ukraine

„Arco Real Estate is the place where I could feel the spirit of professionalism, open-mindedness and innovation.” from Lithuania

Ivar Siimar, the head of the Service Division, admits that 2006 was a breakthrough year for their division.

The turnover of the Service Division grew by 40 percent in 2005 – we thought it was a superb result back then. Upon doing the numbers for 2006 we have to admit that the turnover growth has been even more vibrant – 60 percent compared to 2005. „The keywords I used to characterise 2005 also apply to 2006. Improving service quality, facilitating teamwork, developing new ideas and standardising cross-division systems forms a basis for the continued success in expanding into new markets. The chosen strategic direction has turned out to be a successful one and we shall definitely continue to pursue this path,” Siimar explains.

On one hand, the objective in 2006 was to rapidly expand to Bulgaria and Romania, and on the other hand, to open offices in the existing domestic markets: three in Latvia, two in Estonia and one in Lithuania. In the coming years the company wishes to get its operations running smoothly in the existing countries, while planning in the more long-term context in its strategy,” Siimar says. Besides expanding, he says that the important thing is that all the work done by the division is efficient, customer friendly and high-quality. „After all, we do not compete in who has more employees or offices. We compete in whose work is of higher quality; we constantly have to offer the customers the best quality.”

Opening new offices in Bulgaria and Romania has also increased the demand for high-quality labour. Competition has intensified in these markets after the accession to the European Union, because other international companies, including real estate companies, are also entering these markets. According to Siimar, Arco Real Estate itself takes care of the training of its employees – administrative staff, brokers and project managers. Last year, this meant the implementation

of common working principles and systems, like MIS and AVIS. MIS or Management Information System is an administration system for the management information of the entire Service Division, and AVIS is a real estate and customer management system, which has been developed in Estonia for the last four years. „The common management system and the large database makes us an international company. It enables us better to export the spirit of our group into other countries,” Siimar says.

„As the head of the Service Division, I hold the motivation of employees in high regard. In a service company, every morning means you’re starting all over again. It has to be more interesting for employees tomorrow than it was yesterday,” Siimar says. Arco Real Estate also motivates employees with career opportunities. As an example, Siimar mentions Rauni Tillisoo, who six years ago came to work as a broker in Arco Real Estate, and last year took the position of the head of the Sofia office in Bulgaria. „If the employees themselves are interested and willing, they have the chance of having a career in our company,” Siimar says. He also adds that working in six countries and six different cultural areas is an exciting challenge.

„I would like to thank all the employees of the Service Division for the great result and contribution – and let’s hope for new achievements in the coming years.”

„Arco Real Estate has a very good human environment. The people have a quality of exuberance and are ready for action. This is one of those rare groups of people with so many positive people.” Ergo Tars, Estonia

„Because it looks like there is a little light at the end of the tunnel, hopefully it’s not the train coming towards us.”

Yonko Malinov, Bulgaria

„Arco is a company that cares about its employees, and it does this in a professional and trustworthy way, the perfect values for a company that wants to succeed in a competitive environment. I grow personally and professionally together with the company’s evolution. Arco’s success becomes my own.” Daniela Visan, Romania

„Because we know how to have FUN – work and play go together :)” Erki Arakas, Estonia



Development division focused on residential construction

Veiko Pedosk
Head of group's Development Division

The primary activity for Arco Real Estate group's Development Division is development of integral residential environments and commercial real estate.

The main emphasis is on residential projects, and these make up around 70% of the entire portfolio. In residential development, the finished objects are sold to end buyers. The goal is not investment-oriented holding or leasing.

Nor is it the strategic objective of Arco group to hold developed commercial real estate for the long term. Here, too, the ultimate objective is generally to find a buyer (such as a real estate fund) for a completed project, generally before development gets under way.

The Group management considers the results of the Development Division in 2006 to be good. Detailed plans were initiated and carried out for several major sites, which attested to the fact that the projects in the

„Arco Real Estate is special any way you look at it. Everyone in this organization wants to move faster, higher and farther. Myself included! The best opportunities for acting on your ideas are all right here, because the team is super.”Kadri Lindpere, Estonia

„I'm proud to work at Arco Real Estate. Thank you for your trust and believing in me!”
Toomas Õun, Estonia

„I like to work for Arco Real Estate because I have an opportunity to be a part of a young dynamic committed team lead by experienced individuals. This recipe makes the experience pleasurable and exciting, learning new things and putting each person to work in their own area of expertise in putting together the team.” Dominic Dumitriu, Romania

„Arco Real Estate - beautiful people!”
from Lithuania

investment portfolio were successful. During the year, decisions were made to bow out of a number of projects of lesser value; the focus was set on residential construction. Due to the drop in business on the domestic market, the goal was set to find new markets. To achieve this goal, a number of studies were conducted in the financial year, an activity plan was compiled and work in target countries was launched.

VEIKO PEDOSK, WHAT WERE THE MOST IMPORTANT ACTIVITIES FOR THE DEVELOPMENT DIVISION IN 2006?

We were engaged in our primary activity, investment and capital placements in various real estate projects. Our job is to manage and bring to life these projects. Our division must generate ideas that the market needs.

Our activity no longer involves only the Baltic market; we have to look for new attractive markets to invest in. But we can only invest if we have enough resources and the certainty that we have tested everything at home, and that we have enough competence and experience to export it. I believe Arco Real Estate does.

ON WHAT BASIS DID YOU MAKE YOUR DECISIONS TO EXPAND AND CHOOSE BULGARIA AND ROMANIA AS THE NEW MARKETS?

The decision to expand is preceded by an understanding that a specific real estate market is attractive. Thereafter a new office is opened on the market, and the employees ascertain the market status quo, legal issues and market situation – in other words the possible conditions for growth. Thereafter the Development Division joins them – taking advantage of the synergy, the Development Division begins making investments. In cooperation with the office, we first look for sites, then develop them: design, construction, sales, methods. We then build the project and a few years later the office sells it.

The choice is made according to attractiveness. Bulgaria and Romania have just joined the European Union and we see potential growth on that real estate market. We were chasing two things – one being the rate of return

of the project itself and the second being a possible price increase. The price rise of the end product has always been higher than the input – i.e. higher than the growth in the price of land or construction. The yield is higher by that measure.

THIS MEANS THAT BULGARIA AND ROMANIA ARE THE BEGINNING OF A NEW EXPANSION?

Yes, this is the case. From here on out, the new countries are ones that are not in the European Union. In such countries, it is important to expand the possible capital base so that the risks would not be sizeable in relation to equity. Second, it is necessary for the expansion experience to be tested out in more secure environments. One example is Ukraine – there accession to the WTO and developing regulatory framework will take more time. Right now we are in the stage of exploring the market. The local political situation adds tension to activity there. In the European Union, on the other hand, investment protection and movement of capital is well regulated.

WHAT WERE YOUR DIVISION'S MOST IMPORTANT STEPS IN 2006?

Last year, the Development Division took a decision to bow out of less lucrative projects. We gave up projects that consumed more resources than they brought in. It was a question of effectiveness. By exiting low-yield projects, we were able to free up money for obtaining new projects.

Also in 2006, construction activity began in Latvia as well, and the first residential construction project is nearing completion – the four Bisumuiza buildings with 1500 apartments. We are planning even more large projects in Latvia than we are in Estonia as the planning process is somewhat simpler there.

IS THE REAL ESTATE MARKET VERY DIFFERENT FROM ONE EU COUNTRY TO THE NEXT?

The situation is the same, but purchasing power and construction activity varies. The Baltic States are on an even footing – the three countries' macroeconomic indicators

„Arco Real Estate is a trustworthy, reliable company. I like the pragmatic perspective, the way people interact and help each other to eliminate all territorial boundaries. I like the people: they are common, simple people, professionals in their field and aiming for a higher target.” Tania Rusu, Romania

„A great company with a great name.”
from Latvia

„It is easy and interesting to work under a strong trademark. Experience and stored-up information is so important in the case of commercial space, and Arco Vara has it all!”
Ruth Tõniste, Estonia

„For being free to work on my own; for being appreciated; for the good attitude, for the fun I get and the effort I give.”
Adelina Kovacheva, Bulgaria



are different, but the price level and purchasing intensity are the same. Bulgaria and Romania are similar to one another, but the readiness of banks there shows that they will reach Estonia's level in 3-4 years.

We are accruing expenditures today, but in a couple of years, we will begin receiving additional income from possible price rises. Just half a year ago, banks in these countries were not issuing loans. Now they are. These are markets that are gaining momentum. Furthermore, our techniques and our new and progressive solutions have not yet been used there.

There are many players abroad as well, but there are few large companies who deliberately and consistently deal with integral solutions, Arco Real Estate is not just a broker. We also offer certain values.

WHAT CHANGES DID THE YEAR 2006 BRING TO THE DIVISION ITSELF?

Last year, we performed restructuring. We reduced the number of companies by merging or liquidating them. We also reviewed the investment strategy, focusing two-thirds of our invested resources on residential construction. The most people in the company are connected to this field, and it has the greatest amount of synergy.

We reduced the number of commercial sites in our portfolio, while remaining open to potential cooperation with hotel or retail chains for a closed position. This means that we engage in cooperation with a fund, which buys the completed building. Commercial buildings – that is, the commercial flows they generate – are in turn bought there.

„I like doing big things! And Arco Real Estate offers the opportunity to do them. Our core values are consensual – that is important. So is the fact that we share those values with our co-workers.” Ivar Siimar, Estonia

„Because this is probably the only real estate agency in Sofia, maybe in all of Bulgaria, which provides such excellent working conditions.” Milen Tassev, Bulgaria

„There's no such thing as true perfection, but why not stay as close to it as possible?”

Margus Tinno, Estonia

„Arco Real Estate – exclusive, competitive, contiguous and much more.” from Lithuania

„I like working for Arco, because it's always a challenge here, everything is moving fast and I don't have time to worry.”

Raluca Baducu, Romania



I am glad that we have given up low-yield projects that are not suited to our main activity and strategic bottom line, in order to apply our powers and competence to a greater extent.

As to the domestic market in Estonia, we can mention the good Public-Private Partnership initiative. We entered into negotiations with the city of Tallinn for forming a joint venture to establish the city's parking garage for downtown Freedom Square. The relationship with the Tallinn city government was a good one. Attesting to this fact, the city government invited us – the biggest developer at the Tallinn port – to take part in an urban planning seminar in Great Britain. A real estate festival in Cannes and the Munich real estate trade fair Expo Real lie ahead. We have also had a good working relationship with the Riga city government.

Big steps in 2006

- Detailed plan initiated for construction of a residential community located in the former Tivoli area in Tallinn
- Stage one of the Merivälja residential district completed successfully
- Stage II of construction and sale of row houses in Tallinn in the Maarjamäe area begins
- Construction of office buildings completed in Tallinn, Keemia and Liimi streets
- Construction of Kolde residential district begins
- First stage of shopping centre in Kuressaare enters use
- Preliminary agreement signed for transferring commercial land in Suur-Sõjamäe in Tallinn
- Detailed plan for Mazais Baltezers residential district in Latvia continues
- Joint project for building Drelini residential district initiated
- Preliminary agreement for sale of apartment building development project located in Kyiv signed

„I don't know any company that is as multifaceted and has such an interesting content as Arco Real Estate . There will always be work! :)” Terje Maripuu, Estonia


„Arco has proven its professionalism and success and possesses a very good team with future development prospects.”

Hristo Hristov, Bulgaria

„I like working for ARE because the company is under constant development, and by extension, me as well.” from Latvia

„Arco offers an outstanding career opportunity for me as a young specialist, allowing me to accumulate knowledge and develop my professional skills. It also opens the way to learn from the experience of our colleagues in other countries.”

Daniela Cusnir, Romania



Merger led to creation of a strong construction firm

Ahto Altjõe
Head of group's Construction Division

Arco Real Estate group's Construction Division was created in 2006, when the group merged three companies – Deena Ehituse OÜ, Veemaailm Inc OÜ and Tallinna Linnaehituse AS.

According to head of the division, Ahto Altjõe, the joint venture is a stronger partner for customers. „The Arco Construction brand is a newcomer to the construction

market, but I am sure that the quality of our work and our previous experience will soon make us well-known,” says Altjõe.

Since 2007, the Latvian Construction company is also part of the construction division. Arco holds a 55% stake in that firm. Altjõe notes that there would be little point for Arco Real Estate to have a construction unit in every country in which it operates. „In Lithuania and Ukraine, for instance, the construction market is very competitive

„During these four years, Arco Vara has become my second home sweet home.”

Egerta Mändmets, Estonia

„I like Arco Real Estate because of the amazing people working here, who are always ready to help, and to give advice and praise.” from Lithuania

„Successful and ambitious, and I would like to contribute to their success in Bulgaria.”

Plamena Ruseva, Bulgaria

„I like the flexible work schedule and the friendly attitude of my colleagues.”

Elena, Ukraine

„Because I learn new things, so as one day to become a good professional.”

Martin Tanatsiev, Bulgaria

and there are enough construction companies. Thus it would not be wise to expand in that direction." The situation would change if the number of Arco Real Estate's own development projects were to increase. „Then it might be worth thinking about whether to acquire a stake in a local construction firm or establish one ourselves." Altjõe says the current interest in two new markets, Bulgaria and Romania, involves probing the limits of the market.

Last year, construction volumes continued to grow in both Estonia and Latvia. While construction volumes in Estonia were around 22.2 billion kroons in 2005, they rose to 30 billion kroons in 2006. In Latvia, construction volumes rose from 17.4 billion to 24.4 billion kroons. „The price of construction was affected significantly in 2006 by the growing price of material and labour," said Altjõe. In Estonia, the cost of material increased 10% and the price of labour, 19%. In Latvia, the respective increases were 20% and 40%. „The price of material may continue to rise this year, but the cost of labour will start to stabilize. It has already hit the ceiling," said Altjõe.

In characterizing the large number of construction projects, the head of the division notes the as-yet undeveloped seaside areas in Tallinn and Pärnu. He also mentions Tartu, where new residential areas are still being planned.

„In Estonia it is important to a construction company when projects in the planning stage are completed. It depends how quickly the projects are processed and the detailed plans approved. But the construction market will definitely not cool off: The situation in Latvia is also the same and there are even more potential construction projects as the local market is bigger."

„Arco Vara values in its employees and partners precisely the kinds of values that I consider important everywhere and in everything. It is good to be the employee of a large, well-known and respected corporate group. You feel that your work and thoughts are one link in a long chain – it's a powerful thing." Anu Völma, Estonia

Arco Construction is engaged in construction of residential and commercial buildings and environmental engineering. Public procurements make up 90% of the environment engineering sites. „Our main competitive edge in environmental engineering is the experiences, skills and knowledge of Veemaailm Inc OÜ. We are one of the biggest companies in Estonia when it comes to waste water pumping stations," says Altjõe.

The company's third link, Tallinna Linnaehituse AS, is engaged in construction supervision services. The largest sites supervised are the Viru Prison, the IT College academic building and the Haabersti Recreational Centre.

Last year, commercial building construction accounted for 45%, private houses for 30%, and environmental sites 25% of Arco Construction's activity. Half of the company's turnover comprised projects performed for Arco Real Estate group, and the rest was made up of construction contracts for other entities, local governments and private firms.

As to the biggest construction projects, Altjõe cites the construction of the Keres Centre in Narva (total investment of over 70 million kroons), two residential buildings with a total of 63 apartments on Kolde street in Tallinn, the renovation of a commercial building on Keemia street and the renovation of Sagadi manor. In the field of environmental engineering, major projects included the establishment of bicycle paths and routes in Kuressaare, the completion of the Toila wastewater treatment centre and a sewerage line running from Nasva to Salme. In 2007, the Matsalu water project was launched.

This year, Arco Construction wants to implement the Group organizational culture in Latvia. In the near future it is planned to increase the size of the team and consider acquiring yet another construction firm in Estonia.

„Because ARE is the best and I also want to be the best." from Latvia

„Real estate is our life, passion and dream. Like a garden for a small-town pensioner and firming masks for modelling school students."

Marko Sillar, Estonia



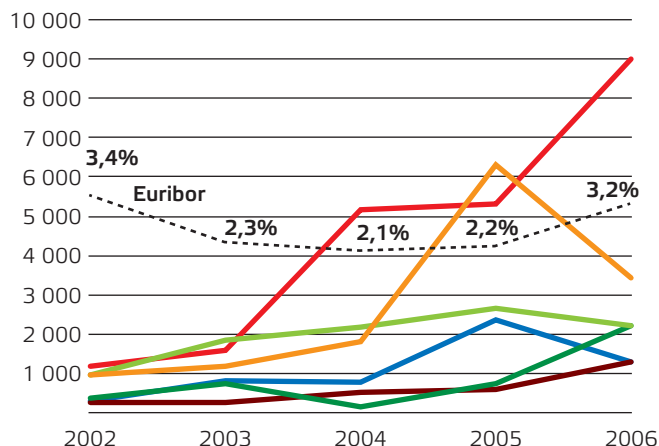
The expanding world of Arco Real Estate group 2006

Macroeconomic background

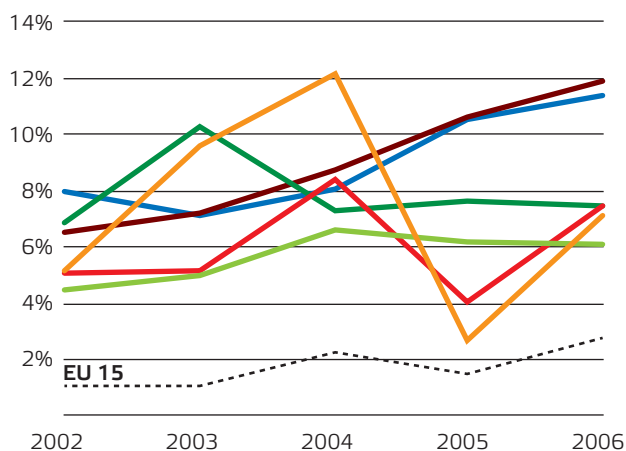
In order to illustrate the economies and potential of the countries Arco Real Estate is present in and the company's ambitious plans in new countries, we shall hereby give a summary of some of the more important economic indicators of these countries.



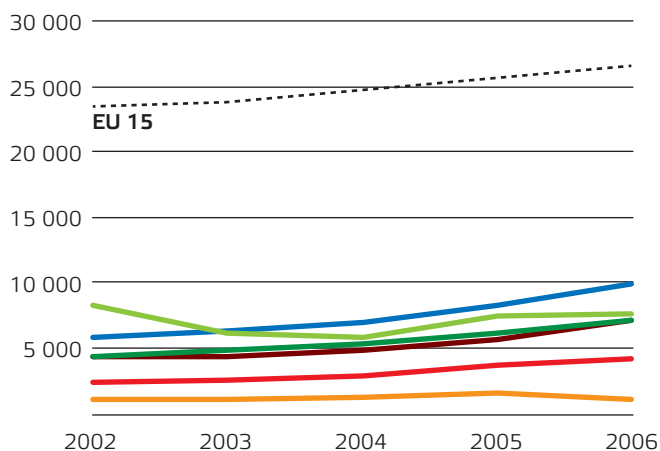
FDI, mIn EUR



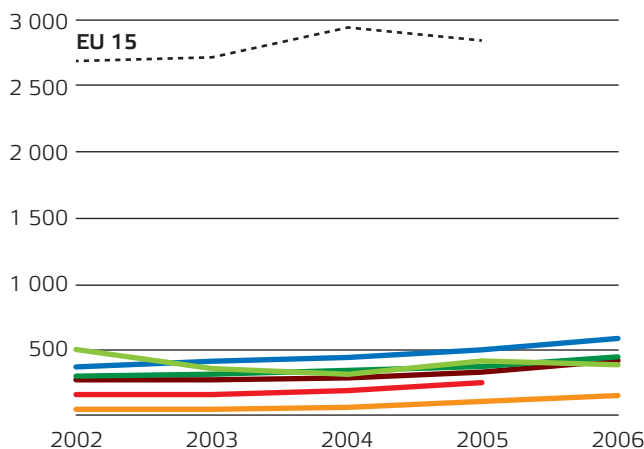
GDP growth, real %



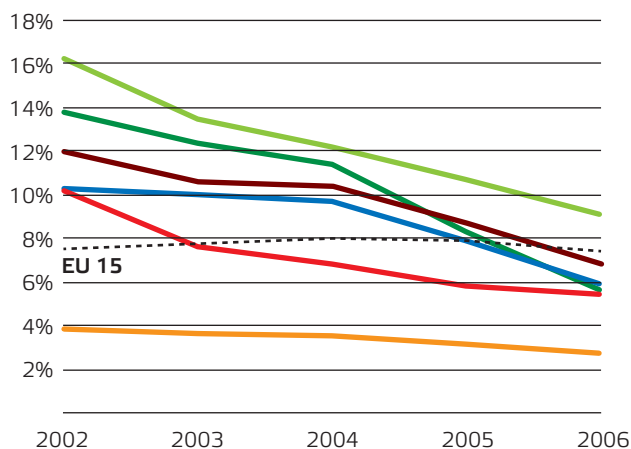
GDP per Capita, EUR



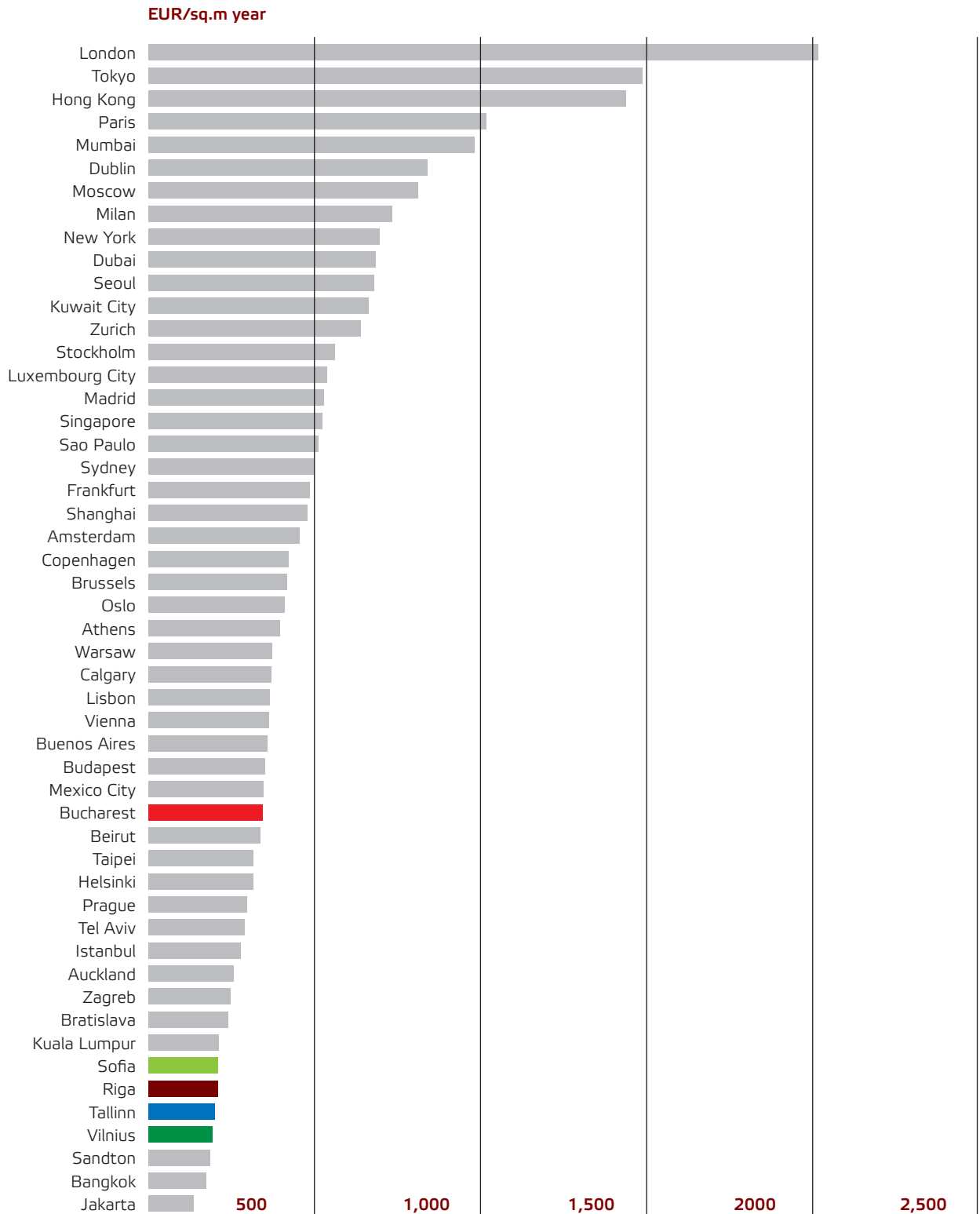
Average gross salary, EUR



Unemployment, %



The real estate firm Cushman & Wakefield Healy & Baker's overview of world office space prices in 2007 allows the price levels on the Arco Real Estate home markets to be viewed in comparison to the prices seen in various places in the world.





Estonia

Our journey starts in Estonia. Capital: Tallinn. With an area of 45,000 square kilometres, Estonia is home to 1.34 million people, 67% of whom live in urban areas. The capital is home to 400,000 people – about one-third of the population. The Estonian monetary unit is the kroon (1 € = 15.6 kr); 1 kroon equals 100 cents.



Arco Real Estate group's parent company is headquartered in Tallinn. This is where the real estate group with its 15 years of experience got its start. In these years of rapid change, Arco became a strong and powerful firm which is now the market and opinion leader in Estonia, with 11 offices throughout the country. In Estonia, Arco Vara is engaged in both real estate services, and development and construction activity.

Arco Vara was the company that laid the foundation for many endeavours: it concluded the first real estate transaction in newly independent Estonia and undertook a larger-scale development project – the Veskimöldre residential community.

Kaido Kangur, who heads the Estonian brokerage network, responds to questions.

WHAT GOALS DID YOU SET FOR YOURSELF FOR 2006?

The goals set for 2006 were above all related to growth, considering business volumes, the range of our activity, and recruitment of good employees. In 2006 the sales results for Arco Vara's service branch in Estonia by brokerage and appraisal activity grew around 40%



Kaido Kangur
Head of Estonian
Brokerage Offices

compared to 2005. The goal was set at 20%, and so this went even better than planned.

We also consider the growth in our team a great success – the number of employees grew by 40% last year.

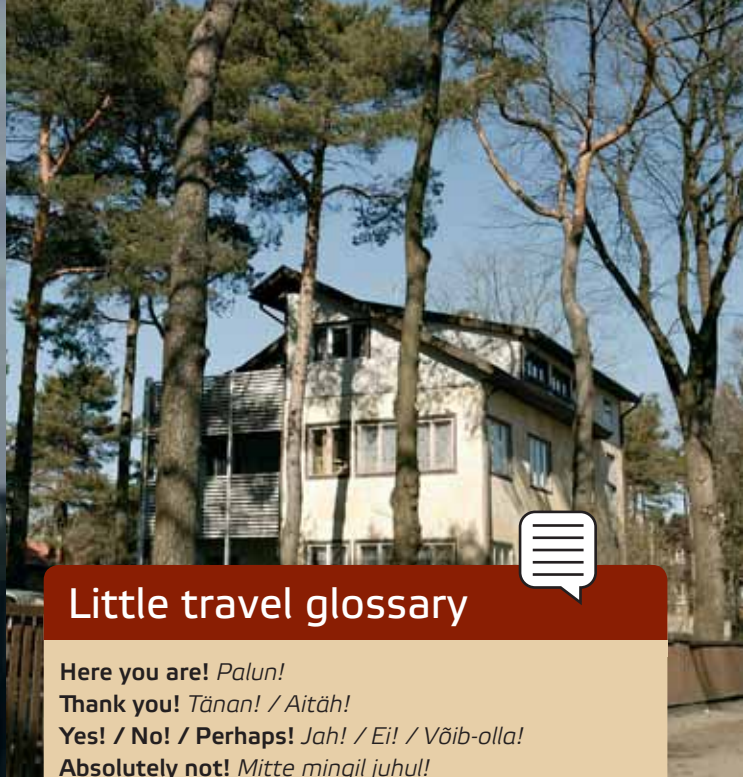
WHAT WERE THE MOST IMPORTANT ACTIVITIES LAST YEAR?

We expanded the range of our activity by adding two regional offices in Estonia. The Paide office opened its doors in the first half of last year and the Viljandi office opened in the second half of the year. The opening of new offices in central Estonia was well-timed – the real estate market has become markedly more active and is undergoing strong development.

Of the various internal organizational events I would emphasize the acquisition of group's property management company, Arco Vara Halduse OÜ by Arco Vara Kinnisvara-büroo AS - as a result, the selection of services we offer is now even wider and more diverse. We consider the addition of talented and hard-working employees to our country-wide team very important. This has strengthened our teamwork, raised the quality of service and has won the satisfaction and trust of customers.

Last year brought many interesting development projects to Arco Vara brokerages not just in Tallinn, but all over Estonia. The rapid growth of development activity in Haapsalu bears mentioning. This is a place where previously activity had been slower.

Office space-related business in the Tallinn region was also quite brisk. 2006 can be considered a very



Little travel glossary

Here you are! *Palun!*

Thank you! *Tänan! / Aitäh!*

Yes! / No! / Perhaps! *Jah! / Ei! / Võib-olla!*

Absolutely not! *Mitte mingil juhul!*

Okay! / Agreed! *Teeme nii! / Kokku lepitud!*

Hello! / Good morning / afternoon / evening!

Tere! / Tere hommikust / päevast / õhtust!

Would you like to have dinner with me tonight? /

Are you free tonight? *Kas te ei sooviks minuga täna õhtust süüa? / Olete te täna õhtul vaba?*

You look gorgeous today! / This colour really suits you! *Sa näed täna lihtsalt võrratu välja! / See värv sobib sulle!*

This is a magnificent city! I'd like to live here.

See on jumalik linn! Mulle tundub, et tahaksin siia elama jääda.

Can you recommend a good restaurant?

Oskate ehk mõnda head restorani soovitada?

How do Estonians like to relax?

Kuidas eestlased kõige meelsamini lõõgastuvad?

I love you. *Ma armastan sind.*

Excuse me, could you tell me how to get to the Arco Vara office? *Vabandage palun, kas te juhataksite mind Arco Vara büroosse?*

In what area would it be wise for my company to build a commercial building / warehouse?

Millisesse piirkonda oleks mu firmal mõistlik ehitada ärihoone / laohoone?

I'm interested in two-room / three-room apartments.

Do you have anything available? *Mind huvitavad kahetoalised / kolmetoalised korterid. On teil midagi pakkuda?*

I would like to buy / rent an apartment in the centre of Tallinn. How much would it cost? *Ma sooviksin osta / rentida korteri Tallinna kesklinnas. Kui palju see maksta võiks?*

successful year for Tallinn with regard to commercial operations – sales results increased by several times, and many projects were dealt with, bringing valuable experiences and satisfied customers to the department.

ARCO VARA IS THE LEADER AND OPINION LEADER ON THE LOCAL REAL ESTATE MARKET. HAS IT BEEN EASY TO MAINTAIN THE POSITION? WHAT IS ARCO VARA KINNISVARA-BÜROO'S COMPETITIVE EDGE IN ESTONIA?

Competition on today's real estate market has undoubtedly become stiffer and it is not easy to maintain the leader position – great effort must be expended to this end. The market normalization that has taken place in the second half of 2006 has shown that the larger real estate firms which have more experience and a longer history as well as the necessary resources in the form of good, talented employees, are better able to stay in competition.

For new start-up companies, it is much harder to act and survive on the real estate market in its current situation. Today, professionalism and trustworthiness are key selling points – both of these are ensured by experience.

The position of opinion leader is an important one to Arco Vara, and this is an important expression of the trustworthiness it has achieved. We consider openness, honesty and transparency critically necessary. Drawing on a study of the reputation of Estonian real estate firms, we can assert that we are the opinion leaders.

The competitive edge of Arco Vara lies in one sense in the range of activity of the entire group – we do more than just sell pieces of property. The various divisions of Arco Real Estate group (Service Division, Development Division, Construction Division) offer all-encompassing real estate solutions based on a standard set of principles. It is the broad scope of our activities and high quality of service along with our 15 years of experience that gives us our edge over competitors.

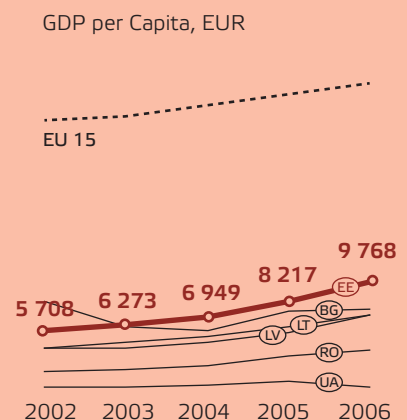
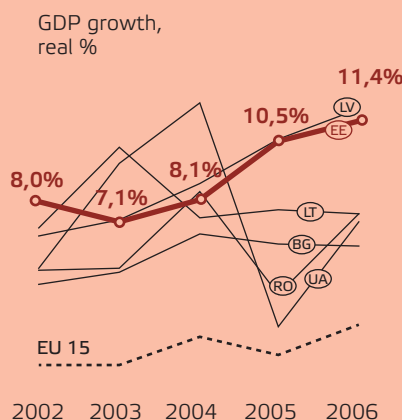


WHAT WERE THE PRIMARY DEVELOPMENTS ON THE ESTONIAN REAL ESTATE MARKET IN 2006 – IN THE FIELD OF RESIDENTIAL, COMMERCIAL, WAREHOUSE AND MANUFACTURING SPACE?

In short, the following summarizes last year on the real estate market:

- an extremely rapid rise in land prices in Tallinn and Harju County in the first half of the year;
- a relatively calm rise in apartment prices in Tallinn
- about 50% of real estate transactions continued to take place in Harju County; no changes have emerged in this trend over time nor are they expected
- strong pressure on performance figures on income stream generating commercial objects caused by heavy demand from investors operating on the market in this sector (real estate funds). At the same time, vacancy of Tallinn office buildings is practically non-existent, which is a precondition for a rise in rents and construction of new office buildings
- real estate prices in other Estonian cities and towns have experienced movement at different rates and times.

Financial indicators: Estonia



Compared to the end of 2005 and the first half of 2006 the market situation has clearly changed. At this time, it was a seller's market. Sellers dictated the price and due to the high number of buyers, prices could also be raised while the sales process was ongoing. The situation is now different and it is more of a buyer's market – thorough analysis performed by buyers as to their means, needs and desires has lengthened the sales periods.

