

Annual report
(Translation of the Estonian original)

ARCO VARA AS

Beginning of financial year:	1 January 2011
End of financial year:	31 December 2011
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Corporate website:	www.arcorealestate.com
Regional websites:	www.arcovara.ee www.arcoreal.lv www.arcoreal.bg
Core activities:	Construction of buildings (EMTAK 41000) Civil engineering (EMTAK 42000) Specialised construction activities (EMTAK 43000) Real estate activities (EMTAK 6800)
Supervisory board:	Richard Tomingas, Hillar-Peeter Luitsalu, Ragnar Meitern, Kalev Tanner, Aare Tark
Management board:	Lembit Tampere
Auditor:	KPMG Baltics OÜ

Contents

MESSAGE FROM THE CHAIRMAN OF THE SUPERVISORY BOARD	3
DIRECTORS' REPORT	4
CORPORATE GOVERNANCE REPORT	21
CONSOLIDATED FINANCIAL STATEMENTS	26
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME	26
CONSOLIDATED STATEMENT OF FINANCIAL POSITION	27
CONSOLIDATED STATEMENT OF CASH FLOWS	28
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY	29
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	30
1 <i>General information</i>	30
2 <i>Statement of compliance and basis of preparation</i>	30
3 <i>Changes in accounting policies and presentation of financial statements</i>	31
4 <i>Significant accounting policies</i>	32
5 <i>Segment reporting – business segments</i>	40
6 <i>Geographical information</i>	41
7 <i>Changes in the structure of Arco Vara group</i>	42
NOTES TO THE STATEMENT OF COMPREHENSIVE INCOME	44
8 <i>Cost of sales</i>	44
9 <i>Other income and other expenses</i>	44
10 <i>Distribution expenses</i>	45
11 <i>Administrative expenses</i>	45
12 <i>Finance income and finance expenses</i>	45
13 <i>Income tax</i>	46
14 <i>Earnings per share</i>	46
15 <i>Operating lease expenses</i>	46
NOTES TO THE STATEMENT OF FINANCIAL POSITION	47
16 <i>Cash and cash equivalents</i>	47
17 <i>Trade and other receivables</i>	47
18 <i>Inventories</i>	48
19 <i>Non-current assets held for sale</i>	49
20 <i>Other investments</i>	49
21 <i>Investment property</i>	49
22 <i>Property, plant and equipment</i>	50
23 <i>Loans and borrowings</i>	51
24 <i>Trade and other payables</i>	51
25 <i>Deferred income</i>	52
26 <i>Provisions</i>	53
27 <i>Share capital</i>	53
28 <i>Financial instruments and financial risk management</i>	54
OTHER NOTES	59
29 <i>Assets pledged as collateral</i>	59
30 <i>Contingent assets and liabilities</i>	59
31 <i>Transactions with related parties</i>	61
32 <i>Events after the reporting date</i>	62
33 <i>Structure of Arco Vara group</i>	63
34 <i>Parent company's unconsolidated financial statements</i>	64
CONFIRMATION BY THE MANAGEMENT BOARD TO THE CONSOLIDATED FINANCIAL STATEMENTS	68
INDEPENDENT AUDITORS' REPORT	69
PROPOSAL FOR COVERING THE LOSS	70
SIGNATURE OF THE MEMBER OF THE MANAGEMENT BOARD	71

Message from the chairman of the supervisory board

Dear investors and partners

Although the year 2011 continued to be complicated for the European economy, in Arco Vara's target markets we could already observe moderate growth in both sales prices and margins. However, the year also brought a sudden upsurge in construction prices, which made it difficult to launch major development projects and exceptionally hard to raise debt financing for larger projects.

Arco Vara's main achievements and activities in 2011 were as follows:

- The group found a partner and funding for Tivoli, the largest-ever apartment project in Estonia, and in 2012 a lot of work has been done to begin construction and pre-sale of apartments.
- The Service division improved sales, profit and profit margins in all its target markets.
- The work of the Construction division was reorganised so as to reduce the risk of future losses.
- The group began seeking new target markets and shareholders with relevant skills and experience who would be willing to step up to the supervisory board. The main purpose of penetrating new target markets is to put the real estate development competencies the group has gained to more effective use.
- Development of existing projects – Manastirski in Bulgaria, Bišumuiža-1 in Latvia and Kodukolde in Estonia – continued successfully. The above projects are funded with a combination of equity and debt instruments. It ought to be noted that all those developments are being executed at a time, when financing conditions have been complicated.

In April 2012, when I am writing to you, it is obvious that the volume of operations launched this year will exceed those started in recent years. The year 2012 must bring a turnaround – our performance has to become profitable, this is what the shareholders expect from management. The supervisory board of Arco Vara will do everything in its power to ensure the company's profitable operation and its ability to continue stable and successful real estate business in the years to come.

Richard Tomingas

Chairman of the Supervisory Board
of Arco Vara AS

Directors' report

Arco Vara group

Arco Vara AS (the "Parent") and other entities of Arco Vara group (together referred to as the "Group") are engaged in various aspects of the real estate business. The Group's three business lines – services, development and construction have been assigned to corresponding divisions that provide a broad range of real estate services.

At 31 December 2011, the Group comprised of the Parent and 27 subsidiaries (31 December 2010: 27). The Group has investments in 5 joint ventures (31 December 2010: 5) and 1 associate (31 December 2010: 0).

The performance of all divisions is subject to seasonal fluctuations. The transaction volumes of the Service division usually increase in autumn and spring and the Construction division's turnover and the Development division's investment volumes decline in winter.

The Service division is engaged in real estate brokerage, valuation, management and consulting as well as short-term investment in residential real estate.

The Development division develops complete living environments and commercial real estate. Fully-developed housing solutions are sold to the end-consumer. Commercial properties are developed until they start generating cash flow after which they are sold to a real estate fund or another developer. Despite the strategy, the Group is currently holding some completed income-yielding commercial properties because they have not been developed to their full potential.

The Construction division provides general construction and environmental engineering services, operating as a general contractor, builder and construction manager as well as a subcontractor.

The Group regards Estonia, Latvia and Bulgaria as its home markets.

Mission, vision and shared values

The **mission** of Arco Vara is to be a comprehensive and valued provider of real estate solutions.

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

Our **core values** include:

Partnership – our client is our partner

Reliability – we are reliable, open and honest

Professionalism – we deliver quality

Consideration – we value our clients as individuals

Responsibility – we keep our promises

Members of the management and supervisory boards of Arco Vara AS

Lembit Tampere, CEO and member of the management board

Lembit Tampere graduated from Concordia International University, department of international business administration, in 1997 and later studied at the Lakeland College in Wisconsin, the USA.

Between 1997 and 2004 he was a project manager in the corporate finance division of Union Bank of Estonia. From 2003 he was on the management board of ECE Capital OÜ and the director of corporate banking at SBM Pank AS. Lembit Tampere was appointed to the management board of Arco Vara AS in 2008.

Richard Tomingas, chairman of the supervisory board

Richard Tomingas studied civil engineering at Tallinn Polytechnic Institute from 1987 to 1990 and graduated from the Estonian Business School, department of business administration, in 2005.

Richard Tomingas is a major shareholder of Arco Vara AS and has worked for the company since 1992. From 1992 to 1993 he was the manager of the Kuressaare office of Arco Vara AS. Richard Tomingas has been on the supervisory board of Arco Vara AS since 1992 and the chairman of the supervisory board since 2008.

Hillar-Peeter Luitsalu, member of the supervisory board

Hillar-Peeter Luitsalu studied sports sciences at Tallinn Pedagogical Institute in the 1978/79 academic year and graduated from the University of Tartu, faculty of law, in 1995.

Hillar-Peeter Luitsalu is a major shareholder of Arco Vara AS. Between 1996 and 2005, he was on the supervisory board of AS Arco Vara Kinnisvarabüroo and from 1999 to 2004 on the management board of Arco Vara AS. Hillar-Peeter Luitsalu was elected to the supervisory board of Arco Vara AS in 2004.

Aare Tark, member of the supervisory board

Aare Tark graduated from the University of Tartu, faculty of law, in 1983.

Since 1991 Aare Tark has been the senior partner in law office Tark Grunte Sutkiene. In 1994, 1995 and from 1998 to 2001 he was elected as the chairman of the Estonian Bar Association. Since 2003 Aare Tark has been a member of the Legal Ethics and Practices Committee of the Estonian Bar Association. Aare Tark has been on the supervisory board of Arco Vara AS since 2007.

Kalev Tanner, member of the supervisory board

Kalev Tanner graduated from the University of Vermont in 1990 and from the J. L. Kellogg Graduate School of Management with an MBA in 1994.

From 1994 to 1998 he worked as an investment banker in Goldman Sachs's branches in New York and London, from 1998 to 2001 as the managing director at AS Cresco and from 1998 to 2001 as a member of the supervisory board of the Tallinn Stock Exchange. From 2000 to 2005 Kalev Tanner was the CEO of Intergate Venture Capital. Since 2000 he has been the chairman of the supervisory board of IIZI Group AS and since 2005 the founder and member of the management board of OÜ Sparkling Group, a company operating in the field of luxury hotels and restaurants, and OÜ IG Partners, a venture capital and advisory services company. Kalev Tanner has been on the supervisory board of Arco Vara AS since 2007.

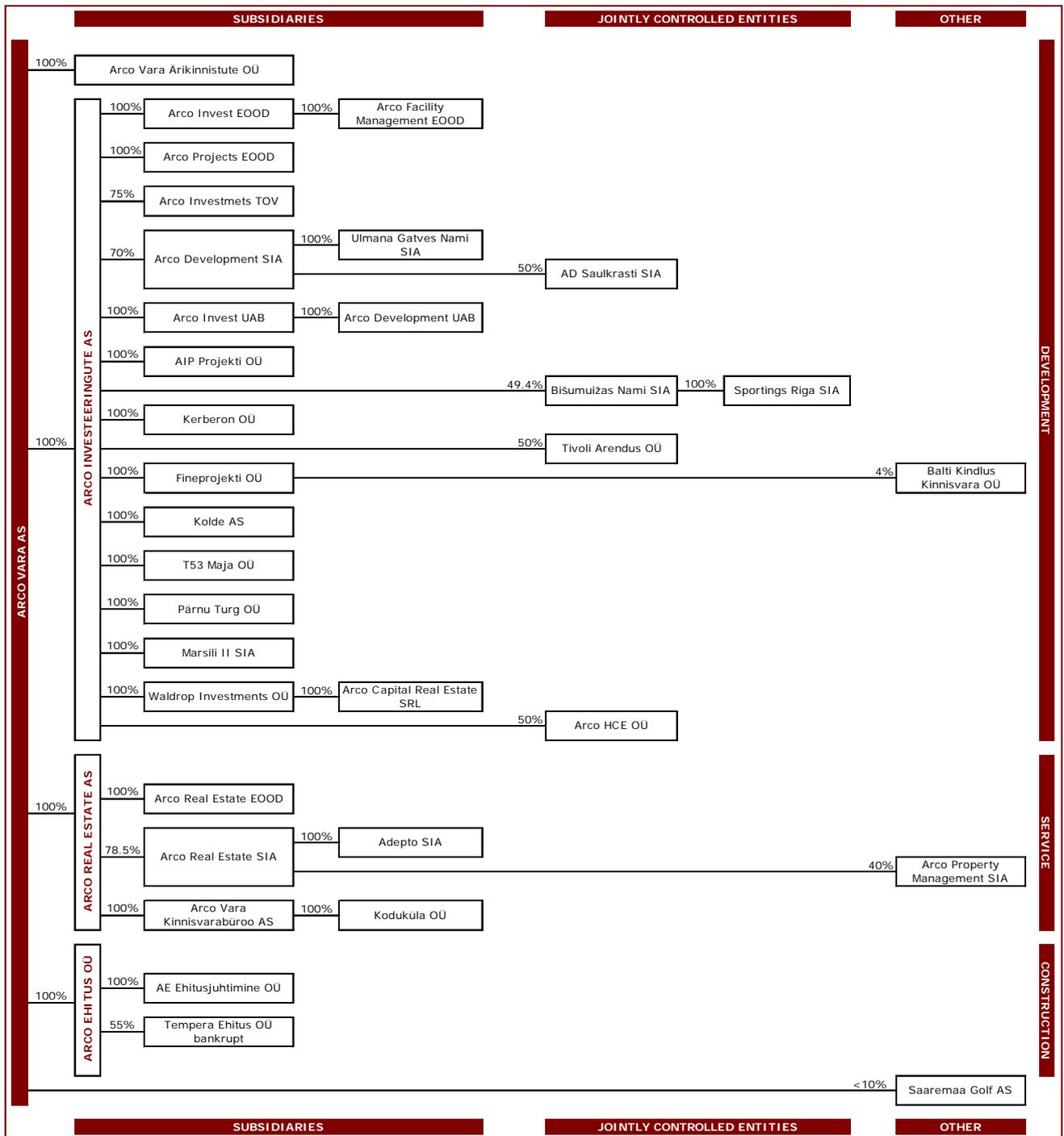
Ragnar Meitern, member of the supervisory board

Ragnar Meitern graduated from Rutgers University, the USA, in 1996.