The supply has increased markedly, and clients are making better informed decisions. Such a change poses new conditions on real estate developers. Customizing a project to the needs of the target group requires thorough preliminary work. Projects are no longer just sold on paper. Rather, planning is becoming more thought-through. The knowledgeability of clients has increased. They understand the alternatives and make wise choices.

LAST YEAR, THE MEDIA AIRED RUMOURS THAT THE REAL ESTATE BOOM COULD TURN TO BUST. DID SUCH RUMOURS AFFECT THE WORK OF ARCO VARA?

I would say it is more a change in the situation, a cyclical or seasonal factor that has always been characteristic of the real estate market in every era. In the end of 2005 and the first half of 2006, people bought real estate regardless of the month or season. The average price rise of residential space in this period was nearly 40%. It is clear that growth rates will at some point taper off.

At the end of 2006, market trading was still very active, but the first signs of stabilization could be seen. Today, we can say that the unnatural level of activity has come to an end on the real estate market.

The key words for 2007 are, on one hand, buyer knowledgeability and, on the other hand, professional, customer-friendly and high-quality work on the part of developers and real estate specialists. The times when relatively poorly-conceived projects could be sold are over. Arco Vara Kinnisvarabüroo has always been discriminating

with regard to the projects that it brokers. Now we are all the more vigilant, and we just say no to low-quality projects. Our main criterion is customer satisfaction, which is why we do effective preliminary work in regard to mapping our target group and ascertaining the needs of the customer.

Customers proceed from quality and cost-effectiveness, and this is a trend that has certainly contributed to market normalization. Smaller developers find it increasingly harder to establish and realize projects on their own, and thus they seek out more experienced real estate firms for seeking sales support.

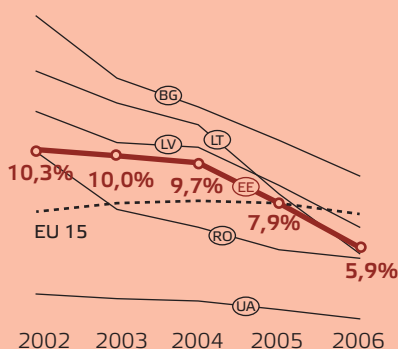
WHAT DOES 2007 HOLD IN STORE FOR THE ARCO VARA'S ESTONIAN OFFICE?

We are continuing our efforts to make the quality of service even better and more comprehensive, with various training programmes planned. We are trying to adapt the activity of our organization to the needs of clients. We consider teamwork and team spirit very important, which is why we are continuing to invest in employees, putting a premium not so much on quantity as on retention and recruitment of talented and good employees.

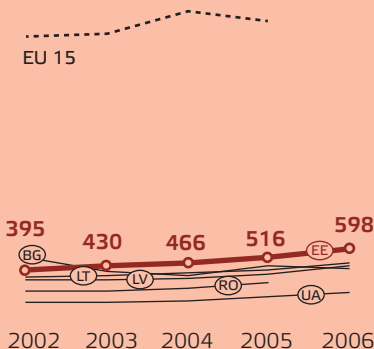
In cooperation with Estonian Business School, Arco Vara is launching a new study programme for educating a new generation of graduates in the real estate field. For our part, we are offering input in terms of lecture series content and opportunities for internships and employment. We will undoubtedly gain both necessary experience and additional team members.

Arco Vara Kinnisvarabüroo is also working toward expanding its range of activity in 2007, without sacrificing anything when it comes to efficient operation and positive internal climate. We consider the satisfaction of our employees just as important as of our customers. I am positive that if we proceed like this, hand in hand, things will work out for the best.

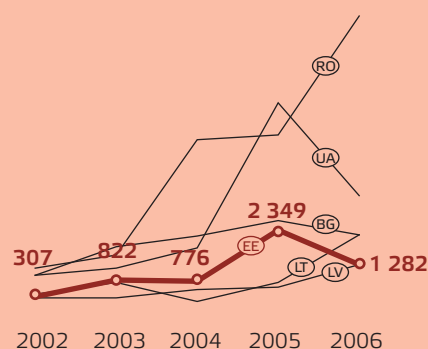
Unemployment, %



Average gross salary, EUR



FDI, mln EUR





Latvia

We leave Tallinn and go 271 kilometres south. Next stop: Latvia. Capital Riga. With an area of 65,000 square kilometres, Latvia is home to 2.28 million people, 68% of whom live in urban areas. The capital has a population of 728,000, or about one-third of the population. The lats is the currency (1 € = 0.7 Ls), 1 lats equals 100 santimi.

Arco Real Estate's Latvia office marked ten full years of activity this year. The company has been industrious in the service and development sectors, and it is the market and opinion leader in the field of Latvian real estate. Successful activity has paved the way for the Development Division. Arco Real Estate's Latvian office, headed by Aigars Smits, is the leading real estate company in the local market with already 8 offices all over Latvia.





Aigars Šmits
Head of Latvian
Brokerage Offices

AIGARS SMITS, WHAT WERE THE MOST IMPORTANT ACTIVITIES FOR ARCO REAL ESTATE LATVIA LAST YEAR?

The primary goal was fulfilling our budget, and this we did 100%. Other important developments during the year were the implementation of the AVIS, MIS, Navision, Intranet, and AD Web programmes. Thanks to these new features, our work is much more effective. In addition, the Latvian branch has developed a solution for the customer service standard. We call it AREKAS in Latvian (Arco Real Estate Klientu Apkalpošanas Standarts). The AREKAS project has already been implemented. To sum up, I believe that we can give the year a rating of seven out of ten.

HOW DO YOU RATE ARCO REAL ESTATE'S POSITION ON THE LATVIAN REAL ESTATE MARKET?

The Latvia branch has developed very rapidly in the last few years. The number of employees has risen to more than one hundred. Arco Real Estate now has two offices in Riga and an additional seven offices elsewhere in Latvia. The goal we are striving toward is to open 15 branches in Latvia by 2009.

WHAT, IN YOUR OPINION, IS ARCO REAL ESTATE'S ADVANTAGE COMPARED TO COMPETITORS IN LATVIA?

We are one of Latvia's leading real estate firms. Our goal is to be the best and offer quality solutions. The Latvian real estate market is developing constantly and one way we are better than others and really stand out is our very good quality of service.



Little travel glossary

Here you are! *Lūdzu!*

Thank you! *Paldies!*

Yes! / No! / Perhaps! *Jā! / Nē! / Iespējams!*

Absolutely not! *Noteikti nē!*

Okay! / Agreed! *Labi! / Sarunāts!*

Hello! / Good morning! / Good afternoon! */*

Good evening! *Sveiks! / Labrīt! / Labdien! / Labvakar!*

Excuse me, can you tell me what time it is?

Atvainojiet, vai Jūs, lūdzu, varat man pateikt, cik šobrīd ir pulkstenis?

Would you like to have dinner with me tonight? /

Are you free tonight? *Vai mēs varētu šovakar paēst kopā vakariņas? / Vai Tu esi brīvs/brīva šovakar?*

You look gorgeous today! / This colour really suits you! *Tu šodien izskaties vienkārši lieliski! / Šī krāsa Tev ļoti piestāv!*

This is a magnificent city! I'd like to live here.

Šī ir brīnišķīga pilsēta! Es labprāt šeit dzīvotu.

Can you recommend a good restaurant?

Vai Tu vari ieteikt kādu labu restorānu?

How do Latvians like to relax? Kā atpūšas latvieši?

I love you. *Es mīlu Tevi!*

In what area would it be wise for my company to build a commercial building / warehouse?

Kurā rajonā mūsu uzņēmumam būtu labāk būvēt biroja ēku/noliktavu?

I'm interested in two-room / three-room apartments.

Do you have anything available? *Mani interesē divistabu/trīsstabu dzīvokļi. Vai Jums ir kas pieejams?*

Excuse me, could you tell me how to get to the Arco Real Estate office?

Atvainojiet, vai Jūs, lūdzu, varat man pateikt kā nokļūt līdz Arco Real Estate birojam?



PLEASE DESCRIBE THE PRIMARY DEVELOPMENTS ON THE LATVIAN REAL ESTATE MARKET IN 2006 IN THE FIELD OF RESIDENTIAL, COMMERCIAL AND WAREHOUSE AND MANUFACTURING SPACE.

The most important project last year was the first-class office building Dunties Nami. In 2006, two new projects were launched – Anninmuizas Boulevard and Priedaines residential communities.

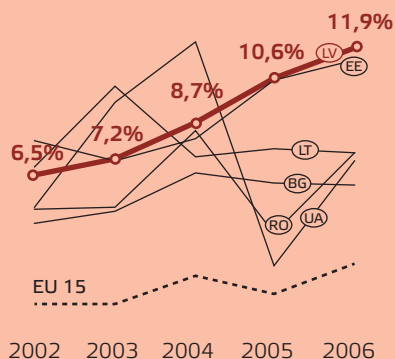
In the field of warehouse and industrial space, the trend

is more toward expanding projects in progress, and many projects are currently being carried out. In the future the wave of new projects may spread outside the capital of Riga – to the vicinity of Riga and larger cities such as Liepāja, Ventspils, Rēzekne and elsewhere.

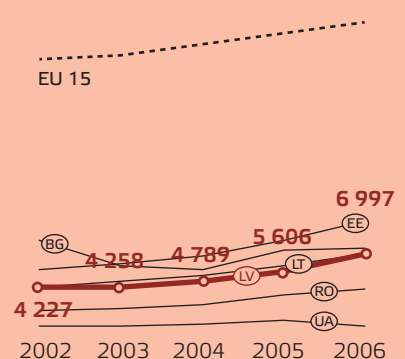
The market situation and prices vary according to region. Commercial space is currently more expensive in Riga than it is elsewhere. Prices depend on location, demand and supply, construction costs, infrastructure and the like.

Financial indicators: Latvia

GDP growth, real %



GDP per Capita, EUR



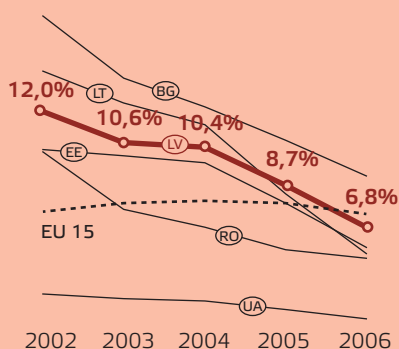


HOW ATTRACTIVE IS LATVIA FOR FOREIGN INVESTORS?

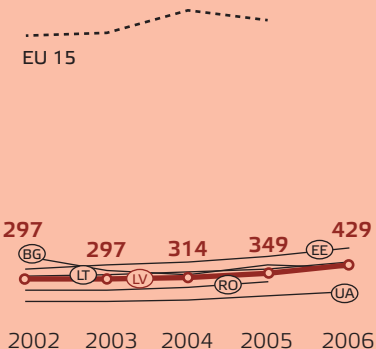
Naturally many investors are interested in Latvian real estate. In most cases, the investors are construction and development firms in the Baltic States, Scandinavia and Germany who are interested primarily in various kinds of business projects in Riga, but also in Jurmala, Jelgava and other areas.

Considering that Riga and all of Latvia is still seeing a shortage of first-class office space and that there is also great potential in the residential sector, we can expect continuing interest from investors in the Latvian real estate market in the future as well.

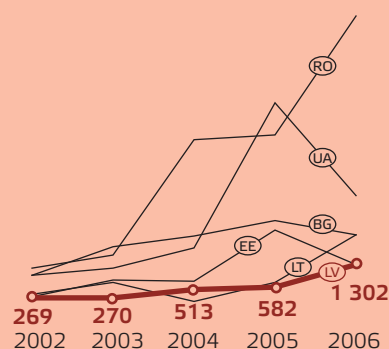
Unemployment, %



Average gross salary, EUR



FDI, mln EUR





Lithuania

We leave Latvia and head 273 kilometres to the southeast. Next stop: Lithuania. Capital Vilnius. With an area of 65,300 square kilometres, Lithuania is home to 3.39 million people, 67% of whom live in urban areas. The capital is home to 553,000 people – about 16% of the population. Of the three Baltic States, Lithuania has the lowest inflation and unemployment. The rise in GDP has been lower than that of the other two countries – 7.8% (compared to 10.5% in Estonia and 10.2% in Latvia). Lithuania's currency is the litas (1 € = 3.5 Lt), 1 litas equals 100 centai.



Arco Real Estate's Lithuania office employs professional appraisers and brokers who are helping the company to grow rapidly. The local branch office performs regular overviews of the current situation of the Lithuanian real estate market. Indre Augulytė, the head of the Lithuanian branch office, answers questions.

WHAT WERE THE GOALS OF THE ARCO REAL ESTATE LITHUANIA BRANCH OFFICE IN 2006?

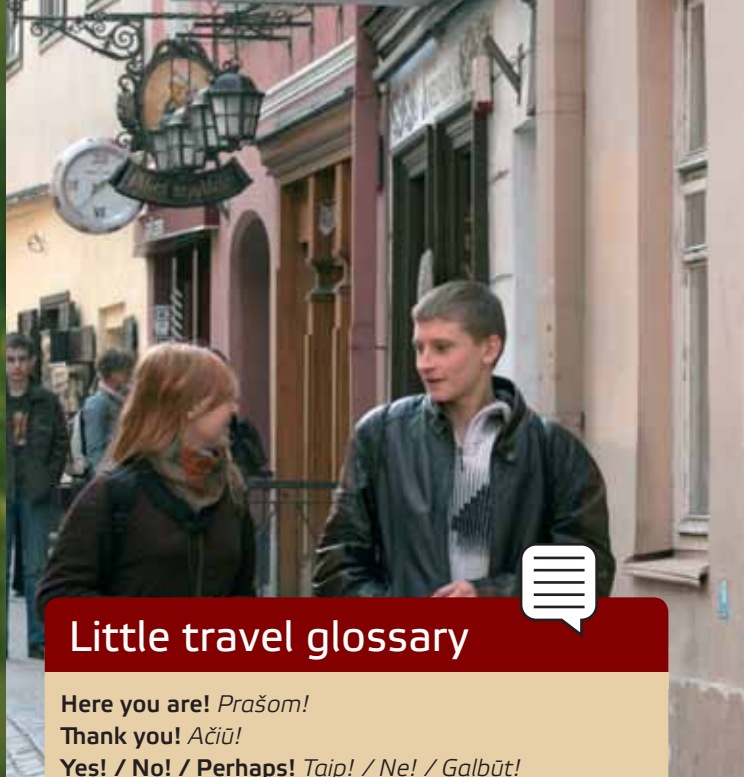
The primary goals of the Lithuanian branch were to increase the size of the team, opening a new office in Kaunas – the second largest office – and offering real estate brokerage services. It was planned to find an individual for our rapidly-developing team whose function would be to deal separately with marketing. All of these goals were fulfilled last year, and as a result our company is now bigger and stronger. I would give 2006 a rating of 8 out of 10.

WHAT WERE THE BIGGEST SUCCESSES LAST YEAR?

The three most important events were the expansion of the company's Development Division, developing the service team under a new manager, and opening a new office in Kaunas. The biggest projects last year were apartments and commercial space in a building complex in downtown Vilnius (Šluškų Slėnis), luxury apartments and commercial space in Old Town Vilnius (Vilniaus/Islandijos streets) and an area of private homes in Vilnius (Mūrinė Vokė).



Indre Augulytė
Head of Lithuanian
Brokerage Offices



Little travel glossary

Here you are! *Prašom!*

Thank you! *Ačiū!*

Yes! / No! / Perhaps! *Taip! / Ne! / Galbūt!*

Absolutely not! *Tikrai ne!*

Okay! / Agreed! *Gerai! / Sutarta!*

Hello! / Good morning! / Good afternoon! /

Good evening! *Sveiki! / Labas rytas! / Laba diena! /
Labas vakaras!*

Would you like to have dinner with me tonight? /

Are you free tonight? *Ar norėtumėte šįvakar su
manimi pavakarieniauti? / Ar šį vakarą Jūs laisvas (-a)?*

**You look gorgeous today! / This colour really suits
you!** *Šiandien Jūs puikiai atrodote! / Ši spalva Jums
labai tinka!*

This is a magnificent city! I'd like to live here.

Tai išties nuostabus miestas! Norėčiau čia gyventi.

Can you recommend a good restaurant?

Gal galite parekomenduoti gerą restoraną?

How do Lithuanians like to relax?

Kaip estai lietuviai mėgsta atsipalaiduoti?

I love you. *Aš tave myliu!*

**Excuse me, could you tell me how to get to the Arco
Real Estate office?** *Atleiskite, gal galėtumėte pasakyti
kaip pasiekti Arco Real Estate biurą?*

**In what area would it be wise for my company to
build a commercial building / warehouse?**

*Kuriame rajone mano kompanijai būtų geriausia
statyti biurų pastatą / sandėlį?*

I'm interested in two-room / three-room apartments.

Do you have anything available? *Mane domina dviejų
/ trijų kambarių butai. Ar turite ką nors pasiūlyti?*

**I would like to buy / rent an apartment in the
centre of Vilnius. How much would it cost?** *Norėčiau
nusipirkti / išsinuomotį butą centre Vilniaus. Kiek jis
galėtų kainuoti?*

HOW DO YOU RATE THE POSITION OF ARCO REAL ESTATE ON THE LITHUANIAN MARKET?

Our company is among the three best Lithuanian real estate companies (depending of course which companies are being compared). The real estate firms on the local market offer certain services and products, but Arco Real Estate is unique in its wide range of services, which is why it is difficult to compare it to other firms. Achieving the current level has not been as easy as we had hoped, but it was a useful experience and we gained experience that will help us develop.

WHAT IS YOUR ADVANTAGE OVER COMPETITORS?

The primary advantage is our employees. It is thanks to them that we can share our values and goals. Partnership, trustworthiness, professionalism, caring and responsibility are not just empty words for us. As a result, our customers enjoy every possible advantage – we truly care for one another and support each other.

DESCRIBE THE PRIMARY DEVELOPMENTS ON THE LITHUANIAN REAL ESTATE MARKET IN 2006 IN TERMS OF RESIDENTIAL, COMMERCIAL AND WAREHOUSE AND MANUFACTURING SPACE

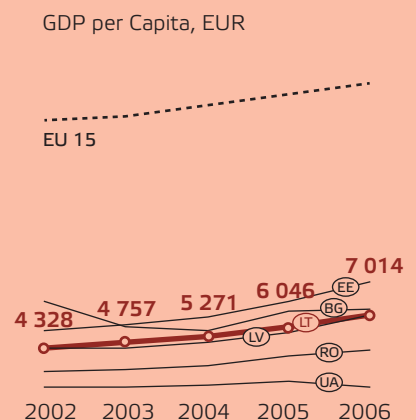
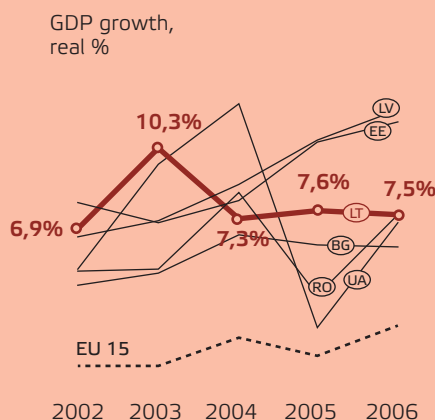
The biggest projects in the medium price range in 2006 were the apartment building in the Pilaitė district and the Perkūnkiemis project in the Pašilaičiai district of Vilnius. A major project was developed in the centre near the river Neris – the Karaliaus Mindaugo apartamentai (King Mindaugas Apartments), with a view of the Gediminas citadel. The development is meant for people with an income substantially higher than the average. Prices vary from one region to the next, but prices in



the port city of Klaipėda for instance rose more rapidly than they did in the second-largest city of Kaunas and more or less attained the same level as the capital Vilnius. The reason is the fact that there are many high-rise buildings in Klaipėda and most of the apartments feature extremely appealing views of the Baltic Sea. Prices also rose in smaller towns, but not as much as in the capital and other larger towns. For the first time in a long time, new projects were launched in a number of smaller cities such as Utena and Šiauliai – this was a big step ahead for the apartment market. The situation was completely different in small port towns such as Palanga and Nida, where prices are as high if not higher than they are in Vilnius. Everything depends on location and views. The Baltic region is very popular. To an increasing extent, „second apartments” are being bought for use as summer homes. New projects were also started in Druskininkai, where prices are on the same level as for

Vilnius apartments in the medium price range. The most important projects on the market for commercial space were BIG (Vilnius) and Grandus (Klaipėda); on the office space market, BCC2 (Vilnius), Kernavė (Vilnius) and K-centras (Klaipėda); and in industry, Sanitex distribution and logistics (Klaipėda). Prices for commercial space vary greatly in Lithuania, depending on the location, city and surroundings. For example, in Vilnius, new office space in business centres costs 7000 litas/m², but in Klaipėda, a similar space would cost about 4500 litas/m². Prices also fluctuate from one part of a city to the next. Especially in Vilnius, office space in the centre and Old Town are much more expensive than other districts. This is caused by greater demand for space in the centre. Commercial space in the centre or Old Town of Vilnius costs about 4500-33,000 litas/m², while in residential districts it costs about 3200-8000 litas/m².

Financial indicators: Lithuania





All Lithuanian photos by Aliona Bondarenko.



In smaller towns, prices are half or less of the prices in Vilnius, as demand is smaller and potential is more modest.

HOW ATTRACTIVE IS THE LITHUANIAN REAL ESTATE MARKET FOR FOREIGN INVESTORS?

The Lithuanian real estate market continues to be attractive for foreign investors, if a little less than it was a few years ago (for example, in 2004, yield was about 12% and 7-8% in 2006). The reason is the increasing competition between a number of foreign investment funds and the rapid drop in income. Investors are especially interested in commercial projects – above all, shopping centres and new industrial space. The trends show that in 2007, net profit will continue to shrink.

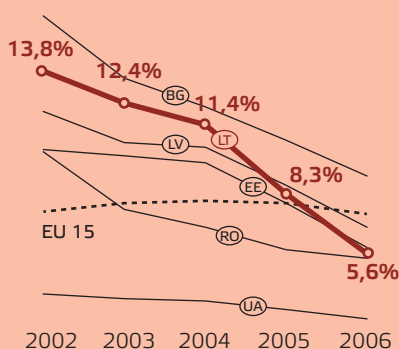
Foreigners who are looking for opportunities to buy into projects at the earliest stage in order to sell or

lease property out later are interested in the Lithuanian real estate market. Another noticeable trend was that customers have more interest in office space than they do in residential space, as commercial space produces a slightly higher rate of return. Investors are very interested in commercial projects, especially shopping centres and new industrial space. Right now the profit is around 6-8%, but in 2007, net profits should be smaller.

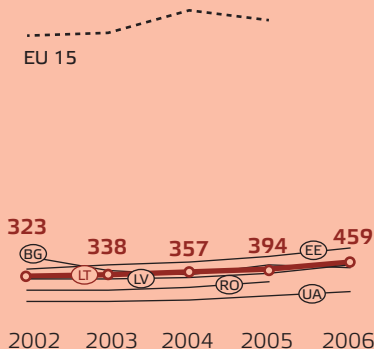
WHAT ARE THE PRIORITIES OF THE ARCO REAL ESTATE LITHUANIA BRANCH OFFICE IN 2007?

In 2007 we want to achieve our revenue goals and start offering services in the port town of Klaipėda, where the real estate market is developing very rapidly. We also plan to hire 70 highly qualified employees. Our abiding goal is to make our vision a reality – to become the symbol of real estate.

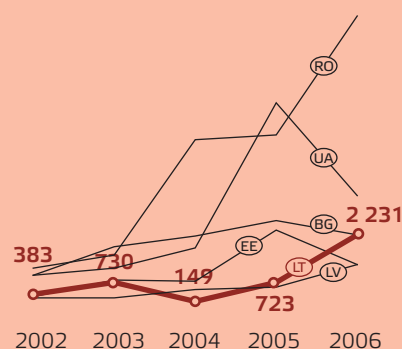
Unemployment, %



Average gross salary, EUR



FDI, mln EUR





Ukraine

We continue on our way, 585 kilometres to the east. The next stop is Ukraine. Capital: Kyiv. The country has an area of 604,000 square kilometres and is home to 46.9 million people, 67% of whom are in urban areas. Only 2 million people live in the capital – just 6% of the population. The hryvnia (1 UAH = 0.14 €) is the unit of currency, 1 hryvnia equals 100 kopecks.



Launched in 2005, the service units that make up Arco Real Estate's Ukraine branch office have during the year gained their stride, developing sales activity and increasing their market share on a regular basis. For the Ukraine office, 2006 was an active year of development. According to director Yuri Nikitin, achievements in the field of brand development, marketing and training programmes attested to this.

The greatest achievements can be considered to be the opening of two departments (one of which handles residential space; the other, land and detached homes), expansion of the personnel and Arco's office space – and the fact that hits on the homepage increased tenfold after a new improved version was launched. The number of visitors put Arco Real Estate on the front page of the popular Ukrainian portal www.bigmir.net. Last year, an agreement was inked with Parex Bank. Other partners in cooperation include Ukrsibbank and Privatbank.



Yuri Nikitin
Head of Ukrainian
Brokerage Office

Nikitin considers the office's advantages over competitors to be openness, transparency and innovation – and the fact that it is a recognizable, international brand. „It is still early to talk about us having a conspicuous position on the real estate market, as there are no firms that have a complete network of regional offices in Ukraine,” says Nikitin.

We asked Nikitin to describe the Ukrainian real estate market. He says a general increase in prices is taking place throughout the country. The highest real estate prices per square metre are being seen in the capital and other cities with over a million inhabitants. The highest average prices per square metre are in Dnepropetrovsk (1372 USD/m²), Odessa (1820 USD/m²) and Kyiv (2446 USD/m²). Elsewhere the price level is much lower. All this makes it clear that there is a big rift in the real estate market. The reasons, according to Nikitin, are that people are moving to Kyiv and other big cities with developed infrastructure. Buying real estate is an alternative to investment for people. „People are placing their money in real estate since there is nothing more secure at the moment,” he says. Last year the conditions for taking housing loans also improved, and this also has a role in increasing the potential buyers segment.



Little travel glossary

Here you are! *Ось, будь ласка!*

Thank you! *Дякую (Вам)!*

Yes! / No! / Perhaps! *Так!/Ні!/Можливо!*

Absolutely not! *Звичайно ні!*

Okay! / Agreed! *Так!/ Згода (згоден)!*

Hello! / Good morning! / Good afternoon! /

Good evening! *Привіт!/ Доброго ранку!/*

Добрий день!/ Добрий вечір!

Would you like to have dinner with me tonight? /

Are you free tonight? *Чи могли б ви сьогодні пообідати зі мною?/ Чи вільний ви у вечері?*

You look gorgeous today! / This colour really suits you! *Ви виглядаєте бездоганно (чудово)!*

Маєте неперевершений вигляд! / Цей колір дійсно підходить вам!

This is a magnificent city! I'd like to live here.

Це місто надзвичайне! Я хотів би тут жити.

Can you recommend a good restaurant?

Який приємний ресторан Ви мені можете порадити?

How do Ukrainians like to relax?

Як українці люблять відпочивати?

I love you. *Я Вас кохаю.*

Excuse me, could you tell me how to get to the office of Arco Real Estate? *Вибачте, не підкажете, як добратися до офісу Arco Real Estate?*

In what area would it be wise for my company to build a commercial building / warehouse?

В якому місці було б найвигіднішим для моєї компанії, побудувати бізнес-центр/ склад?

I'm interested in two-room / three-room apartments. Do you have anything available?

Мене цікавлять двокімнатні/ трикімнатні квартири. Чи є якісь пропозиції?

I would like to buy / rent an apartment in the centre Kiev. How much would it cost? *Я хотів би купити/ взяти в оренду квартиру в центрі Києва. Скільки це коштує?*

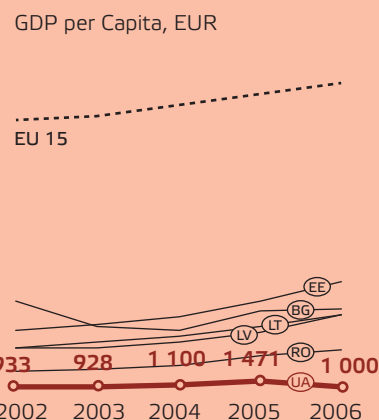
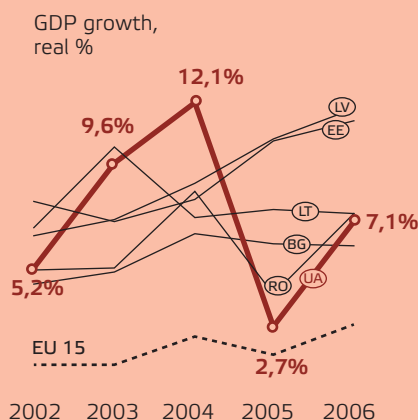


Ukraine is an attractive country for foreign investors. In the last two years, investments in Kyiv and all of Ukraine have doubled. There are many potential investors in Ukraine. For example, Ukraine is a potential target country for investors from Russia. The reason is that many restrictions have been established in markedly more attractive Russian cities such as Moscow and St. Petersburg. Kyiv thus has much higher prospects. There are investors from elsewhere as well: while Eastern Ukraine contains primarily Russian investors, Western Ukraine is of interest to countries that have been historically linked to the region, such as Austria, Hungary

and Poland. Crimea is attractive for Baltic, Turkish and Russian investors, and Odessa and Dnepropetrovsk are popular cities as well.

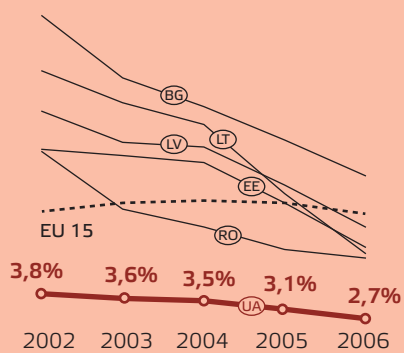
From 2007 to year 2010, one of the activities pursued by the Arco Real Estate Ukrainian office is implementing communication programmes such as AVIS and Intranet, improving cooperation between departments and increasing the number of employees. In the next few years, Arco Real Estate wants to open offices in all of the largest cities in Ukraine.

Financial indicators: Ukraine

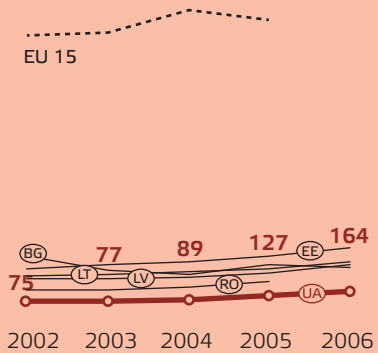




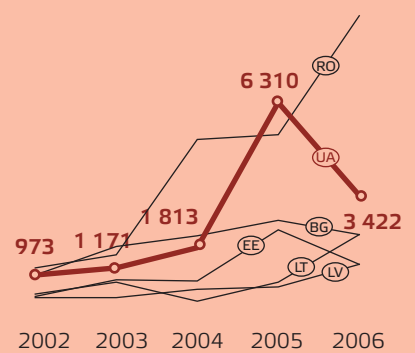
Unemployment, %



Average gross salary, EUR



FDI, mln EUR





Bulgaria

We leave Kyiv and start on a 1,021-kilometer leg to the West. Next stop: Bulgaria. Capital: Sofia. This 100,000-square-kilometre country, which joined the European Union in 2007, has a population of 7.97 million people, of whom 70% live in cities. The capital Sofia is home to barely one-sixth of the population – 1.3 million inhabitants. The Bulgarian unit of currency is the lev (1 € = 1.9 levs), 1 lev equals 100 stotinkas.



Launched in 2006, Arco Real Estate's Bulgarian branch office got the attention of the local press immediately with its active profile. In 2006, the Bulgarians were busy launching their customer service unit, and now the development activity has been started as well. The Bulgarian office is headed by Rauni Tillisoo, who has been on the Arco Real Estate team for many years, going from broker to one of the top people in her field. Running the Bulgarian office is a new kind of challenge for her.

HOW EASY WAS IT FOR YOU TO ENTER THE BULGARIAN REAL ESTATE MARKET? HOW MUCH INTEREST WAS EXPRESSED IN YOU?

I believe that entering a new market is never easy, but for us the decision to start in Bulgaria was not like diving into water in an unknown place. We conducted a fairly thorough market situation analysis. Besides, I also already had personal experience in Bulgaria, in addition to my experiences in Latvia, Lithuania and Ukraine. Thus we had a realistic vision of what we would have to start doing and what we could realistically hope for.

It seems that we are experiencing a situation similar to



Rauni Tillisoo
Head of Bulgarian
Brokerage Offices



Little travel glossary

Here you are! *Заповядай!* **Thank you!** *Благодаря!*

Yes! / No! / Perhaps! *Да! / Не! / Може би!*

Absolutely not! *Абсолютно не!*

Okay! / Agreed! *Добре! / Разбрахме се!*

Hello! / Good morning! / Good evening!

Здравейте! / Добро утро! / Добър Вечер!

Excuse me, can you tell me what time it is?

Извинете, бихте ли ми казали колко е часа?

Would you like to have dinner with me tonight? /

Are you free tonight? *Ще вечеряте ли с мен тази*

вечер? / Свободен (а) ли сте тази вечер?

You look gorgeous today! / This colour really

suits you! *Изглеждаш страхотно днес! / Този цвят*

наистина ти отива!

I love you. *Обичам те!*

This is a magnificent city! I'd like to live here.

Този град е прекрасен! Бих искал (а) да живея тук!

Can you recommend a good restaurant?

Можете ли да препоръчате някой добър ресторант?

How do Bulgarians like to relax?

Как Българите обичат да релаксират?

Excuse me, could you tell me how to get to the

Arco Real Estate office? *Извинете, можете ли да ми*

кажете как да стигна до офиса на Arco Real Estate?

In what area would it be wise for my company to build a commercial building / warehouse?

В кой район ще бъде разумно да се построи търговска сграда / склад?

I'm interested in two-room / three-room apartments. Do you have anything available?

Интересувам се от двустайни / тристайни апартаменти. Имате ли нещо на разположение?

I would like to buy / rent an apartment in the centre

Sofia. How much would it cost? *Бих искал (а) да*
закупу / наема апартамент в центъра на София.

Колко ще струва?

what Estonia and the whole of the Baltic real estate market experienced after EU accession. Here, too, the expectations and attitudes are similar. For me, the biggest surprise was how warmly we were welcomed. The fairly widespread attitude of „why did they come play in our sandbox“ might just as well have been encountered. In Bulgaria, it was different, people were interested and the openness was impressive. Perhaps this is partly because of the fact that Bulgarians and Estonians are united in some manner by a similar complicated past. Bulgarians do not need to be told where Estonia is located; everyone has knowledge or memories or friends from Estonia.

For Arco Real Estate, developments related to European Union accession in 2007 were definitely important, although we launched our activity back in July of last year.

WHAT WERE THE EXPECTATIONS OF THE BULGARIANS WITH REGARD TO ARCO REAL ESTATE, AN INTERNATIONAL COMPANY ENTERING THE BULGARIAN REAL ESTATE MARKET? WHAT THEY EXPECT MOST?

Good service providers and professionalism are always welcomed, regardless of the country and field. Indeed, the media, colleagues from other real estate firms and clients welcomed us in Bulgaria with just this attitude. It is good to see that people were surprised in a good way upon discovering that Arco Real Estate, originally from the Baltic states, is now in Bulgaria as well. I think that in the beginning we were the most beneficial to clients and partners who knew us from other markets. On the local

market, the primary goal and mission is to prove in the first year what we can do, how we can do it and whether it has a definite value for them.

The greatest expectations are tied to the nature of our company – the fact that we are already operating in six countries, and as a result they themselves will enjoy greater prospects on new markets. There are other international real estate firms in Bulgaria, but none of them are from this part of Europe.

WHAT WERE YOUR GOALS FOR 2006?

The biggest goal was to integrate the corporate culture, successfully launch service in Sofia and then to expand to other larger cities. At the moment, we already represent a number of residential projects in Sofia, by the Black Sea and ski resorts. The Sofia office has a staff of 22 people and we are getting bigger with each passing day.

In certain places, market trends are harder to comprehend than we initially thought. In 2006, a bit of a slow-down occurred on the market, based on the hopes that EU accession would result in a price rise.

WHAT WERE SOME OF THE KEY ACTIVITIES FROM LAST YEAR?

First of all, we got off to a successful start in Bulgaria by opening the Sofia office. Second, we have a strong and ambitious team, consisting of 22 people working diligently toward our goals. Third, we have more than fifty new development and construction projects – this shows that we have much to do.

WHAT IS THE ADVANTAGE YOU OFFER COMPARED TO COMPETITORS?

The biggest advantage is the fact that Arco Real Estate has a unique structure and long experience in the Baltic countries. The Baltic market is slightly ahead of Bulgaria's – although I can say that it is not so far ahead as we thought in the beginning, viewing it from a distance.

We have know-how within the corporate group when it comes to buying, developing, selling and managing land. This is a synergy, which gives us a strong leg up on the competition. Of course, we have a long way to go to reach the same level as Estonia and in order for us to offer just as wide a selection of services as we do in Estonia. But this is our goal.

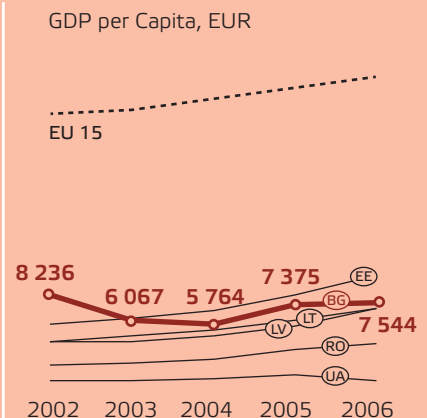
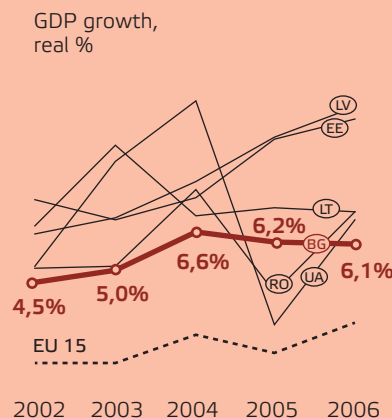
CHARACTERIZE THE CURRENT SITUATION ON THE BULGARIAN REAL ESTATE MARKET.

Every field of the Bulgarian real estate market has potential. For the locals, the most attractive field is residential development. Our skills are on the highest level in development activity in the sector – we do not create just a house or apartment, but rather integral places to live; we create homes. The sales unit's close cooperation with developers throughout the entire project is not yet the norm, but it is the only way to create the best solutions for the end customer.

For foreign investors, logistics centres and commercial space offer the most interest. They are looking for completed sites that already generate income streams, so that they would not need to deal with design and construction themselves. But there are few such sales offerings.

The holiday-oriented real estate sector is seeing the fastest pace of development – in some cases it is said it is maybe even too active. On the other hand, the price level is very low compared to similar holiday spots in Europe. A 354 km Black Sea coastline, top ski resorts, a short flight time from Europe and in summer, average air temperature of 27 degrees Celsius and average water temperature of 22 degrees on the coast. If Bulgaria as a whole is able to draw tourist flows and see constant improvement in this area, it will undoubtedly become the most popular vacation destination aside from Spain and Italy – as well as being a much lower-cost one.

Financial indicators: Bulgaria





IS THE REAL ESTATE MARKET SITUATION AN EVEN ONE FROM ONE REGION OF BULGARIA TO ANOTHER?

In general, the price levels in similar market segments are on a comparable level from one region to another – in Sofia and other larger cities. They are followed by ski resorts and seaside holiday areas. The centre of Sofia is completely a separate case – price levels reach 3,000 EUR/m², but the price of land just 20–30 kilometres from Sofia may be only 10–15 EUR/m² (depending on the size and conditions, etc, of course).

Apartment prices for flats with good interior finishing and a modern layout in larger cities and resorts are more or less on the same level. The detached house market varies greatly in price depending on location – in a nice small town in the middle of the country one can be had for 20,000 to 30,000 euros, while close to major cities, the price goes up to 100,000 euros and to 200,000–300,000 euros in the city centre.

HOW TEMPTING IS BULGARIA'S REAL ESTATE MARKET TO FOREIGN INVESTORS?

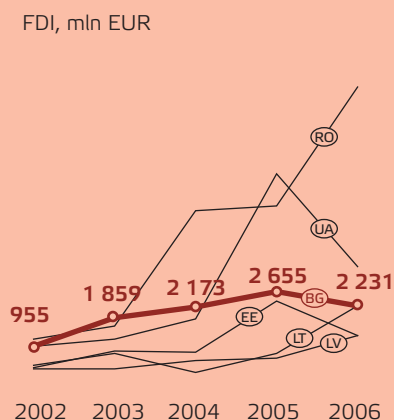
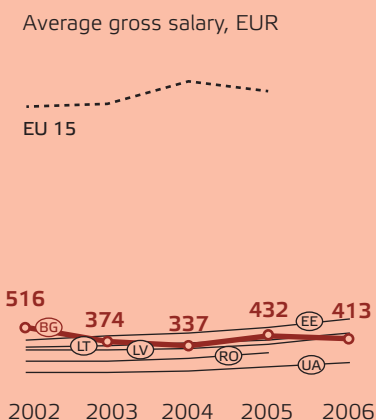
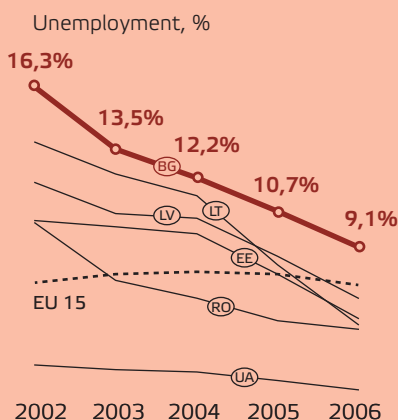
The Bulgarian real estate market is very attractive in the eyes of investors and certainly not only in the real estate sector, but in other branches of the economy and on the

business world as a whole. For us, this is a big advantage, as the development of every company or sector is, like it or not, related to real estate – there is a need for new buildings, space, residential space. We see interesting challenges for ourselves. Demand is growing in a number of fields – shopping, hotels, telecommunications, manufacturing and naturally also many real estate developers and real estate funds who are looking for the best yields on developing markets. Accession to the European Union has resulted in interest from an additional number of people, and those who were monitoring developments before are now actually in country.

WHAT ARE YOUR OBJECTIVES FOR 2007?

The company wants to expand in Bulgaria and open new offices in two other major cities. According to our plans, there will be 40 people working at the Arco Real Estate Bulgaria office by the end of the year. In addition, we hope that our development department will start its own developments as well.

The biggest challenges are constantly improving our professionalism, and expanding our range of services – appraisal, management service and other solutions that may be of service to our local clients.





Romania

Our tour ends 297 kilometres southwest of Sofia. Our last stop: Romania. Capital: Bucharest. Like Bulgaria, Romania joined the European Union in 2007. A total of 22.3 million people inhabit a territory of 238,000 square kilometres. Over half live in the cities. One-tenth of the population, which makes 2.3 million people, live in the capital Bucharest. The currency is the leu (1 L = 0.30 €), 1 leu is 100 bani.




The team of the Romanian branch, launched at the end of 2006, is active, innovative, hard at work, with big plans in store. They are at the beginning of the road of their development. Ciprian Lopata talks of the ambitious plans for the Romania branch office.

**HOW EASY WAS IT FOR YOU TO ENTER
THE ROMANIAN REAL ESTATE MARKET?
HOW MUCH INTEREST WAS EXPRESSED?**

Romania as a brand-new European Union member state should be the primary target for foreign investors who want to develop and expand their company. It is easier to operate on the real estate market of the European Union's newest members. The market's youth means it is full of life and open to new players.

In countries similar to Romania, the media tends at first to be very interested in new players. After the official opening, interest dies down, because there are so many competitors at one time and they tend to drown each other out with their talk of their activities. A company's ability to communicate is the most important thing: you must be newsworthy for the public, offering solid and useful information to publications that write about real estate.

Getting coverage for the official opening of Arco Real Estate Consulting in the local press was a true *coup de grace*. Now every journalist who writes about real estate



Ciprian M. Lopata
Head of Romanian
Brokerage Office

knows what Arco Real Estate Consulting is and they want to hear more and more about the company. Arco Real Estate Consulting has won the support of journalists.

WHAT WERE THE EXPECTATIONS OF THE ROMANIANS WITH REGARD TO ARCO REAL ESTATE AS AN INTERNATIONAL COMPANY ENTERING THE ROMANIAN REAL ESTATE MARKET? WHAT THEY EXPECT MOST?

Romanians are very aware what kinds of services and products they buy and want to receive. This means that they want to get quality service and professional interaction from all companies and brokers. Our potential customers in Romania prefer companies with good reputations that are known abroad as well. Potential clients look for good prices and desire constant consultation services. Transparency, honesty and meticulousness are the values that Romanians want as the clients of service providers. And Arco Real Estate has all of this – the services and the necessary values.

WHAT GOALS DID YOU SET FOR YOURSELF FOR 2006?

Last year our primary goal was to find those two right employees who would jointly start establishing a company with big potential on the Romanian market. And that goal was fulfilled. Now our main aim is to develop a strong team of professional real estate consultants throughout the country. We started work in this direction in late 2006 and it is ongoing.

AS THE DIRECTOR OF THE ROMANIAN OFFICE, WHAT WERE YOU MOST PLEASED OF IN LAST YEAR?

As of the start of 2007, we are well into the race and



Little travel glossary

Here you are! *Am ajuns!*

Thank you! *Mulumesc!*

Yes! / No! / Perhaps! *Da! Nu! Poate!*

Absolutely not! *Exclus!*

Okay! / Agreed! *In regula!*

Hello! / Good morning / afternoon! / evening!

Buna! / Buna dimineata / dupa-amiaza / seara!

Excuse me, can you tell me what time it is?

Puteti sa-mi spuneti cat este ora va rog?

You look gorgeous today! / This colour really suits you! *Arati minunat astazi! Culoarea asta ti se potriveste de minune!*

Would you like to have dinner with me tonight? /

Are you free tonight? *Vrei sa luam cina impreuna diseara? Esti liber/a diseara?*

This is a magnificent city! I'd like to live here.

Orasul e minunat! Mi-ar placea sa locuiesc aici.

Is the weather always so bad / beautiful?

Vremea e mereu asa de urata/frumoasa?

I love you. *Te iubesc.*

Excuse me, could you tell me how to get to the Arco Real Estate office? *Poti sa-mi spui cum ajung la sediul Arco Real Estate?*

I would like to buy / rent an apartment in the centre Bucharest. How much would it cost? *As vrea sa cumpar/inchiriez un apartament in central Bucurestiului. Care este pretul?*

I'm interested in two-room / three-room apartments. Do you have anything available?

Ma intereseaza apartamente cu doua/trei camere. Aveti ceva disponibil?

Does this district have good access to the city centre by bus / train? *Are acest sector acces la central orasului circuland cu autobuzul/metrou?*



gaining our stride. „It’s a marathon, not a sprint,” one of my Bulgarian colleagues said. We have great hopes in this regard – that we will be able to develop our company in the near future in the best possible manner. The most important event for us was the official PR event that took place at the start of the year. It was a big success – 57 journalists attended. This event resulted in 32 articles in the media, 7 wire service stories, 8 online stories and one TV segment. The number of total readers was 4.818.400 and it was registered a total financial value of EUR 52.878 (Rate Card). We want to be just as successful in the future.

WHAT IS THE ADVANTAGE YOU OFFER COMPARED TO COMPETITORS?

Today the Romanian real estate market is in the same situation as all former communist countries ten years ago. This knowledge gives us an edge in the form of

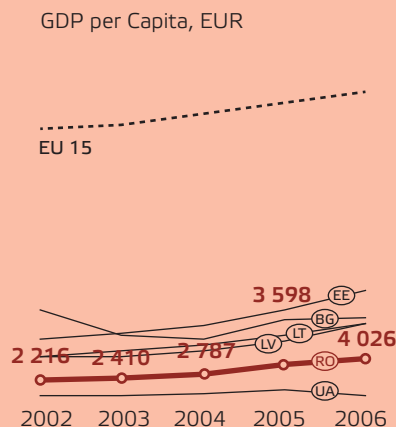
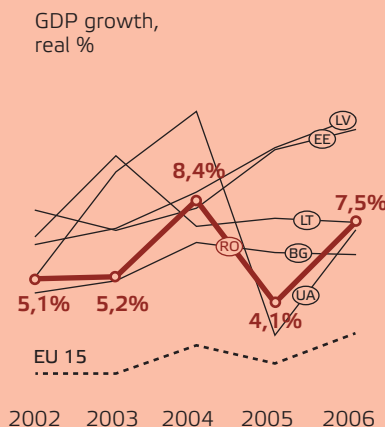
familiarity with market development and trends. The multinational network possessed by Arco Real Estate can offer effective solutions as well as a rock-solid experience in developing markets in countries that underwent the same kind of evolution.

The primary assets of the Arco Real Estate Consulting Romania department – favourable and unique price offers and valuable team of consultants – are advantages which are unprecedented on the Romanian real estate market. This is just a part of our activity. In addition, our company is made stronger by our Nordic origin, since this involves new business solutions and principles that Romanians hold dear: transparency, honesty and fairness.

PLEASE CHARACTERIZE THE CURRENT SITUATION ON THE ROMANIAN REAL ESTATE MARKET.

Romania’s real estate market has high potential when it

Financial indicators: Romania





comes to investments. For investors, it's a big challenge. All real estate investments have a big rate of return – whether we're talking about residential, commercial or storage or manufacturing land and space. All of the fields of real estate have high potential as we see it.

IS THE REAL ESTATE MARKET SITUATION AN EVEN ONE FROM ONE REGION OF ROMANIA TO ANOTHER?

The prices are not currently even, as demand exceeds supply right now. The entire economic context makes a rise in real estate prices nearly certain. The market is growing and developing, and a big real estate boom lies in store in a few years. Romania is developing dynamicaly and it will reach the boom situation in about 10 years.

HOW ATTRACTIVE IS ROMANIA'S REAL ESTATE MARKET TO FOREIGN INVESTORS?

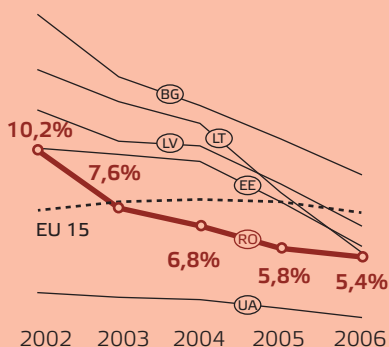
The biggest transactions and investments in Romania are

currently being conducted on the real estate market. That will be the case for a long time. The local market should be very much of interest to foreign investors. Companies with lower expectations who have arrived have reported success in a very short period. Romania is a gold mine for real estate. Investors are interested in purchasing land and industrial areas. Interest is keenest in residential, office and commercial development projects. Detached houses in new development districts are selling well and office space is being reserved in early stages of projects.

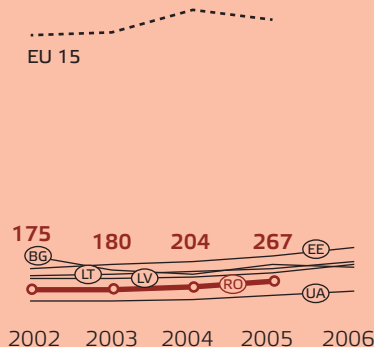
WHAT ARE YOUR OBJECTIVES FOR 2007?

We want to become customers' number one choice among all real estate service providers. We have to be synonymous with professionalism in offering the best possible service.

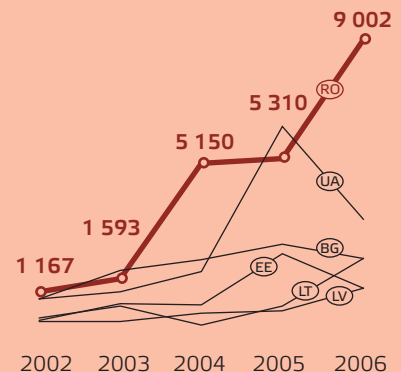
Unemployment, %



Average gross salary, EUR



FDI, mln EUR



From past to the future 2006

Arco Real Estate group turns 15



February 2007 marked 15 years of activity for Arco Real Estate group. There are few such companies that have had a run of success from the restoration of independence in Estonia up to the present – Arco Real Estate is proud to be among them.

Throughout its history, Arco Real Estate has been a progressive company, ahead of its time: the first post-independence real estate transaction in Estonia was conducted through us. We have served as founding members of various professional associations in the area of real estate. Fifteen years later, we want to continue to have a say in shaping market trends. Experience, the best team around, and quality forged in the winding paths of history in all three of our divisions – Service, Development and Construction – add up to a major competitive edge. By Estonian standards, we may have reached a respectable age, but on the world level, there is boundless room for growth. Together we will move ahead!

We celebrated our 15th birthday with our team and partners. We took time out to enjoy some entertainment and look back on the years that have helped us come so far.

Arco Real Estate hosted guests in the Blue Pavilion of the Estonian Fairs hall. The dinner was accompanied by a rich musical programme.

On right page, top row: Chairman of the Supervisory Board Arti Arakas recaps Arco's 15-year history.

Chairman of the Management Board Viljar Arakas thanks partners.

Internationally known brother and sister Gerli and Tanel Padar made a rare appearance together on the concert stage. Arco organized the reunion.

An energetic show added pizzazz to the performance by the Tallinn University of Technology men's choir.

Middle row:

The programme hosts were Mart Mardisalu and Elektra.

The calm opening music on the banquet night was courtesy of Tatjana and Enno Lepnurm.

Bottom row: Director of the Development Division Veiko Pedosk hands over a present to Arti Arakas.

Guest performers from Latvia were the saxophone quartet N[ex]t.



Sponsorship projects

Arco Real Estate has always looked forward. The future is important for us, and we want to play our part in securing a better future through sponsorship. We have always supported endeavours that create new knowledge. We favour initiatives that broaden knowledge of real estate and better living. We also take an interest in exploring the limits of human ability. We provide support to very dedicated people who enrich the lives of others.



Olympic champion Kristina Šmigun

Kristina Šmigun, known affectionately to thousands as Kiku, won two gold medals in Turin in 2006, making her own as well as her country's dreams come true. We, too, strive to be a symbol of Olympic excellence and to be there for you in all real estate matters at a championship level.

We put a premium on the same values that Kiku promotes – dedication, determination and willpower. These qualities take us closer to our goal. This year Arco Real Estate group celebrated 15 full years of activity. We were one of the first real estate companies to be founded after independence in Estonia was restored. Our clear objectives and forward momentum have taken us to where we are today: offices in six countries and expertise in all areas of real estate.



Sponsorship of top Estonian skier Jaak Mae

Dedication leads one closer to the goal. Arco Real Estate is one of the supporters of one of Estonia's top skiers, Jaak Mae. Jaak's impressive showings in competition, his unflagging self-confidence, as well as his skill and determination to keep on improving, serve as an example to many.





The annual World Cup round – a major skiing event

The World Cup round held at Tehvandi sports centre in Otepää, southern Estonia, is a tradition and a major event in Estonian skiing. Arco Real Estate is the headline sponsor, along with Hansabank. For more information, visit www.suusaliit.ee and www.tehvandi.ee.

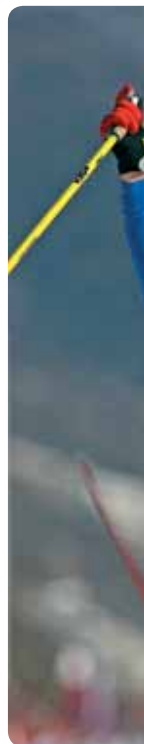
Karupesa Team

Arco Real Estate also supports an Otepää-based training group of young cross-country skiers called Karupesa Team, created by older skiers. It includes a number of promising members.



The real estate, banking and sales programme at the Estonian Business School

In cooperation with EBS, Arco Real Estate is launching a new programme whose graduates' proficiency in real estate, banking and sales will undoubtedly be second to none. Other project partners include SEB Eesti Ühispank and Vain&Partners. Students will have direct contact with their chosen field from the beginning of their studies and they will gain a real picture of the profession and working environment as rapidly as possible. In addition, partners will offer the more active students opportunities for internships and employment. For more information, visit www.ebs.ee.



Financial report of Arco Vara AS 2006



A year of large-scale developments

Sulev Luiga
CFO

Arco Real Estate group's CFO Sulev Luiga provides an overview of market trends in 2006 and describes how restructuring and expansion to new European Union countries affected financial results.

Arco Real Estate group's net profit grew by 87% last year, with minimal growth in turnover. The gains mainly stemmed from the domestic market – the Baltic states – while activities were launched as well as expanded in Ukraine, Bulgaria and Romania. I would like to emphasise the six factors and market trends that had the greatest bearing on financial results last year.

First of all, real estate prices continued to rise. The market in all real estate sectors in the Baltic states has continued to be very active and real estate prices have also risen outside the capital cities. The growth is also expressed by the gains reported in the income statement as the change in the value of real estate investments and sales of real estate. These had the greatest influence on the final net profit. Changes in value were recognized on the basis of estimations by independent real estate experts outside the group.

Secondly, the average period for real estate development projects continued to become longer. The reason is attributed to local governments becoming slower in processing detailed plans, together with a shortage of construction resources in the market. The longer project duration affected operating revenue the most. Consequently part of the sales revenue planned for the year before will be deferred to next year. The delays with detailed plans also affected refinancing decisions made by banks. As a result, the share of short-term borrowings (with a term of under one year) increased significantly.

Last year also saw housecleaning take place in the Group's real estate project portfolio. In shaping the real estate portfolio, the goal was not merely the taking of positions. Our activity was aimed at raising the proportion of higher quality and more liquid residential development real estate in the Baltics and partial diversification of risks by investing into new markets.

In 2006, the growth trend on EURIBOR continued, and the number of loans also grew. The growth rate in the loans taken has been comparable to the growth of the real estate portfolio. The growth of loan volumes and interest rates in the market has increased the costs of servicing loans.

And naturally, the expansion to new markets and restructuring of the Group was an important step for the Group in 2006. Expenditure related to restructuring and expansion, which began in 2005, also had an effect on general expenses. The revenue from these activities will largely be recognized in subsequent reporting periods.

WHAT DID LAST YEAR MEAN FOR THE GROUP'S FINANCIAL SERVICE?

In 2006, central financial management was improved primarily in six fields. First of all, it was important to ensure the sufficient capitalization of the Group. The liabilities of Arco Real Estate group grew by nearly half a billion kroons last year compared to investments. In addition to conventional mortgages, operating credit and bond issues were also used as financing. It is gratifying to note that the Group's liquidity has improved with each passing year.

Secondly, the financial arm of the Group dealt with the launching and implementing of structural changes that supported the Group strategy. We took part actively in modernizing the investment strategy and restructured the system for analysis and monitoring our investment activity. From the standpoint of accounting and reporting the existing managerial accounting system was supplemented with a division consolidation level.

In 2006, we continued to stay our current financial accounting course. This meant that as new countries were added, we made sure that the accounting and reporting system was integrated across the entire Group. Indeed, I can say that expansion to new countries did not reduce the speed or quality of our reporting.

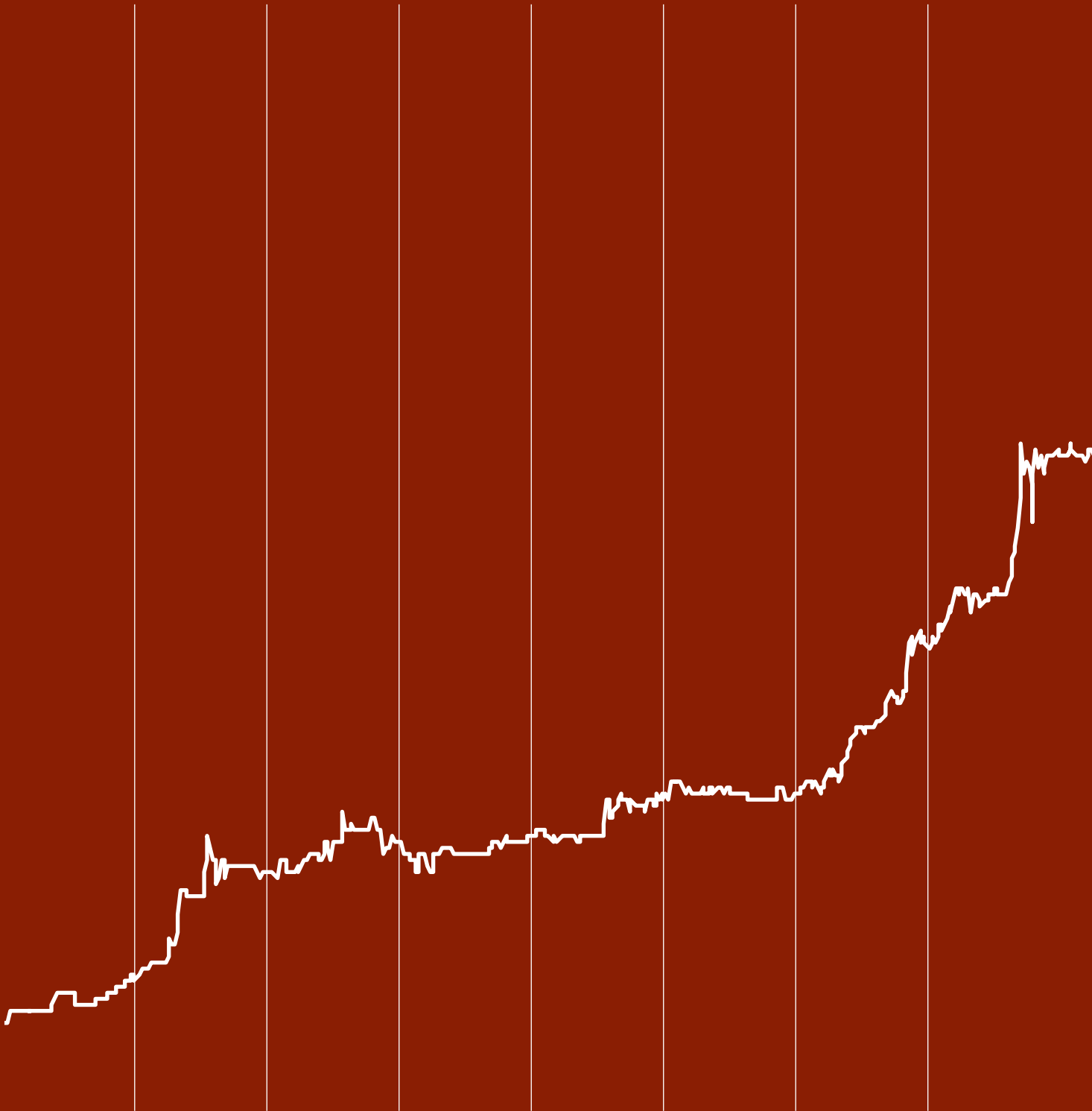
Last year we also made sure that we raised our standards of financial accounting and reporting. The work done in this field is illustrated vividly by the title of Flagship of Estonian Accounting conferred on Arco Vara AS in the category of unlisted companies.

We continued to flesh out our budget and forecasting system. With regard to budgeting, the main focus was on increasing the accuracy of forecasting cash flows from investment and financial activity. In the years ahead, the goal is the Group-wide integration of the investment project portfolio, information systems covering the main operations and financing, and direct linkage to budgeting.

Finally, a major activity undertaken last year was the improvement of the internal audit system. This consisted of establishing a number of procedural rules, as a result of which the results of many critical activities are monitored constantly and reported to the head of the relevant area.

Thus 2006 can be graded only positively from the standpoint of Group financial management – as a stable year of large-scale developments.

Consolidated Annual Report



ARCO REAL ESTATE

ARCO VARA AS

Beginning of financial year: 1 January 2006

End of financial year: 31 December 2006

Registry code: 10261718

Address: Jõe 2b
10151, Tallinn
Republic of Estonia

Telephone: +372 6 144 630

Fax: +372 6 144 631

E-mail: info@arcovara.ee

Corporate web page: www.arcorealestate.com

Regional web pages: www.arcovara.ee
www.arcoreal.lv
www.arcoreal.lt
www.arcoreal.bg
www.arcoreal.com.ua
www.arcoreal.ro

Main activities: Real estate development and investments (EMTAK 701)
Real estate related services (EMTAK 702, 703)
Construction (EMTAK 45)

Supervisory Board: Arti Arakas, Hillar-Peeter Luitsalu, Richard Tomingas

Management Board: Viljar Arakas, Sulev Luiga, Ivar Siimar, Veiko Pedosk, Ahto Altjõe

Auditor: Ernst & Young Baltic AS

Table of contents

Management report of the consolidated Group	62	18 Long-term receivables	108
Financial indicators	73	19 Associates	108
Consolidated financial statements	75	20 Long-term investments into financial assets	108
Management representation		21 Investment property	109
to the consolidated financial statements	75	22 Property, plant and equipment	110
Consolidated income statement	76	23 Intangible assets	112
Consolidated balance sheet	77	24 Borrowings	114
Consolidated cash flow statement	78	25 Finance lease liabilities	115
Consolidated statement of changes in equity	79	26 Short-term payables	116
		27 Prepayments	117
Notes to the consolidated financial statements	80	28 Short-term and long-term provisions	117
1 General information	80	29 Other long-term payables	118
2 Statement of compliance and basis for preparation	80	30 Pledged assets	118
3 Changes in the presentation and accounting principles	81	31 Share capital	119
4 Summary of significant accounting policies	82	32 Contingent liabilities	119
5 Segment information - business segments	93	33 Government grants	120
6 Segment information - geographical segments	95	34 Financial instruments and financial risk management	121
7 Changes in the Arco Vara Group structure	96		
7.1 Scope of consolidation	96	Notes to the cash flow statement	126
7.2 Changes in the Group's ownership in subsidiaries	98	35 Cash flows from operating activities	126
7.3 Changes in the Group's ownership in joint ventures	100	36 Cash flows from investing activities	126
7.4 Business combinations	101	37 Cash and cash equivalents	126
Notes to the income statement	103	Other information	127
8 Cost of sales	103	38 Transactions with related parties	127
9 Other income and expenses related to other operating activities	103	39 Events after the balance sheet date	128
10 Financial and investment activity income and financial and investment activity expenses	104	40 Group structure of Arco Vara AS	130
11 Income tax expense	105	41 Main statements of the Parent as required by Estonian Accounting Act	132
12 Operating lease	105		
13 Earnings per share	105	Auditor's report	136
		Profit allocation proposal	137
Notes to the balance sheet	106	Signatures of the Management Board and the Supervisory Board to the Annual Report 2006	138
14 Receivables	106		
15 Prepaid expenses	106		
16 Inventories	107		
17 Biological assets	107		

Management report of the consolidated group

Arco vara in brief

Mission, vision and corporate values

The mission of Arco Vara is **to be an all-encompassing, highly-valued provider of real estate solutions.**

The vision of Arco Vara is **to become the symbol of real estate.**

Arco Vara's core values:

Partnership – our clients are our partners

Reliability – we are reliable, open and honest

Professionalism - we guarantee quality service

Respect – we respect our client's personality

Responsibility – we keep our promises

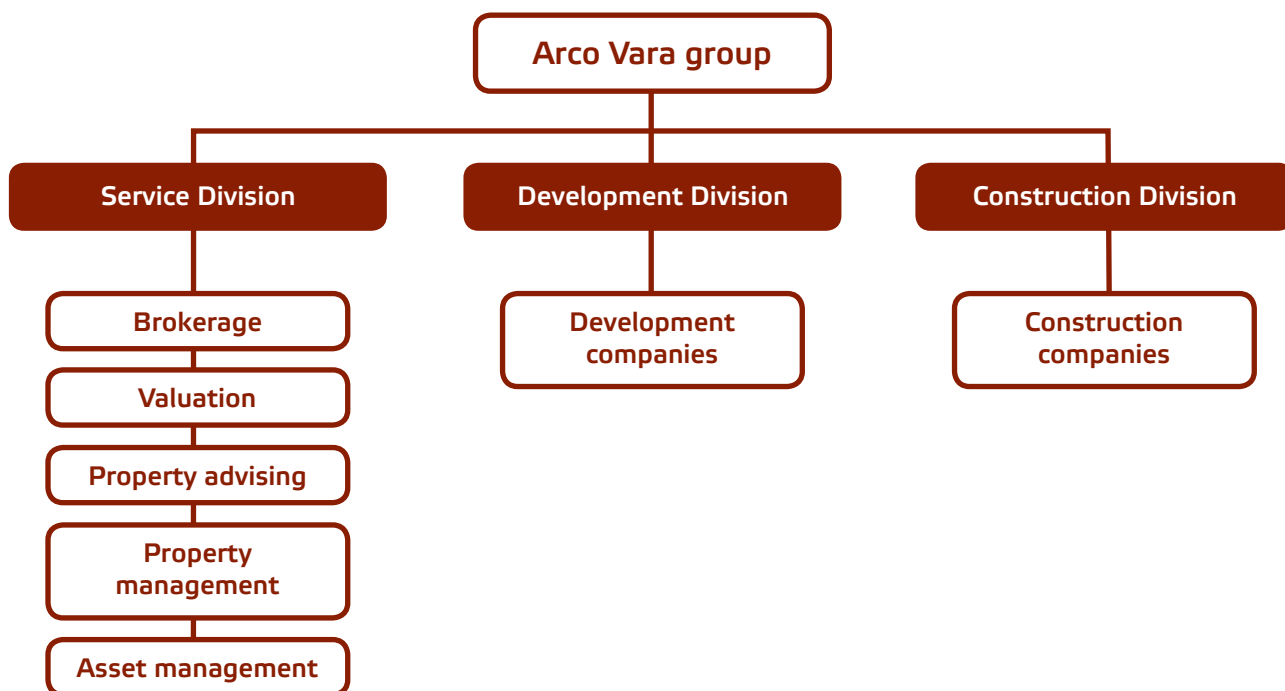
Strategy and operating principles

Our objective is to achieve at least a 10% ROA (return on assets) in each financial year.