Having started his investment banking career with Salomon Brothers in New York in 1996, he joined Stanton Capital Corporation as an investment manager in 1998 and stayed there until 2000. After that he worked for the investment banking unit of Citigroup in London and in Dubai. Since 2010 Ragnar Meitern has been working as the chief executive of the Standard Chartered bank in Dubai, which is one of the leading financial institutions in Asia, Africa and the Middle East. Ragnar Meitern has been on the supervisory board Arco Vara AS since 2008.

GROUP STRUCTURE

As at 31 December 2011



CHANGES IN GROUP STRUCTURE

On 7 February 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, divested 29.99% of its ownership interest in its Latvian subsidiary Arco Development SIA to SL Development SIA. The sales price of the shares was 104 euros.

On 18 March 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, sold 50% of its stake in Tivoli Arendus OÜ. As a result of the transaction, the interest of Arco Investeeringute AS in Tivoli Arendus OÜ decreased from 100% to 50%. The transaction was conducted at the nominal value of the shares, which was 1,278 euros.

On 26 April 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established Fineprojekti OÜ, a wholly-owned subsidiary with a share capital of 2,500 euros.

On 27 May 2011, Arco Vara Kinnisvarabüroo AS increased its interest in Koduküla OÜ from 50% to 100%. The additional 50% stake in Koduküla OÜ was acquired for 1 euro. The transaction did not have a significant impact on the Group's operations.

On 15 June 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, sold its 100% interest in Alasniidu LA OÜ for 360,778 euros. Through the transaction, the Group's long-term liabilities decreased by 1,041,937 euros and total assets decreased by 766,908 euros. The transaction gave rise to sales gain of 275,029 euros.

On 5 July 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established a wholly-owned subsidiary, SIA Mārsili II, with a share capital of 1.071 million Latvian lats (1.5 million euros). The subsidiary's share capital was contributed with a non-monetary contribution consisting of the plots of the Baltezers 5 project that belonged to Arco Investeeringute AS. The transaction did not have a significant impact on the Group's operations.

On 29 July 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established a 70% subsidiary, Prime Capital SIA, whose share capital is 2,000 Latvian lats (2,846 euros). The transaction did not have a significant impact on the Group's operations.

On 10 August 2011, Balti Kindlus Kinnisvara OÜ in which Arco Vara AS's wholly-owned subsidiary Fineprojekti OÜ has a 4% stake was entered in the Commercial Register. The transaction did not have a significant impact on the Group's operations.

On 25 August 2011, in order to raise financing for privatisation, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, temporarily transferred its interest in Prime Capital SIA for 2 thousand euros (1,400 Latvian lats, the nominal value of the shares) to Dreiliņi-Ulbroka-1 SIA, a related party that is connected to Viktors Savins. The transaction did not have a significant impact on the Group's operations.

On 15 September 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, divested its investment in Lilletee LA OÜ. The investment was acquired by VM Investments OÜ. The transaction did not have a significant impact on the Group's operations.

On 10 October 2011, Arco Vara Riia Valduste OÜ registered a change in business name. The entity's new business name is AIP Projekti OÜ.

On 29 November 2011, in connection with the increase of the share capital of Arco Real Estate SIA that is a subsidiary of Arco Real Estate AS (a wholly-owned subsidiary of Arco Vara AS), Arco Real Estate AS's interest in the subsidiary decreased from 80% to 78.5%. The transaction also lowered the Group's interest in Arco Real Estate SIA's subsidiary Adepto SIA from 80% to 78.5%.

On 12 December 2011, based on an agreement concluded on 1 December 2011, Arco Vara AS transferred a 12.5% stake in Floriston Grupp OÜ to EPRI Invest OÜ, a company related to Indrek Porila. The transaction did not have a significant impact on the Group's financial position and financial performance.

On 21 December 2011, Arco Real Estate SIA that is a subsidiary of Arco Real Estate AS (a wholly-owned subsidiary of Arco Vara AS) acquired a 40% stake in Arco Property Management SIA. The entity is a Latvian property management company whose other shareholder is Viktors Savins who has a related party relationship with Arco Vara.

Key performance indicators of Arco Vara Group

- The Group's revenue and other income for 2011 totalled 46.2 million euros, a roughly two-fold improvement on the previous financial year.
- Operating loss for 2011 was 1.5 million euros, a substantial increase on 2010 when operating loss was 0.1 million euros.
- Net loss for 2011 was 3.4 million euros, a substantial increase on 2010 when net loss was 0.3 million euros.
- Equity to assets ratio at the year-end was 40% (31 December 2010: 39.4%). In 2011, return on equity was negative (2010: negative) and return on invested capital was negative (2010: 1.8%).
- At the end of 2011, the Group's order backlog stood at 11.7 million euros compared with 16.8 million euros at the end of 2010.
- In 2011 the Group sold 111 apartments and plots (2010: 129 apartments and plots).

	2011	2010	2009	2008
Revenue (EUR, millions)	43.1	21.1	24.6	40.5
Gross profit/loss (EUR, millions)	0.3	4.9	-1.8	-22.1
Operating loss (EUR, millions)	-1.5	-0.1	-5.9	-40.7
Loss before tax (EUR, millions)	-3.6	-0.3	-23.9	-64.1
Net loss (EUR, millions)	-3.4	-0.3	-23.8	-64.6
Net loans (EUR, millions)	22.9	27.5	32.0	31.0
Remaining maturity of loans (in years)	2.2	0.8	1.2	2.0
Gross margin	0.7%	23.2%	-7.3%	-54.6%
Operating margin	-3.5%	-0.5%	-24.0%	-100.5%
Net margin	-7.8%	-1%	-96.7%	-159.5%
ROE	neg	neg	neg	neg
ROA	neg	neg	neg	neg
ROIC	neg	1.8%	neg	neg
Quick Ratio	0.5	0.3	0.4	1.1
Current Ratio	1.5	1.2	1.7	2.9
EPS	-0.7	-0.1	-5.0	0.0
Lowest share price*	2.0	3.2	1.2	3.0
Highest share price*	6.3	6.0	7.6	29.7
Number of staff	146	153	171	384

* For comparability, share prices have been adjusted for the reduction of shares performed in the first quarter of 2010.

FORMULAS USED

Net loans = current interest-bearing liabilities + non-current liabilities – cash and cash equivalents – short-term investments in securities (at end of period)

Return on equity (ROE) = past four quarters' net profit / average equity

Return on assets (ROA) = past four quarters' net profit / average total assets

Return on invested capital (ROIC) = past four quarters' profit before tax and interest expense / average invested capital

Earnings per share (EPS) = net profit attributable to owners of the parent / (weighted average number of ordinary shares outstanding during the period – own shares)

Current ratio = current assets at end of period / current liabilities at end of period

Quick Ratio = (total current assets – inventories and biological assets) / total current liabilities (at end of period)

Gross margin = gross profit / revenue

Operating margin = operating profit / revenue

Net margin = net profit / revenue

Group chief executive's review

We reached an important turnaround in our operating results in 2011 when after three consecutive years of decreasing sales revenue began to grow. Compared with 2008 when the Group's revenue was 40 million euros, 2009 when it was 25 million euros and 2010 when it was 21 million euros, revenue of roughly 43 million euros is a strong improvement. Above all, sales growth was underpinned by two factors: increasing activity in the Estonian construction market, where the public sector is driving market growth, and improvements in the outlook of the development sector of the whole region, which allowed completing an important block transaction in Bulgaria.

The Group's loss for 2011 resulted mostly from the Construction division, which operates in an industry that continued to be adversely affected by unfavourable contracts secured in earlier years and the bankruptcies of construction companies. On the other hand, after a gap of several years the Service division earned a profit, and the operating profit of the Development division improved slightly compared with 2010.

In 2011, 111 apartments and plots were sold in Arco Vara's projects: 60 in Estonia, 20 in Latvia and 31 in Bulgaria. In the fourth quarter we completed the sale of plots at Merivälja. Major ongoing development projects include the Tivoli apartment building in Tallinn, which is in the design stage. We continue to develop the Bišumuiža-1 apartment project and to sell plots in Riga. Construction and sale of apartments continues also in the Kodukolde community in Tallinn where the progress of site operations can be viewed in real time at <http://www.kodukolde.ee/#webcam>.

A significant transaction of the fourth quarter was the signature of a certificate of delivery and acceptance with Cleves EOOD for the delivery of 21 apartments and 13 parking spaces in the Madrid project in Bulgaria. The total price of the transaction, which triggered strong growth in the Group's Bulgarian sales, was 4.3 million euros, of which 2.5 million euros was prepaid in March 2008 and 1.8 million euros was paid in November 2011. In addition, the Group sold the property at Laeva 2 in Tallinn and, after the reporting date, the right of superficies on the property at Kadaka tee 131 in Tallinn.

For the Service division, 2011 was better than several previous years. Revenue grew and the division ended the year with an operating profit of 0.1 million euros compared with an operating loss of 0.4 million euros for 2010. The number of brokerage transactions increased by 29% and the number of valuation reports issued grew by 39% compared with 2010. At the same time, the number of brokers increased by only 1% and the number of appraisers grew by 17%.

During the year, the Group secured new construction contracts of 10.9 million euros. Our order backlog as at 31 December 2011 was 11.7 million euros compared with 16.8 million euros at the end of 2010. The Construction division's operating loss is attributable to the unfavourable terms of some construction contracts signed in 2010 and the bankruptcies of its business partners. Due to the joint and several liability of consortium partners Arco Ehitus had to continue the performance of two contracts on its own.

The largest construction projects that generated a negative contribution in 2011 comprised:

- Construction of the Aviation Academy building in Tartu, performed in a consortium with OÜ Kristiine Ehitus (bankrupt), which resulted in a loss of 500 thousand euros.
- Reconstruction of the academic building of the University of Life Sciences in Tartu, performed in a consortium with OÜ Wolmreks Ehitus (bankrupt), which resulted in a loss of 600 thousand euros.
- Construction of the water and wastewater networks of Tamsalu rural municipality, performed as a subcontractor for AS K&H (bankrupt), which resulted in a loss of 240 thousand euros due to unsettled invoices.
- Construction of the Emajõe drinking water facilities for AS Emajõe Veevärk, performed as a subcontractor for AS K&H (bankrupt), which resulted in unearned revenue of 340 thousand euros.
- Construction and renovation of the water and wastewater networks of Iru village, which resulted in a loss of approximately 660 thousand euros due to incorrect data provided by the customer.
- Construction of the water and wastewater pipelines of the wastewater collection area of the Kadrina rural community, which resulted in a loss of approximately 480 thousand euros, caused by a steep rise in labour, materials and service costs (15-35%) in the first half of 2011.

In the reporting period, the Group's loans and borrowings decreased by 6.6 million euros while equity to assets ratio remained virtually the same (around 40%). The weighted average interest rate of loans and borrowings rose year over year due to higher margins charged by banks and a higher Euribor and the weighted average duration of loans and borrowings increased.

In 2011 we wrote up our Bulgarian investment properties by around 3 million euros. At the same time, we wrote down our Bulgarian inventories by 1.2 million euros and receivables from our Estonian and Bulgarian joint ventures by almost 0.9 million euros. Thus, the overall effect of fair value adjustments was 0.9 million euros. The revision was undertaken to adjust our earlier highly conservative estimates made immediately after the crisis to the present market conditions.

Since the reporting date, we have been able to improve sales in all our target markets, largely because the macroeconomic environment has stabilised and the European sovereign debt crisis has started to subside.

We are pleased to report that in April 2012 we successfully completed phase I of the Manastirski apartment project and the sale of apartments is going well. Completion of an apartment building of around 7000 square metres allows us to deliver the apartments to customers and to repay by the year-end up to 3 million euros of the loan taken for the construction of the building. By doing this, we will be able to reduce our finance costs by around 0.15 million euros. We intend to extend the Manastirski project with another block because the current sales rate is highly encouraging.

Although the European sovereign debt crisis has not been unequivocally resolved and the macroeconomic environment of all our target markets remains uncertain, we are confident that thanks to smaller finance costs and continuing demand in 2012 the outlook for our products and services is brighter than in the past three years.

REVENUE AND PROFIT

	2011	2010
EUR, millions		
Revenue		
Service	2.4	1.9
Development	23.0	11.0
Construction	18.1	8.7
Eliminations	-0.4	-0.5
Total revenue	43.1	21.1
Operating profit/loss		
Service	0.1	-0.4
Development	2.3	1.5
Construction	-2.9	-0.5
Eliminations	0.3	0.5
Unallocated expenses	-1.3	-1.2
Total operating loss	-1.5	-0.1
Interest income and expense	-1.4	-1.2
Other finance income and expenses	-0.7	1.0
Income tax	0.2	0.0
Net loss	-3.4	-0.3

The Development division's revenue for 2011 was significantly boosted by the sale of inventory of 8.3 million euros to joint venture Tivoli Arendus OÜ and a block apartment sale transaction of 3.5 million euros conducted in the fourth quarter in Bulgaria. The revenue of the Construction division grew year over year mainly on account of increased construction activity while its operating loss is attributable to a rapid upsurge in construction prices that emerged in 2010 and business partner bankruptcies. Finance income and expenses were strongly influenced by interest expense, which grew because the Madrid project was completed and capitalisation of associated borrowing costs was discontinued.

CASH FLOWS

	2011	2010
EUR, millions		
Cash flows from operating activities	-0.7	1.8
Cash flows from investing activities	0.3	6.1
Cash flows from financing activities	-1.6	-7.8
Net cash flow	-2.0	0.1
Cash and cash equivalents at beginning of period	4.2	4.1
Cash and cash equivalents at end of period	2.2	4.2

In March 2011, Arco Investeeringute AS repaid ahead of schedule the remaining 5.27 million euros of the loan taken from SEB Pank for acquiring the plot of the Tivoli project and 0.12 million euros of the loan taken for acquiring the plot of the Laeva project. Repayment of the Tivoli loan is not reflected in the Group's cash flows because the buyer of the 50% stake in Tivoli Arendus OÜ paid the cash directly to SEB Pank. Nor do the cash flows reflect that in December, following the sale of the Laeva 2 property, the Group repaid to SEB Pank a loan of 1.12 million euros.

Interest payments accounted for 2.0 million euros of the net cash outflow from financing activities. Scheduled settlements of loan principal and those related to inventory sales totalled 6.3 million euros. During the year, the credit limit was used for financing the construction of the two last phases in the Kodukolde project and the Alasniidu and Lille tee nursery schools to the extent of 4.4 million euros in aggregate. Use of the credit limit by AS Kolde is not reflected in cash flows because invoices received from AS Merko Ehitus Eesti are booked as a loan and there are no actual cash movements.

The largest current liabilities to be settled in the next 12 months comprise:

- estimated principal repayments to be made on the sale of reserved premises and payments under the settlement schedule of the loan taken for the Boulevard Residence Madrid project in Sofia of 2.4 million euros;
- repayments of the loan taken for the Manastirski project of 1.3 million euros;
- repayments of an investment loan taken for a cash flow project at Kadaka tee 131 of 2.2 million euros;
- repayments of the construction loan taken by AS Kolde of 1.3 million euros;
- repayments of the loan taken for the Bišumuiža-1 project of 0.8 million euros.

In 2011 the Group made repayments under the loans taken for the Kodukolde and the Merivälja 2 projects in Tallinn, the Bišumuiža-1 project in Riga and the Madrid project in Sofia and scheduled settlements under the loans taken for its cash flow generating projects. The Group also followed the principal repayment schedules set for the bank loans of Koduküla OÜ and the Laeva 2 project.

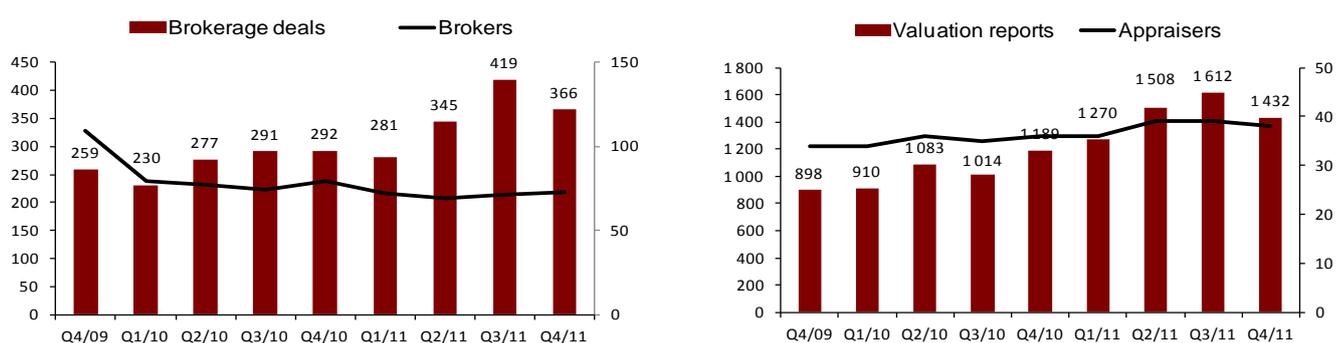
SERVICE DIVISION

Activity in the Estonian real estate market began increasing at the beginning of the second quarter of 2011. Recovery of the real estate market was supported by adjustment to the euro and the consumers' increasing confidence in the future. In 2011 the Service division increased both the number of brokerage transaction completed and the sale of valuation services. For the property management department, the year was relatively stable although in the second half sales dropped slightly. In 2012 we are going to improve service quality by providing employee training and will work with different partners to increase the customer base by carrying out a number of marketing campaigns. The main targets for 2012 are to increase the Group's share in the Estonian brokerage and valuation markets and to strengthen the property management team by hiring a new sales manager.

The Service division performed well in the Latvian market. The general economic situation in Latvia is improving, which has a positive effect on the real estate market. The ongoing business strategy is to maintain brand awareness by improving the company's recognition in the real estate market and to operate in this market segment successfully with a focus on making a profit. In 2011 we sought new and capable employees, who would specialise in selling and renting out residential and commercial properties.

The Bulgarian economy grew moderately throughout 2011, with presidential and local elections having a broad effect on social and business life in the second half of the year. Despite the fact that on the whole the real estate market in Sofia has not expanded, the brokerage team was able to end the year with a significant increase in both the number of completed transactions and generated revenue. More than 70% of the apartments in phase I of project Madrid were sold before construction was completed. According to plan, valuation and advisory services have been added to the service portfolio and together with the newly hired residential and commercial brokers the Bulgarian team is ready to meet the challenges of 2012.

In 2011 the performance of the Service division was in every respect better than in 2010. The division ended 2011 with an operating profit of 0.1 million euros compared with an operating loss of 0.4 million euros for 2010. The number of brokerage transactions increased by 29% and the number of valuation reports issued grew by 39%. At the same time, the number of brokers increased by only 1% and the number of appraisers grew by 17%.



	2011	2010	Change, %
Number of brokerage transactions conducted	1,411	1,090	29%
Number of projects on sale at end of period	139	130	7%
Number of valuation reports issued	5,822	4,196	39%
Number of appraisers at end of period ¹	42	36	17%
Number of brokers at end of period ¹	73	72	1%
Number of staff at end of period	45	55	-18%

¹ Includes people working under service contracts

CONSTRUCTION DIVISION

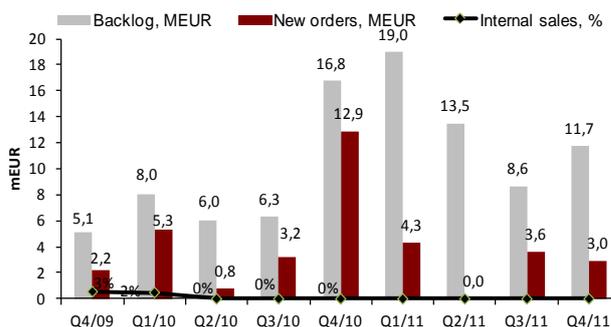
The Construction division is generally actively involved in environmental, infrastructure and civil engineering (mostly educational establishments-related) projects.

At the end of 2011, the largest construction contracts in progress were the design and build of water and wastewater pipelines for the town of Loksa (remaining balance 3.1 million euros) and the design and build of the reconstruction and extension of the public water and wastewater systems of the Suure-Jaani rural municipality (phase I with the remaining balance of 2.1 million euros and phase II with the remaining balance of 2.4 million euros).

During the year, the division secured new construction contracts of 10.9 million euros. At the reporting date the order backlog was 11.7 million euros compared with 16.8 million euros at the end of 2010.

At the end of 2011, the Construction division employed 58 people (31 December 2010: 49).

In 2011 the division's largest projects in Estonia were as follows:



Civil engineering

1. Renovation of Tallinn University of Technology Study Block IV
2. Construction of Block 4 of the Estonian University of Land Sciences
3. Construction of the Academic Building of the Estonian Aviation Academy

Environmental engineering

1. Construction and renovation of water and wastewater networks in Iru village
2. Renovation and extension of the public water supply and wastewater systems of Jõgeva town and the Jõgeva rural community
3. Renovation and extension of the public water supply and wastewater systems of the Jõgeva rural municipality
4. Design and build of water and wastewater facilities for the wastewater collection area of the Kadrina rural community in the framework of the European Cohesion Fund (CF) water management project
5. Construction of water and wastewater networks and facilities for the Kallavere residential area in the framework of the water management project of Maardu town
6. Construction of connecting networks and facilities for the Tallinn-Muuga water and wastewater systems in the framework of the water management project of Maardu town
7. Design and build of a new wastewater treatment plant, water supply networks and an exterior wastewater system for Neeme village
8. Construction of a wastewater treatment plant for the Kose wastewater collection area in the Kose rural municipality in the framework of the CF water management project
9. Reconstruction and extension of the public water supply and wastewater systems of the Jõgeva and Puurmani rural municipalities
10. Design and build of water supply and wastewater systems for the Nasva rural community in the Kaarma rural municipality
11. Reconstruction of the Sandla wastewater treatment plant
12. Design and build of the public water supply and wastewater systems of the wastewater collection area of Loksa town in the framework of the CF water management project (project commenced at the end of 2011)
13. Design and build of the reconstruction and extension of the public water supply and wastewater systems of the Suure-Jaani rural municipality, phase I (project commenced at the end of 2011)
14. Design and build of the reconstruction and extension of the public water supply and wastewater systems of the Suure-Jaani rural municipality, phase II (project commenced at the end of 2011)

DEVELOPMENT DIVISION

In 2011, 111 apartments and plots were sold in Arco Vara's projects of: 17 apartments in the Bišumuiža-1 project and 3 plots in the Baltezers project in Latvia, 56 apartments in the Kodukolde project and 4 plots in the Merivälja project in Estonia, and 31 apartments in the Madrid project in Sofia in Bulgaria

In the Tivoli project, the Development division partnered up with International Invest Project OÜ and raised financing for phase I. During the year contaminated land was remediated and design work was launched. In the fourth quarter, Tivoli Arenduse OÜ obtained a permit for the construction of six residential buildings. According to plan, construction will start in spring 2012.