The area of activity of Arco Vara and the undertakings in its Group ("**Arco Group**") includes a number of different real estate related services and activities, each of which can be grouped in one of three divisions: **Service, Development and Construction**. As of year end 2006 the Arco Vara AS group included 32 subsidiaries (2005: 31), 25 joint ventures (2005: 11) and one associate (2005: 0).

The **Service Division** is engaged primarily in real estate brokerage and appraisal, real estate management and real estate fund management. The Services Division also makes short term investments (as a rule up to 12 months) into residential real estate and small-scale development activity with the goal of resale to the end user.

The primary activity for the **Development Division** is development of residential living environment and commercial real estate such as office buildings and shopping centres. The main emphasis is on residential projects, and these make up around 70% of the entire portfolio. Developed residential projects are sold to end users; the ultimate goal is not investment-oriented holding or letting. Nor is it the strategic objective of Arco Group to hold developed commercial real estate for the long term.



As a rule, here too the ultimate objective is to find a buyer for a completed project (such as a real estate fund), generally before the start of the development. Nevertheless, Arco Vara does at the present time own commercial real estate from which it earns rental (so called cash flow generating projects).

The primary activity for the **Construction Division** is providing the services of a general building contractor, providing owner supervision and performing environment-related construction.

The domestic markets for Arco Vara are the Baltic States: Estonia, Latvia and Lithuania. For Arco Vara, “domestic market” includes any country where an Arco Vara brokerage office has been making a profit for at least a year

and where the company’s turnover is growing, and where the company is taking the first steps in the field of real estate development. Besides its active profile on the domestic market, Arco launched operations in Ukraine in 2005, and in Bulgaria and Romania in 2006. Entering new markets consists of passing through the following three stages:

Stage 1 – establishing a brokerage (services: brokering residential and commercial properties on the local market, a team of 3-5 people)

Stage 2 – successful launch of brokerage (services: brokerage and appraisal of residential and commercial properties, team of around 5-15 people)

Stage 3 - launching development activity.

Overview of Arco Vara's locations

Arco Vara AS, founded in 1992 in Estonia, is the largest real estate firm in the Baltic States. Today it has offices in 25 cities in Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania.

The Group's team is nearly 480 strong. Our long-standing experiences and our all-encompassing spectrum of

services form an integral whole – in essence a “one-stop shop” for all goods and services connected to real estate. We live up to our values and create environments which endure from one generation to the next. We treat our partners with respect and always work in the name of offering the best possible solution.

Arco Vara in figures, by country 2006

	Estonia	Latvia	Lithuania	Ukraine	Romania	Bulgaria
Area (thousands of km ²)	45	65	65.3	604	238	110
Capital	Tallinn	Riga	Vilnius	Kyiv	Bucharest	Sofia
Population (thousands)	1,344	2,287	3,390	46,988	22,303	7,970
Urban population	67%	68%	67%	67%	55%	70%
population of capital (thousands)	400	728	553.6	2,682	2,300	1,378
population of capital (%)	29%	32%	16.3%	6%	10%	17%
GDP (millions of EUR)	11,060	12,716	23,600	60,000	58,900	19,433
GDP growth (%)	10.5	10.2	7.8	2.2	6.9	5.5
Inflation rate (%)	4.5	6.8	4.2	10.3	4.9	4.5
Unemployment (%)	5.4	6.2	3.7	3.1	5.2	8.7
Average wage (EUR per month)	579	435	478	255	250	180

Source: Department of Statistics of the Government of the Republic of Lithuania, Lithuanian Ministry of Finance, Central Statistical Bureau of Latvia, Bank of Estonia, National Statistical Institute of Bulgaria, National Institute of Statistics of Romania, National Commission of Prognosis of Romania, EUROSTAT, The State Committee of Statistics of Ukraine

Summary of the Group's financial results

Consolidated revenue in 2006 was **30,907** thousand euros (2005: 30,418 thousand euros). Other operating income tripled compared to last year and was **27,030** thousand euros (2005: 8,646 thousand euros). Gross profit of **8,597** thousand euros (2005: 7,511 thousand euros), operating profit of **16,639** thousand euros (2005: 9,812 thousand euros) and net profit of **13,891** thou-

sand euros (2005: 7,442 thousand euros) all represented improvements. After deduction for income tax and minority interest, consolidated net profit attributable to the owners of the parent in 2006 was 13,290 thousand euros (2005: 6,470 thousand euros), which meant a net profit margin of over **42%** (2005: over 20%) and average ROA of over **11%** (2005: over 8%).

Contributions of the Divisions to the financial indicators (thousands of euros):

	Service	Development	Construction	Eliminations	Unallocated expenses and assets	Total
2006						
Total revenue & other operating income	7,633	40,048	22,966	-12,710	0	57,937
Total operating profit	551	17,779	61	90	-1,842	16,639
Total assets	2,039	131,275	5,895	-1,321	6,384	144,272
2005						
Total revenue & other operating income	5,088	23,605	14,922	-4,551	0	39,064
Total operating profit	846	9,440	215	308	-997	9,812
Total assets	2,040	77,625	5,147	-4,310	12,930	93,432

We are pleased with the results of the **Development Division**. Detailed plans were initiated and carried out for several large-scale sites, which provided confirmation of the success of the projects in the investment portfolio. During the year, decisions were made to exit from a number of projects of lesser value; the focus was set on residential construction. Due to the drop in business on the domestic market, the goal was set to find new markets. To achieve this goal, a number of studies were conducted in the financial year, an activity plan was compiled and work in target countries was launched. In the financial year, the planned growth in investment assets was achieved and, compared to the previous financial year, a higher ROA.

Revenue for the **Construction Division** was 22,872 thousand euros in 2006, which was 54% more than in 2005 (14,886 euros). Operating profit was 61 thousand euros (2005: 215 thousand euros).

Revenue and other operating income for the **Service Division** was 7,632 thousand euros in 2006, which was 50% more than in 2005. Operating profit was 551 thousand euros (2005: 846 thousand euros). The primary increases in turnover were courtesy of the Estonian and Latvian real estate offices. The Ukraine company saw the greatest turnover growth, up from 60 thousand euros to 340 thousand euros (469%).

The Group's main activities by geographical area (thousands of euros):

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Sweden	Eliminations	Unallocated assets	Total
2006									
Total revenue	28,099	2,154	382	340	17	0	-85	0	30,907
Total assets	126,881	10,932	55	479	27	0	-108	6,006	144,272
2005									
Total revenue	28,882	835	175	60	0	560	-94	0	30,418
Total assets	78,874	3,284	23	34	0	0	-1,712	12,929	93,432

Areas of activity

Arco Vara Group Management

In 2006, the management of the Arco Vara Group compiled a development strategy for 2007-2009. Projections were made for turnover and profit for each of the three Divisions, and the management agreed on priorities for activities that support achievement of financial goals. For better management of the Group, the management board of Arco Vara decided to adopt the Balance Scorecard, an internationally recognized system, for use in Estonia. In developing the system, the assistance of KPMG business strategy advisors was used and the critical success factors for all three divisions and the entire Group were set out in four categories:

- finances
- customers and marketing
- processes
- personnel

In late 2006, the base indicators for critical success factors were recorded and from 2007, critical success factors will be measured quarterly.

Arco Vara Group expanded in 2006 to two new markets – Bulgaria and Romania. With this step, Arco Vara is now operating in six countries. Thus, for ensuring sustainable and profitable growth, one of the management priorities of Arco Vara Group is staffing a competent, professional back office and offering all facets of management service for the divisions of Arco Vara Group. Arco Vara AS offers the following service within the Group – accounting and managerial accounting, marketing and media communications management, legal consultation, handling of personnel issues, IT developments, administrative management and secretarial training.

Development Division

Noteworthy achievements in 2006:

- detailed plan for construction of a residential community located in the former Tivoli area in Tallinn, Narva mnt. 67;
- stage I of the Merivälja residential district completed successfully;
- stage II of construction and sale of row houses in Tallinn, in the Maarjamäe area, began;
- stage II of the process of land exchange begun in Merivälja;
- detailed plan established for Ahtri 3 and joint venture formed with Rotermann Eesti OÜ;
- construction of office buildings completed in Tallinn, Keemia and Liimi streets;
- construction of Kolde residential district begun;
- preliminary agreement for transfer of Kereše shopping centre in Narva signed;
- first stage of shopping centre in Kuressaare, Tallinna mnt. 75/77 put into use;
- commercial land in Tallinn, Betooni 8B, transferred;
- preliminary agreement signed for transferring commercial land in Suur-Sõjamäe in Tallinn;
- construction of stage I Bišumuiža residential district in Latvia continued;
- land unit in Latvia, in Ulmana gatve, sold with office space development rights;
- detailed plan for Mazais Baltezers residential district in Latvia continued, design and advance sales of stage V networks began;
- rights to construct office complex in Ķipsala district of Riga acquired;
- final round of negotiations of PPP project in Plavnieki district reached as tender winner;
- joint project for building Drelini residential district initiated;
- preliminary agreement for sale of apartment building development project located in Kyiv signed.

Noteworthy projects of the Development Division as of 31.12.2006

Development	Country	City	Type of project	Estimated construction period
Bišumuiža 2	Latvia	Riga	Residential/apartments	2007-2014
Ahtri tn 3	Estonia	Tallinn	Office space and retail space	2008-2011
Tivoli	Estonia	Tallinn	Residential/apartments	2008-2011
Ķipsala	Latvia	Riga	Office space and apartments	2008-2011
TOP	Estonia	Tallinn	Residential/apartments	2008-2011
Kolde	Estonia	Tallinn	Residential/apartments	2006-2009
Paldiski mnt 80	Estonia	Tallinn	Office space and retail space	2008-2011
Bišumuiža 1	Latvia	Riga	Residential/apartments	2006-2009
Ilmarine	Estonia	Tallinn	Office space and retail space	2008-2011
Laeva 2	Estonia	Tallinn	Office space	2008-2009
Tooma 1	Estonia	Saue	Residential/plots	2007
Kereše	Estonia	Narva	Office and retail space	2006-2007
Baltezers-5	Latvia	Riga	Residential/plots	2008-2009
Pärtli	Estonia	Saue	Residential/plots	2007
Vahi	Estonia	Tallinn	Residential/plots	2007

Cash flow project	Country	City	Type of project	Fair value as of 31.12.2006 (thousands of euros)
TOP (rent)	Estonia	Tallinn	Office space	7,439
Melon	Estonia	Tallinn	Office space and retail space	4,793
Kerberon	Estonia	Tallinn	Office space and industrial	4,627
Pärnu turg (market)	Estonia	Pärnu	Retail space	1,918
Tallinna tn 77/79	Estonia	Kuressaare	Office space and retail	1,911
Rüütli	Estonia	Tallinn	Office space and retail space	1,182
Mustamäe tee 5c	Estonia	Tallinn	Office space	959
Enerpoint	Estonia	Kuressaare	Industry	814
Raekoja	Estonia	Kuressaare	Office space and retail space	684
Kotzebue	Estonia	Tallinn	Office space and retail space	103

As of the end of 2006, there are 40 people employed in the Development Division.

Construction Division

Today two companies in Estonia are part of the Construction Division: Arco Ehitus OÜ and Tallinna Linnaehituse AS. Starting from 2007 there is also Arco Construction SIA in Latvia. As of the end of 2006, there are 90 people employed in the Construction Division.

The Construction Division is engaged in main construction contractor services, environment-related construction services and owner building inspection services.

It was decided in 2006 to merge Deena Ehituse OÜ and Veemaailm Inc OÜ into one company, Arco Ehitus OÜ. Tallinna Linnaehituse AS ended construction activity and is now focused on providing project management services.

In January 2007 a subsidiary Arco Construction SIA as acquired in Latvia of which Arco Ehitus OÜ owns a majority stake of 55%.

Major projects of the Construction Division in 2006

Project	Country	Location	Type	Total investment (thousands of euros)	Construction period
Kerese Keskus (Centre)	Estonia	Narva	Retail and office building	4,512	2006-2007
Helme tn. 11A and 11B	Estonia	Tallinn	Apartment building	4,205	2006-2007
Helme tn. 13A and 13B	Estonia	Tallinn	Apartment building	3,963	2006-2007
Tehvandi sports centre	Estonia	Otepää	Stadium and stands construction	1,457	2006
Sagadi manor	Estonia	Lääne-Viru County	Renovation	1,336	2006
Nasva Salme sewerage	Estonia	Saaremaa	Building clearance	767	2006
Hirvepargi residential district	Estonia	Pärnu	Construction of roads and clearances	639	2006
Urmetu fish farm	Estonia	Saaremaa	Construction of cleaning equipment	607	2006
Viru prison	Estonia	Jõhvi	Supervision	588	2005-2008
Kuressaare clearances	Estonia	Saaremaa	Building clearances	320	2006
Kuressaare marina	Estonia	Saaremaa	Construction work	320	2006
Vabaduse Väljak 7	Estonia	Tallinn	Supervision	26	2006

Service Division

The Service Division is engaged primarily in real estate brokerage and appraisal, real estate management and real estate fund management. As of 31.12.2006 the Service Division has expanded to 6 countries: Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania. The Service Division employs 332 employees as of the end of the year, which is 69% of the people working for Arco Vara Group. At the end of 2006, the Service Division companies had offices in 23 cities in six countries. There were 10 offices in Estonia, 8 in Latvia, 2 in Lithuania and 1 each in Ukraine, Bulgaria and Romania.

2006 was a turningpoint for the Service Division. There was rapid expansion, with brokerage operations opening in Bulgaria and Romania. At the same time, it was important to ensure quality of expansion both within each country and across the entire division in this rapid

growth phase. The goals for 2006 were to double turnover in all of the existing countries, increasing the number of employees and broadening the network of offices. In recruiting employees, we find it important to stress the core values of Arco Vara: partnership, caring, professionalism, conscientiousness and honesty.

In the financial year, the Service Division joint venture Arco Varavalitse AS managed two real estate funds: Arco Balti Kinnisvarafond AS (hereinafter ABKF) and Explorer Property Fund - Baltic States (hereinafter EPF). Both funds operate in the Baltics and invest into income stream generating commercial real estate. In 2006 EPF acquired and covered with preliminary agreements a total of eight real estate objects with a cost of nearly 89.5 million euros. The Fund portfolio includes a total of 10 sites and has reached 108.6 million euros. The ABKF portfolio also included ten sites with a total value of 18.3 million euros. Five of these properties were acquired in 2006.

Major projects brokered in 2006

Project	Country	Location	Type	Developer	Sales volume	Development period
Kodu Pirital (Home in Pirita)	Estonia	Tallinn	Apartment building	TTP AS	600 apartments	2004 - 2008
Kodukolde	Estonia	Tallinn	Apartment building	Kolde AS	372 apartments	2005 - 2008
Bišumuiža 1	Latvia	Riga	Residential / apartments	Arco Development AS	238 apartments	2005 - 2008
Jüripere	Estonia	Harju County	Apartment building	Jüri Arenduse OÜ	188 apartments	2004 - 2007
Marsili 2	Latvia	Riga	Residential/plots	Arco Development AS	53 plots	2006 - 2008

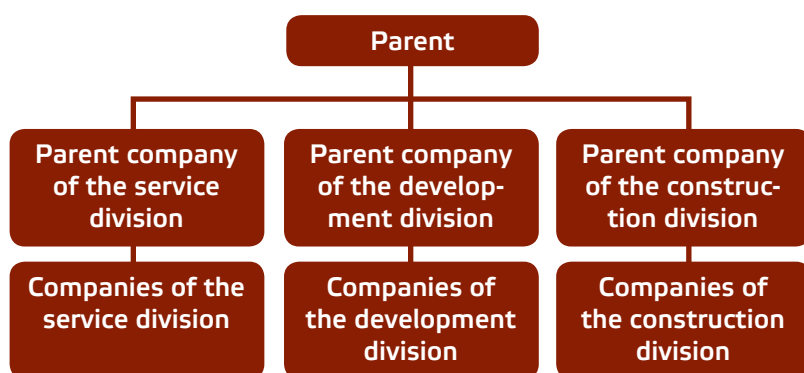
Major internal development goals were implementing unified principles and systems (including Navision, AVIS, MIS) across the Division:

- we implemented MIS (Management information System), a system for administering management information across the Service Division;
- implementation of the accounting information system, Navision, in the countries in which the Service Division is active;
- preparing expansion of AVIS, a system for managing real estate sites and customers, to new countries of activity;
- evaluation and improvement of service quality.

Business processes and support services

Corporate governance and restructuring of the Group

In 2006, the companies began to be consolidated by division under a single legal management body. The following figure illustrates the result of restructuring:



In early 2007, Hansabank's share in the parent Arco Vara AS was bought back by the rest of the shareholders.

In 2006, total remuneration to members of the management board of the parent (including taxes) amounted to 522 thousand euros (195 thousand euros in 2005).

The Group's customer relations, marketing and communications

In a real estate company name recognition study carried out by Emor (a market research company) in early 2007, Arco Vara received the title of best-known company, and thus the marketing activities in 2006 can be considered successful. In the Arco Vara group as a whole, the primary keywords in 2006 marketing activity were development and implementation of customer management, standardizing communications related to expansion to new countries (Arco Vara style book, employee manuals), partner relations and cross-marketing to partners and development of internal communications.

Personnel

The number of employees at Arco Vara Group Management reached 478 at the end of 2006 (2005: 280). Total remuneration with taxes was 5,713 thousand

euros (3,448 thousand euros). By region and area of activity, employees were distributed as follows as of 31.12.2006:

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	TOTAL
2006							
Service	128	108	34	31	16	7	324
Development	30	8	2	0	0	0	40
Construction	90	0	0	0	0	0	90
Corporate governance	24	0	0	0	0	0	24
TOTAL	272	116	36	31	16	7	478

2005							
Service	93	71	13	16	0	0	193
Development	14	6	1	1	0	0	22
Construction	47	0	0	0	0	0	47
Corporate governance	22	0	0	0	0	0	22
TOTAL	176	77	14	17	0	0	284

Financing

Bond issues to date are characterized by the following indicators (in thousands of euros):

	Issue date	Maturity date	Amount at nominal value	Interest (%)	Refinancing	Additional amount
2005						
	14.04.2005	14.04.2006	4,026	4.75	0	4,026
	22.06.2005	22.06.2006	5,899	4.28	2,013	3,886
	14.07.2005	1.12.2006	2,876	4.20	0	2,876
	1.12.2005	1.12.2008	5,432	4.60	5,432	0
TOTAL in 2005			18,233		7,445	10,788
2006						
	22.06.2006	22.01.2007	5,586	5.25	5,586	0
	22.06.2006	1.12.2008	611	5.87	611	0
TOTAL in 2006			6,197		6,197	0
2007						
	22.01.2007	21.01.2011	1,785	6.46	1,785	0
	22.01.2007	21.09.2007	3,863	7.89	3,863	0
TOTAL in 2007 as of 31.03.2007:			5,648		5,648	0

In terms of involving external capital, the following can be brought out in respect to 2006:

- New funds were not raised by way of bond issues. Issues took place primarily to refinance previous bond issues.
- In an environment of growing interest rates, investors preferred short term debt instruments to long term ones.
- For the first time, coupon bonds with a 5-year maturity were issued.

Plans for 2007

The objective of the **Development Division** for the year 2007 is to increase sales revenue and to structure the investment projects' portfolio in a manner that provides a stable growth in the years to come.

The 2007 goal of the **Construction Division** is to increase construction volumes by 30%.

Based on the set goals, there is a need to increase the number of project managers, site managers and skilled labourers, as well as to raise the qualifications of personnel through training. It is planned to increase the amount of work performed by our own skilled workforce. There are also plans to create a department in charge of internal plumbing work. In connection with the significant growth of development volumes in Latvia, Arco Ehitus OÜ in January 2007 acquired a majority holding in Arco Construction. In doing so, it entered the foreign market for the first time.

The objective of the **Service Division** is to offer its customers greater opportunities for acquiring real estate through broader cross-marketing. Service Division has set the following goals for 2007:

- increasing the consolidated turnover of the companies of the Service Division;
- increasing the number of Service Division offices from 23 to 30;
- increasing the number of employees from 332 to 470;
- make Arco Varavalitsemise AS the largest real estate fund manager on Arco Vara's domestic markets in 2007.

Financial indicators

in thousands of euros (except for share indicators and financial ratios)

	2006	2005	2004
Per annum			
Revenue	30,907	30,418	22,365
Gross profit	8,597	7,511	6,982
Operating profit	16,639	9,812	8,283
Profit before income tax	14,502	7,705	6,950
Net profit for the financial year	13,891	7,442	6,815
Net profit attributable to the owners of the Parent	13,290	6,470	6,395
Cash flow from operating activities	-7,507	3,563	5,812
Cash flow from investing activities	-21,853	-19,132	-6,680
Cash flow from financing activities	23,959	23,298	1,186
TOTAL CASH FLOW	-5,401	7,729	319
End of financial year			
TOTAL ASSETS	144,272	93,432	64,457
Current assets	38,553	25,746	14,470
Non-current assets	105,719	67,686	49,987
TOTAL LIABILITIES	96,858	56,316	41,889
Current liabilities	64,822	30,460	18,825
Non-current liabilities	32,036	25,856	23,063
TOTAL OWNER'S EQUITY	47,414	37,116	22,568
Equity attributable to owners of the Parent	46,330	33,829	17,977
Minority interest	1,084	3,287	4,591
Current ratio (current assets / current liabilities)	0.6	0.8	0.8
Equity ratio (equity including minority interest / total assets)	0.3	0.4	0.4
Equity/debt ratio (equity including minority interest / (short-term borrowings + long-term borrowings))	0.6	0.8	0.6
Equity ratio for equity attributable to owners of the Parent (equity w/o minority interest / total assets)	0.3	0.4	0.3
Equity/debt ratio for equity attributable to owners of the Parent (equity w/o minority interest / (short-term borrowings + long-term borrowings))	0.6	0.7	0.5

Financial indicators

(continued)

	2006	2005	2004
Performance indicators			
Net profit margin (net profit attributable to owners of the Parent / revenue)	0.4	0.2	0.3
Operating profit margin (operating profit / revenue)	0.5	0.3	0.4
Gross profit margin (gross profit / revenue)	0.3	0.2	0.3
ROA (net profit attributable to owners of the Parent / average total assets)	0.1	0.1	0.1
Profitability of assets ((revenue + other income) / average total assets)	0.5	0.5	0.5
ROE 1 (profit before minority interest / average equity including minority interest)	0.3	0.3	0.4
ROE 2 (net profit attributable to owners of the Parent / average equity w/o minority interest)	0.3	0.3	0.4
Expense/revenue ratio (operating expenses without the effects of goodwill / revenue and other operating income without the effects of goodwill)	0.7	0.7	0.7
Expense/average assets ratio (expenses without the effects of goodwill / average assets excluding goodwill)	0.4	0.4	0.3
Share related indicators			
Number of shares, as of the end of the year	30,453,037	30,453,037	8,400
Nominal value	0.64	0.64	31.96
Book value of shares (number of shares / equity w/o minority interest at the end of the year)	0.0027	0.0037	0.0000
EPS (net profit attributable to owners of the Parent / average number of shares in the year)	0.44	0.24	0.23
Dividends paid/net profit	0.064	0.089	0.0000
Dividends paid per share	0.03	0.02	0.0000

Consolidated financial statements

Management representation to the consolidated financial statements

We hereby take responsibility for preparation of the financial statements set out on pages 75-135, and confirm that:

1. the accounting principles used in preparing the financial statements of Arco Vara AS (hereinafter also the "Parent") and its subsidiaries and joint ventures (hereinafter also the "Group") are in compliance with the International Financial Reporting Standards (IFRS) as adopted by the EU;
2. the consolidated financial statements give a true and fair view of the financial position of the Group, as well as the results of its operations and cash flows;
3. the Group and the Parent are able to continue as a going concern.



Viljar Arakas
Chairman of the Management Board



Sulev Luiga
Member of the Management Board



Veiko Pedosk
Member of the Management Board



Ivar Siimar
Member of the Management Board



Ahto Altjõe
Member of the Management Board

31.03.2007

Consolidated income statement

in thousands of euros

	Note	2006	2005
Revenue from rendering services		20,749	19,202
Revenue from sale of goods		10,157	11,216
Total revenue	5,6	30,907	30,418
Cost of sales	8	-22,309	-22,907
Gross profit		8,597	7,511
Other operating income	9	27,030	8,646
Marketing expenses	9	-1,189	-783
General and administrative expenses	9	-7,396	-4,715
Other operating expenses	9	-10,404	-847
Operating profit		16,639	9,812
Financial and investment activity income	10	1,036	835
Financial and investment activity expenses	10	-3,173	-2,942
Profit before income tax		14,502	7,705
Income tax expense	11	-611	-263
Net profit		13,891	7,442
attributable to:			
owners of the parent		13,290	6,470
minority interests		601	972
Profit attributable to owners of the Parent per share (in euros)	13		
- basic		0,44	0,24
- diluted		0,44	0,24

Consolidated balance sheet

in thousands of euros

Note **31.12.2006** 31.12.2005

ASSETS

Current assets

Cash and cash equivalents	37	3,729	9,202
Receivables	14	6,551	6,159
Prepaid expenses	15	283	166
Inventories	16	27,598	9,834
Biological assets	17	392	385
Total current assets		38,553	25,746

Non-current assets

Long-term receivables	18	682	1,085
Long-term investments into financial assets	20	4,203	192
Investment property	21	94,544	54,395
Property, plant and equipment	22	5,222	11,146
Intangible assets	23	1,068	868
Total non-current assets		105,719	67,686

TOTAL ASSETS		144,272	93,432
---------------------	--	----------------	---------------

LIABILITIES AND EQUITY

Current liabilities

Borrowings	24	44,711	20,251
Payables	26	15,932	7,525
Prepayments	27	4,054	2,643
Provisions	28	125	41
Total current liabilities		64,822	30,460

Non-current liabilities

Long-term borrowings	24	29,224	25,076
Other long-term payables	29	2,656	710
Deferred income taxes	11	86	0
Long-term provisions	28	70	70
Total non-current liabilities		32,036	25,856
Total liabilities		96,858	56,316

Equity

Equity attributable to the owners of the Parent

Share capital	31	19,463	19,463
Share premium	31	7,866	7,866
Legal mandatory reserve		351	27
Other reserves		-12	30
Retained earnings	32	18,662	6,443
Total equity attributable to the owners of the Parent		46,330	33,829
Minority interest		1,084	3,287
Total equity		47,414	37,116

TOTAL LIABILITIES AND EQUITY		144,272	93,432
-------------------------------------	--	----------------	---------------

Consolidated cash flow statement

in thousands of euros

	Note	2006	2005
Cash flow from operating activities			
Operating profit		16,639	9,812
Adjustment of operating profit, incl.		-21,332	-6,865
Depreciation of property, plant and equipment and amortisation of intangible assets (Notes 8 and 9)		58	626
Impairment of plant, property and equipment (Note 9)		4,654	0
Gains/losses from disposals of property, plant and equipment and intangible assets (Note 9)		-407	-42
Gains/losses from disposals of investment property (Note 9)		-1,612	-789
Gains/losses from changes in fair value of investment property and biological assets (Note 9)		-24,025	-6,661
Other adjustments		0	1
Change in receivables related to operating activities and inventories		-13,348	-1,047
Change in liabilities and prepayments related to operating activities		10,534	1,663
Total cash flow from operating activities	35	-7,507	3,563
Cash flow from investing activities			
Purchase of property, plant and equipment, and intangible assets		-18,814	-8,877
Proceeds from disposals of property, plant and equipment		763	30
Acquisition of investment property and biological assets		-1,126	-20,336
Sale of investment property and biological assets		3,649	9,210
Acquisition of subsidiaries and joint ventures (net of cash acquired)		-5,832	-1,388
Proceeds from disposals of subsidiaries and joint ventures		0	-332
Acquisition of other investments		0	-33
Proceeds from disposals of other investments		0	381
Loans granted		-1,428	-977
Repayments of loans granted and finance lease		811	2,899
Interest received		124	291
Total cash flow from investing activities	36	-21,853	-19,132
Cash flow from financing activities			
Loans received		46,225	46,006
Loan and finance lease repayments		-18,682	-29,839
Change in overdraft		647	-562
Interest paid		-2,902	-1,549
Issue of shares ¹		-78	10,036
Dividends paid		-848	-621
Paid income tax on dividends		-402	-173
Total cash flow from financing activities		23,960	23,298
TOTAL CASH FLOW		-5,400	7,729
Cash and cash equivalents at the beginning of the period		9,202	1,492
Change in cash and cash equivalents		-5,400	7,729
Effect of changes in currency exchange rates on cash and cash equivalents		-73	-19
Cash and cash equivalents at the end of the period	37	3,729	9,202

¹ The negative cashflows from the issuance of shares in 2006 relate to transaction costs payable in 2006 incurred in connection with the 2005 issuance.

Consolidated statement of changes in equity in thousands of euros

	Share capital	Share premium	Legal mandatory reserve	Other reserves	Retained earnings	Total	Minority interest	Total owner's equity
Balance as of 31.12.2004	268	565	27	364	16,753	17,977	4,591	22,568
Bonus issuance	17,151	-565	0	-331	-16,255	0	0	0
Issued share capital	2,044	7,866	0	0	0	9,910	0	9,910
Distribution of dividends ¹	0	0	0	0	-498	-498	0	-498
Dividends of subsidiaries	0	0	0	0	0	0	-53	-53
Adjustments of retained earnings	0	0	0	0	-27	-27	0	-27
Unrealised currency exchange rate differences	0	0	0	-3	0	-3	0	-3
Change in minority interest caused by changes in the Parent's ownership in subsidiaries (Note 7.2)	0	0	0	0	0	0	-2,223	-2,223
Net profit for the financial year	0	0	0	0	6,470	6,470	972	7,442
Balance as of 31.12.2005	19,463	7,866	27	30	6,443	33,829	3,287	37,116
Distribution of dividends ¹	0	0	0	0	-747	-747	-13	-760
Unrealised currency exchange rate differences	0	0	0	-42	0	-42	0	-42
Transfer to legal mandatory reserve	0	0	324	0	-324	0	0	0
Change in minority interest caused by changes in the Parent's ownership in subsidiaries (Note 7.2)	0	0	0	0	0	0	-2,791	-2,791
Net profit for the financial year	0	0	0	0	13,290	13,290	601	13,891
Balance as of 31.12.2006	19,463	7,866	351	-12	18,662	46,330	1,084	47,414

Additional information on the share capital
and share premium has been disclosed in Note 31.

¹ Dividends per share were announced in the reporting period as follows:

	2006	2005
Dividends announced	747	498
Number of shares at the announcement date	30,453,037	8,400
Dividends per share (in euros)	0.025	59.286

Notes to the consolidated financial statements

1. General information

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures for the financial year ended 31.12.2006 were authorised for issue on 31.03.2007. According to the Commercial Code of the Republic of Estonia, the annual report, prepared by the Management Board and approved by the Supervisory Board, is authorised by the General Meeting of Shareholders. These consolidated financial statements form a part of the annual report to be approved by the shareholders, and basis for profit allocation. The shareholders shall have the right not to approve the annual report prepared by the management board and approved by the supervisory board, and demand preparation of a new annual report.

The annual report to be approved by the shareholders will be presented in the Estonian language and currency (the Estonian kroon). Current financial statements are a translation of the statutory Estonian originals presented in euros. In case of differences arising on translation between the Estonian original and the current set of financial statements the statutory Estonian original shall prevail.

Arco Vara AS (the Parent) is a limited liability company incorporated and domiciled in Estonia. In 2006, the Group employed approximately 480 employees (2005: 280 employees). The main activities of the Group have been described in Note 4 "Segment reporting" and the Group operates through its subsidiaries and joint ventures in Estonia, Latvia, Lithuania, Ukraine, Bulgaria and Romania.

The structure of Arco Vara Group as at 31.12.2006 has been disclosed in Note 40.

2. Statement of compliance and basis for preparation

The consolidated financial statements of Arco Vara AS and its subsidiaries and joint ventures have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the EU. These consolidated financial statements have been prepared and presented for approval in accordance with and in order to meet the requirements of the Estonian Accounting Act and the Commercial Code.

The functional currency of Arco Vara AS is Estonian kroon (EEK) and the presentation currency of these financial statements in the euro (EUR). Unless otherwise noted, these financial statements have been prepared in thousands of euros.

The consolidated financial statements of the Group have been prepared on a historical cost basis, unless indicated otherwise in the accounting policies described in Note 4 "Summary of significant accounting policies" (e.g., certain financial investments, derivative financial instruments, investment property and biological assets have been measured at fair value).

BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries consolidated line by line as well as joint ventures using proportionate consolidation. The reporting years of the financial statements of the Group companies coincide with the calendar year. The companies use consistent accounting policies and estimates to a material extent (or accounting policies and estimates used by certain foreign entities have been adjusted, if necessary).

A subsidiary is an entity that is controlled by the Parent. Generally, a subsidiary is considered to be under the control of the Parent, when the Parent owns, directly or indirectly (through other subsidiaries), more than half of the voting power of an entity or the Parent has otherwise power to govern the financial and operating policies of a subsidiary under a contractual agreement or otherwise.