Phase V of the Kodukolde development project (50 apartments) was completed in June. By the end of 2011, only one apartment was still unsold. It is used as a show apartment to support sales and promote conclusion of preliminary contracts on the sale of apartments in phase VI. The construction of phase VI at Helme 16 in Tallinn (48 apartments) began in the second quarter of 2011. The work is performed and financed by AS Merko Ehitus Eesti. The buildings are scheduled for completion in the first half of 2012.

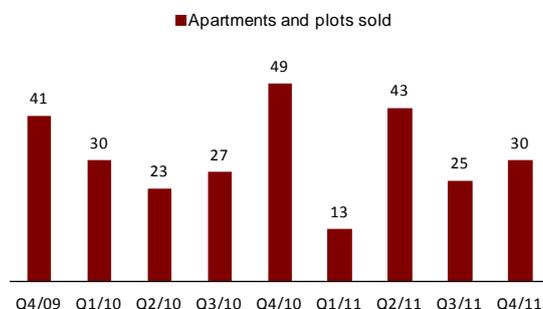
The Alasniidu nursery school was granted a use permit at the end of May and was delivered to Harku local government with whom a rental agreement had been signed. The entity that owned the nursery school was sold in the second quarter of 2011 and with this the project was successfully completed.

At the end of the first quarter of 2011, Lilletee LA OÜ, a wholly-held subsidiary of Arco Investeeringute AS, acquired the right of superficies on the property at Lille tee 23 in Viimsi with a view to building a nursery school for six groups of children. In March 2011, a long-term lease agreement was signed with Viimsi local government. The nursery school should be completed in the first quarter of 2012. Construction work is performed by YIT. Arco Investeeringute AS sold its 100% interest in Lilletee LA OÜ in September 2011 but will remain the project manager until the nursery school is completed.

In Bulgaria, the construction of phase I of the Manastirski project is under way. At the reporting date, 65% of the apartments were reserved. In the commercial and residential building Boulevard Residence Madrid in Sofia the division continues to lease out commercial premises, to deliver reserved apartments under real right contracts, and to sell the remaining free apartments.

At the end of 2011, the Development division employed 24 people (31 December 2010: 26).

Further information on our projects can be found at: www.arcorealestate.com/development.



SUMMARY TABLE OF MAJOR PROJECTS

Project type	Name	Location	Legal interest	Building rights according to business plan	Current status	Classification in the statement of financial position
Commercial	Ahtri 3	Estonia, Tallinn	50%	48,518m ²	Building rights have been obtained.	Investments in joint ventures
Project type	Name	Location	Legal interest	Leasable area	Current status	Classification in the statement of financial position
Cash flow	Kerberon	Estonia, Tallinn	100%	13,236 m ²	Building rights and the right of superficies have been obtained. Generates cash flow.	Investment property
Cash flow	Madrid	Bulgaria, Sofia	100%	6,950 m ²	Building rights have been obtained. Generates cash flow.	Investment property
Cash flow	Pärnu market	Estonia, Pärnu	100%	2,529 m ²	Building rights have been obtained. Generates cash flow.	Investment property
Project type	Name	Location	Legal interest	Building rights according to business plan	Current status	Classification in the statement of financial position
Apartments	Bišumuiža-1	Latvia, Riga	70%	Area of unsold apartments 12,055 m ²	Construction and sale are under way. In 2011 the third building was completed in phase II (phase II consists of 5 buildings). Construction of the second building is under way.	Inventories
Apartments	Bišumuiža-2	Latvia, Riga	49%	87,737 m ²	Building rights have been obtained. Design work is under way.	Investments in joint ventures
Apartments	Hills	Lithuania, Vilnius	100%	6,500 m ²	Building rights have been obtained.	Inventories
Apartments	Kodukolde	Estonia, Tallinn	100%	Area of unsold/ unreserved apartments 2,140 m ²	The right of superficies and building rights have been obtained. Sale of apartments and construction of phase VI are under way.	Inventories
Apartments	Madrid	Bulgaria, Sofia	100%	Area of unsold/ unreserved apartments 2,563 m ² .	The building is complete, sales continue.	Inventories

Property type	Project name	Location	Ownership %	Area of unsold/ unreserved apartments	Development status	Classification
Apartments	Manastirski	Bulgaria, Sofia	100%	2,511 m ²	Construction and sales are under way.	Inventories
Apartments	Paldiski mnt 70c	Estonia, Tallinn	-	ca 34,000 m ²	The initial planning outline for the detailed plan is under preparation. The Group owns a 33% legal share in the property.	Investment property
Apartments	Tehnika tn 53	Estonia, Tallinn	100%	1,515 m ²	The detailed plan has been adopted. Design work is under way.	Inventories
Apartments	Tivoli	Estonia, Tallinn	50%	58,470 m ²	The detailed plan has been adopted. A construction permit has been obtained. Construction tenders are being sought.	Investments in joint ventures
Plots	Baltezers-3	Latvia, Riga	70%	604,674 m ² residential land	Land has been privatised. The right of superficies has been obtained. 188 plots. Preparations for construction of phase I infrastructure are under way (phase I comprises 33 plots).	Investment property
Plots	Baltezers-5	Latvia, Riga	100%	No of unsold plots 22	Building rights have been obtained. Construction has been completed. On sale.	Inventories
Plots	Palusambla 1	Estonia, Nõmme	100%	55,466 m ²	The detailed plan for the formation of 12 plots for one detached building each is in the final phase of adoption.	Inventories
Plots	Pärtli	Estonia, Saue	100%	84 plots, average plot 1,500 m ²	No building rights. The detailed plan process is under way. Is awaiting an improvement in the market situation.	Investment property
Plots	Tooma	Estonia, Saue	100%	107 plots, average plot 1,802 m ²	No building rights. The detailed plan process is under way. Is awaiting an improvement in the market situation.	Inventories
Plots	Vahi	Estonia, Vääna	100%	21 plots, average plot 3,363 m ²	Building rights have been obtained. Construction design documentation has been prepared. Is awaiting an improvement in the market situation.	Inventories

Note: The development and success of the Group's development projects depend largely on external factors, particularly on the adoption of plans and the issue of building permits by the local government and the planning authorities. The information presented in the table, such as building rights according to business plan, current status, project type and classification of the project in the statement of financial position, has been recorded based on management's intentions and best judgment and may change in line with changes in the planning process. Expectations of the projects' realisation may also change over time in connection with changes in the market situation and the competitive environment. Management estimates the value of the projects portfolio on an ongoing basis and is prepared to sell any project or part of a project at any time, depending on the results of the cost-benefit analysis.

The projects presented in the summary table account for the following portions of the Group's assets:

Line item in the statement of financial position	Balance of line item at 31 December 2011	Carrying amount of projects presented in the summary table of major projects at 31 December 2011
EUR, millions		
Total assets	60.0	43.6
Inventories	21.7	20.6
Investment property	24.0	23.0
Investments in joint ventures	0.0	0.0

SIGNIFICANT CHANGES IN DETAILED PLANS IN 2011

Tehnika 53: A detailed plan for the property was initiated on 30 January 2002 for determining building rights. On 7 January 2004, Tallinn City Government approved the detailed plan and put it on public display. Owing to an objection lodged during public display, the adoption proceedings halted until 2009. To date, an updated version of the plan has been adjusted to effective legislation and has been approved by all relevant authorities. The detailed plan has also passed a new public hearing during which three submissions/objections were lodged, all of which have been removed. On 10 November 2010, the Tallinn City Government sent the plan for official adoption to the Tallinn City Council. The Tallinn City Council adopted the detailed plan on 2 December 2010 and the detailed plan took effect on 2 January 2011.

Palusambla 1: A detailed plan was initiated on 22 November 2000 with a view to designating part of the area as residential land with associated building rights and maintaining the remainder as a green corridor. The detailed plan was approved by the Tallinn City Government on 9 June 2004 and was put on public display. In connection with the submissions and objections lodged, adoption proceedings halted. On 22 December 2009, the Tallinn City Planning Department decided that after the adjustment of the plan in light of submissions made, adoption proceedings could resume. In response to the submissions, the number of residential plots (for detached houses) was reduced to 12 (the average size of a plot is approximately 1,700 square metres), a new topo-geodetic base plan was prepared and a dendrological survey was conducted. The plan was adjusted to effective legislation. Currently, the plan has been approved by the possessors of the utility lines and the Environmental Department and has been sent for adoption to the Tallinn City Planning Department. The adoption of the plan and its public display are expected to take place in spring or summer 2012.

PEOPLE

At the end of 2011, the Group had 146 employees compared with 153 at the end of 2010. During year the year, headcount decreased by seven. Personnel expenses for 2011 totalled 3.8 million euros, 9% up on the 3.5 million euros posted for 2010. Part of the growth stemmed from larger transaction volumes, which increased the remuneration of people receiving performance pay. The trend is continuing in 2012, coupled with upward pressure from employees earning a fixed salary, whose remuneration has remained relatively stable in recent years. Remuneration levels are also influenced by decreasing unemployment in Estonia and Latvia.

The remuneration of the member of the management board and the members of the supervisory board of the Group's parent company amounted to 0.2 million euros. The figure for 2010 was also 0.2 million euros. Since 5 September 2009 the Group's management board has had one member – Lembit Tampere.

We believe that our greatest assets are highly professional employees who are valued by both customers and colleagues.

Employees by geography and division at 31 December 2011:

2011	Estonia	Latvia	Bulgaria	Total
Service	21	8	16	45
Development	13	5	6	24
Construction	58	0	0	58
General administration	19	0	0	19
Total	111	13	22	146

2010	Estonia	Latvia	Bulgaria	Total
Service	26	17	12	55
Development	11	6	9	26
Construction	49	0	0	49
General administration	23	0	0	23
Total	109	23	21	153

Similarly to previous years, the Group upheld all its traditions. The staff could participate in a country-wide briefing day, corporate summer days and Christmas party, and selection of employees of the year and all agreements and promises under the corporate motivation system were fulfilled.

Implementation of the training strategy continued. Many activities were focused on the Service division: in spring the staff could improve their sales skills through a relevant training programme and in autumn managers could enhance their competencies at a broad-based training course. In addition, we provided the usual induction training for new employees and essential in-house and external training for staff needing to upgrade their legal and IT knowledge. In 2011 the Group also launched a programme aimed at raising the staff's awareness of document management rules and practices.

All employees may join Arco Vara Sports Club, established in 2008 with a view to creating opportunities for engaging in team sports and contributing to employee health. In 2011, club members participated in various summer and winter competitions. One of the largest where Arco Vara was represented with its own team was the Pühajärve triathlon competition TriStar111.