Joint ventures are companies whose economic activities are jointly controlled under a contractual agreement by two or more parties (incl. the Parent company). Joint control means sharing of control, where in order to determine the strategic financial and operating decisions of an investment object require unanimous consensus of the parties sharing control.

Assets, liabilities, income, expenses and cash flow of subsidiaries and joint ventures are consolidated from the date on which control or joint control (respectively) is transferred to the group, and cease to be consolidated from the date on which the control or joint control over the investment object is transferred out of the group.

The group's share in the joint ventures is consolidated under proportionate consolidation—the group's share of

the joint ventures' assets, liabilities, income and expenses are combined with similar items in the consolidated financial statements.

Any receivables, liabilities, income, expenses, cash flow and unrealised profit and loss arising from transactions between the Parent company and its subsidiaries have been fully eliminated in the consolidated financial statements. When eliminating the effect of transactions with joint ventures, the amount of holding of the Group is assessed. Unrealised losses are eliminated unless the loss is generated by decrease in the value of assets.

Minority interest – the share of the subsidiary's profit, loss and net assets which does not belong to the group, is recorded under a separate caption in the consolidated income statement and balance sheet (under owner's equity).

The acquisition of subsidiaries and joint ventures is recorded on the basis of the purchase method of accounting - the acquired assets and liabilities as well as contingent liabilities (hereinafter jointly also referred to as "net assets") of the subsidiary and joint venture are recognised at fair value. Any positive difference between the cost of the business combination and the fair value of the net assets of the investment object is recorded as goodwill. If as a result of the purchase price allocation the Group's share of the fair value of the net assets of the investment object exceed the cost of the business combination then the Group reassesses the fair values of the subsidiary's or joint venture's assets, liabilities and contingent liabilities and then recognises any differences (negative goodwill) immediately as income (see Note 4 "Goodwill" for the subsequent measurement of positive goodwill).

When the Company increases its share in a subsidiary by means of acquiring minority then the difference between the acquisition cost of the minority and the acquired minority's share of the net assets of the subsidiary is recorded as either positive or negative goodwill, whereas the net assets of the subsidiary are not revalued to fair value (the purchase method described in IFRS 3 „Business Combinations“ does not apply to the acquisition of minority) in these cases.

When an interest in a subsidiary or joint venture is disposed of, the difference between the proceeds from the disposal and the carrying amount of the parent's interest in the subsidiary's or joint venture's assets and liabilities plus the carrying amount of goodwill related to the subsidiary or joint venture is recognised in the income

statement as a gain or loss on disposal.

If control ceases, but only part of the subsidiary is disposed of, depending on the level of influence still held by the investor, the remaining interest in the carrying amounts of the subsidiary's or joint ventures assets and liabilities and of goodwill is accounted for either as an associate, as a joint venture or as a financial asset.

3. Changes in the presentation and accounting principles

The accounting policies and presentation adopted in preparation of the current financial statements are consistent with those of the previous financial year. In addition, the following new/revised standards have been adopted, which had no material effect on the financial results and disclosures of 2006:

- IAS 1 Presentation of Financial Statements (revised);
- IAS 19 Employee Benefits (revised);
- IAS 21 Effect of Changes in Foreign Exchange Rates (revised);
- IAS 39 Financial Instruments: Recognition and Measurement (revised);
- IFRS 4 Insurance Contracts (revised);
- IFRS 6 Exploration for and Evaluation of Mineral Resources¹;
- IFRIC 4 Determining whether an Arrangement Contains a Lease;
- IFRIC 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds¹;
- IFRIC 6 Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment¹.

According to management, the new or revised standards and interpretations that have been approved but have not yet entered into force as of the balance sheet date have no significant effect on the material accounting principles used by the group. The requirements of the below standards and interpretations will be adopted as of their date of entry into force, which for the standards and interpretations, applicable to the Group, is 01.01.2007 (IFRS 7, IAS 1, IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 10), 01.01.2008 (IFRIC 11, IFRIC 12) or 01.01.2009 (IFRS 8, IAS 23):

- IAS 1 Presentation of financial statements (revised);
- IFRS 7 Financial Instruments: Disclosures;
- IFRS 8 Operating segments²;
- IFRIC 7 Applying the Restatement Approach

¹ The amendments are not relevant to the Group's operating activities.

² The standard or interpretation has not yet been endorsed by the EU.

under IAS 29 Financial Reporting in Hyperinflationary Economies¹;
IFRIC 8 Scope of IFRS 2;
IFRIC 9 Reassessment of Embedded Derivatives;
IFRIC 10 Interim Financial Reporting and Impairment;
IFRIC 11 IFRS 2 – Group and Treasury Share Transactions²;
IFRIC 12 Service Concession Arrangements²;
IAS 23 Borrowing costs (revised)²

4. Summary of significant accounting policies

Significant accounting assumptions and judgements of the Management

The preparation of consolidated financial statements in conformity with International Financial Reporting Standards requires the management of the Group to make estimates and decisions that affect the reported amounts and accounting policies of assets, liabilities, income and expenses and disclosure of contingencies. Although the estimates and decisions are reviewed by management consistently and these are based on the previous experiences and the best knowledge on future trends, the actual outcomes may differ from the current estimates.

The more important judgements, which have effect on the information recognised in the financial statements, concern the following areas of accounting:

CLASSIFICATION OF REAL ESTATE

The classification of real estate items into classes as inventories, investment property or property, plant and equipment (construction-in-progress) is both on the initial classification as well as on later reclassification based on the intention of the management on the future use of the real estate. The accomplishment of the management's plans depends also on the decisions not controlled by the Group (i.e., changing registered intended use of land, approving detailed plans, issuing licence for construction etc), which reduces the accuracy of classification of real estate.

The real estate items with the intention on the future use for development and sale of living environments, individual house or plot of land have been classified as inventories. Real estate items purchased for sale in the course of ordinary business have also been recognised as inventories.

The aim of the purchase of an investment property is to earn income from rent or capital appreciation. The real estate items held for long-term perspective and with several possible intentions on future use are also considered to be investment properties.

The property being developed for the future use as commercial spaces leased out under operating lease terms or purchased commercial property with extensive ongoing reconstruction, is recorded as investment property only after completion of the work (after obtaining the permit for use). These properties have been recorded as constructions-in-progress under property, plant and equipment until completion.

Existing investment property that is being re-developed for continued future use as investment property is not temporarily re-classified to construction-in-progress.

OPERATING LEASES: GROUP AS THE LESSOR

Detailed examination of the lease agreements of several real estate objects has indicated that the material risks and rewards from ownership of the leased assets have not been transferred to the lessee. Therefore these leases are treated as operating leases.

REAL ESTATE FUNDS MANAGED BY THE GROUP: SUBSIDIARIES OR OTHER FINANCIAL ASSETS

The Group owns more than half of the voting power of the fund *Explorer Property Fund - Baltic States AB* managed by the Group. In the shareholder agreement of the fund and the management agreement of the fund, such managing and governing principles, which do not give control of the fund's financial and operating policies to the Group, have been established. Hence the fund is accounted for as a special purpose entity and the investment into the fund has been classified as financial asset at fair value through profit or loss.

Estimation uncertainty

The estimates made by the management of the Group are based on the previous experiences and all information available by the date of completing the financial statements. There is a risk that the estimates reported at the balance sheet date and related to value of assets, liabilities, revenue and expenses will be adjusted in the future. Areas, where due to uncertainty of estimates there is a heightened risk of adjustment, are described below:

¹ The amendments are not relevant to the Group's operating activities.

² The standard or interpretation has not yet been endorsed by the EU.

GOODWILL – IMPAIRMENT TEST

The Group determines whether goodwill arisen on acquisition of subsidiaries and joint ventures is impaired at least on an annual basis. This requires an estimate of fair value (less costs to sell) or value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the management to make an estimate of the expected future net cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill as at 31.12.2006 was 994 thousand euros (2005: 835 thousand euros). More details about the impairment test principles and results have been laid out in Notes 4 and 23.

INVESTMENT PROPERTY: DETERMINING THE FAIR VALUE

At each reporting date, investment properties are measured at their fair value. The management of the Group decided to rely mostly on external certified appraisers when determining the fair values of investment properties as at year end 2006. For properties where an internal certified appraiser is used, the discounted cash flow method is the valuation techniques used in most cases for determining fair value. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate (incl. rent prices per 1 m² and vacancy of premises under lease) and the related operating expenses. In order to calculate the present value of those net cash flows an appraiser has to choose also a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best possible way. The carrying amount of the investment properties with the fair value determined by the Group's internal appraisers using the discounted cash flow method as at 31.12.2006 amounted to 2,621 thousand euros (2005: 15,978 thousand euros). Carrying amount of the investment properties with the fair value determined by the external certified appraisers using the discounted cash flow method as at 31.12.2006 amounted to 21,810 thousand euros. More details about determining the fair value of investment properties, using the discounted cash flow method have been disclosed in Note 21.

For investment properties where as at 31.12.2006 the valuation technique used was the discounted cash flow method the following can be said regarding the sensitivity of the fair values to changes in key assumptions:

- an average 1% increase in the discount rate would have resulted in a 2,573 thousand euro decrease in the fair value of investment property recorded as at 31.12.2006;
- an average 1% decrease in the discount rate would have resulted in a 3,282 thousand euro increase in

the fair value of investment property recorded as at 31.12.2006;

- an average 5% decrease in the forecasted net operating income would have resulted in a 1,222 thousand euro decrease in the fair value of investment property recorded as at 31.12.2006;
- an average 5% increase in the forecasted net operating income would have resulted in a 1,222 thousand euro increase in the fair value of investment property recorded as at 31.12.2006.

RECEIVABLE FROM LOCAL MUNICIPALITIES: PROBABILITY OF THE RECEIPT

Paragraph 30 of the Planning Act requires local municipalities to acquire the real estate or a part of it from the Group, if it is intended for public use already in the approved detailed plan. Although the act requires local municipalities to purchase such real estate or a part hereof immediately and for a fair price, there are no explicit bases for determining the compensatory amount and payment schedule. The estimates on the likelihood of receipt from local municipalities have been taken as basis for the recognition of the receivables in the balance sheet. The carrying amount of such receivables as at 31.12.2006 amounted to 0 euros (2005: 410 thousand euros). More information on the amount and maturity of the receivable has been disclosed in Note 18.

Segment reporting

The segment reporting is based on the segmentation principles of structural units, used in the internal accounting and reporting (i.e., management reporting and budgeting) of the Group. The primary basis for segmentation is the type of business activity, whereby a segment has been disclosed as a separate reportable segment, if its products and services distinctly differ from the products and services offered by other segments, and it operates as an independent profit centre.

The business segments of the Group are the following:

- real estate development: development projects of living and business environments, investments into real estate with long-term perspective;
- services related to real estate: real estate brokerage and appraisal services, real estate management and real estate fund management, investment into real estate with short-term perspective;
- construction: provision of main and sub-construction contractor services, building inspection services.

Segment revenue is the revenue that is directly attributable to a segment and the relevant portion of other revenue that can be allocated on a reasonable basis to a segment. These are revenues from the sales to external customers or from transactions with other segments

of the Group. Revenue from the transactions between the companies belonging to same segment has been eliminated.

Segment expense is the expense resulting from the operating activities of a segment that is directly attributable to a segment and the relevant portion of other expense that can be allocated on reasonable basis to a segment. These are expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include financial expenses, general and administrative expenses and other expenses that are related to the Group as a whole. Expenses incurred at the Group level are allocated to the segment, if these expenses relate to the segment's operating activities and they can be directly attributed or allocated to the segment on reasonable basis. Expenses related to the transactions between the Group companies belonging to same segment have been eliminated.

Segment operating profit is the segment revenue less segment expenses.

Unrealised profit and loss, arising from the transactions between one Group segment with another, are not allocated to any of the segments, but are indicated as elimination between segments. Unrealised profit and loss, arising from transactions between Parent and the segments which can, on a reasonable basis, be allocated to the segment, is included in the operating profit of segment. Such profit or loss can be e.g. interest expenses previously capitalised in the Group, which upon reclassification of assets, initially recorded at cost, into fair value, are presented as an adjustment of fair value gain/loss during reclassification period of assets.

Segment assets are those assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets include current assets, investment property, property, plant and equipment (PPE) and intangible assets related to the operating activities of the segment. If a particular item of depreciation or amortisation is included in segment expense, the related asset is also included in segment assets. Segment assets do not include assets used for general Group purposes or which cannot be allocated directly to the segment. Segment assets shared by two or more segments are allocated between these segments, if a reasonable basis for allocation exists. Segment liabilities are these liabilities related to the operating activities, which either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include, for example,

accounts payable and other payable, accrued expenses, customers' prepayments, warranty provisions and other product and service related liabilities. Segment liabilities do not include loans, financial leases, bonds and other liabilities related to financing activities. Income tax liability is also not included in segment liabilities.

Revenue and expenses, assets and liabilities, which are not directly related to the segment and cannot be allocated to the segment, are presented as unallocated revenue and expenses, assets and liabilities of the Group.

The secondary basis of segmentation is geographical location. As at 31.12.2006 the geographical segments include Estonian, Latvian, Lithuanian, Ukrainian and Bulgarian segments. Romanian companies are considered as a separate segment starting from 2007.

FOREIGN CURRENCY TRANSACTIONS

All currencies, except Estonian kroon (the functional currency of the Parent) are considered to be foreign currencies. Transactions denominated in foreign currency are initially recorded on the basis of the foreign currency exchange rates of the Bank of Estonia officially valid on the transaction date. Monetary assets (cash, cash equivalents and receivables) and liabilities (loans received and payables) denominated in foreign currency have been translated into euros on the basis of the currency exchange rates of the Bank of Estonia officially valid on the balance sheet date. Foreign exchange gains and losses resulting from revaluation are recorded in the income statement of the reporting period as "Financial and investment activity income" or "Financial and investment activity expenses". Non-monetary items that are measured at historical cost in a foreign currency are translated using the currency exchange rates of the Bank of Estonia officially valid on the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated into the functional currency using the currency exchange rates of the bank of Estonia, officially valid on the date when the fair value was determined.

When the functional currency of subsidiaries and joint ventures differs from the Parent's functional currency (e.g. functional currency of Latvian subsidiaries is Latvian lats, functional currency of Lithuanian subsidiary is Lithuanian litas and functional currency of Ukrainian subsidiaries is US dollar), the following exchange rates are used for translation of financial statements of subsidiaries and joint ventures for the purpose of consolidation:

- all of the assets and liabilities of foreign subsidiaries and joint ventures (incl. goodwill and fair value adjustments arising from acquisitions of these

- companies) are translated at the rate of exchange ruling at the balance sheet date;
- the income, expenses and changes in equity of the subsidiaries and joint ventures are restated on the basis of the weighed average exchange rate of the period.

The exchange differences arising on the translation i.e. between balance sheet date and weighted average rates, are presented in the balance sheet row "other reserves". On disposal or partial disposal of foreign subsidiaries and joint ventures as well as on capital re-contributions, the amounts presented in the equity row "other reserves" relating to that particular disposed entity are recognised in the income statement as profit or loss for the year.

Revenue recognition

Revenue is recognised at the fair value of the consideration received/receivable. Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

PROCEEDS FROM DISPOSALS OF REAL ESTATE

Sales of real estate are recognised when all material risks and rewards related to the real estate have been transferred to the purchaser and the seller has no further substantial acts to complete under the contract. In general, the sale is deemed completed when the real right contract (the contract, agreeing the transfer of the ownership of real estate), is concluded. Payments received from customers before concluding the contract are recorded under "prepayments".

REVENUE FROM LONG-TERM SERVICE AGREEMENTS

The stage of completion method is used for recording revenue and expenses of long-term service contracts, incl. construction contracts. The stage of completion of the rendered service is estimated based on the proportion of expenses actually incurred on the project until the balance sheet date compared to the estimated total expenses of the project. If, by the balance sheet date, the invoice issued by the service provider to the customer differs from the amount of revenue calculated based on the stage of completion method, the difference will be recorded in the balance sheet under liabilities or receivables, respectively.

If it has become evident that the anticipated costs of the project exceed the total revenue, the loss will be recorded immediately and fully in the income statement.

REVENUE FROM RENDERING OF OTHER SERVICES

Revenue from the sales of services is recorded upon

rendering of the service. Revenues from brokerage services are recognised when the mediated operation has been concluded. Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Revenue and expenses related to utility services (i.e. electricity, heat, water, etc.) are offset.

REVENUE FROM SALES OF OTHER GOODS

Revenue from sales of other goods is recognised when all material risks and benefits related to the ownership of the asset have been transferred to the purchaser, and the amount of revenue can be reliably measured.

FINANCIAL INCOME

Interest income is recorded on an accrual basis in the income statement, based on the effective interest rate method. Dividend income is recognised when the respective right of claim arises.

Cash and cash equivalents

Cash equivalents are short-term (with a term of up to 3 months from the date of acquisition) highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in market value. Such assets are cash in hand and current bank accounts, term deposits with an original maturity of three months or less and money market fund shares.

Financial assets

All financial assets are initially recognised at cost, being the fair value of the consideration given. The acquisition cost includes all expenditures directly related to the purchase of the financial asset, including service charges payable to brokers and advisors, non-refundable taxes and other similar expenditures. As an exception to this rule - transaction costs directly attributable to the purchases of financial assets at fair value through profit or loss are recognised as expenses when incurred.

Regular way purchases and disposals of financial assets are recorded on the transaction/trade date. A transaction date is the date when the Group commits (e.g. concludes an agreement) to purchase or sell the financial asset. Regular way purchases or sales are purchases or sales of financial assets, where the seller has delivered the assets to the buyer within the period generally established by conventions in the marketplace or regulations. After initial recognition the financial assets are divided into groups (see below). The Group re-evaluates designation of the financial asset at each financial year-end and, if necessary, makes respective adjustments. The classification of financial assets, which according to the

International Financial Reporting Standards may not be reclassified, is not changed. The following measurement bases are used for financial assets:

- 1) financial assets at fair value through profit or loss - fair value;
- 2) held-to-maturity investments - measured at amortised cost;
- 3) receivables - measured at amortised cost;
- 4) available-for-sale financial assets – measured at fair value, except investments in equity instruments whose fair value cannot be reliably measured, which are measured at cost.

FINANCIAL ASSETS MEASURED AT FAIR VALUE

Financial assets that are measured at fair value are revaluated on each balance sheet date, with no deduction for possible transaction costs related to the disposal of the asset. The fair value of listed securities is based on the closing price of the security, as well as the official exchange rate of the Bank of Estonia on the balance sheet date. For securities, which are not listed on a stock exchange, fair value is determined based on all available information and using the fair value of another instrument, which is substantially the same, at the reporting date and/or discounted cash flow analysis as valuation techniques.

A gain and loss arising from changes in the fair value of a financial asset is recognised in profit or loss (under “Financial and investment activity income” or “Financial and investment activity expenses”). An exception is available-for-sale financial assets, measured at fair value, with gains or losses being recognised directly in equity (as “other reserves”). After the investment is derecognised or is determined to be impaired, the balance of revaluation reserves is transferred to the income statement. The impairment loss recycled from owner’s equity to the income statement is the difference between the acquisition cost (less any principal repaid, and amortisation) and the current fair value of the financial asset, less any impairment losses relating to the financial asset previously recorded in the income statement.

A gain and loss arising from disposal of financial assets measured at fair value as well as interests and dividends from these assets are recognised in profit or loss (under “Financial and investment activity income” or “Financial and investment activity expenses”).

RECEIVABLES AND HELD-TO-MATURITY INVESTMENTS

Receivables, except those that the Group intends to sell in the near term, and held-to-maturity investments are measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any discount or premium on acquisition, as well as expenses directly related to the transaction, over the

useful life of the asset.

If there is objective evidence that an impairment loss on financial assets carried at amortised cost has been incurred, the difference between the asset’s carrying amount and the recoverable amount is recorded in the income statement. The recoverable amount of a financial asset is the net present value of future cash flows from the financial asset, discounted with the effective interest rate determined upon the assets initial recognition. The impairment loss of financial assets related to operating activities is charged to operating expenses in the income statement (under “Administrative and general expenses”) while the impairment loss of financial assets related to investing activities is charged to financial expenses in the income statement.

The impairment loss is determined separately for financial assets that are individually significant. Receivables overdue more than 180 days are considered to be fully impaired and are expensed. If impairment in the value of the assets becomes known sooner, the receivables are considered as impaired earlier.

If a receivable previously written down is collected or any other event occurs, which cancels the impairment, the reversal of the previously recognised impairment loss is recognised in the income statement as a reduction of the expense where the impairment was initially recognised.

Interest income from receivables and held-to-maturity investments is recognised under “Financial and investment activity income” and “Financial and investment activity expenses” in the income statement.

FINANCIAL ASSETS MEASURED AT ACQUISITION COST

A financial asset, measured at acquisition cost is written down to its recoverable amount if the recoverable amount is less than the carrying amount of the financial asset. The recoverable amount of financial assets measured at cost consists of the estimated future cash flows from the financial asset, discounted with the average rate of return from similar financial assets on the market. The impairment loss is recognised under “Financial and investment activity expenses” in income statement and shall not be reversed.

The derecognition of financial assets will take place when the Group no longer controls the rights to receive cash flows arising from the financial assets, or when the Group is obliged to, without a material delay, transfer to a third party all cash flows attributable to the asset, and the majority of the risks and rewards related to the financial asset.

Derivative financial instruments

The Group uses derivative instruments such as interest rate swap to hedge the risk associated with interest rate fluctuations. Such derivative instruments are initially stated at fair value on the contract conclusion date. Subsequent to initial recognition, the instrument will be revaluated in accordance with the change in its fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. The fair value of the currently operational interest rate swap contract is determined by reference to discounted future cash flows based on estimates on fluctuation of 6-month EURIBOR (from Reuters).

Gains and losses arising from changes in the fair value of the derivative instrument are charged to the "Financial and investment activity income" and "Financial and investment activity expenses" of the period except for derivative instruments that qualify for hedge accounting. The Group had no instruments that qualified for hedge accounting in the reporting period, or in the comparative period.

Inventories

Finished products and work-in-progress are recorded at production cost, consisting of the direct and indirect production costs incurred upon bringing the inventories to their present condition and amount. General production expenses are allocated to work-in-progress and finished goods, based on a normal production volume. Other inventories are recorded at acquisition cost consisting of all the direct and indirect expenditures necessary for converting inventories into ready for sale. Indirect costs, which are included in the cost of the real estate recorded as inventory, are also borrowing costs (interest, amortisation of contract fees, etc) related to the financing of construction of real estate items. Borrowing costs are capitalised into the acquisition cost of inventory until completion of the construction. Borrowing costs related to registered immovable and apartments treated as movables are included in the acquisition cost until a permit for use has been issued.

Generally, inventories are accounted for by using weighted average cost method. An exception to this rule is registered immovable and apartments, treated as movables, where individual cost method is used.

Inventories are valued in the balance sheet at whichever is lower, acquisition cost or the net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale. The amount of write-down of inventories to their net

realisable value is recorded as expenses of the reporting period, under "cost of sales" in the income statement.

Investment property

Investment property is property, land or a building held to earn rentals or for capital appreciation, and which is not used for the business activities of the Group. Real estate items held with long-term perspective and with several possible intentions on future use are also considered to be investment properties. Land and buildings purchased for development of living environment have been recognised as inventories. Properties being developed for future use as investment properties (construction of commercial buildings) and buildings treated as movables (reconstruction of commercial buildings) are recorded as PPE until completion of the development work.

Investment properties are initially recognised in the balance sheet at cost, including the transaction costs directly related to the acquisition (i.e. notary's fees, state duty, consulting fees and other expenses incurred for the purpose of concluding the transaction). Thereafter, investment properties are stated at fair value at each reporting date, which reflects market conditions at the balance sheet date.

Expert opinion of certified valuers is used to determine the fair value of the investment property. For more significant investment properties, an independent appraiser's valuation is used in parallel. The following methods are used for determining the fair value:

- Discounted cash flow method. Estimating the discounted cash flows requires an appraiser to forecast rental income generated by the real estate (incl. rent prices per m² and vacancy) and related operating expenses. Depending on the termination possibilities of the lease agreement, appraiser chooses between existing cash flows or market average cash flows. In order to calculate the present value of the net cash flows an appraiser has to estimate also a suitable discount rate, which reflects the time value of money and specific risks related to the assets in the best way. For discount rate calculations market average capital structure is used, not asset specific structure. Discounted cash flow method is used for determining the value of properties with stable rental flows.
- Comparable prices method. For comparable prices method transactions concluded on comparable conditions with the valued property are examined and the market value of the property is derived through the price per m² of the concluded transactions. Comparable prices method is used for real estate with no rental flow and which are held for future development

potential or capital appreciation. By nature it's almost impossible to find exactly the same property or deal to compare with, therefore appraiser adjusts the property by transaction time, district, location, size and detail plan.

- Sale contract under the law of obligations concluded as at the balance sheet date. For real estate, which has been disposed of as at the balance sheet date on the basis of a contract under the law of obligations, but for which the real right contract has not been signed yet, the basis for determining the fair value is the sales price in the sales contract under the law of obligations. The sales price is used as the basis for determining the fair value of the investment property only when the Group has sufficient certainty that a real right contract under the same terms will be concluded (for example the buyer has made a considerable prepayment for the acquisition of the property as at the balance sheet date or the real right contract has been concluded after the balance sheet date but before the financial statements are approved for issue).

Gain/loss from the change in value is recorded under "Other operating expenses"/"Other operating income" in the income statement.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses arising from derecognition of investment property are charged to "Other operating income" or "Other operating expenses" in the income statement of the period when the investment property was derecognised.

Investment property is reclassified in the balance sheet when there is a change in use. From the date of the change in use, the Group uses the accounting principles applicable to the group of assets, into which the property was re-classified. For a transfer from investment property to inventories or property, plant and equipment, the new deemed cost of property for subsequent accounting is its fair value as at the date of reclassification.

For a transfer from PPE to investment property, the positive difference between fair value at that date and its previous carrying amount is recognised in revaluation reserve. The negative difference is recognised in the income statement under depreciation expense. An exception to this rule is transfer from construction-in-progress, where both positive and negative difference is recognised in profit or loss, under "other operating income" or "other operating expenses". If a property previously recognised as inventories is reclassified to investment property, both the positive and negative differences between the fair value on the day of reclassification and carrying amount

will be recorded, under "Other operating income"/ "Other operating expenses" in the income statement.

Biological assets

A living animal or plant is recognised as a biological asset, if it is held for the purpose of future economic benefit and its fair value or cost can be measured reliably. Upon both their initial and subsequent recognition, biological assets are recorded at their fair value, less the estimated sales expenses. Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. If an active market exists, the market price is considered to be the fair value of a biological asset. If an active market does not exist, the fair value of an asset is determined using the discounted cash flow method.

When determining the number of plants 15 sample areas are used per each 100 m², the size of a sample area being 77cm x 77cm (2 planting boxes x 2 planting boxes) or 0.593 m². All living plants are counted on the sample area and the average result of sample areas is calculated. Based on this information the number of plants per 1 m² is calculated, which is multiplied with the area of all planting boxes.

Biological assets are divided into consumable and productive assets. All biological assets recognised on the Group's balance sheet are consumable assets and these assets have been distinguished between mature and immature biological assets, as appropriate (see Note 17). For the purpose of determining the fair value, the assets were divided into groups based on their characteristic (age, sort and level of maturity). For each group the estimated sales period, sales revenue, based on current market prices and estimated sales costs were determined. The fair value is determined based on the discounted cash flow method.

Gain/loss from the change in value is recorded under "Other operating expenses"/"Other operating income" in the income statement.

Property, plant and equipment

Assets with an acquisition cost of over 1,278 euros and a useful life of over 1 year are considered to be property, plant and equipment. Assets with an acquisition cost of less than 1,278 euros and estimated useful life over 1 year, are recorded as low-value items (under inventories) and are fully expensed when the asset is taken into use. PPE are initially recorded at cost, consisting of the purchase price and expenditures directly related to the acquisition. Costs, which are included in the cost of the

real estate recorded as PPE, are also borrowing costs (interest, amortisation of contract fees, etc) related to the financing of construction of properties. Borrowing costs are capitalised into the acquisition cost of PPE from the start of the construction until completion hereof.

Subsequent to initial recognition, an item of PPE is carried in the balance sheet at cost less accumulated depreciation and any accumulated impairment losses.

If an item in the PPE consists of clearly separable components with different useful lives, each such component is accounted for separately in the accounting of the Group. Depreciation rates are determined for each component individually, depending on its estimated useful life.

Expenses incurred on PPE after their recognition (e.g. replacement of a part of the asset) are added to the carrying value of the asset, provided they meet the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the Group; and (b) the acquisition cost of the item can be reliably measured. Replaced parts are derecognized from the balance sheet. All other expenditures are recognised as an expense in the period in which they have been incurred.

Depreciation of PPE is calculated on a straight-line basis. Depreciation rates are determined for each tangible asset item individually, depending on its estimated useful life. The following annual depreciation rates are applied for PPE groups:

Buildings and facilities	2–18%
Machinery and equipment	8–20%
Transport vehicles	15–25%
Fixtures, fittings and tools	20–40%

Depreciation is calculated until the moment the residual value of the asset exceeds its carrying value. The residual value is the amount that the Group would currently obtain from disposal of the asset, if the asset was already of the age and in condition expected at the end of its useful life.

The depreciation rates, depreciation methods and the residual value of items of PPE are reviewed at the end of each financial year, and changed, where necessary. If the methods of valuation change, the changes are accounted for prospectively.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The impairment test has been described in more detail below (see the accounting principles for impairment of asset).

PPE is derecognised upon disposal of the asset, or when no future economic benefits are expected from the use or disposal of the asset. Any profits and losses arising from derecognition of an item of PPE are charged to “Other operating income” or “Other operating expenses” in the income statement of the period when the PPE item was derecognised.

PPE items which are very likely to be sold within 12 months are reclassified into non-current assets held for sale. Non-current assets held for sale are presented separately from current and non-current assets in the balance sheet, and are no longer depreciated. Non-current assets held for sale are valued at whichever is lower, net carrying amount or fair value less costs to sell.

Goodwill

Goodwill acquired in a business combination is initially measured at cost. Goodwill is the positive difference of the acquisition cost of the acquired holding and the Group’s interest in the fair value of the net assets of the subsidiary or joint venture as at the date of acquisition. Net assets of the subsidiary or joint venture as at the acquisition date are the net value of the identifiable assets, liabilities and contingent liabilities.

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. In order to determine the impairment, any goodwill acquired is allocated to each cash-generating units expected to benefit from the combination’s synergies, or groups of such units. An independent cash-generating unit (set of units) is the smallest identifiable group of assets, which is not larger than a primary segment based on the Group’s segment reporting.

Goodwill is reviewed for impairment annually, as at the end of the financial year or more frequently if events or changes in assessments indicate that the carrying value may be impaired. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Impairment loss is recognised in profit and loss, under “general and administrative expenses”.

Other intangible assets

Other acquired intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are measured at cost, less accumulated amortisation and any accumulated impairment losses. The intangible assets are divided into assets with either finite or indefinite useful lives.

Intangible assets with finite lives are amortised on a straight-line basis, over the useful economic life (generally 3 to 6 years). The amortisation expense on the assets is recognised in the income statement in the expense category consistent with the function of the intangible asset. The amortisation period and amortisation methods of intangible assets with finite useful life are reviewed at the end of each financial year. Changes in the expected useful life and the expected time structure of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method prospectively.

Intangible assets with indefinite useful lives are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, calculation of amortisation is started on the asset and necessary changes are made on a prospective basis. Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. The carrying values of intangible assets with finite useful lives are reviewed for impairment when circumstances indicate that the carrying value may not be recoverable. If the impairment test reveals that the recoverable amount of the asset item is lower than its carrying amount, the item will be written down to its recoverable amount. The amounts of impairment are recorded likewise to amortisation costs in income statement, i.e. grouped by the purpose of use of the assets. The accounting principle for impairment of assets has been described in section "Impairment of assets".

Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If such an indication exists or at least once a year (if so required by IFRS), the Group makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is written down, either individually or as part of a cash-generating unit¹, to its recoverable amount. An asset's recoverable amount is either the present value of an asset's estimated future cash flows (value in use) or its fair value less costs to sell, whichever is higher. In assessing value in use, the estimated cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Independent experts are used for determining the fair value of the asset. Impairment losses, incl. impairment of the asset as a part of a cash-generating unit, are recognised in the income statement in the depreciation/amortisation costs

of the reporting period.

If there is an indication that the reason for the impairment no longer exists, the previously recognised impairment is reversed. An assessment about the change of circumstances is made at least at each reporting date. The previously recognised impairment loss is reversed and the value of the asset is increased to its carrying value, which the asset would have had, had no impairment loss been recognised. Cancellation of the write-down is recorded in the income statement— as a reduction of expenses under the same caption previously used for the write-down. As an exception to this rule, impairment loss of goodwill is not reversed.

Financial liabilities

All financial liabilities (accounts payable, loans taken, accrued expenses, bonds issued, other short-term and long-term payables) are initially accounted for at their acquisition cost, which includes all expenses directly related to the acquisition. After initial recognition, financial liabilities are subsequently measured at amortised cost (except financial liabilities held for trading, which are measured at their fair value).

The amortised cost of short-term financial liabilities equals to their nominal value. Therefore, short-term financial liabilities are recorded in the balance sheet at the amount payable. In order to calculate the amortised cost of a long-term liability, the liability is initially recorded at the fair value of the amount to be received (less transaction costs), by charging interest on the liability in future periods based on the effective interest rate method. Interest expenses related to the financial liability are charged to the expenses of the period on accrual basis under "Financial and investment activity income" and "Financial and investment activity expenses" in the income statement. Interests related to financing the development of assets (real estate projects under inventories, investment property and PPE) that have been incurred from the launch of the development until completion of the work are, as an exception, capitalised as part of the cost of the asset.

A financial liability is classified as short-term, if it is payable within 12 months as of the reporting date or if the Group has no unconditional right to postpone the payment of the liability for more than 12 months as of the reporting date. Borrowings, which are payable within 12 months as of the reporting date, however which are refinanced into a long-term liability after the reporting date, but before approval of the annual report, are recognised as short-term liabilities. Borrowings which are

¹ The Group views segments as cash generating units

due upon demand due to the violation of a provision of the loan agreement are also recorded under short-term borrowings.