The Group's management values employee health. In addition to promoting sports and providing opportunities for engaging in sports, the Group arranges and pays for regular medical assessments and examinations.

CHARITABLE ACTIVITIES AND SOCIAL RESPONSIBILITY

In 2011 Arco Vara continued contributing to its chosen causes - education and sports. In the framework of its cooperation with the Academy of Arts, every term the Group provides a scholarship to one student from the faculty of architecture who has an excellent academic and professional record.

A lot of attention was paid and substantial support was provided to Estonian skiers and various sports events. Through its partnership with the Estonian Ski Association, Arco Vara sponsored young skiers Karel Tammjärv and Madis Vaikmaa. Skiing is also a sport that is much loved by the Group's employees: in 2011 the commercial premises unit organised Arco Vara's own skiing competition in Kõrvemaa.

During the year, Arco Vara helped finance the Pühajärve triathlon competition TriStar111, where our employees could participate both in teams and individually, and continued to sponsor football club Nõmme Kalju. In 2011 Arco Vara also decided to begin supporting Estonian cycling through cooperation with cyclists' club Pro Jalgratturite Klubi.

Our people contributed to saving the environment, conserving nature and setting a positive example by participating in the cleanup of Pirita beach and forest park.

Arco Vara is committed to supporting education, culture and sports as well as selected charities on a long-term basis. We are determined to set a positive example and are seeking opportunities for our staff to become involved so that we could work together to improve life in Estonia.

SHARE AND SHAREHOLDERS

Arco Vara AS has issued a total of 4,741,707 shares. At 31 December 2011, the company had 1,857 shareholders and the share price closed at 2.06 euros, a 63% decrease compared with the previous year-end.

The following charts reflect movements in the Arco Vara share price and daily turnover in 2011:

In euros (EUR)



Changes in share price compared with the benchmark index OMX Tallinn in 2011



Index/equity	1 Jan 2011	31 December 2011	+/-%
_OMX Tallinn	698.38	531.17	-23.94
_ARC1T	EUR 5.51	EUR 2.06	-62.61

Major shareholders at 31 December 2011	Number of shares	Interest, %
OÜ HM INVESTEERINGUD OÜ	1,025,338	21.62%
OÜ TOLETUM	1,024,681	21.61%
OÜ BALTPLAST	900,000	18.98%
GAMMA HOLDING OÜ	450,563	9.50%
FIREBIRD REPUBLICS FUND LTD	205,064	4.32%
Skandinaviska Enskilda Banken Ab Clients	183,709	3.87%
Central Securities Depository of Lithuania	136,573	2.88%
FIREBIRD AVRORA FUND, LTD.	106,897	2.25%
FIREBIRD FUND L.P.	86,600	1.83%
Other	622,282	13.12%
Total	4,741,707	100.0%

Share price and associated statistics for the past four years:

EUR	2011	2010	2009	2008
Year-end closing share price	2.06	5.51	3.42	3.42
Lowest share price	2.03	3.22	1.21	3.02
Highest share price	6.26	6.00	7.64	29.74
Average share price	3.99	4.53	3.31	13.22
Traded volume	716,964	1,119,201	3,021,064	3,259,404
Turnover, in millions	3.42	4.96	11.69	36.79
Market capitalisation, in millions	9.77	26.13	16.20	16.20
Earnings per share (EPS)	-0.76	-0.06	-5.01	-0.01
Dividend per share	n/a	n/a	n/a	0.02
Dividend payout ratio	n/a	n/a	n/a	-1.84
Price to earnings ratio (P/E)	neg	neg	neg	neg
Price to book ratio (P/BV)	0.41	0.94	0.58	0.31

Note: For comparability, the share price and traded volume have been adjusted for the reduction in the number of shares in the first quarter of 2010 (adjustment coefficient 20.09490464).

P/E – year-end closing share price/earnings per share

P/BV - year-end closing share price /equity per share

Share positions of members of the management and supervisory boards at 31 December 2011	Position	Number of shares held	Interest, %
Lembit Tampere	Member of Management Board	0	0%
Richard Tomingas (Toletum OÜ)	Chairman of Supervisory Board	1,024,681	21.6%
Hillar-Peeter Luitsalu (HM Investeeringud OÜ, connected persons)	Member of Supervisory Board	1,034,845	21.8%
Aare Tark	Member of Supervisory Board	0	0%
Kalev Tanner	Member of Supervisory Board	0	0%
Ragnar Meitern	Member of Supervisory Board	0	0%
Total		2,059,526	43.4%

DESCRIPTION OF THE MAIN RISKS

Credit risk

Credit risk exposure is the highest at the Construction division. Accordingly, counterparties' settlement behaviour is monitored on an ongoing basis.

Liquidity risk

The Group's free funds are placed in overnight or short-term fixed-interest term deposits with the largest banks operating in Estonia. The duration of a term deposit is generally one week. Due to continued refinancing risk, cash flow management is tight. The Group's cash and cash equivalents balance is constantly smaller than the balance of loans that require refinancing in the next 12 months. At 31 December 2011 the weighted average duration of interest-bearing liabilities was 2.2 years, which means that on average all loans need to be refinanced every two years. Although at the end of 2011 the Group's cash and cash equivalents totalled 2.2 million euros, 0.7 million euros of this was under the Group's own control but the rest was in accounts with restricted withdrawal opportunities (mostly accounts of designated purpose where withdrawal requires the bank's consent). Liquidity and refinancing risk continues to be the most significant risk for the Group.

Interest rate risk

The base currency of most of the Group's loan agreements is the euro and the base interest rate is 3 or 6 month EURIBOR. As a result, the Group is exposed to developments in international capital markets. Currently the Group does not use hedging instruments to mitigate its long-term interest rate risk. In 2011 the Group's interest-bearing liabilities decreased by 6.6 million euros to 25.1 million euros at 31 December 2011. Interest payments of the year totalled 2.0 million euros. Compared with 2010, the weighted average interest rate has risen from 6.4% to 7.4%.

Currency risk

Purchase and sales contracts are mostly signed in local currencies: euros (EUR), Latvian lats (LVL) and Bulgarian levs (BGN). The Group is not protected against currency devaluations. After the adoption of the euro in Estonia from 1 January 2011, the currency risk arising from the exchange rate of the Estonian kroon and the euro ceased to exist. Most liquid funds are held in short-term deposits denominated in euros.

Corporate governance report

The shares of Arco Vara AS were listed in the main list of Tallinn Stock Exchange on 21 June 2007.

As a listed company, Arco Vara AS observes effective Estonian legislation, the rules and recommendations of the Tallinn Stock Exchange, and its own corporate values:

- Partnership – our client is our partner
- Reliability – we are reliable, open and honest
- Professionalism – we deliver quality
- Consideration – we value our clients as individuals
- Responsibility – we keep our promises

The annual report of Arco Vara AS includes its corporate governance report in which management confirms the company's compliance with the Corporate Governance Recommendations (CGR) of the Tallinn Stock Exchange. Any instances of non-compliance with the CGR are separately disclosed and explained.

This annual report has been prepared in accordance with the guidance of CGR. The corporate governance report is a separate section of the directors' report, which is part of the company's annual report.

I General meeting

The company's highest governing body is the general meeting of its shareholders.

The powers of the general meeting and the procedure for calling general meetings and passing resolutions are set out in the company's articles of association.

In 2011 there was one annual general meeting and one extraordinary general meeting.

The annual general meeting was held on 12 May 2011 at Viru Väljak 4 in Tallinn, in the conference centre of Sokos Hotel Viru. The notice of the general meeting was published on 20 April 2011 in the newspaper *Eesti Päevaleht*, in the information system of the stock exchange and on the company's website. The notice included information on where significant information and materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to the information on the agenda items and relevant materials on the company's website. The information was published in Estonian and in English. The company answered the questions raised by the shareholders before the general meeting and published the questions and answers, which were related to the agenda items, on its website.

On 27 April 2011, a shareholder holding over 5% of the company's share capital submitted motions for supplementing the agenda of the general meeting. Notice of supplements to the agenda was published on 4 May 2011 in the newspaper *Eesti Päevaleht*, in the information system of the stock exchange and on the company's website. On the same day the company made available on its website the resolutions proposed and the position of the management board in respect of the supplements.

The supervisory board did not publish its proposals regarding the agenda items on the company's website before the general meeting because the supervisory board did not have any additional proposals that would have been relevant. The proposals were published in the notice of the annual general meeting.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the company's supervisory board nor a member of the company's management board.

The agenda of the annual general meeting was as follows: approval of the annual report for 2010, resolution on the allocation of profit, appointment of the auditor, amendment of the articles of association, resolution on the performance of a special audit, resolution on the legality of the information request of Baltplast OÜ and the management board's obligation to provide the requested information (if the general meeting resolves against the special audit). The meeting was attended by 14 shareholders whose votes represented 71.82% of the total voting power. The meeting was conducted in Estonian and the chairman of the meeting made sure that it was conducted smoothly. The meeting was attended by the member of the management board, Lembit Tampere, who gave an overview of the company's performance in 2010. In addition, the meeting was attended by the chairman of the supervisory board, Richard Tomingas, and a member of the supervisory board, Hillar-Peeter Luutsalu. Other members of the supervisory board, Aare Tark, Kalev Tanner and Ragnar Meitern, were unable to attend due to prior business commitments related to other companies.

The extraordinary general meeting was held on 17 June 2011 at Narva mnt 7C in Tallinn, in the conference centre of Park Inn Central Tallinn. The notice of the general meeting was published on 26 May 2011 in the newspaper *Eesti Päevaleht*, in the information system of the stock exchange and on the company's website. The notice included information on where significant information and materials concerning the general meeting had been made available, where shareholders could submit their questions and a direct link to the information on the agenda items and relevant materials on the company's website. The information was published in Estonian and in English. No questions or proposals regarding the agenda items were submitted prior to the general meeting.

The meeting was chaired by Hannes Vallikivi, who is neither the chairman of the company's supervisory board nor a member of the company's management board.

The agenda of the extraordinary general meeting was as follows: amendment of a resolution of the annual general meeting adopted on 12 May 2011. The meeting was attended by 4 shareholders whose votes represented 62.71% of the total voting power. The meeting was conducted in Estonian and the chairman of the meeting made sure that it was conducted smoothly. The meeting was attended by the member of the management board, Lembit Tampere, who gave explanations regarding the draft resolution. In addition, the meeting was attended by the chairman of the supervisory board, Richard Tomingas and a member of the supervisory board, Hillar-Peeter Luitsalu. Other members of the supervisory board, Aare Tark, Kalev Tanner and Ragnar Meitern, were unable to attend due to prior business commitments related to other companies.

The resolutions and minutes of the general meetings as well as other relevant materials were made available on the company's website. Information on the agenda items of all annual and extraordinary general meetings as well as the questions submitted by the shareholders before the meetings and the answers to those questions are available online at least until the information on the next general meeting is published on the company's website.

II Management board

Since 4 September 2009 the management board of Arco Vara AS has had one member:

- Lembit Tampere – chief executive officer responsible for the overall management of the company.

In 2011 there were no changes in the composition of the management board.

When the member of the management board assumed office, a service contract was signed with him. The term of the management board member's service contract is three years. The member of the management board may not concurrently be a member of the management board or the chairman of the supervisory board of another listed company or the chairman of the supervisory board of another listed company belonging to the same group as the company.

The service contract signed with the member of the management board sets forth the powers, obligations, responsibilities and liability of the member of the management board and regulates disbursement of his basic remuneration. Remuneration was agreed taking into account the board member's duties and activities and the company's current financial performance and future prospects. If the member of the management board is recalled without due cause, he will be entitled to termination benefits equal to his four-fold basic monthly remuneration. The company does not have any incentive schemes for the member of the management board that are linked to the company's securities.

In 2011 the remuneration of the member of the management board amounted to 0.2 million euros. No incentives (bonuses) or termination benefits were paid.

The member of the management board has notified the company of his interests and involvement in the governing bodies of the following companies that are not part of the Group:

- Lembit Tampere – member of the management board of OÜ Alasniidu, OÜ Harku Projektijuhtimine and OÜ Overseas and sole shareholder and member of the management board of OÜ Rimmelga Aiand.

Ownership interests in, and involvement in the governing bodies of, certain other companies do not constitute a breach of the prohibition on competition. The member of the management board has undertaken by contract not to breach the prohibition on competition. Moreover, the company's internal regulations provide that no member of the management board or staff may demand or accept for personal gain money or any other benefits from third persons in connection with their work and may not grant unlawful or unjustified benefits or discounts to third persons.

The member of the management board has not conducted any significant transactions with himself or persons close to, or connected with him, and has not made any decisions in the interest of personal gain.

III Supervisory board

The supervisory board is responsible for planning and organising the activity of the company and overseeing the activities of the management board. Members of the supervisory board are elected by the general meeting.

Under the CGR, half of the members of the supervisory board of a listed company have to be independent. In the event of an odd number of members of the supervisory board, the number of independent members may be smaller by one.

The company's supervisory board has five members. In 2011 the composition of the supervisory board did not change and throughout the year members of the supervisory board were Richard Tomingas (chairman), Hillar-Peeter Luitsalu, Aare Tark, Kalev Tanner and Ragnar Meitern.

According to the definition provided in the CGR, independent members of the supervisory board are Aare Tark, Kalev Tanner and Ragnar Meitern. Members of the supervisory board Hillar-Peeter Luitsalu and Richard Tomingas cannot be regarded as independent because over the past three years they have been members of the governing bodies of various companies belonging to the company's group and have business relations with the company through companies belonging to them, OÜ HM Investeeringud and OÜ Toletum.

Accordingly, the company's supervisory board has three independent and two non-independent members and the company is in full compliance with the CGR. The composition of the supervisory board ensures effective management and is the best for the company and its shareholders.

Members of the supervisory board elect the chairman of the supervisory board from among themselves.

Richard Tomingas has been the chairman of the supervisory board since 21 January 2008.

Throughout 2011 the remuneration of a member of the supervisory board was 959 euros per month. The remuneration was approved by the general meeting with a resolution adopted on 17 December 2009. Members of the supervisory board are not eligible for any additional remuneration or termination benefits and the remuneration of the chairman of the supervisory board does not differ from that of other members of the supervisory board.

The company has provided Richard Tomingas and Hillar-Peeter Luitsalu, who are actively involved in the work of the supervisory boards of entities controlled by the company, with cars, computers and mobile phones whose costs are covered by the company based on a resolution adopted by the general meeting

At a meeting held on 15 April 2011, the supervisory board decided to form an audit committee and to elect members to the audit committee. The meeting appointed Ragnar Meitern, Kalev Tanner and Richard Tomingas to the audit committee with Ragnar Meitern as chairman of the committee. The Auditors Activities Act stipulates that the audit committee has to have at least two members and at least two of them have to be experts in accounting, finance or law. Internal auditors, members of the management board, authorised signatories and persons performing the audit may not serve as members of the audit committee and the chairman of the supervisory board may not be the chairman of the audit committee. The composition of Arco Vara AS's audit committee meets all regulatory requirements.

In 2011 the supervisory board had nine meetings. Members of the supervisory board Richard Tomingas, Hillar-Peeter Luitsalu and Kalev Tanner attended all meetings, member of the supervisory board Aare Tark attended seven meetings and member of the supervisory board Ragnar Meitern attended five meetings of the supervisory board. Aare Tark was unable to attend two meetings due to his prior commitments at other companies and Ragnar Meitern was unable to attend four meetings due to commitments abroad.

In 2011 no members of the supervisory board had a conflict of interest with the company.

IV Cooperation of the management and supervisory boards

In line with the company's articles of association and historical practice, the management and supervisory boards cooperate closely.

Members of the supervisory board Hillar-Peeter Luitsalu and Richard Tomingas are actively involved in the work of the supervisory boards of the parent companies of the three business lines (divisions) controlled by the company (Arco Ehitus OÜ, Arco Investeeringute AS and Arco Real Estate AS). In addition, Richard Tomingas is a member of the supervisory board of Arco Development SIA.

The management and supervisory boards hold joint meetings for discussing matters related to the company's strategy and exchange information about the company's strategic development on an ongoing basis. During the period under review the member of the management board attended all meetings of the supervisory board. At the meetings, the member of the management board informs the supervisory board about any deviations from the company's plans and objectives and the reasons for those deviations.

The chairman of the supervisory board and the member of the management board meet and exchange information as and when necessary. There is a routine in place according to which the member of the management board provides an overview of significant matters and developments concerning the company at least once a week. In information exchange, all parties observe the rules approved by the supervisory board for keeping and disclosing inside information, making transactions with Arco Vara AS shares and segregating the functions of the management and supervisory boards.

V Disclosure of information

Since the flotation of its shares on the Tallinn Stock Exchange, Arco Vara AS has observed the information disclosure rules of the Tallinn Stock Exchange and the principle that all shareholders should be treated equally.

The website of Arco Vara AS is at www.arcorealestate.com and the information intended for shareholders is available in the "Investor Relations" menu. The website including the information intended for shareholders is available in both Estonian and English. The company discloses on its website all facts, forecasts and estimates that are disseminated to financial analysts or other parties. Publicly disclosed information includes annual and interim reports, stock exchange announcements, information pertaining to the general meeting, general facts about the company, etc. The company also publishes on its website information about meetings with analysts, the times and locations of presentations and press conferences organised for analysts, investors or institutional investors and the company's general strategic plans. General and more specific information about the company can be found on the corporate website, in different menus. The information is logically structured and easy to find.

The company's website (www.arcorealestate.com) contains the following information for shareholders: the corporate governance report; the dates, locations and agendas of general meetings and other data concerning general meetings; the company's articles of association; the composition of the management and supervisory boards; information on the company's auditor; and annual and interim reports. The website does not include information on shareholder agreements on concerted exercise of shareholder rights because such agreements have not been concluded.

The company has not organised presentations to investors and analysts directly before the release of a financial report and has never disclosed inside information or unreleased financial data at meetings with analysts or investors.

The company did not prepare a financial calendar at the beginning of 2011 although all reports were presented and released in line with regulatory requirements. Preparation of the financial calendar was hindered by delays in the launch of the consolidation project that would have allowed speeding up the preparation of annual and interim reports.

VI Financial reporting and auditing

The consolidated financial statements of Arco Vara AS are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

The company publishes the annual report once a year and interim reports several times during the year. All reports are available to shareholders on the company's website.

The auditor attended the meeting of the supervisory board where the results of the audit were discussed. The auditor presented his report. The member of the management board and the chief financial officer were not present during the discussion. Minutes were taken of the meeting.

The notice of the annual general meeting included the name of and relevant information on the candidate for the company's auditor.

For better risk assessment and management, most Group entities prepare a budget for the next financial year, which is approved by the entity's supervisory board or general meeting. The company's consolidated budget is approved by the supervisory board. Completion of and adherence to approved budgets is monitored by the company's controller and, where necessary, additional internal control services are purchased from qualified service providers. In addition, the management board organises reporting meetings that review budget completion at least on a quarterly basis. The meetings are attended by the managers of all divisions and other key personnel.

To ensure high quality financial reporting and to counteract the risks related to financial reporting, the company has created the financial controller's position. The financial controller participates actively in the preparation of the consolidated annual and interim reports. The consolidated financial statements are prepared using uniform Group-wide cross-border financial accounting and reporting software. Consolidation procedures have been largely automated and are performed monthly. Monthly reporting is presented to the managements of relevant entities and units and monthly consolidated reporting is presented to the Group's management.

Statement by the management board to the director' report

The management board confirms that the directors' report provides a true and fair view of the development, financial position and financial performance of the company and the Group as well as a description of the main risks and uncertainties.

/signature/

Lembit Tampere
Chief Executive Officer and Member of the Management Board

19 April 2012

Consolidated financial statements

Consolidated statement of comprehensive income

	Note	2011	2010
EUR, thousands			
Revenue from rendering of services		23,214	11,583
Revenue from sale of goods		19,918	9,550
Total revenue	5, 6	43,132	21,133
Cost of sales	8	-42,790	-16,237
Gross profit		342	4,896
Other income	9	3,049	1,712
Distribution expenses	10	-346	-302
Administrative expenses	11	-3,903	-4,041
Other expenses	9	-634	-2,394
Operating loss		-1,492	-129
Finance income	12	586	1,677
Finance expenses	12	-1,811	-1,635
Share of loss of equity-accounted investees	7	-914	-181
Loss before income tax		-3,631	-268
Income tax income/expense	13	250	-26
Loss for the year		-3,381	-294
<i>Loss attributable to owners of the parent</i>		<i>-3,371</i>	<i>-281</i>
<i>Loss attributable to non-controlling interests</i>		<i>-10</i>	<i>-13</i>
Total comprehensive expense for the year		-3,381	-294
Earnings per share	14		
- Basic		-0.71	-0.06
- Diluted		-0.71	-0.06

Consolidated statement of financial position

As at 31 December	Note	2011	2010
EUR, thousands			
Cash and cash equivalents	16	2,209	4,209
Trade and other receivables	17	7,012	5,760
Prepayments		433	414
Inventories	18	21,564	35,518
Non-current assets held for sale	19	469	0
Total current assets		31,687	45,901
Investments in equity-accounted investees	7	4	1
Other investments	20	8	995
Trade and other receivables	17	3,058	76
Deferred income tax asset	13	250	0
Investment property	21	24,046	22,887
Property, plant and equipment	22	934	703
Intangible assets		26	20
Total non-current assets		28,326	24,682
TOTAL ASSETS		60,013	70,583
Loans and borrowings	23	9,662	27,126
Trade and other payables	24	7,735	4,813
Deferred income	25	2,012	4,859
Provisions	26	1,205	1,378
Total current liabilities		20,614	38,176
Loans and borrowings	23	14,675	3,855
Trade and other payables	24	741	724
Total non-current liabilities		15,416	4,579
Total liabilities		36,030	42,755
Share capital	27	3,319	3,030
Statutory capital reserve		2,011	2,011
Retained earnings		18,653	22,787
Total equity		23,983	27,828
Equity attributable to non-controlling interest		155	-70
Equity attributable to equity holders of the parent		23,828	27,898
TOTAL LIABILITIES AND EQUITY		60,013	70,583

Consolidated statement of cash flows

	Note	2011	2010
EUR, thousands			
Loss for the year		-3,381	-294
Adjustments for:			
Interest income and interest expense	12	1,381	1,161
Gain/loss on sale of subsidiaries and interests in joint ventures	12	-285	-85
Share of profits and losses of equity-accounted investees	7	914	181
Gain/loss on other long-term investments		88	-1,165
Depreciation, amortisation and impairment losses on property, plant and equipment and intangible assets	8, 11	99	135
Gain/loss on the sale of property, plant and equipment and intangible assets	9	28	3
Gain/loss on change in the fair value of investment property	9, 21	-2,998	1,711
Gain/loss on the sale of investment property	9	92	21
Gain/loss on change in the value of inventories and receivables	8, 11	1,345	-1,079
Foreign exchange gains and losses	12	7	-67
Income tax income/expense	13	-250	26
Operating cash flow before working capital changes		-2,960	548
Change in receivables and prepayments		-2,471	827
Change in inventories		4,749	2,396
Change in payables and deferred income		12	-2,021
NET CASH USED IN / FROM OPERATING ACTIVITIES		-670	1,750
Acquisition of property, plant and equipment and intangible assets		-94	-40
Proceeds from sale of property, plant and equipment and intangible assets		5	2
Paid on development of investment properties		-967	-238
Proceeds from sale of investment property		774	1,568
Acquisition of investments in subsidiaries and joint ventures	7	-4	-32
Proceeds from sale of investments in subsidiaries and joint ventures	7	893	1,477
Proceeds from sale of other investments		0	3,323
Loans granted		-631	-231
Repayment of loans granted		114	5
Interest received		197	243
NET CASH FROM INVESTING ACTIVITIES		287	6,077
Proceeds from loans received		6,646	4,164
Settlement of loans and finance lease liabilities		-6,308	-9,675
Interest paid		-1,955	-2,241
NET CASH USED IN FINANCING ACTIVITIES		-1,617	-7,752
NET CASH FLOW		-2,000	75
Cash and cash equivalents at beginning of period	16	4,209	4,137
Decrease/increase in cash and cash equivalents	16	-2,000	75
Effect of exchange rate fluctuations on cash held		0	-3
Cash and cash equivalents at end of period		2,209	4,209