Government grants

Government grants are recorded under income during the period the company incurs the expenses for which the grant was allocated. Government grants, which are allocated for covering expenses incurred in previous periods or which do not incur deferred liabilities, are charged to income during the period the grant was allocated. Government grants are not recorded as income before the Group has sufficient reason to believe that the Group meets the conditions established for the government grant, and the grant will be awarded. Contingent government grant related liabilities are recorded as provisions or contingent liabilities.

Assets acquired with government grants are recorded at acquisition cost, less the amount of government grant (the net method). The acquired assets are depreciated to expenses over the useful life of the asset.

Provisions and contingent liabilities

Provisions are recognised only if the Group has a present obligation (legal or constructive) as a result of a past event, the performance of which most likely requires future outflow of resources and a reliable estimate can be made about the amount of the obligation.

Promises, guarantees and other commitments that in certain circumstances (which have not yet occurred) may become liabilities are disclosed as contingent liabilities in the notes to the financial statements.

Present obligations that arise from past events, which according to the judgement of the management of the Group will not realise or which can not be reliably measured, are also disclosed as contingent liabilities.

Accounting for lease

Lease transactions, where all material risks and rewards from ownership of the leased asset are transferred to the lessee, are treated as finance lease. All other lease transactions are treated as operating lease.

Assets acquired under the terms of finance leases are recognised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Thereafter leased assets are depreciated over the shorter of the following: the

estimated useful life of the asset and the agreed lease term. Assets sold under finance lease terms are recorded in the balance sheet as a receivable in the amount of the net investment in the lease. Lease payments are apportioned between the financial expense or income and lease liability or receivable, using a constant rate of interest throughout the lease term.

In case of operating lease, the assets are recorded in the lessor's balance sheet. Operating lease receipts and payments are recognised as an income or expense in the income statement on a straight-line basis over the lease term.

Legal mandatory reserve

According to the Commercial Code, the mandatory reserve has to be at least 10% of the share capital of the Parent. Accordingly, the Parent transfers at least 5% of the net profit at profit distribution to the mandatory reserve each financial year. When the reserve capital has reached the prescribed amount, the net profit transfers are terminated. The mandatory reserve cannot be paid out as dividends. It can be used for covering accumulated loss, if loss cannot be covered from the free shareholder's equity. Mandatory reserve can also be used for increasing the share capital of the company by way of a bonus issue.

Income tax

Income tax assets and liabilities and income tax expense and income are recognised as current and deferred income tax. Current income tax is recorded as short-term asset or liability and deferred income tax as long-term asset or liability.

PARENT COMPANY, SUBSIDIARIES AND JOINT VENTURES REGISTERED IN ESTONIA

Pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit. Rather, they are subjected to income tax on the disbursed dividends. The established tax rate was 23/77 of the net dividend disbursed until 31.12.2006 and 22/78 of the net dividend disbursed from 01.01.2007 onwards. The Income Tax Act establishes further decrease of applicable income tax rate by one point until 20/80 on net dividends paid out after 01.01.2009. Income tax from disbursement of dividends is recorded under expenses in the income statement at the moment of declaring the dividends (upon incurring the payment obligation).

Since pursuant to the Income Tax Act, Estonian companies are not subjected to pay income tax on the profit

thus there are no temporary differences between the tax bases and carrying values of assets and liabilities and no deferred tax assets or liabilities arise. A Group's potential tax liability related to the distribution of its retained earnings as dividends is not recorded in the balance sheet. The maximum amount of potential income tax liability has been disclosed in Note 32.

LATVIAN, LITHUANIAN, UKRAINIAN, BULGARIAN AND ROMANIAN SUBSIDIARIES AND JOINT VENTURES

The company's net profit is subject to income tax in Latvia, Lithuania, Ukraine, Bulgaria and Romania. The tax rate is 15% in Latvia and Lithuania, 25% in Ukraine, 15% in Bulgaria (10% starting from 01.01.2007) and 16% in Romania. The chargeable tax is calculated on the profit before income tax, and temporarily or permanently adjusted with additional income and expense items in accordance with the requirements of the local income tax laws.

In case of foreign subsidiaries, the deferred income tax assets or liabilities are calculated on the temporary differences between the tax basis and carrying values of assets and liabilities. The deferred income tax assets will be presented in the balance sheet only if the company is likely to incur, in the foreseeable future, an income tax liability in a comparable amount to the deferred income tax assets and which can be used for offsetting.

Accounting for investments in subsidiaries and joint ventures in the parent company's unconsolidated main statements as required by Estonian Accounting Act

The Parent's non-consolidated main statements (presented in Note 41) represent supplemental information in line with the Estonian Accounting Act and they are not deemed to present separate financial statements of the Parent in accordance with IAS 27.

In the Parent's non-consolidated main statements investments in its subsidiaries and joint ventures are carried at cost. This means that the investment is initially recognised at acquisition cost, consisting of the fair value of the consideration given, adjusted thereafter by the impairment losses arising from impairment in the value of the investment.

If events or changes in circumstances indicate that the carrying value of an investment may be impaired then such investments are tested for impairment at each reporting date or more frequently, (accounting principle "Impairment of assets"). Impairment losses are recognised under "Financial and investment activity income" and "Financial and investment activity expenses" in the income statement.

Dividends receivable/received from subsidiaries and joint ventures are recognised as financial and investment activity income, when the right to receive the payment is established. The part of dividends paid out on account of the retained earnings generated by the subsidiary or joint venture before the acquisition of the entity are not considered as income. The respective portion of the dividends is recorded as a reduction of the investment.

5. Segment information – business segments in thousands of euros

	Service	Development	Construction	Eliminations	Total
As of 31.12.2006 or for the year 2006, respectively					
Revenue from external customers	6,855	12,761	11,291	0	30,907
Other operating income from external customers	45	26,955	30	0	27,030
Revenue and other operating income to other segments	733	332	11,645	-12,710	0
Total revenue & other operating income	7,633	40,048	22,966	-12,710	57,937
Segment results	551	17,779	61	90	18,481
Unallocated operating expenses					-1,842
Total operating profit					16,639
Financial and investment activity income					1,036
Financial and investment activity expenses					-3,173
Income tax expenses					-611
Net profit for the financial year					13,891
Segment assets	2,039	131,275	5,895	-1,321	137,888
Unallocated assets					6,384
Total assets					144,272
Segment liabilities	1,445	16,910	3,044	-1,321	20,078
Unallocated liabilities					76,780
Total liabilities					96,858
Segment investments into non-current assets	604	21,328	342	0	22,274
Unallocated investments					223
Total investments into non-current assets					22,497
Depreciation and amortisation included in segment results (Note 9, 22, 23)	-62	-34	-66	0	-162
Impairment loss on goodwill included in segment results (Note 9, 23)	0	-805	0	0	-805
Goodwill charged to income, included in segment results (Note 9, 23)	0	925	18	0	943
Unallocated depreciation and amortisation (Note 9, 22, 23)					-34
Total depreciation, amortisation and impairment loss					-59
Non-monetary income and expenses (except depreciation and amortisation)					
Gains and losses from change in the fair value of investment property and biological assets (Note 9, 21)	11	24,014	0	0	24,025
Write-down and liquidation of PPE (Note 22)	0	-4,653	-1	0	-4,654
Allowance for receivables and write-off of liabilities (Note 9)	-106	-28	-1	0	-135
Total non-monetary income and expenses					19,236

5. Segment information – business segments in thousands of euros (Continued)

	Service	Development	Construction	Eliminations	Total
As of 31.12.2005 or for the year 2005, respectively					
Revenue to external customers	4,123	15,077	11,218	0	30,418
Other operating income to external customers	207	8,397	42	0	8,646
Revenue and other income to other segments	758	131	3,662	-4,551	0
Total revenue & other operating income	5,088	23,605	14,922	-4,551	39,064
Segment results	846	9,440	215	308	10,809
Unallocated operating expenses					-997
Total operating profit					9,812
Financial and investment activity income					835
Financial and investment activity expenses					-2,942
Income tax					-263
Net profit for the financial year 2005					7,442
Segment assets	2,040	77,625	5,147	-4,310	80,502
Unallocated assets					12,930
Total assets					93,432
Segment liabilities	936	25,436	3,736	-21,491	8,617
Unallocated liabilities					47,699
Total liabilities					56,316
Segment investments into non-current assets	32	14,822	913	0	15,767
Unallocated investments					5
Total investments into non-current assets					15,772
Depreciation and amortisation included in segment results (Note 9, 22, 23)	-53	-22	-68	0	-143
Impairment loss included in segment results (note 9, 23)	0	-454	0	0	-454
Unallocated depreciation and amortisation (Note 9, 22, 23)					-27
Total depreciation, amortisation and impairment loss					-624
Non-monetary income and expenses (except depreciation and amortisation)					
Gains and losses from change in the fair value of investment property and biological assets	186	6,392	130	-47	6,661
Allowance for receivables and write-off of liabilities	-11	-103	0	0	-114
Total non-monetary income and expenses					6,547

6. Segment information – geographical segments in thousands of euros

Revenue by geographical location of customer			Segment assets by geographical location of assets		
	2006	2005		31.12.06	31.12.05
Estonia	28,099	28,882	Estonia	126,881	78,874
Latvia	2,154	835	Latvia	10,932	3,284
Lithuania	382	175	Lithuania	55	23
Sweden	0	560	Ukraine	479	34
Ukraine	340	60	Bulgaria	27	0
Bulgaria	17	0	Inter-segment eliminations	-108	-1,712
Inter-segment eliminations	-85	-94	Unallocated assets	6,006	12,929
Total	30,907	30,418	Total	144,272	93,432

Non-current assets acquired in 2006 by type of assets

	Estonia	Latvia	Lithuania	Bulgaria	Ukraine	Total
Investment property	1,781	0	0	0	0	1,781
Property, plant and equipment	20,486	89	18	15	27	20,635
Intangible assets	68	1	2	5	5	81
Total acquired non-current assets	22,335	90	20	20	32	22,497

Non-current assets acquired in 2005 by type of assets

	Estonia	Latvia	Lithuania	Ukraine	Total
Investment property	3,504	612	0	0	4,116
Property, plant and equipment	11,105	24	17	17	11,163
Intangible assets	488	5	0	0	493
Total acquired non-current assets	15,097	641	17	17	15,772

7. Changes in the Arco Vara Group structure

7.1 Scope of consolidation

	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Total
Parent and subsidiaries							
As of 01.01.2006	21	7	1	2	-	-	31
Additions	1	1	1	-	1	-	4
Disposals	-2	-1	-	-	-	-	-3
As of 31.12.2006	20	7	2	2	1	-	32
Joint ventures							
As of 01.01.2006	10	1	-	-	-	-	11
Additions	14	1	-	-	-	1	16
Disposals	-2	-	-	-	-	-	-2
As of 31.12.2006	22	2	-	-	-	1	25
Associated companies (not consolidated)							
As of 01.01.2006	-	-	-	-	-	-	-
Additions	1	-	-	-	-	-	1
As of 31.12.2006	1	-	-	-	-	-	1

As of 31.12.2006, 42 Estonian, 9 Latvian, 2 Lithuanian, 2 Ukrainian, 1 Bulgarian and 1 Romanian company had been consolidated under the Arco Vara Group. In 2006, the Group acquired 4 subsidiaries, consolidation of three companies was stopped. 16 proportionally consolidated joint ventures were added to the Group.

The most significant joint ventures from the Group's perspective are Tallinna Olümpiapurjespordikeskus AS (owns the Regati pst 1 property) and Floriston Grupp OÜ (owns several development properties in Tallinn).

The effect of joint ventures on the consolidated balance sheet and income statement (in thousands of euros):

	2006	2005
Operating income	17,877	5,965
Operating expenses	-3,348	-1,250
Financial income and expenses	-91	-663
Current assets	6,327	1,841
Non-current assets	38,341	18,960
Current liabilities	5,482	1,437
Non-current liabilities	11,007	3,929

Companies belonging to the Arco Vara consolidation group:

Service segment companies

Group's subsidiaries in the service segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country	Group's joint ventures in the service segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Neruhomist TOV ¹	75%	75%	Ukraine	Arco Varavalitsemise AS	50%	50%	Estonia
Arco Real Estate EOOD	100%	0%	Bulgaria	Arco Rumeenia Valdused OÜ	50%	0%	Estonia
Arco Real Estate SIA	80%	80%	Latvia	Arco Real Estate Consulting SRL ¹	50%	0%	Romania
Arco Real Estate UAB	80%	80%	Lithuania	Lehe Elamud OÜ	sold	50%	Estonia
Arco Ukraina Valdused OÜ	75%	75%	Estonia	Home Service SIA ^{1,3}	40%	40%	Latvia
Arco Vara Halduse OÜ	merged	100%	Estonia				
Arco Vara Kinnisvarabüroo AS	100%	100%	Estonia				

Development segment companies

Group's subsidiaries in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country	Group's joint ventures in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Capital TOV ¹	75%	75%	Ukraine	Arco & Koger			
Arco Development SIA	80%	80%	Latvia	Investeeringute AS ¹	50%	0%	Estonia
Arco HCE OÜ	100%	100%	Estonia	Arco Vara Arenduse OÜ	50%	50%	Estonia
Arco Invest UAB ¹	80%	0%	Lithuania	Arco Vara Saare Kinnistud OÜ	50%	50%	Estonia
Arco Investeeringute AS	100%	84%	Estonia	Arco Ärikeskuse OÜ ²	50%	50%	Estonia
Arco Maadehaldus OÜ	100%	100%	Estonia	Barrow Investments OÜ ¹	50%	0%	Estonia
Arco Management SIA ¹	liquidated	100%	Latvia	Castleberry OÜ ¹	50%	0%	Estonia
Arco Vara Kinnistute AS	100%	100%	Estonia	Chalwell OÜ ¹	50%	50%	Estonia
Arco Vara Puukool OÜ	75%	75%	Estonia	Cromer Trade OÜ ¹	50%	0%	Estonia
Arco Vara Riia Valdused OÜ	75%	75%	Estonia	Dreilini-Ubroko-1 SIA ^{1,3}	40%	0%	Latvia
Arcofond OÜ	100%	84%	Estonia	Floriston Grupp OÜ	50%	50%	Estonia
Bisumuiza Nami SIA ¹	80%	0%	Latvia	Hopson Capital OÜ ¹	50%	0%	Estonia
Kerberon OÜ	83,4%	67%	Estonia	Kastner Grupp OÜ ¹	50%	0%	Estonia
Kolde AS	89,3%	73%	Estonia	Koduküla OÜ ¹	50%	0%	Estonia
Metro Kinnisvara OÜ	100%	100%	Estonia	Kramer Kinnisvara OÜ	50%	0%	Estonia
Pärnu Turg OÜ	100%	84%	Estonia	Noland Grupp OÜ ¹	50%	0%	Estonia
Rasmussen Invest SIA ¹	60%	60%	Latvia	Pärnu Elumaja OÜ ^{1,3}	50%	42%	Estonia
Sportings Riga SIA	80%	80%	Latvia	Pärnu Ärihoone OÜ ^{1,3}	merged	42%	Estonia
Zeus Haldus OÜ	100%	100%	Estonia	Redman Invest OÜ ¹	50%	0%	Estonia
Ulmana Gatves Nami SIA ¹	80%	80%	Latvia	Snowden OÜ ¹	50%	0%	Estonia
Waldrop Investments OÜ ¹	100%	0%	Estonia	Steadman OÜ ¹	50%	0%	Estonia
Vidus Nams SIA ¹	75%	75%	Latvia	Tallinna Olümpiapurjespordi- keskus AS ^{1,3}	50%	42%	Estonia
(under liquidation)				Varamaad Kinnisvara OÜ ¹	50%	0%	Estonia
Wilson Kinnisvara OÜ	100%	100%	Estonia				

The Group's associated companies in the development segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Gilmor Grupp OÜ ¹	20%	0%	Estonia

Construction segment companies

Group's subsidiaries in the construction segment	The Group's share as of 31.12.06	The Group's share as of 31.12.05	Home country
Arco Ehitus OÜ (formerly known as Deena Ehituse OÜ)	100%	84%	Estonia
Fimaier OÜ	100%	80%	Estonia
Tallinna Linnaehituse AS ¹	80%	80%	Estonia
Veemaailm Inc OÜ ¹	100%	84%	Estonia

¹ The Group has a stake in the company through a subsidiary or joint venture.

² Arco Ärikeskus OÜ bought back its shares, proportionally from all shareholders, in 2006. The Group's participation in Arco Ärikeskuse OÜ's share capital thus decreased in 2006, while the voting right remained the same.

³ The Group has or had the specified ownership through its not fully owned subsidiary. The subsidiary owns or owned directly 50% shares in mentioned joint venture, whereas the Group's ultimate participation is or was lower.

7.2 Changes in the Group's ownership in subsidiaries

In March 2006, the Group purchased from a minority shareholder the following shares in subsidiaries belonging to the Group:

Company	Segment	Share of Arco Vara AS before the transaction	Share acquired	Share of Arco Vara AS after the transaction	Purchase price	Goodwill on acquisition (Note 23)	Negative goodwill on acquisition (Note 23)
Arco Investeeringute AS	Development	84.00%	16.0%	100.00%	1,752	0	682
Kolde AS	Development	73.43%	15.9%	89.30%	276	0	0
Kerberon OÜ	Development	67.35%	16.0%	83.35%	143	0	243
Arcofond OÜ	Development	84.00%	16.0%	100.00%	0	0	0
Pärnu Turg OÜ	Development	84.00%	16.0%	100.00%	101	10	0
Deena Ehituse OÜ	Construction	84.00%	16.0%	100.00%	284	231	0
Fimaier OÜ	Construction	80.00%	20.0%	100.00%	126	0	18
Total					2,682	241	943

The purchase price is subject to payment in March 2008 at the latest.

A share exchange transaction was concluded at the beginning of 2005, with the Group acquiring and transferring the following shares:

	Before the transaction	Share acquired	Share transferred	After the transaction
Arco Vara Korter AS (merged with Arco Investeeringute AS)	80.0%	+4.0%		84.0%
Kolde AS	71.4%	+2.0%		73.4%
Kerberon AS	66.8%	+0.6%		67.4%
Arcofond OÜ	80.0%	+4.0%		84.0%
Arco Vara Ehitus AS (merged with Arco Investeeringute AS)	95.0%		-11.0%	84.0%
Pärnu Turg OÜ	100.0%		-16.0%	84.0%
Deena Ehitus OÜ	100.0%		-16.0%	84.0%

The exchange transaction generated a profit of 115 thousand euros (the net book value of the minority interest was decreased in the same amount).

Acquisitions (establishment) of subsidiaries

In 2006, the Group established the following new subsidiaries:

Company	Segment	The Group's share the acquired in company	Share capital contribution (in thousands of euros)
Arco Invest UAB	Development	80%	3
Bisuiimuiza Nami SIA	Development	80%	2
Waldrop Investments OÜ	Development	100%	3
Arco Real Estate EOOD	Service	100%	2
Total			10

In 2005, the Group established the following new subsidiaries:

Company	Segment	The Group's share the acquired in company	Share capital contribution (in thousands of euros)
Arco Capital TOV	Development	75%	6
Arco Neruhomist TOV	Service	75%	6
Arco Ukraina Valdused OÜ	Service	75%	2
Ulmana Gatves Nami SIA	Development	80%	3
Total			17

Mergers of subsidiaries

At the beginning of 2006 Arco Vara Ärijuhtimise OÜ, which was involved with the management of the Group, was merged into the Parent.

In October 2006, the Group merged Arco Vara Kinnisvarabüroo AS (the surviving company) and Arco Vara Halduse OÜ, both 100% subsidiaries of the Group.

With the merger, the surviving companies became the legal successors of the merged companies. The activities of the merged companies as an independent legal entity were terminated. No shares were issued or nominal value of shares changed in the course of the merger. Mergers of companies under common control have had no effect on the results or financial position of the Group.

Disposal of subsidiaries

In 2005, the Group disposed of shares in the following subsidiaries:

Company	Transferred share in the Group	Sales price	Profit/loss from transfer
Arco Development SIA	20%	0	-1
Arco Kinnisvaraholduse AS	100%	0	-346
Arco Vara Geodeesia OÜ	100%	16	-50
Arco Real Estate SIA	20%	0	0
Arco Real Estate UAB	20%	0	-1
Arco Varavalitsemise AS	50%	70	108
Nurmenuku Kaubanduskeskus OÜ	100%	317	-213

The effect of the disposal of subsidiaries on the Group's assets and liabilities in 2005:

in thousands of euros	2005
Cash and cash equivalents	-619
Other current assets	-236
Investment property (Note 21)	-3,590
Property, plant and equipment (Note 22)	-30
Intangible assets (Note 23)	-5
Borrowings	-2,093
Other payables	-1,480
In 2005 the Group's stake in the subsidiary which owned	

the preference share in Arco Balti Kinnisvarafond AS decreased to 50%. The decrease in influence conditioned the reclassification of Arco Balti Kinnisvarafond AS in 2005 to a long-term financial investment which is measured at fair value through profit or loss.

As a result of the change in estimates, the Group's assets, liabilities and owner's equity (minority interest) decreased in 2005 as follows:

	1.01.2005
Cash and cash equivalents	-116
Other current assets	-62
Investment property (Note 21)	-5,359
Intangible assets (Note 23)	-77
Borrowings	-3,612
Other payables	-66
Minority interest	-1,936

No shares in subsidiaries were disposed of the Group in 2006.

7.3 Changes in the Group's ownership in joint ventures

Acquisitions (establishment) of joint ventures

In 2006, the Group established the following joint ventures:

Company	Segment	The Group's share in the acquired joint venture	Share capital contribution (in thousands of euros)
Arco & Koger Investeeringute OÜ	Development	50%	1
Barrow Investments OÜ	Development	50%	1
Castleberry OÜ	Development	50%	1
Cromer Trade OÜ	Development	50%	1
Dreilini-Ubroko-1 SIA	Development	40%	1
Hopson Capital OÜ	Development	50%	1
Kastner Grupp OÜ	Development	50%	1
Koduküla OÜ	Development	50%	6
Noland Grupp OÜ	Development	50%	1
Redman Invest OÜ	Development	50%	1
Snowden OÜ	Development	50%	1
Steadman OÜ	Development	50%	1
Arco Rumeenia Valduse OÜ	Service	50%	1
Arco Real Estate Consulting SRL	Service	50%	1
Total			19

Disposals of joint ventures

In 2006, the Group disposed of a 50% stake in the joint venture Lehe Elamud OÜ. The company's sales price was 86 thousand euros, subject to payment before the end of 2007. The Group posted a 3-thousand-euro profit from the transaction.

The effect of the disposal of Lehe Elamud OÜ on the Group's assets and liabilities (in thousands of euros):

Receivable related to the cash pooling account	-24
Receivables and prepayments	-47
Inventories	-116
Property, plant and equipment (Note 22)	0
Short-term payables and prepayments	-24
Long-term borrowings	-80

7.4 Business combinations

Business combinations in 2006

Total revenue generated by entities acquired through business combinations in 2006 amounted to 241 thousand euros of the Group's revenue for 2006, with the effect on the Group's net profit amounting to -732 thousand euros. The negative effect on the Group's net profit was, above all, conditioned by the goodwill impairment arising from the business combination at the end of the year (see Note 23). Had the business combinations happened on 1 January 2006, the effect of the revenue and net profit of the business combinations on the Group's result would not have significantly differed from the effect of business combinations from the moment of the acquisition until the end of 2006.

In August 10, 2006, the Group acquired Varamaad Kinnisvara OÜ, a joint venture which owns investment property in Tallinn.

Net assets of the acquired company and the generated goodwill were as follows:

in thousands of euros	2006
Acquisition cost	1,660
Fair value of the net assets acquired	937
Goodwill	723

Acquisition cost of Varamaad Kinnisvara OÜ in 1,660 thousand euros was paid in cash.

The goodwill was related to the net present value of the estimated future cash flows of the object recognised as investment property. This amount is estimated on the basis of the detailed plan to be established for the real estate.

As of the date of acquisition of Varamaad Kinnisvara OÜ, the acquisition cost was allocated to the assets and liabilities as follows:

in thousands of euros	Varamaad Kinnisvara OÜ's assets and liabilities before acquisition	Adjustment into fair value	Varamaad Kinnisvara OÜ's assets and liabilities after acquisition
Cash	40	0	40
Investment property (Note 21)	897	0	897
Goodwill (Note 23)	0	723	723
Liabilities	0	0	0
Acquisition cost			1,660

In June 1, 2006, the Group acquired Pennington Kinnisvara OÜ (a joint venture involved in land development in Saaremaa), together with its 100%

subsidiaries Kramer Kinnisvara OÜ and Merise Arenduse OÜ. A monetary payment of 3 thousand euro was made for the group of joint ventures.

On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of the acquired companies as follows:

in thousands of euros	Pennington Kinnisvara's assets and liabilities before acquisition	Adjustment into fair value	Pennington Kinnisvara's assets and liabilities after acquisition
Cash	12	0	12
Receivables and prepayments	10	0	10
Inventories	820	86	907
Current liabilities	-287	0	-287
Non-current liabilities	-639	0	-639
Acquisition cost			3

In the autumn of 2006, Pennington Kinnisvara OÜ and its subsidiaries were merged, with Kramer Kinnisvara OÜ being the surviving entity. Mergers of companies

under joint control have had no effect on the results of operations or financial position of the Group.

Business combinations in 2005

The net profit of business combinations in 2005 had no significant effect on the Group, making up 79 thousand euros of the Group's net profit. The net profit of the 2005 business combinations for the whole year 2005 amounted to 9 thousand euros, and turnover to 5,542 thousand euros in 2005.

In March 23, 2005, Deena Ehituse OÜ acquired a 100% share in OÜ Thornhill. In March 24, 2005, Thornhill acquired a 100% stake in Veemaailm Inc OÜ, a company involved in environmental construction.

Net assets of the acquired company and the generated goodwill were as follows:

in thousands of euros	2006
Acquisition cost paid in 2005	514
Conditional acquisition cost ¹	221
Acquisition cost	736
Fair value of the net assets acquired	254
Goodwill	482

¹ The conditional part of the acquisition cost will be paid before the end of 2009 at the latest, in the amount of 256 thousand euros. No interest is charged on the unpaid amount. The unpaid amount is thus discounted with a 6% discount rate. The discounted acquisition cost amounted to 221 thousand euros.

On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of Veemaailm Inc OÜ as follows:

in thousands of euros	Veemaailm Inc OÜ's assets and liabilities before acquisition	Adjustment into fair value	Veemaailm Inc OÜ's assets and liabilities after acquisition
Cash	10	0	10
Other current assets	424	0	424
Property, plant and equipment (Note 22)	395	0	395
Goodwill (Note 23)	0	482	482
Liabilities	-573	0	-573
Acquisition cost			736

The generated goodwill is mainly associated with Veemaailm Inc OÜ's customer base as well as the relationship between the company and its potential customers which allow concluding more beneficial sales agreements in the future than the Group could have concluded without acquiring Veemaailm Inc OÜ. The above customer base and customer relations have not been recorded separately as intangible assets, since there were no existing long-term sales

contracts, but good relations and therefore they could not be identified as separate assets.

In June 15, 2005, the Group acquired Agnetha OÜ, a company involved in investment property management, by paying 323 thousand euros for the subsidiary. Agnetha OÜ and Arco HCE OÜ were merged after the acquisition.

On the date of acquisition, the acquisition cost was allocated to the assets and liabilities of Agnetha OÜ as follows:

in thousands of euros	Agnetha OÜ's assets and liabilities before acquisition	Adjustment into fair value	Agnetha OÜ's assets and liabilities after acquisition
Cash	3	0	3
Property, plant and equipment (Note 22)	320	0	320
Liabilities	0	0	0
Acquisition cost			323

Notes to the income statement

8 Cost of sales in thousands of euros	2006	2005
Carrying value of real estate sold	-6,311	-7,035
Construction services purchased	-9,491	-11,383
Administrative expenses	-1,046	-605
Personnel expenses	-4,214	-2,419
Depreciation, amortisation and impairments (Note 22, 23)	-72	-77
Other expenses	-1,175	-1,388
Total cost of sales	-22,309	-22,907

9 Other income and expenses related to other operating activities in thousands of euros

	2006	2005
Other operating income		
Gain on change in fair value of investment property (Note 21)	24,859	7,337
Gain on disposals of investment property	1,612	789
Gain on change in the fair value of biological assets (Note 17)	63	122
Gain on disposals of PPE	407	42
Other income	89	356
Total other operating income	27,030	8,646

Marketing expenses		
Advertising expenses	-684	-626
Brokerage fees	-351	-73
Market research expenses	-7	-14
Personnel expenses	-52	-51
Other marketing expenses	-95	-19
Total marketing expenses	-1,189	-783

General and administrative expenses		
Personnel expenses	-2,982	-1,664
Office expenses	-1,155	-517
Legal services; consulting	-2,345	-1,109
Depreciation, amortisation and impairments (Note 22, 23) ¹	14	-549
Allowance for doubtful receivables	-135	-296
Other expenses	-793	-580
Total general and administrative expenses	-7,396	-4,715

¹ Depreciation, amortization and impairment includes negative goodwill charged to income in the amount of 943 thousand euros (2005: 2 thousand euros) and an impairment loss on goodwill in the amount of 805 thousand euros (2005: 454 thousand euros). For additional information on goodwill, see Note 7.2 and 7.4.

	2006	2005
Other operating expenses		
Losses on change in the fair value of investment property (Note 21)	-897	-762
Loss on change in the fair value of biological assets (Note 17)	0	-36
Loss on disposals of PPE	-2	0
Loss from write-down and impairments of PPE ¹ (Note 5 and Note 22)	-4,654	0
Fines and penalties ²	-4,792	-16
Other expenses	-59	-33
Total other operating expenses	-10,404	-847

¹ Loss from write-down of PPE includes write-down in the amount of 4,652 thousand euros of a real estate object recorded as construction-in-progress to its recoverable value. The recoverable amount of the property was determined as the fair value less cost to sell. The write-down is based on the expert opinion of an external certified appraiser, given on the basis of the comparative price method, as well as the management's estimates on the sales expenses.

² Fines and penalties for 2006 include the contractual penalty for withdrawal from the contract related to the Holiday Club Estonia project in the amount of 4,700 thousand euros.

10 Financial and investment activity income and financial and investment activity expenses in thousands of euros

	2006	2005
Financial and investment activity income		
Gains from disposal of shares of subsidiaries ¹	477	432
Gains from disposals of shares of joint ventures (Note 7.3)	3	0
Interest income	215	249
Income related to other long-term financial investments ³	341	154
Total financial and investment activity income	1 036	835

Financial and investment activity expenses		
Losses from disposal of shares of subsidiaries ¹	0	-821
Loss from associates based on the equity method (Note 19)	-3	0
Interest expense ²	-1 968	-1 527
Expenses related to other long-term financial investments ⁴	-410	-324
Foreign exchange loss	-43	-33
Other financial expenses ⁵	-749	-239
Total financial and investment activity expenses	-3 173	-2 942

¹ Gain and losses from disposal of shares of subsidiaries includes the profit from disposal of Sportings Riga SIA by Arco Development SIA to a minority shareholder in the amount of 477 thousand euros in 2006. As a result of the transaction, the stake held by the minority shareholder was not increased; that is, the Group's stake in Sportings Riga SIA was not decreased. See Note 7.2 for information on gains/losses generated from disposals of the shares of subsidiaries in 2005.

² Interest expenses consist, to a material extent, of the interest charged on loans and bonds taken/issued for financing purchase of investment property. Interest expenses arising from loans taken for financing development projects in progress have been capitalised. In 2006, total capitalised interest amounted to 1,072 thousand euros (2005: 1,019 thousand euros).

³ Among other things, income from other long-term financial investments in 2006 includes change in the fair value of financial assets measured at fair value in the amount of 342 thousand euros (2005: 146 thousand euros). Additional information on financial assets measured at fair value has been disclosed in Note 20;

⁴ Among other things, expenses from other long-term financial investments in 2006 include Write-down of the receivable from local governments in the amount of 410 thousand euros (2005: 324 thousand euros). Additional information on the receivable from local governments has been disclosed in Note 18.

⁵ Among other things, other financial expenses for 2006 include.

- write-down of receivables from associated companies in the amount of 569 thousand euros (Note 19);

- write-downs of other long-term financial investments in the amount of 180 thousand euros (2005: 239 thousand euros).

11 Income tax expense in thousands of euros

	2006	2005
Income tax on dividends	-228	-233
Income tax on the profit of Latvian and Bulgarian subsidiaries ¹	-383	-30
Total income tax expenses	-611	-263

¹ Income tax expenses on the profit of Latvian and Bulgarian subsidiaries in 2006 includes the income tax expenses calculated on the fair value gain of an object recognised as investment property in the Latvian subsidiary in the amount of 86 thousand euros. The Group has recognised a deferred long-term income tax liability in this amount.

12 Operating lease in thousands of euros

OPERATING LEASE: GROUP AS THE LESSOR

Lease payments to be received from non-cancellable operating lease contracts	31.12.2006	31.12.2005
up to 1 year	293	428
2-5 years	596	562
over 5 years	797	885
Total	1,686	1,875

The operating lease contracts involve lease of investment property.
See also Note 21 for information on rental income for the reporting period.

OPERATING LEASE: GROUP AS THE LESSEE

Rental expenses	2006	2005
Premises	-365	-248
Vehicles	-235	-162
Office equipment	-119	-33
Total rental expenses	-719	-443

13 Earnings per share in thousands of euros

In order to calculate basic EPS, the net profit attributable to the Parent's shareholders is divided by the weighted average number of common shares outstanding during the period. Since the Parent has no contingently issuable common shares, diluted EPS is equal to basic EPS.

	2006	2005
Weighted average number of common shares ¹	30,453,037	27,521,932
Net profit attributable to the owners of the Parent	13,290	6,470
EPS (in euros per share)	0.44	0.24

¹ In 2005, the Group conducted a bonus issue, increasing the share capital in the amount of 17,151 thousand euros at the expense of the company's equity without making any additional contributions. With the bonus issue, 26,835,468 new shares were issued at a nominal value of 0.64 euros (10 kroons). For this reason, the average number of shares in 2004 was retroactively changed to 27,255,468 shares.

Notes to the balance sheet

14 Receivables in thousands of euros

	31.12.2006	31.12.2005
Accounts receivable		
Accounts receivable, gross	2,903	2,438
Allowance for doubtful receivables	-18	-51
Accounts receivable, net	2,885	2,387
Other receivables		
Receivables from joint ventures (Note 38)	578	420
Loans granted ¹	963	1,405
Other short-term receivables ²	636	490
Total other receivables	2,177	2,315
Accrued income		
Interest	194	143
Accrued income from long-term construction contracts ³	290	514
Prepaid and refundable value added tax	1,003	797
Other accrued income	2	3
Total accrued income	1,489	1,457
Total receivables	6,551	6,159

¹The unsecured loans granted had an average annual interest rate of 5% (2005: 5.4%). Loans granted include balances due from related parties in the amount of 852 thousand euros (2005: 1,312 thousand euros). See Note 38 for information on loans granted to related parties.