Consolidated statement of changes in equity

	Note	Equity attributable to equity holders of the parent					Non-controlling interest	Total equity
		Share capital	Statutory capital reserve	Own shares	Retained earnings	Total		
EUR, thousands								
Balance at 31 December 2009		60,898	2,011	-255	-34,475	28,179	-76	28,103
Change in non-controlling interest (through change in the Group's interests in subsidiaries)		0	0	0	0	0	19	19
Reduction of share capital		-57,868	0	255	57,613	0	0	0
Total comprehensive expense for the year		0	0	0	-281	-281	-13	-294
Balance at 31 December 2010		3,030	2,011	0	22,857	27,898	-70	27,828
Change in non-controlling interest (through change in the Group's interests in subsidiaries)		0	0	0	-235	-235	235	0
Effect of acquisition of a subsidiary	7	0	0	0	-464	-464	0	-464
Increase of share capital	27	289	0	0	-289	0	0	0
Total comprehensive expense for the year		0	0	0	-3,371	-3,371	-10	-3,381
Balance at 31 December 2011		3,319	2,011	0	18,498	23,828	155	23,983

Notes to the consolidated financial statements

1 General information

These consolidated financial statements of Arco Vara AS and its subsidiaries as at and for the year ended 31 December 2011 were authorised for issue by the member of the management board on 19 April 2012. Under the Commercial Code of the Republic of Estonia, final approval of the annual report prepared by the management board and approved by the supervisory board rests with the shareholders' general meeting. The consolidated financial statements are part of the annual report that has to be approved by the shareholders, and they serve as a basis for adopting the profit allocation resolution. Shareholders may decide not to approve the annual report, which has been prepared by the management board and approved by the supervisory board, and may demand that a new annual report be prepared.

Arco Vara AS (the "Parent") is a company incorporated and domiciled in Estonia. The address of the company's registered office is Jõe tn 2B, Tallinn. At the end of 2011, Arco Vara AS and its subsidiaries (the "Group") employed 146 people (2010: 153 people). The principal activities of the Group are described in notes 5 and 6. In addition to Estonia, the Group operates through its subsidiaries in Latvia, Lithuania and Bulgaria.

The structure of the Group as at 31 December 2011 is presented in note 33.

2 Statement of compliance and basis of preparation

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

In connection with the change of the official currency of Estonia, as from 1 January 2011 the Group's presentation currency is the euro, which replaced the Estonian kroon. The euro is also the functional currency of the Parent company and the Group's other Estonian entities. Prior period financial information that was presented in Estonian kroons has been translated to euros in accordance with the relevant Council Regulation (EU) in which the conversion rate was set at 15.6466 kroons per 1 euro. Because of the fact that the Estonian kroon was previously pegged to the euro at the same exchange rate, the change in the functional and presentation currency had no effect on the Group's financial position, financial performance or cash flows.

The financial statements are presented in thousands of euros, unless indicated otherwise.

The consolidated financial statements have been prepared on a historical cost basis, unless explained otherwise in note 4 *Significant accounting policies*.

Significant judgements, estimates and assumptions

The preparation of consolidated financial statements in conformity with IFRS as adopted by the EU requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses, and the disclosure of contingent assets and contingent liabilities.

Although estimates and underlying assumptions are reviewed on an ongoing basis and they are based on historical experience and expectations of future events that are believed to be reasonable under the circumstances, actual results may differ from the estimates.

In applying the Group's accounting policies, management has made the following judgements that have the most significant effect on the financial statements:

Classification of properties (real estate)

Properties (items of real estate) are classified as inventories, investment properties and items of property, plant and equipment both on initial recognition and on any subsequent reclassification based on management's intentions regarding their further use. Realization of management's plans depends, among other factors, on resolutions adopted by other parties (e.g. changes in the intended purpose of land, approval of detailed plans, issue of construction permits, etc).

Properties which are acquired for the development of and subsequent sale as living environments, single residential buildings, or residential plots, and properties which are acquired for resale in the ordinary course of business are classified as inventories.

Properties which are held to earn operating lease rentals or for capital appreciation and properties which are held over an extended period for an undetermined future use are classified as investment property.

Properties which are being developed for future use as commercial or business environments that will be leased out under operating leases and commercial and business properties which are being extensively renovated are also classified as investment properties.

Estimation uncertainty

The estimates made by management are based on historical experience and the information available at the date the financial statements are authorised for issue. There is a risk that the estimates applied at the reporting date in respect of assets and liabilities and associated income and expenses need to be revised in the future. The key sources of estimation uncertainty that have a significant risk of causing material adjustments to the consolidated financial statements are discussed below.

Measurement of loans and receivables

The Group's loans and receivables include mostly trade receivables and loans granted. Loans and receivables are measured based on management's best estimates. The measurement principles applied are disclosed in note 4 *Significant accounting policies*. Changes in market conditions or the customers' financial position may cause management to significantly revise its estimates. Further information on risks that may affect the value of loans and receivables is presented in note 28.

Estimation of the net realisable value of inventories

The Group has several properties that have been classified as inventories. The net realisable values of all significant properties classified as inventories were measured as at 31 December 2011 in order to determine whether:

- 1) the net realisable value of any item had decreased below its carrying amount;
- 2) any impairments recognised in prior periods needed to be reversed.

The net realisable values of the properties were measured in the same way as the fair value of investment properties is measured, i.e. by using the following methods:

- the discounted cash flow analysis
- the sales comparison method

Determination of the fair value of investment properties

At each reporting date, investment properties are measured at their fair values. In addition to management's estimates, where necessary, the fair value of investment properties is measured based on valuation reports issued by independent real estate appraisers. This means that in the case of significant investment properties, parallel appraisals are commissioned from independent appraisers. Fair value is mainly determined by using two basic techniques - the discounted cash flow method and the sales comparison method.

The discounted cash flow method is used to determine the value of investment properties that generate stable rental cash flow and properties whose fair value, according to management's assessment, cannot be determined reliably under the sales comparison method (for example, inactive property market in the location of the property being valued, absence of comparable transactions or an extensive period between a comparable transaction and the date of valuation). In order to determine the value of a property's discounted cash flows, the appraiser has to forecast the property's future cash flow (including rental per square metre and the occupancy rate or sale of apartments), capital expenditures and operating expenses. The present value of the future net cash flow is found by applying to the cash flow an appropriate discount rate that best reflects the current market assessments of the time value of money and the risks specific to the asset. Further information on measuring the fair value of investment properties is presented in note 21.

The sales comparison method is applied to properties that do not generate rental cash flow and are held for future development or capital appreciation. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. As the transactions selected for comparison are practically never identical with the property being valued their prices are adjusted to reflect differences in time, location, size and detailed plan. Where necessary, another valuation technique is applied (e.g. the discounted cash flow analysis) if management believes that the latter can measure the fair value of the property more reliably.

3 Changes in accounting policies and presentation of financial statements

The consolidated financial statements are prepared in accordance with the principles of consistency and comparability, which means that the Group consistently applies the same accounting and presentation policies. Accounting policies and presentation are changed only when this is required by new or revised International Financial Reporting Standards (IFRS) as adopted by the EU and their interpretations or when a new accounting policy or presentation practice represents the Group's financial position, financial performance and cash flows more faithfully.

The Group's key management personnel

Arco Vara AS has decided to change the definition of key management personnel. From now on the Group's key management personnel are members of the management board and supervisory board of Arco Vara AS, because only those persons have real and significant authority to influence the operation of the Group. Previously the Group's key management personnel included also members of the management boards and supervisory boards of the subsidiaries of Arco Vara AS.

New and revised IFRS and interpretations not yet adopted

The following new Standards and Interpretations are not yet effective for the year ended 31 December 2011 and have therefore not been applied in preparing these financial statements:

Amendments to IFRS 7 Financial Instruments: Disclosures – Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011; to be applied prospectively; earlier application is permitted). The amendments require disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities, and to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets. The amendments define "continuing involvement" for the purposes of applying the disclosure requirements. Because of the nature of the Group's operations and the types of financial assets that it holds, the Group does not expect the amendments to IFRS 7 to have a material impact on its consolidated financial statements.

IASB and IFRIC have published a number of other accounting pronouncements that are effective for periods beginning after 1 January 2011; however at the date these consolidated financial statements are authorised for issue those pronouncements had not yet been endorsed by the European Union. Therefore they are not discussed here.

4 Significant accounting policies

Business combinations and basis of consolidation

The consolidated financial statements comprise the financial statements of Arco Vara AS and its subsidiaries, combined line by line, and the Group's interests in joint ventures and associates, accounted for using the equity method. The financial statements of all Group entities coincide with the calendar year. Group entities use in all material respects uniform accounting policies and measurement bases. Where necessary, the accounting policies and measurement bases of Group entities are adjusted (in the case of some foreign entities), to ensure consistency with the policies adopted by the Group.

A subsidiary is an entity that is controlled by the Parent. Control is the power to govern the financial and operating policies of an entity under a statute or an agreement or by some other means. Control is presumed to exist when the Parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control exists when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

Subsidiaries are consolidated from the date the control commences until the date the control ceases.

In preparing the consolidated financial statements, all receivables, liabilities, income, expenses, cash flows and unrealised gains and losses arising from transactions between the Parent and its subsidiaries are eliminated in full. Unrealised losses are eliminated only to the extent that there is no evidence of impairment.

A non-controlling interest, i.e. the portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, is separately presented in the consolidated statement of financial position (within equity) and the consolidated statement of comprehensive income.

Acquisitions of subsidiaries and interests in joint ventures are accounted for using the purchase method. Under the purchase method, the acquiree's assets, liabilities and contingent liabilities ("net assets") are recognised at their fair values. The excess of the cost of the business combination over the Group's interest in the fair value of the acquiree's net assets is recognised as goodwill. If the Group's interest in the fair value of the acquiree's net assets exceeds the cost of the business combination, the Group reassesses the identification and measurement of the acquiree's assets, liabilities and contingent liabilities and recognises any excess remaining after that reassessment (negative goodwill) immediately as income in profit or loss for the period.

When the Group increases its interest in a subsidiary by purchasing shares from a non-controlling shareholder, the difference between the cost of the interest acquired and the book value of the share of the net assets acquired is recognised directly in equity and attributed to owners of the Parent. If the Group acquires assets or net assets that can be defined as a business under IFRS 3, the cost of the assets is allocated to the individual identifiable assets and liabilities on the basis of their fair values at the date of acquisition.

When an interest in a subsidiary is disposed of, the difference between the sum of the consideration received and the carrying amount of the Group's share in the subsidiary's assets, liabilities and goodwill is recognised immediately in profit or loss, either as a gain in finance income or a loss in finance expenses, as appropriate. If control ceases (e.g. the Group's interest decreases to or below half of the voting power), the remaining interest is measured at its fair value as at the reporting date and is classified either as an investment in an associate or joint venture or other investment.