²As of 31.12.2006, other short-term receivables include:

- receivable for encumbering real estate with a personal right of use in the amount of 148 thousand euros (2005: 148 thousand euros);
- receivables from related parties in the amount of 332 thousand euros (2005: 110 thousand euros). See Note 38 for additional information on related parties;
- receivable from interest rate swap agreement recorded at fair value in the amount of 100 thousand euros (2005: 0 euros). Additional information on interest swap agreement has been presented in Note 34.
- other smaller receivables in the amount of 56 thousand euros (2005: 136 thousand euros).
- as of 31.12.2005, other short-term receivables included a refundable prepayment in the amount of 96 thousand euros. This receivable was deemed doubtful in 2006, and has been recorded under general and administrative expenses, under "Allowance for doubtful receivables" in the income statement (Note 9).

³Accrued income from long-term construction contracts in the amount of 290 thousand euros (2005: 514 thousand euros) include receivables from customers, calculated based on the stage of completion method (see Note 27).

15 Prepaid expenses in thousands of euros

As of 31.12.2006, prepaid expenses consist of the following future expenses:

- prepayments for the advertising events to be held in 2007 in the amount of 128 thousand euros (2005: prepayments for advertising events in 2006: 26 thousand euros);
- expenses on analysis of the real estate fund portfolio with respect to transactions in 2007 in the amount of 78 thousand euros (2005: 0 euros);
- other prepaid expenses in the amount of 77 thousand euros (2005: 54 thousand euros);
- as of 31.12.2005, prepaid expenses included prepayments for purchase of real estate in the amount of 86 thousand euros.

16 Inventories in thousands of euros

	31.12.2006	31.12.2005
Real estate purchased for resale or development	26,560	9,266
Other goods purchased for resale	420	264
Materials and finished goods	0	33
Prepayments to suppliers	618	271
Total inventories	27,598	9,834

In connection with the decrease in the net realisable value of real estate purchased for resale below their carrying amount, inventories were written down in the amount of 487 thousand euros in 2005. As of 31.12.2005, the carrying amount of written-down inventories amounted to 23 thousand euros. The net realizable value of inventory was measured through the fair value of real estate less cost sell. No inventories were written down in 2006.

Real estate purchased for resale and development have been pledged in collateral to the Group's borrowings in the total amount of 17,415 thousand euros (2005: 6,342 thousand euros).

17 Biological assets in thousands of euros

Balance as of 31.12.2004	338
Acquisitions	15
Disposals	-39
Gain/loss from change in fair value	86
Reclassifications into PPE (Note 22)	-15
Balance as of 31.12.2005	385
Acquisitions	22
Government grants (Note 33)	-15
Disposals	-63
Gain/loss from change in fair value	63
Balance as of 31.12.2006	392

The balance of biological assets, by level of maturity, as of 31.12.2006:

	31.12.2006	31.12.2005
Mature (ready for sale) plants	30	42
Immature (not ready for sale) plants	52	49
Forest ready for felling	31	89
Growing forest for which the Group has not yet received the cutting permit	279	205
Total biological assets, categorised by their stage of completion:	392	385

The Group owns a total of 443 ha of growing forest (2005: 366 ha).

Biological asset management expenses amounted to 47 thousand euros in 2006 (2005: 54 thousand euros).

A total of 203 thousand euros worth of biological assets recorded in the balance sheet had been set as collateral to the Group's borrowings as of 31.12.2005. No biological assets served as collateral to the Group's borrowings as of 31.12.2006.

18 Long-term receivables in thousands of euros

	31.12.2006	31.12.2005
Receivables from joint ventures (Note 38)	141	55
Long-term loan receivables ¹	356	344
Prepayments for long-term financial investments ²	178	174
Other long-term receivables ³	7	512
Total long-term receivables	682	1,085

¹ As of 31.12.2006, long-term loan receivables included receivables from related parties in the amount of 332 thousand euros (2005: 344 thousand euros). The due dates for repayment range up to 31.12.2008. The receivables have not been secured (2005: the same). Receivables bear an annual interest of 4-6% (2005: 4-4.5%). See Note 38 for information on related parties.

² As of 31.12.2006, prepayments for long-term financial investments consisted of:

- prepayment for establishment of a joint venture in the Republic of Latvia in the amount of 174 thousand euros (2005: the same);
- other smaller prepayments in the amount of 4 thousand euros (2005: 0).

³ As of 31.12.2005, other long-term receivables included, among other things, a receivable from the local government in the nominal amount of 733 thousand euros. In connection with the estimation of the probability of receipt of the receivable, the receivable was written down in 2006 in the amount of 410 thousand euros (2005: 324 thousand euros). Starting from 31.12.2006, the receivable is in full amount recorded off-balance sheet. The write-down had been recorded as "Income and expenses related to other long-term financial investments" under financial items and investment activity income (expenses) in the income statement (Note 10).

19 Associates in thousands of euros

In April 2006, the Group established the associated company Gilmor Group OÜ. On 12 April 2006, Gilmor Group OÜ concluded a contract under the law of obligations, providing the company with the right to acquire real estate in Tallinn. Under the contract, the company made a prepayment to the seller of the real estate in the amount of 959 thousand euros. The purchase contract stipulated the obligation to pay a contractual penalty in the amount of 959 thousand euros in case of cancellation of the contract. As of the balance sheet date, the management of Gilmor Group OÜ deems it unlikely that the right to acquire the real estate, arising from the contract under the law of obligations, will be exercised. The company has therefore charged the contractual penalty to the expenses of 2006. As of 31.12.2006, the Group's share in the equity of Gilmor Group OÜ amounted to -192 thousand euros, of which 3 thousand euros was

charged to loss from equity method under financial items and investment activity income (expenses) in the Group's income statement, and the remainder was recorded off-balance sheet.

The Group gave Gilmor Group OÜ a 569-thousand-euro loan for acquiring real estate in Tallinn in 2006. Deeming the project completion unlikely, the Group recorded a 100% allowance for the granted loan. The allowance has been charged to "Other financial expenses" under financial and investment activity expenses in the income statement.

The Group holds a 20% stake in the company. As of 31.12.2006, the Group has a 3-thousand-euro payable for the Gilmor Group OÜ share capital contribution to non-related parties.

20 Long-term investments into financial assets in thousands of euros

	31.12.2006	31.12.2005
Long-term investments in unquoted shares - measured at acquisition cost	8	8
Long-term investments in unquoted shares - measured at fair value ¹	525	184
Prepayments for shares ²	3,670	0
Total other long-term securities	4,203	192

¹ Investments measured at fair value belong to the asset group "Financial assets measured at fair value through profit or loss".

² As of 31.12.2006, prepayments for shares included a prepayment for acquisition of the shares of the Latvian company Euroline SIA.

21 Investment property in thousands of euros

Balance as of 31.12.2004	43,560
Acquisitions, except for capitalised borrowing costs	3,617
Capitalised borrowing costs	499
Sales	-8,382
Disposals related to sale of subsidiaries (Note 7.2)	-8,949
Reclassification from/into inventories	16,288
Reclassification from/into PPE (Note 22)	1,187
Gain/loss from change in fair value (Note 9)	6,575
Balance as of 31.12.2005	54,395
<hr/>	
Acquisitions, except for capitalised borrowing costs	849
Capitalised borrowing costs	35
Sales	-1,697
Additions from business combinations (Note 7.4)	897
Gain/loss from change in fair value (Note 9)	23,962
Reclassification from PPE	16,103
Balance as of 31.12.2006	94,544

The fair value of material investment property items was established in 2006 on the basis of the expert opinions of independent appraisers. On the basis of the above expert opinions, the Group has recorded a change in the fair value of 42 real estate objects with the carrying amount of 64,642 thousand euros (2005: 11 objects in the carrying amount of 45,402 thousand euros). The fair value of three investment properties has been

established on the basis of the sales price stipulated in the contract under the law of obligations in the amount of 27,280 thousand euros.

The fair value of other investment property was established on the basis of the analyses of in-house analysts and authorised appraisers.

The fair value of investment property was established on the basis of the following estimates:

	2006	2005
Annual increase in rental revenue	1-5%	2%
Annual increase in expenses	2-3%	2-3%
Vacancy rate of the lease space	3-25%	3%
Exit yield	7-10%	10-11.5%

The Group earned 2,412 thousand euros (2005: 3,145 thousand euros) of rental revenue from investment property in 2006. Expenses directly related to investment property management amounted to 700 thousand euros (2005: 710 thousand euros).

A total of 556 thousand euros (2005: 906 thousand euros) was invested in the improvement of existing investment property.

The Group has made a total of 320 thousand euros (2005: 0) of prepayments for investment property in accordance with the sales contracts under the law of obligations, and 43 thousand euros (2005: 0) are still to be received from sale of investment property.

As of 31.12.2005, the Group had a 256 thousand euro payable for purchase of investment property. The debt was paid in 2006.

As of 31.12.2006, finance lease payable for the purchase of investment property amounted to 125 thousand euros (2005: 93 thousand euros).

As of 31.12.2006, the Group had pledged total of 76,856 thousand euros (31.12.2005: 44,373 thousand euros) worth of investment property in collateral to its borrowings.

22 Property, plant and equipment in thousands of euros

	Land and buildings	Machinery and equipment	Other property, plant and equipment	Construction- in-progress and prepayments	Total property, plant and equipment
Acquisition cost 31.12.2004	1,094	278	470	1,359	3,201
Accumulated depreciation 31.12.2004	-224	-203	-415	0	-842
Balance as at 31.12.2004	870	74	56	1,359	2,359
Additions	11	42	113	10,051	10,217
Capitalised borrowing costs	0	0	0	231	231
Additions from business combinations (Note 7.4)	231	65	41	378	715
Disposals	0	-15	-11	0	-26
Disposals related to sale of subsidiaries (Note 7.2)	0	-25	-5	0	-30
Depreciation charge (Note 9)	-43	-36	-76	0	-155
Reclassification ¹	15	-12	70	-2,238	-2,165
Balance as at 31.12.2005	1,084	94	187	9,781	11,146
Acquisition cost 31.12.2005	1,589	314	455	9,781	12,139
Accumulated depreciation 31.12.2005	-505	-220	-268	0	-993
Additions	362	101	207	18,928	19,598
Capitalised borrowing costs	0	0	0	1,037	1,037
Government grants (Note 33)	-46	-15	-20	-7	-88
Write-down(Note 9)	0	-1	-1	-4,652	-4,654
Sales	-2	0	-6	-350	-358
Disposals related to sale of joint venture (Note 7.3)	0	0	0	0	0
Depreciation charge (Note 9)	-53	-34	-91	0	-178
Reclassification ¹	19	0	-1	-21,299	-21,281
Balance as at 31.12.2006	1,363	145	276	3,438	5,222
Acquisition cost 31.12.2006	1,921	355	528	3,438	6,242
Accumulated depreciation 31.12.2006	-558	-210	-252	0	-1,020

¹ **Reclassifications in 2006 and 2005:**

	Land and buildings	Machinery and equipment	Other property, plant and equipment	Construction- in-progress and prepayments	Total property, plant and equipment
<i>Reclassification of facilities constructed for resale into inventories</i>	0	0	0	-993	-993
<i>Reclassification of commercial properties into investment property upon completion of development</i>	0	0	0	-1,318	-1,318
<i>Reclassification from investment property</i>	0	0	0	131	131
<i>Reclassification from biological assets</i>	0	0	0	15	15
<i>Reclassification between PPE groups</i>	15	-12	70	-73	0
Total reclassifications in 2005	15	-12	70	-2,238	-2,165
<i>Reclassification of commercial properties into investment property upon completion of development</i>	0	0	0	-16,103	-16,103
<i>Reclassification into inventories^{1.1}</i>	0	0	0	-5,178	-5,178
<i>Reclassification between PPE groups</i>	19	0	-1	-18	0
Total reclassifications in 2006	19	0	-1	-21,299	-21,281

^{1.1} In the summer of 2006, the Group signed a letter of intent regarding the sale of a real estate object located in Narva recorded as construction-in-progress. Under the above letter of intent, the Group undertook to complete construction work on the real estate object by the spring of 2007 at the latest, and to conclude rental contracts with tenants to occupy at least 50% of the rental space. Due to the change in the intended use of the property, the object was reclassified into inventories in 2006 in the amount of 5,178 thousand euros.

	31.12.2006	31.12.2005
Net book value of PPE pledged as collateral	4,131	10,715
Accounts payable for purchase of PPE	1,296	55
Capital commitments related to construction contracts of real estate objects recorded as construction-in-progress	0	5,056

23 Intangible assets in thousands of euros

	Goodwill	Negative goodwill	Computer software	Total
Balance as at 31.12.2004	885	0	43	928
Purchases	0	0	11	11
Additions from business combinations (Note 7.4)	482	-2	0	480
Negative goodwill recorded as income	0	2	0	2
Disposals related to sale of subsidiaries (Note 7.2)	-77	0	-5	-82
Impairment loss (Note 9)	-454	0	0	-454
Amortisation charge (see Note 9)	0	0	-17	-17
Balance as at 31.12.2005	836	0	32	868
Acquisition cost 31.12.2005	836	0	69	905
Accumulated amortisation 31.12.2005	0	0	-37	-37
Purchases	0	0	60	60
Additions from acquisition of minority interest (Note 7.2)	241	-943	0	-702
Additions from business combinations (Note 7.4)	723	0	0	723
Disposals	0	0	-1	-1
Impairment loss (Note 9)	-805	0	0	-805
Goodwill recorded as income (Note 9)	0	943	0	943
Amortisation charge (see Note 9)	0	0	-18	-18
Balance as at 31.12.2006	995	0	73	1,068
Acquisition cost 31.12.2006	995	0	118	1,113
Accumulated amortisation 31.12.2006	0	0	-45	-45

The balance of goodwill by segments has been disclosed in the below table:

	Service segment	Development segment	Construction segment	Total
Balance as at 31.12.2004	77	526	282	885
Additions from business combinations (Note 7.4)	0	0	482	482
Disposals related to sale of subsidiaries (Note 7.2)	-77	0	0	-77
Impairment loss (see Note 9)	0	-454	0	-454
Balance as at 31.12.2005	0	72	764	836
Additions from acquisition of minority interest (Note 7.2)	0	10	231	241
Additions from business combinations (Note 7.4)	0	723	0	723
Impairment loss (see Note 9)	0	-805	0	-805
Balance as at 31.12.2006	0	0	995	995

A goodwill impairment test was conducted at the end of the year 2006. As a result, goodwill arising from two objects in the development segment was written down. The write-down of one object in the amount of 723 thousand euros was conditioned by the fact that, as of the end of the year, neither the fair value nor the

future cash flows of the investment property associated with the goodwill could be measured/estimated reliably. The write-down of the other object in the amount of 72 thousand euros was conditioned by the sales of the investment property associated with the goodwill in 2006.

A goodwill impairment test was conducted at the end of the year 2005. As a result, goodwill was written down by 454 thousand euros. The write-down was caused by determining the fair value of the investment property associated with the goodwill on the basis of discounted cash flows. The value of the investment property was determined on the basis of the analysis of the cash flows of the real estate object for the next five years, with an estimated annual 2% increase in revenue and expenses, a 3% annual vacancy rate of the lease premises, and a 10% annual discount rate. The investment property was adjusted to its fair value after the above analysis. Since goodwill associated with the object was based on the previously estimated future cash flows from the investment property, the recoverable amount test revealed that the cash flows from the real estate object no longer exceeded the amount of investment property and goodwill recorded in the balance sheet before the write-down.

Judgements used upon measuring the recoverable amount of goodwill of the construction segment

- recoverable amount was determined based on the value-in-use;
- basis for the management's forecast on cash flows:
- Forecasted growth in the volume of environmental construction projects in Estonia (arising from the EU requirements), and the related opportunities to participate, in the next five years, in public procurements worth 56 million euros. The Group has forecasted an annual 20-30% increase in environmental construction revenue, and an increase in gross profit from an annual 3.5% to 7.7%. Due to the higher quality indicators of the environmental construction company of the Group, and the efficiency of the technology developed in Estonia, the forecasted revenue increase is a bit higher than that of companies operating in the same branch.

- Forecasted aggressive growth in real estate market, and the market demand for residential and commercial buildings. The revenue forecast is based on the number of square metres to be constructed, the average sales price per square metre, and the growth in these indicators, compared to the previous period. The number of square meters to be constructed is forecasted to increase by 26% in 2006, 51% in 2007, 46% in 2008 and an annual 14-20% thereafter. The price of the average square metre of construction is forecasted to increase by 21% in 2006, 10% in 2007 and an annual 5% thereafter. The cost of sales forecasted by construction companies makes up 92% of the revenue.
- Free cash flows associated with the construction companies are discounted by using an annual 13.65% weighed average cost of capital. A 10% specific risk is added upon calculation of the continuing cash flow (CCF). CCF is thus calculated based on a 23.65% cost of capital.
- Cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

Judgements used upon measuring the recoverable amount of goodwill of the development segment:

- recoverable amount was determined based on the value-in-use;
- the management uses previous experience regarding leased-out business space upon forecasting cash flows:
- an annual 2% increase in rental revenue;
- an annual 2-3% increase in expenses;
- an annual 3% vacancy rate of the lease space;
- the forecasted discount rate of 11.5% upon exiting the project;
- cash flow forecasts are based on the budgets approved by the Management Board for the next five years.

The balance of negative goodwill by segments has been disclosed in the below table:

	Development segment	Construction segment	Total
Balance as at 31.12.2004	0	0	0
Additions from business combinations (Note 7.4)	-2	0	-2
Negative goodwill recorded as income (Note 9)	2	0	2
Balance as at 31.12.2005	0	0	0
Additions from acquisition of minority interest (Note 7.2)	-925	-18	-943
Negative goodwill recorded as income (Note 9)	925	18	943
Balance as at 31.12.2006	0	0	0

The part of the fair value of assets, liabilities and contingent liabilities acquired from business combinations, which exceeds the acquisition cost of the business combination or acquisition of minority, is recorded as negative goodwill.

24 Borrowings in thousands of euros

Short-term borrowings	31.12.2006	31.12.2005
Overdraft ¹	1,184	538
Current portion of long-term borrowings, incl.	1,203	2,631
Bank loans	1,134	2,367
Other loans	4	190
Finance lease liabilities (Note 25)	64	74
Short-term bank loans and bonds	40,933	16,188
Other short-term loans ²	1,391	894
Total short-term borrowings	44,711	20,251

Long-term borrowings

Total long-term borrowings	30,427	27,706
incl. current portion	1,203	2,631
incl. long-term portion, incl.	29,224	25,076
Bank loans (Note 34)	26,343	23,824
Other loans (Note 34) ²	2,691	904
Finance lease liabilities (Notes 25, 34)	190	348

In 2006, the Group issued short-term and long-term commercial papers in the total amount of 6,197 thousand euros (2005: 18,234 thousand euros). The average effective interest rate was 5.16% (2005: 4.6%). The commercial papers have been recorded under short-term and long-term bank loans.

AVERAGE LOAN INTEREST RATES	2006	2005
Overdrafts	5.3%	5,0%
Short-term bank loans	5.9%	4,7%
Other short-term loans	6.8%	6,6%
Long-term bank loans	5.7%	4,9%
Other long-term loans	7.2%	7,8%

INTEREST TERMS OF MOST SIGNIFICANT BANK LOANS	Loan balance as at 31.12.06 (thousand euros)	Interest rate 2006	Interest rate 2005
Short-term bank loan	9,267	5,65%	4,25%
Short-term bank loan	5,561	5,75%	4,95%
Short-term bank loan	5,317	5,50%	-
Short-term bank loan	5,000	4,63%	-
Long-term bank loan	4,127	5,45%	-

¹ An overdraft facility has been provided to the Group companies in the amount of 2,275 thousand euros as of 31.12.2006 (2005: 2,397 thousand euros).

² Other short-term and long-term loans as of 31.12.2006 include liabilities to related parties in the amount of 1,244 thousand euros (2005: 0). See Note 38 for additional information on related parties. See Note 30 for additional information on assets pledged as collaterals to loans. All loan liabilities are denominated in either Estonian kroons, Latvian lats or euros.

25 Finance lease liabilities in thousands of euros

Finance lease liability, by term of payment	31.12.2006		31.12.2005	
	Minimum lease payments	Present value of minimum lease payments	Minimum lease payments	Present value of minimum lease payments
up to 1 year	69	64	112	74
2-5 years	185	179	371	327
over 5 years	11	11	23	21
Lessor's total gross investment	265	254	506	422
Future interest expenses	-11		-84	
Lessor's total net investment	254	254	422	422

Assets acquired on finance lease terms

	31.12.2006	31.12.2005
Investment property	205	3,716
Property, plant and equipment	122	51
Intangible assets	0	6
Total book value of leased assets	327	3,773

26 Short-term payables in thousands of euros

	31.12.2006	31.12.2005
Payables to suppliers¹	4,347	3,439
Other payables		
Payables to joint ventures (Note 38)	0	12
Payables related to transactions with securities ²	610	500
Payables related to transactions with non-current assets ³	320	397
Other payables ⁴	7,335	1,109
Total other payables	8,265	2,018
Taxes payable		
Value added tax	605	107
Income tax on dividends	114	204
Personal income tax	131	108
Social tax	252	173
Other taxes payable	331	113
Total taxes payable	1,433	705
Accrued expenses		
Interest payable	270	157
Payables to employees	667	379
Dividends payable	249	392
Other accrued expenses ⁵	701	435
Total accrued expenses	1,887	1,363
Total payables	15,932	7,525

¹ As of 31.12.2006, payables to suppliers included, among other things, payables related to acquisitions of PPE in the amount of 1,351 thousand euros (2005: 55 thousand euros).

² As of 31.12.2006, payables related to transactions with securities included the liability arising from the increase in the Group's share in subsidiaries in 2004 in the amount of 607 thousand euros (2005: 500 thousand euros) and a payable for the associated company acquired in 2006 in the amount of three thousand euros.

³ As of 31.12.2006, payables related to transactions with non-current assets included a deposit received in accordance with the contract under the law of obligations concluded for the sale of an investment property in the amount of 320 thousand euros. As of 31.12.2005, payables related to transactions with non-current assets included a payable arising from acquisition of investment property in the amount of 397 thousand euros.

⁴ As of 31.12.2006, other payables include:

- Contractual penalty for cancellation of the contract associated with the Holiday Club Estonia project in the amount of 4,700 thousand euros;
- Payables to related parties in the amount of 2,532 thousand euros (2005: 1,016 thousand euros). See Note 38 for additional information on related parties;
- Other smaller payables in the amount of 103 thousand euros (2005: 93 thousand euros).

⁵ As of 31.12.2006, other accrued expenses included the following liabilities:

- Accrued expenses related to the sale of development projects, calculated on accrual basis, in the amount of 588 thousand euros (2005: 121 thousand euros);
- Payables related to real estate fund management, calculated on accrual basis, in the amount of 68 thousand euros (2005: 0);
- Other accrued expenses in the amount of 45 thousand euros (2005: 224 thousand euros);
- As of 31.12.2005, other accrued expenses included, among other things, a payable for arrangement of the issue of the shares of Arco Vara AS in the amount of 90 thousand euros.

27 Prepayments in thousands of euros

	31.12.2006	31.12.2005
Prepayments received from sales of real estate	3,771	1,909
Prepayments received from long-term service agreements ¹	41	515
Other prepayments	242	219
Total prepayments	4,054	2,643

¹ Adjustment of revenue from long-term service agreements

	31.12.2006	31.12.2005
Costs incurred and recognised profits of long-term service agreements	6,941	9,220
Invoices issued	-6,692	-9,221
Total adjustment of revenue	249	-1
incl. increasing revenue (Note 14)	290	514
incl. decreasing revenue	-41	-515

28 Short-term and long-term provisions in thousands of euros

	Guarantee provision	Provision for profit of the client	Other provisions related to business	Total provision
Provision as at 31.12.2004	15	0	79	94
Additional provision	4	22	0	26
Provision used during the year	0	0	-9	-9
Provision as at 31.12.2005	19	22	70	111
Additional provision	10	0	97	107
Provision used during the year	-1	-22	0	-23
Provision as at 31.12.2006	28	0	167	195
incl. long-term provision			70	70

The guarantee provision related to construction is based on previous years' experiences, i.e. the actual guarantee expenses incurred in 2005 to 2006 and the amount of projects with guarantee periods as of 31.12.2006. The guarantee provision is established for covering the expenses that are expected to occur during the guarantee period. The guarantee period is 2 years from completion of the work.

According to one construction agreement, the client has a right to receive 80% of the difference between the contract price and the actual cost of the project under the contract. Due to this clause the Group has recorded a provision on the profit to be paid to the client based on the stage of completion of the project. The project was completed in 2006.

Under the resolution of the Supervisory Board of one of the joint ventures of the Group, the Group has established a provision for management and staff bonuses in the amount of 97 thousand euros as of 31.12.2006, with the provision expected to be used in March 2007. As of 31.12.2006, the Group has established a provision in the amount of 70 thousand euros for covering any additional expenses which may arise from transactions that took place in previous periods. The risk of these expenses is expected to expire within 3 to 5 years.

29 Other long-term payables in thousands of euros

	31.12.2006	31.12.2005
Payables related to transactions with securities ¹	2,528	564
Payables related to transactions with non-current assets	0	21
Deposits ²	96	122
Other long-term payables	32	3
Total other long-term payables	2,656	710

¹ As of 31.12.2006, payables related to transactions with securities consisted of the acquisition cost of the minorities acquired by the Group in March 2006 in the amount of 2,682 thousand euros, payable in March 2008. The liability bears no interest and has been discounted with the rate of 5%. The discount for 2006 amounted to 93 thousand euros, and has been recorded as "Interest expense" under financial items and investment activity expenses in the income statement.

² Deposits consist of amounts deposited by tenants as security to rental contracts. As of 31.12.2006, the contracts associated with the deposits will remain in force until 2014. The deposits bear no interest.

30 Pledged assets in thousands of euros

The Group has pledged the following assets as collateral to its borrowings, i.e. finance lease liabilities:

	31.12.2006	31.12.2005
Real estate recorded under inventories (Note 16)	17,415	6,342
Investment property (Note 21)	76,856	44,373
Property, plant and equipment (Note 22)	4,131	10,715
Intangible assets (Note 23)	0	6
Biological assets (Note 17)	0	203
Commercial pledge	227	81
Total pledged assets	98,629	61,720

The parent has given a 8,309 thousand euro guarantee (2005: 3,835 thousand euros) as collateral to the bank loan taken by the Group's subsidiary Arco HCE OÜ. The guarantee contract has been concluded for the refinancing period and will expire on 28 August 2007 at the latest. As of 31.12.2006, one of the terms of the guarantee contract was a restriction on dividend payment without the bank's previous written consent.

31 Share capital

in thousands of euros

	31.12.06	31.12.05
Issued and fully paid-in-capital (no. of shares)	30,453,037	30,453,037
Share capital	19,463	19,463
Share premium per share (in euros)	0.26	0.26
Total share premium	7,866	7,866

In 2005, Arco Vara AS split the shares by reducing the nominal value of a share from 32 euros (500 kroons) to 0.64 euros (10 kroons). With the split, the number of shares was increased by 411,600 from 8,400 (as of 01.01.2005) to 420,000 shares. Thereafter, 17,151 thousand euros were transferred to the Parent's share capital through bonus issue at the expense of equity without making additional contributions. With the bonus issue, 26,835,468 new shares were issued at a nominal value of 0.64 euros (10 kroons).

In December 2005, the Parent increased the share capital by 3,197,569 shares through private placement. The nominal value of new shares was 0.64 euros (10 kroons) per share. The shares were issued with a share premium amounting to 7,956 thousand euros. The service charges related to the arrangement of the issue, which have been recorded as a reduction of the share premium, and which amounted to 90 thousand euros, were paid in 2006. A monetary contribution was made for the shares issued and share premium.

32 Contingent liabilities

in thousands of euros

Income tax on dividends	2006	2005
Retained earnings as at 31.12	18,662	6,443
Potential income tax liability	4,106	1,482
Available dividends	14,556	4,961

The maximum possible income tax liability has been calculated based on the assumption that the net dividends to be paid and the related total income tax expenses would not exceed the distributable profit as of 31.12.2006.

The Group's management has decided to propose to the Group's Supervisory Board and shareholders to distribute dividends from the net profit for 2006 in the amount of 1,083 thousand euros (2005: 747 thousand euros), which is 0,036 euros per share (2005: 0,025 euros per share). Should the proposal be approved by the Supervisory Board and shareholders, the dividend payment would incur income tax in the amount of 306 thousand euros (2005: 223 thousand euros).

Pending court cases

CLAIM FILED AGAINST THE JOINT VENTURE AS TALLINNA OLÜMPIAPURJESPORDIKESKUS (HEREINAFTER AS TOP)

Regati Valduste OÜ (the other shareholder of AS TOP) and Urmas Uustal, member of the Supervisory Board of AS TOP, have filed a petition against the joint venture AS TOP, demanding nullification of the resolution of the Supervisory Board of AS TOP on the sale of 21374/175937 legal share of the real estate; as well as an application for prohibition of the transaction and an application for securing the petition. Harju County Court dismissed the petition with its ruling of 19 October 2006.

In November 2006, Urmas Uustal and Regati Valduste OÜ appealed the case in the Tallinn Circuit Court. AS TOP has already filed its objections. The court case was still pending at the time of preparation of this Annual Report.

According to the Group's management, the claim is unfounded—no breach of procedure for passing resolutions has occurred in the joint venture AS TOP. In these financial statements, the contested transaction has been recorded as disposal of investment property in 2005. No provision was established for contingent liabilities arising from the court case. The management of the Group does not consider it probable that any penalties or other liabilities will arise in connection with this transaction.

CLAIM FILED AGAINST THE SUBSIDIARY ARCO INVESTEERINGUTE AS

In December 2006, Profitör Group OÜ filed a petition against Arco Investeeringute AS for an outstanding invoice in the amount of 88 thousand euros and the accumulated default interest in the amount of 14 thousand euros.

In January 2007, Arco Investeeringute AS filed a counterclaim against Profitör Group OÜ for payment without basis of 279 thousand euros for unreceived services. The proceedings had not yet commenced at the time of preparation of this Annual Report.

The Group's management believes the claim to be unfounded - Profitör Group OÜ has not rendered the agreed service.

CLAIM FILED AGAINST THE SUBSIDIARY ARCO VARA KINNISTUTE AS

At the beginning of 2006, OÜ Faalanks (bankrupt) filed a petition against Arco Vara Kinnistute AS for a receivable for failure to fulfil the obligations arising from the construction contract concluded between the parties in the amount of 211 thousand euros, incl. default interest in the amount of 142 thousand euros and a claim against unjustified enrichment in the amount of 297 thousand euros. In July, OÜ Faalanks filed an application for reduction of the claim, reducing the claim against Arco Vara Kinnistute AS by 271 thousand euros, and asking the court to order payment of 238 thousand euros to OÜ Faalanks.

According to the Group's management, the claim is unfounded as: 1) 69 thousand euros of the claim were offset with Arco Vara Kinnistute OÜ's receivables from OÜ Faalanks in 2004; 2) since there is no claim on the principal, the claim for default interest in the amount of 142 thousand euros is unfounded; 3) the parties regulated their mutual relations with a contract and a signed document regarding the acceptance of the work, according to which OÜ Faalanks completed work on the site, and Arco Vara Kinnistute AS has no other liabilities besides payments of the amounts specified on the invoices.

The court case was still pending at the time of preparation of this Annual Report.

33 Government grants

in thousands of euros

In 2006, the Group received a government grant for production of potted forest plants in the amount of 88 thousand euros and establishment of forest plantation on arable land in the amount of 22 thousand euros. The government grant received for potted forest plants has been deducted from the acquisition cost of property, plant and equipment (Note 22). The amount received for the forest plantation was deducted from the acquisition cost of biological assets in the amount of 15 thousand euros (Note 17) and from the cost of sales in the amount of 7 thousand euros.

34 Financial instruments and financial risk management

in thousands of euros

Arco Vara AS is an international real estate Group active in 3 main fields of activity (real estate services, real estate development and construction) and 6 countries:

	Real estate services	Real estate development	Construction
Estonia	Started in 1992	Started in 1995	Started in 2001
Latvia	Started in 1997	Started in 2003	Started in 2007
Lithuania	Started in 2000	Started in 2006	
Ukraine	Started in 2005	Started in 2005	
Bulgaria	Started in 2006	Will be started in 2007	
Romania	Started in 2006	Will be started in 2007	

From the viewpoint of managing financial risks, business activities in the real estate market are primarily related to the adequate evaluation of the investment period and profitability and the systematic hedging of risks arising from potential inaccuracies. The pace of internationalisation is another source of risk. Success in financial risk management is manifested in the actual changes in the liquidity, interest rates, exchange rates, creditworthiness and fair value positions compared to the maximum possible changes.

Risk management in Arco Vara Group is based on the notion that corporate success depends on continual risk monitoring, accurate risk evaluation and skilful risk hedging. The Financial Service of the Group takes care of centralised financial risk management. The main purpose of risk management is to prevent any damage that could endanger the sustainability of Arco Vara Group's equity or operations. In order to hedge risks, the Group develops policies and implements various activities so as to evaluate and ascertain the risks, and disperse the risks over time, fields of activity, and geographical areas. The activities developed and necessary for risk hedging are implemented by the managers of the Group companies.

Liquidity risk

Liquidity risk arises from the potential change in the financial position, reducing the Group's ability to generate sufficient positive cash flows for the prompt settlement of obligations assumed. Above all, the following factors have an effect on the Group's liquidity risk:

- The ability of the Group companies to independently generate positive net cash flows; and the seasonality of these cash flows;
- The terms of receipt/payment of assets/liabilities; flexibility in changing these terms;
- Marketability of long-term assets;
- Volume and speed of real estate development activities;
- Volume and speed of acquisitions of new investments;
- Volume and speed of expansion of operations into new countries;
- Financing proportions/gearing.

Liquidity management in the Financial Service is based on a strategy adjusted in accordance with the changes in the Group's investment plan. Any such changes are approved by the Supervisory Board of the Parent.

Above all, short-term liquidity management is based on the annual budgets approved for the Group companies. The purpose of short-term liquidity management is to guarantee the sufficient availability of highly liquid assets (i.e. cash and cash equivalents, quickly disposable real estate).

Short-term liquidity management is mostly conducted through the cash pooling account of the Group companies. Depending on the season, the estimated amount of cash and cash equivalents needed to ensure the continuity of the regular business activities (short-term liquidity) of the Group companies is 1-2.6 million euros. In order to guarantee the availability of the relevant resources, the Parent has concluded overdraft agreements with banks and linked these to the cash pooling account.

Long-term liquidity is primarily influenced by investment decisions. Investments are made on the principle that the net cash flows from the business operations of the companies together with the net cash flows from investment activities have to cover the financing expenses of the entire Group. Thus the purpose of long-term liquidity management is to ensure the sufficient liquidity of the investment(property) portfolio, harmonize the timing of cash flows from investing and financing activities more regular, and to find a suitable financing proportion. Long-term projects are monitored to ensure that the timing and amounts of cash flows from investing activities do not considerably differ from the terms and amounts of the cash flows from financing activities. And as a rule, the Group does not accept investment projects where the required equity financing exceeds 30% of the total cost of the project. The table below characterises Arco Vara Group's open position in financing short-term borrowings and thus the liquidity requirements for the real estate portfolio:

The maturity of financial assets and financial liabilities as of 31.12.2006

	< 1 year	1-5 years	>5 years	Total
ASSETS				
Cash and cash equivalents	3,729	0	0	3,729
Receivables	6,551	682	0	7,233
Financial investments into securities	0	4,203	0	4,203
Total assets	10,280	4,885	0	15,165
LIABILITIES				
Borrowings	44,711	17,260	11,964	73,935
Payables	15,932	2,656	0	18,588
Total liabilities	60,643	19,916	11,964	92,523

The maturity of financial assets and financial liabilities as of 31.12.2005

	< 1 year	1-5 years	>5 years	Total
ASSETS				
Cash and cash equivalents	9,202	0	0	9,202
Receivables	6,159	675	410	7,244
Financial investments into securities	0	192	0	192
Total assets	15,361	867	410	16,638
LIABILITIES				
Borrowings	20,251	21,239	3,836	45,326
Payables	7,525	710	0	8,235
Total liabilities	27,776	21,949	3,836	53,561

Interest risk

Interest risk constitutes a danger that changes in the interest rate and/or payment period could significantly affect the profitability of the Group's operations.

The Group's long-term borrowings are for the most part tied to EURIBOR. Therefore, the Group is exposed to the events on the international financial markets. The long-term EURIBOR decrease has been brought to a halt, and the interest rate is showing initial signs of a moderate rise. Therefore, the primary purpose of interest risk management in the Group is to fix the floating interest rate of long-term borrowings.

In managing short-term interest risks, the Group regularly compares potential losses arising from interest changes against risk hedging expenses. So far, no transactions have been concluded with financial instruments for the purposes of hedging short-term interest risk, since the Group believes hedging expenses would exceed the potential losses arising from interest rate fluctuations.

Interest-bearing receivables and liabilities of the Group as of 31.12.2006

FIXED INTEREST RATES

Maturity dates:

	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	957	362	0	1,319
Interest-bearing liabilities	14,499	2,721	152	17,372
Net position	-13,542	-2,359	-152	-16,053

FLOATING INTEREST RATES

Re-pricing date:

	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	0	0	0	0
Interest-bearing liabilities	55,995	0	0	55,995
Net position	-55,995	0	0	-55,995

Interest-bearing receivables and liabilities of the Group as of 31.12.2005

FIXED INTEREST RATES

Maturity dates:

	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	1,526	472	0	1,998
Interest-bearing liabilities	7,480	6,281	158	13,920
Net position	-5,954	-5,809	-158	-11,922

FLOATING INTEREST RATES

Re-pricing date:

	< 1 year	1-5 years	>5 years	Total
Interest-bearing receivables	0	0	0	0
Interest-bearing liabilities	30,948	0	0	30,948
Net position	-30,948	0	0	-30,948

The above table does not contain long-term receivables and payables with a contractual 0% interest, which have been discounted at the rate of 5-6%. Bonds which have a contractual interest rate of 0%, but which were issued with a discount (discount bonds), constitute an exception to the rule and are included in the above table.

The return on projects financed with external capital is reduced upon the extension of the interest payment period primarily in case the realisation value of the project does not increase. The length of the interest payment period is linked to the detailed plan approval and building permit issuance timetable. The mentioned decisions are in the competence of state or local municipality and beyond the Group's control. Therefore there is a risk that as sales prices stabilise and the originally planned implementation period of the project is extended, the profitability of the projects and thus the entire Group may decrease. This kind of risk is primarily hedged: a) with the sales of projects not generating the expected return and b) the selection of projects acquired into the investment property portfolio on the basis of geographical regions and implementation periods. The estimated amount of interest the Group pays its creditors a year is 2.8 million euros.

Currency risk

Currency risk involves the potential losses arising from unfavourable changes in currency exchange rates with respect to the Estonian kroon. The Bank of Estonia has pegged the rate of kroon to euro (1 EUR=15.6466 EEK). Arco Vara Group is operating in another 5 countries, the currencies of which are fixed to the euro as follows:

Country	Currency	1 euro (EUR)	Status
		31.12.2006	
Latvia	lats (LVL)	0.6975	Fixed rate
Lithuania	litas (LTL)	3.4528	Fixed rate
Ukraine	hryvnia (UAH)	6.6572	Floating rate
Bulgaria	lev (BGN)	1.95583	Fixed rate
Romania	leu (RON)	3.3817	Floating rate

As of 31.12.2006 or per 2006 (%)	Estonia	Latvia	Lithuania	Ukraine	Bulgaria	Romania	Eliminations
Proportion of Group companies in the consolidated balance sheet	92.1	7.6	0.0	0.3	0.1	0.0	-0.1
Proportion of Group companies in the consolidated income	90.9	7.0	1.2	1.1	0.1	0.0	-0,3

In order to hedge the currency risk of the Group companies, the majority of transactions and contracts are in euros or currencies pegged to the euro. The main currency risk therefore stems from the risk that, with the adoption of the euro, the exchange rates between local currencies and the euro will significantly change. Considering the low probability of devaluation of local currencies, and the share of the Baltic countries in the Group's activities, the exposure to the currency risk is thus considered modest.

Any currency risks arising from open positions are hedged with euro-based transactions between countries, as well as local harmonization of the timing of receipt and payment.

Credit risk

Credit risk involves the potential losses arising from the counterparties' inability to perform their liabilities to Arco Vara Group, as well as the ability of subsidiaries and joint ventures to fulfil their obligations to the Parent. Considering the amounts involved, credit risk constitutes the biggest risk for the Group. Credit risk management mostly involves the monitoring of accumulated credit risk concentration in the Group. Credit risk prevention and minimization involves the daily monitoring and directing of the customers' payment behaviour. This allows the operative application of the necessary measures. In addition, sales and construction activities are partly financed by repayments from customers. In order to hedge the risks involved, the Group also co-operates with various banks, since many real estate transactions are financed through credit institutions. Consequently, the company deems the overall credit risk exposure to be hedged.

Allowances are made for covering known potential losses. Evaluation of potential losses is carried out on the basis of previous experience as well as the current outlook of the counterparty and the overall economic environment.

The Group companies conclude transactions only with counterparties previously deemed creditworthy. Immediate payment is demanded for transactions, or additional collaterals that cover the risks involved. Consequently, the management deems the need for additional credit risk hedging to be minimal. The maximum potential credit risk equals the total book value of receivables, cash and cash equivalents and other financial investments.

Fair value

The principal financial assets and liabilities of the Group companies are recorded in the balance sheet – i.e. the Group has no known off-balance sheet financial assets and liabilities not recorded in these financial statements. As a result of the accounting and reporting principles applied, the book value of the financial assets and liabilities of the Group companies does not significantly differ from their fair value, which has been determined using the discounted cash flow method for practically all the financial assets and liabilities. The fair value of receivables and payables with fixed interest rates is not considered different from their book value, since the fixed interest rate does not significantly differ from the prevalent interest rates on the market.

Risk hedging

All derivative instruments are recorded either as assets or liabilities. Regardless of their purpose, they are initially recognised at fair value. Changes in the fair value of such derivative instruments are recognised in the income statement on line "Interest expenses" under financial and investment activity expenses.

The fair value of risk hedging transactions as of 31.12.2006 was 100 thousand euros (2005: -11 thousand euros). The interest swap contract matures on 01.12.2008. The fair value of the interest swap contract is recognised on the balance sheet either under other short-term receivables (2006, Note 14) or other short-term payables (2005, Note 26).

Notes to the cash flow statement

35 Cash flows from operating activities

in thousands of euros

The Group's cash flows from operating activities consist of cash flows related to the sales of services and real estate as inventories, and of the costs related to the mentioned sales and the overhead expenses of the company. In 2006, the cash flow from real estate objects recorded as inventories mostly consisted of expenditure related to development projects in Riga in the amount of 8,096 thousand euros, income and expenditure related to the Kolde development project in Tallinn in the amount of -4,936 thousand euros, expenditure related to the Merivälja and Viimsi development projects in the amount of 1,414 thousand euros, and the expenditure of minor development projects in the rural areas of Estonia in the amount of 615 thousand euros.

Non-cash adjustments of operating profit in the cash flow statement for the year 2006 totalled -21,332 thousand euros (2005: -6,867 thousand euros).

36 Cash flows from investing activities

in thousands of euros

The Group's cash flows from investment activities consist of the acquisition and sales of plant, property and equipment, cash flows related to granted loans and received interest amounts.

In 2006, the acquisition of plant, property and equipment and intangible assets mainly included the acquisition of real estate objects in the port area in Tallinn in the amount of 11,997 thousand euros, the acquisition of real estate objects in Narva and Kuressaare in the amount of 5,616 thousand euros and the acquisition of a real estate object in Kyiv in the amount of 435 thousand euros.

Amounts received for real estate objects in Tallinn, Rakvere and Kuressaare have been recognised under the sale of investment property in the cash flow statement. In addition to the items described in Note 7, the acquisition of subsidiaries and joint ventures includes a prepayment for the foundation of a Latvian joint venture in the amount of 3,710 thousand euros.

37 Cash and cash equivalents

in thousands of euros

	31.12.06	31.12.05
Cash on hand and demand deposits	2,239	1,137
Term deposits	1,490	8,065
Total cash and cash equivalents	3,729	9,202

As of 31.12.2006, term deposits consist of a 1-month deposit in the amount of 1,161 thousand euros and an overnight deposits in the amount of 329 thousand euros (2005: 7,281 thousand euros). The interest rates of term deposits were between 2.46% and 3.69% in 2006.

As of 31.12.2005, term deposits consisted of deposits with maturity up to 3 months in the amount of 785 thousand euros. The interest rates of term deposits were between 0.2% and 2.38% in 2005.

The interest rates of demand deposits were 0.25% to 0.5% per annum (2005: the same).

Other information

38 Transactions with related parties in thousands of euros

The Group considers the following as related parties:

- joint ventures;
- associated companies;
- companies and other persons with joint control over or significant influence on the Group or the Group companies. Besides joint venturers these include owners of the Parent;
- key management personnel of the Group. These include members of Supervisory Board as well Management Board members of Group companies;
- other related parties, mainly companies with which members of the Supervisory Board members are associated.

Transactions with joint ventures¹:

As of 31.12 or per year	2006	2005
Sales revenue	635	464
Services purchased	5	4
Short-term loan receivables (Note 14)	260	112
Short-term interest receivable (Note 14)	8	4
Accounts receivable (Note 14)	310	304
Long-term loan receivables (Note 18)	141	54
Short-term payables (Note 26)	0	12

¹ The above figures do not include the sales, purchases, receivables and payables eliminated in the Group's financial statements in accordance with the Group's holding in the joint ventures.

Sales to joint ventures in 2006 mainly comprised sale of properties in the amount of 511 thousand euros. In 2005 sales to joint ventures comprised mainly sale of construction services in the amount of 408 thousand euros.

Loans granted to joint ventures as of 31.12.2006 earn an interest of 10% p.a. (2005: 6%-15% p.a.) and the maturity dates of these loans are from 2007 to 2008. The granted loans are unsecured.

Transactions with companies with joint control over the Group or the Group companies:

	2006	2005
Purchased services	7	0
Short-term loan receivables (Note 14)	7	7
Short-term borrowings (Note 24)	207	0
Long-term borrowings (Note 24)	795	0

Short-term loan receivables as of 31.12.2006 earn an interest of 4% p.a. (2005: the same).

Short-term and long-term borrowings from companies with joint control over the Group companies have been received at the interest rate of 10% per annum and have to be repaid by 2011 at the latest.

Transactions with key management personnel of the Group companies

	2006	2005
Short-term loan receivables (Note 14)	321	305
Other short-term receivables (Note 14)	7	0
Short-term borrowings (Note 24)	17	0

Short-term loan receivables as of 31.12.2006 earn an interest of 4% to 9% p.a. (2005: the same).

Transactions with other related parties

Other related parties are companies over which the key management personnel of the Group companies have dominating or significant influence, and close relatives of owners.

	2006	2005
Sales revenue	16	117
Purchased services	1,774	1,373
Short-term loan receivables (Note 14)	524	999
Other short-term receivables (Note 14)	325	110
Long-term loan receivables (Note 18)	332	344
Other long-term receivables (Note 18)	0	45
Short-term borrowings (Note 24)	35	0
Long-term borrowings (Note 24)	189	0
Short-term payables (Note 26)	2,532	1,016

Purchased services from other related parties mainly comprised different fees from real-estate transactions as well management fees.

Short-term and long-term loans have been granted at the interest rate of 4% to 6% p.a. (2005: 4% to 4,5% p.a.) with maturity dates falling due in 2007 and 2008.

Transactions with associated companies

In 2006, the Group granted a loan to its associated company in the amount of 569 thousand euros, which was considered as an doubtful receivable at the end of the year. Further information on the said transaction is provided in Note 19.

Remuneration to the management

In 2006, the Group's remuneration to the Management Board of the Parent and the division managers amounted to a total of 555 thousand euros, incl. taxes (2005: 273 thousand euros, incl. the compensation for the termination of the employment relationship to a member of the Management Board calculated in 2005 in the amount of 33 thousand euros).

In thousands of euros

Cash and cash equivalents	7,756
Other current assets	-155
Long-term receivables	3,152
Investment property	-12,303
Short-term borrowings	-3,995
Other short-term payables	-2,962
Long-term borrowings	3,152
Total	-5,355

After the transfer of the holding the share capital of Arco HCE OÜ was increased by 1.3 thousand euros, whereas the nominal value of the share of each owner of Arco HCE OÜ was increased in proportion to their holding. The increase in the holdings was paid for at a premium in the total amount of 4,718 thousand euros, of which the share premium paid by the Group formed 4,655 thousand euros.

Acquisition of a construction company in the Republic of Latvia

At the beginning of 2007 the Group acquired a 55% stake in the Latvian construction company Arco Construction SIA. The acquisition cost was 275 thousand euros, of which 83 thousand euros was paid in the first quarter of 2007 and the rest will be paid over three years. The acquisition cost does not bear interest and therefore it was discounted, as a result of which the net present value of the acquisition cost amounts to 260 thousand euros. The acquired net assets and the created goodwill according to preliminary purchase price allocation is presented in the table below (in thousands of euros):

Acquisition cost	260
Fair value of acquired net assets	47
Goodwill	213

The acquisition cost is allocated to the assets and liabilities of Arco Construction SIA as follows (in thousands of euros):

Cash and cash equivalents	12
Receivables and prepayments	216
Inventories	37
Property, plant and equipment	26
Goodwill	213
Liabilities	-244
Acquisition cost	260

39 Events after the balance sheet date in thousands of euros

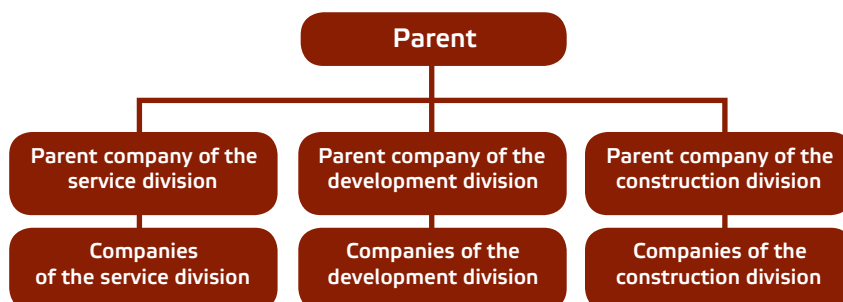
Transfer of the Group's holdings in subsidiary Arco HCE OÜ

In December 2006 Arco Vara AS concluded a conditional sales contract with for the transfer of the 50% stake in Arco HCE OÜ. The conditions deriving from the sales contract were fulfilled at the beginning of 2007 and the holding was sold by the time of preparing these financial statements. The sales price of Arco HCE OÜ was 1,451 thousand euros, in addition to which the buyer paid 50% of the Parent's claim against the subsidiary, which as of 31.12.2006 amounted to 6,305 thousand euros. The sales of the holding in the subsidiary and its consequent transformation into a joint venture had the following effect on the Group as of 31.12.2006:

Changes in the Group structure

At the beginning of 2007 the Group will carry out a restructuring, as a result of which every Group division will have a parent company and the companies in the division will be legally owned by the parent company of the division.

The following drawing illustrates the Group structure after the restructuring:



As a part of the restructuring, the Group's management has decided to merge the following subsidiaries on 1 January 2007:

Merging (surviving) company

Arco Vara AS

Arco Ehitus OÜ (formerly Deena Ehituse OÜ)

Arco Investeeringute AS

Companies merged

Fimaier OÜ, Arcofond OÜ

Veemaailm Inc OÜ

Metro Kinnisvara OÜ, Zeus Haldus OÜ

The restructuring of Arco Vara Group will have no effect of the Group's financial position or results.

Incorporation of a subsidiary of the development division

Incorporation of a subsidiary of the development division In March 2007 the Group incorporated a development company, Arco Investments TOV, in Ukraine, paying five thousand euros into the share capital of the company. The Group's stake in the said company is 75%.

Issue of Arco Vara bonds

At the beginning of 2007 Arco Vara AS issued short-term and long-term bonds as follows:

Name of security	Type of bond	Issue volume (in thousands of euros)	Currency	Interest rate
Arco Vara Kommertspaber 21.09.2007	Discount bonds	3,863	EEK	6.46%
Arco Vara Kommertspaber 21.01.2011	Coupon bonds	1,785	EUR	6 month Euribor +4%

Sale of real estate

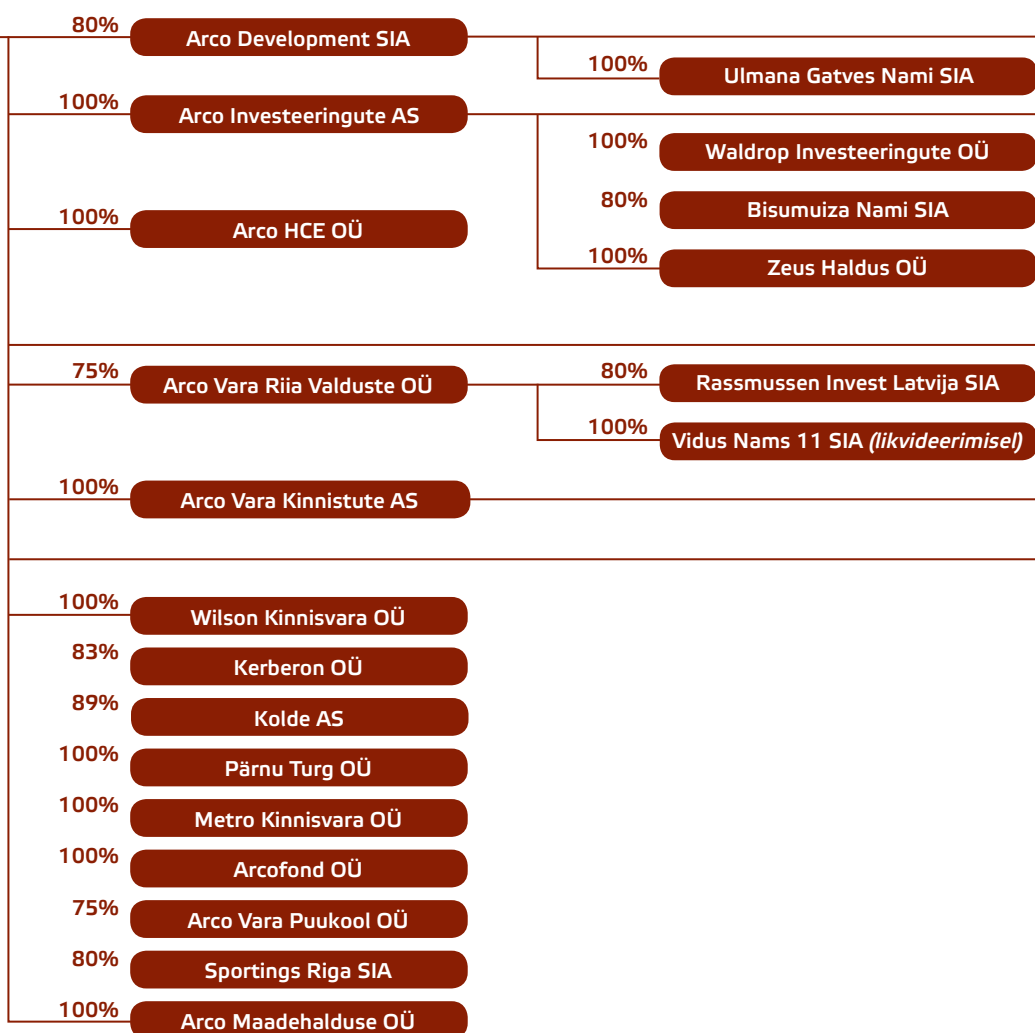
In March 2007 the Group sold real estate in Narva which was accounted as inventories, generating sales revenue of 6,538 thousand euros.

Real Estate objects accounted as investment property were sold in the beginning of Year 2007 in the total amount of 2,674 thousand euros. As those properties were accounted in fair value as of 31.12.2006 with the fair value having been determined according to sales contracts under the law of obligations then those transactions have had no impact on the Group's equity in 2007.

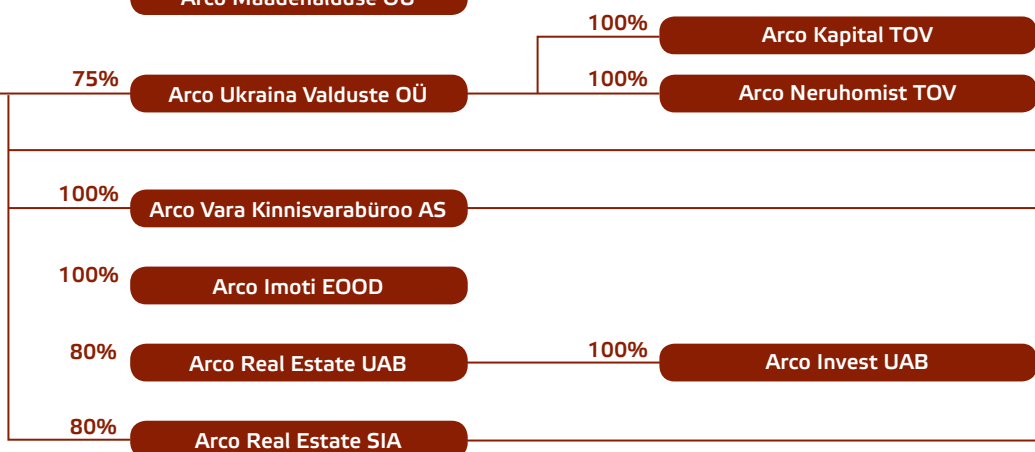
40 Group structure of Arco Vara

Subsidiaries

Development



Service



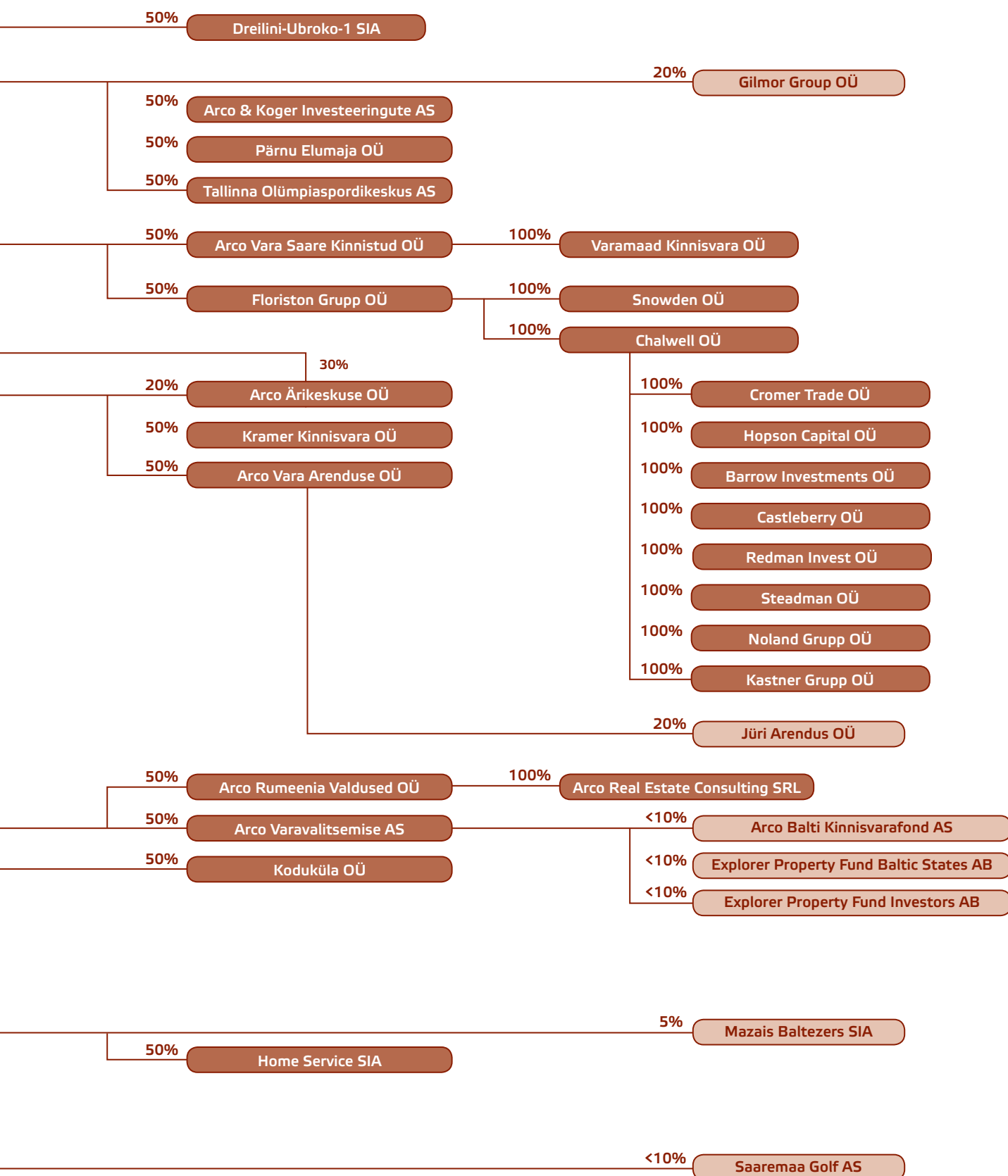
Construction



Other

Joint ventures

Other investments



41 Main statements of the Parent as required by Estonian Accounting Act

in thousands of euros

The main statements of the Parent as required by the Estonian Accounting Act are not prepared as separate financials statements of the Parent as described in IAS 27.

Income statement	2006	2005
Sales revenue	991	0
Cost of Sales	-775	0
Gross profit	216	0
Other operating income	149	0
Marketing expenses	-108	0
General and administrative expenses	-1,253	-186
Other operating expenses	-11	0
Operating profit	-1,007	-186
Gain or loss from shares in subsidiaries and joint ventures	455	633
Other financial income	2,677	1,566
Other financial expenses	-1,312	-1,292
Profit before income tax	813	720
Income tax expense	-211	0
Net profit	602	720

Balance sheet

ASSETS

31.12.2006 31.12.2005

Current assets

Cash	904	27
Receivables	15,664	20,956
Prepaid expenses	85	0
Total current assets	16,653	20,983

Non-current assets

Long-term financial investments	18,701	6,015
Investment property	1,089	0
Property, plant and equipment	234	0
Intangible assets	16	0
Total non-current assets	20,040	6,015
TOTAL ASSETS	36,693	26,998

LIABILITIES AND EQUITY

Current liabilities

Borrowings	6,739	5,783
Payables	5,771	1,298
Total current liabilities	12,510	7,081

Non-current liabilities

Long-term borrowings	6,035	5,432
Other long-term payables	2,560	594
Total non-current liabilities	8,595	6,026
Total liabilities	21,105	13,107

Equity

Share capital	19,463	19,463
Share premium	7,866	7,866
Legal mandatory reserve	351	27
Retained earnings	-12,092	-13,465
Total equity	15,588	13,891
TOTAL LIABILITIES AND EQUITY	36,693	26,998

STATEMENT OF CHANGES IN EQUITY

	Share capital	Share premium	Legal mandatory reserve	Retained earnings	Total
Balance at 31.12.2004	268	565	27	2,899	3,759
Bonus issue (Note 31)	17,151	-565	0	-16,586	0
Issue of new shares	2,044	7,866	0	0	9,910
Dividends	0	0	0	-498	-498
Net profit for the year	0	0	0	720	720
Balance at 31.12.2005	19,463	7,866	27	-13,465	13,891
Change in retained earnings due to merger with subsidiary	0	0	0	1,842	1,842
Increase in legal mandatory reserve	0	0	324	-324	0
Change in legal mandatory reserve due to merger with subsidiary	0	0	0	0	0
Dividends	0	0	0	-747	-747
Net profit for the year	0	0	0	602	602
Balance at 31.12.2006	19,463	7,866	351	-12,092	15,588

ADJUSTED STATEMENT OF EQUITY

	31.12.2006	31.12.2005
Unconsolidated equity of the Parent	15,588	13,891
Deducting the carrying value of subsidiaries and joint ventures in the Parents unconsolidated balance sheet	-7,698	-2,917
Adding the carrying value of subsidiaries and joint ventures according to equity method	38,440	22,855
Adjusted equity of the Parent	46,330	33,829

CASH FLOW STATEMENT

	2006	2005
Cash flows from operating activities		
Operating profit	-1,007	-186
Adjustments to operating profit	-139	0
Change in receivables and prepayments related to operating activities	-228	-29
Change in payables and prepayments related to operating activities	237	20
Other financial income and expenses	0	0
Total cash flows from operating activities	-1,137	-195

Cash flows from investing activities		
Acquisition of property plant and equipment and intangible assets	-34	0
Acquisition of investment property	-586	0
Acquisition of subsidiaries and joint ventures	-658	-568
Sales of subsidiaries and joint ventures	456	16
Acquisition of other investments	0	-2
Sales of other investments	0	3
Loans granted	-5,721	-3,944
Repayments of loans granted	12,477	369
Interest received	1,854	97
Change in cash pool receivable	-14,516	-14,683
Dividends received	153	575
Total cash flows from investing activities	-6,575	-18,137

Cash flows from financing activities		
Loans received	6,019	18,110
Repayments of loans and finance lease obligations	-6,204	-9,120
Change in cash pooling liabilities	2,157	0
Change in overdraft credit	1,016	1
Interest paid	-551	-57
Issue of shares	-90	10,000
Dividends paid	-804	-575
Income tax on paid dividends	-239	0
Total cash flows from financing activities	1,302	18,359

TOTAL CASH FLOWS	-6,410	27
-------------------------	---------------	-----------

Cash and cash equivalents at the beginning of the period	7,316	0
Change in cash and cash equivalents	-6,410	27
Effect of changes in exchange rates on cash and cash equivalents	-2	0
Cash and cash equivalents at the end of the period	904	27

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Arco Vara AS

Report on the Financial Statements

We have audited the consolidated financial statements of Arco Vara AS and its subsidiaries (hereafter "the Group"), identified by us on the pages 75 - 135 of the Company's yearbook, which comprise the consolidated balance sheet as of December 31, 2006, the consolidated statements of income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

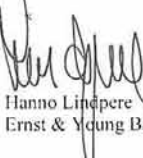
Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2006, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.


Report on Other Legal and Regulatory Requirements

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The financial information of Arco Vara AS as a parent company in Note 41 is presented because it is required by the Estonian Accounting Law and is not a required part of the consolidated financial statements prepared under International Financial Reporting Standards as adopted by the European Union. Such financial information has been subject to the auditing procedures applied in our audit of the consolidated financial statements and, in our opinion, is prepared in all material respects in accordance with the requirements of the Estonian generally accepted accounting principles and in relation to the consolidated financial statements taken as whole.

Tallinn, April 16, 2007



Hanno Lindepere
Ernst & Young Baltic AS



Indrek Luuk
Authorised Auditor

A Member of Ernst & Young Global

Profit allocation proposal

The Management Board of Arco Vara AS proposes to the General Meeting of Shareholders to distribute the profit as follows (in thousands of euros):

Retained earnings as of 31.12.2006	18,662
Transfer to legal mandatory reserve	933
Net dividends for distribution	1,083
Retained earnings after the above transfer and distribution	16,646



Viljar Arakas
Chairman of the Management Board



Sulev Luiga
Member of the Management Board



Veiko Pedosk
Member of the Management Board



Ivar Siimar
Member of the Management Board



Ahto Altjõe
Member of the Management Board

26.04.2007

Signatures of the Management Board and the Supervisory Board to the Annual Report 2006

We hereby confirm the correctness of the data presented in the Annual Report 2006 of the consolidated group of Arco Vara AS.



Arti Arakas
Chairman of the Supervisory Board



Hillar-Peeter Luitsalu
Member of the Supervisory Board



Viljar Arakas
Chairman of the Management Board



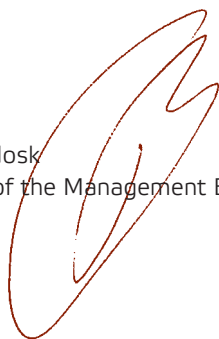
Richard Tomingas
Member of the Supervisory Board



Sulev Luiga
Member of the Management Board



Ivar Siimar
Member of the Management Board



Veiko Pedosk
Member of the Management Board



Ahto Altjõe
Member of the Management Board

26.04.2007

www.arcorealestate.com