Investments in associates and joint ventures

Investments in associates and joint ventures are accounted for using the equity method whereby the investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition, and its carrying amount is adjusted to recognise the investor's share of the profit or loss of the associate or joint venture after the date of acquisition.

When the Group's share of losses exceeds the carrying amount of its interest in an equity-accounted investee, the carrying amount of that interest is reduced to zero and additional losses are not recognised unless the Group has incurred legal or constructive obligations on behalf of the associate or joint venture and at the reporting date it is evident that the associate or joint venture is unable to meet its commitments. In such cases additional losses are provided for and recognised to the extent that the Group has incurred obligations on behalf of the investee.

Segment reporting

Segment reporting is based on the grouping of structural units for the Group's internal accounting and reporting purposes (management accounting and budgeting). Segmentation is based on business activity. A business segment is a distinguishable component of the Group that is engaged in providing products or services that are different from those of other business segments, and which operates as an independent profit centre. Segment reporting complies with internal reporting that is regularly reviewed by the Group's chief operating decision maker – the member of the management board of the Group's Parent company, Arco Vara AS.

The Group's business segments comprise:

- Real estate development (Development segment): the development of residential and commercial environments and long-term investment in real estate
- Real estate services (Service segment): real estate brokerage, valuation and management, and short-term investment in real estate.
- Construction (Construction segment). General and sub-contracting in the field of general construction and civil and environmental engineering, and construction supervision.

Segment revenue is revenue that is directly attributable to a segment and the relevant portion of the Group's revenue that can be allocated to the segment on a reasonable basis, whether from sales to external customers or from transactions with other segments of the Group.

Segment expense is expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of the Group's expense that can be allocated to the segment on a reasonable basis, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the Group. Segment expense does not include finance and investment expenses, the Group's general administrative expenses and other expenses that arise at the Group level. The costs incurred at the Group level are allocated to a segment only if they relate to the segment's operating activities and they can be directly attributed to the segment on a reasonable basis.

Unrealised gains and losses arising from transactions between the Group's segments are not allocated to any segment but are presented within inter-segment eliminations. Unrealised gains and losses arising from transactions between the Parent and a segment which can be allocated to the segment on a reasonable basis are included in the segment result. Such gains and losses may include previously capitalised interest expense which upon the reclassification of assets accounted for under the cost model to assets accounted for under the fair value model is recognised as a fair value adjustment in the period in which the assets are reclassified.

Segment assets are operating assets that are employed by a segment in its operating activities and are either directly attributable to the segment or can be allocated to it on reasonable basis. Segment assets include current assets, investment properties, property, plant and equipment and intangible assets used in a segment's operating activities. If an asset's depreciation or amortisation expense is included in segment expenses, the asset is included in segment assets. Segment assets do not include assets used for the Group's general needs or which cannot be directly allocated to the segment. Assets shared by two or more segments are allocated to the segments if a reasonable basis for allocation exists.

Segment liabilities are operating liabilities that result from the operating activities of a segment and are either directly attributable to the segment or can be allocated to it on a reasonable basis. Segment liabilities include, for example, trade and other payables, accrued expenses, advances from customers, warranties provisions and other liabilities related to the segment's products and services. Segment liabilities do not include loans, finance lease liabilities, debt securities and other liabilities related to financing activities. Income tax liabilities are not included in segment liabilities either.

Unallocated items comprise revenue and expenses and assets and liabilities which are not directly related to any segment and therefore cannot be allocated to any segment.

Foreign currency transactions

All currencies other than the euro (the functional currency of the Parent) are treated as foreign currencies. Transactions in foreign currencies are initially recorded at the foreign exchange rates of the European Central Bank ruling at the date of the transaction. Monetary assets (cash, cash equivalents and receivables) and monetary liabilities (loans and borrowings, payables and other liabilities) denominated in foreign currencies at the reporting date are retranslated to euros at the exchange rates of the European Central Bank ruling at the reporting date. Foreign exchange gains and losses are recognised in finance income and finance expenses respectively in the period in which they arise. Non-monetary items denominated in foreign currencies that are measured in terms of historical cost are translated using the exchange rates of the European Central Bank ruling at the dates of the original transactions. Non-monetary items denominated in foreign currencies that are measured at fair value are translated using the exchange rates of the European Central Bank ruling at the date when the fair value was determined

When the functional currency of a subsidiary differs from the Parent's functional currency, the financial statements of the subsidiary (e.g. in Latvia, Lithuania and Bulgaria) are translated for consolidation purposes using the central exchange rates of the currencies against the euro, which is why translation does not give rise to any significant exchange differences. All relevant countries, Latvia, Lithuania and Bulgaria, have pegged their currency to the euro. The Latvian lats has the widest permitted fluctuation corridor – its exchange rate may differ from the fixed central exchange rate by up to 1%.

Revenue

Revenue is measured at the fair value of the consideration received or 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 measured reliably.

Revenue from the sale of real estate

Sales of real estate (including real estate development projects: buildings, apartments, etc built on properties belonging to Group companies) are recognised when all significant risks and rewards related to the properties have been transferred to the buyer and the Group has no obligation to perform significant additional work. In general, a sale is deemed to have occurred when the real right contract (the contract by which title is transferred) has been signed. Payments made by customers before the signature of the real right contract are recognised as deferred income.

Revenue from long-term service contracts

The revenue and expenses arising from long-term service contracts (including construction contracts) are recognised by reference to the stage of completion method. The stage of completion of a service is determined as the proportion that the costs incurred until the reporting date bear to the estimated total costs of the transaction. If the amount of progress billings as at the reporting date differs from the revenue determined by reference to the stage of completion method, the difference is recognised as a payable or a receivable.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Revenue from the sale of other services

Revenue from the rendering of other services arises when the service has been rendered. Revenue from brokerage services is recognised when the transaction has been completed. Rental income from investment properties is recognised on a straight-line basis over the lease term. Revenue from intermediation of utilities services (payments for electricity, heating, water, etc) is offset against the costs of purchasing those services.

Revenue from the sale of other goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have been transferred to the buyer and the amount of revenue can be measured reliably.

Cash and cash equivalents and the statement of cash flows

Cash and cash equivalents comprise cash and short-term (with a term of up to 3 months from the date of acquisition) highly liquid investments which can be converted to known amounts of cash within three months and are subject to an insignificant risk of changes in value. Such assets are cash, demand deposits, term deposits with a maturity of up to three months and units in money market funds.

In the statement of cash flows, cash flows from operating activities are reported using the indirect method. Cash flows from investing and financing activities are reported using the direct method, i.e. by disclosing separately gross cash receipts and gross cash payments.

Financial assets

Financial assets are classified to different categories (see below). The designation is re-evaluated and adjusted, where necessary, at each financial year-end. Financial assets whose reclassification is not permitted by IFRS are not reclassified.

The Group classifies its financial assets to the following categories:

- 1) financial assets at fair value through profit or loss;
- 2) loans and receivables;
- 3) available-for-sale financial assets.

When a financial asset is recognised initially, it is measured at cost, which is the fair value of the consideration given for it. Acquisition costs are any costs that are directly attributable to the acquisition of the asset, including fees and commissions paid to agents, advisers, brokers and dealers, as well as any non-recoverable levies, taxes and duties. Exceptions include transaction costs directly attributable to the acquisition of a financial asset at fair value through profit or loss which are recognised as an expense as incurred.

A regular way purchase or sale of financial assets is recognised using trade date accounting. The trade date is the date on which the Group commits itself to purchase or sell a financial asset (e.g. the date on which the agreement is signed). A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established by regulation or convention in the marketplace concerned.

Financial assets measured at fair value

Financial assets that are measured at fair value are re-measured to fair value at each reporting date without any deduction for transaction costs that may be incurred on the sale or disposal of the asset. The fair values of listed securities are based on their closing prices and the official exchange rates of the European Central Bank ruling at the reporting date. The fair values of unlisted securities are determined based on all available information and using a comparison with the fair values of other instruments which are substantially the same and/or the discounted cash flow analysis.

Gains and losses arising from changes in the fair value of financial assets are recognised in finance income and finance expenses respectively.

Gains and losses arising on the disposal of financial assets measured at fair value as well as the interest and dividends on these assets are recognised in finance income and finance expenses.

Loans and receivables

Loans and receivables, except those that the Group intends to sell in the near term, are measured at amortised cost using the effective interest method. The amortised cost is calculated taking into account any discount or premium on acquisition and any directly attributable transaction costs.

If there is objective evidence that an impairment loss on a financial asset carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the carrying amount and recoverable amount of the asset. The recoverable amount is the present value of the estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses on financial assets related to operating activities are charged to administrative expenses and impairment losses on financial assets related to investing activities are charged to finance expenses

Financial assets that are individually significant are assessed for impairment individually. Receivables overdue for 180 days or more are considered impaired and are expensed in full. If impairment becomes evident sooner, the asset is written down earlier.

If a receivable that has been written down is collected or any other event occurs which reverses an impairment loss that has been recognised, the reversal is recognised by reducing the line item in the statement of comprehensive income within which the impairment loss was originally recognised.

Interest income on loans and receivables is recognised in finance income.

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available for sale and are not classified to any other category of financial assets. A gain or loss on an available-for-sale financial asset is recognised in other comprehensive income or expense. When an available-for-sale financial asset is sold or its value declines (it becomes impaired), the cumulative gain or loss that has been recognised in other comprehensive income or expense is reclassified to profit or loss.

Inventories

Inventories include mostly land and buildings that have been acquired or are being developed for housing development purposes. Finished goods and work in progress are initially recognised at their cost of conversion. The cost of conversion includes all direct and indirect production costs incurred in bringing the inventories to their present location and condition. Production overheads are allocated to the costs of conversion based on the normal capacity of the production facilities. Other inventories are initially recognised at cost. The cost of inventories includes all direct and indirect costs incurred in bringing the inventories to their present location and condition. Indirect costs that are included in the cost of items of real estate classified as inventories include the borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing associated construction activities. Capitalisation of borrowing costs commences when borrowing costs and expenditures for development of inventories have been incurred and development activities have been undertaken. Borrowing costs are capitalised during the active development stage. Capitalisation of borrowing costs ceases when the asset is complete (usually when the building has been granted a permit of use) or its development has been suspended for an extended period.

The cost of inventories is assigned using the weighted average cost formula except that the cost of registered immovable properties and apartments treated as movable properties is assigned by specific identification of their individual costs.

In the statement of financial position, inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Inventory write-downs to net realisable value are recognised in the cost of sales.

Investment property

Investment property is property (land or a building or both) held to earn rentals or for capital appreciation, rather than for use in the production or supply of goods or services or for administrative purposes. In addition, investment property includes properties which are held over an extended period for an undetermined future use. Properties being constructed or developed for future use as investment properties (commercial buildings) and buildings treated as movable properties (commercial buildings under renovation) are carried as investment properties.

An investment property is measured initially at its cost. Directly attributable transaction costs are included in the initial measurement. Transaction costs that are directly attributable to acquisition include notary's fees, stamp duties, advisors' fees and other transaction costs. After initial recognition, investment properties are measured using the fair value model. The fair value of investment property reflects market conditions at the reporting date.

In addition to estimates made by management, the fair value of investment property is determined, where necessary, based on the valuations performed by qualified independent appraisers. This means that in the case of significant investment properties valuation reports are also commissioned from independent real estate appraisers. Fair value is determined using the following methods:

- Discounted cash flow analysis. The discounted cash flow method is used to determine the value of investment properties that generate stable rental income and properties whose fair value, according to management's assessment, cannot be determined reliably under the sales comparison method (for example, inactive property market in the location of the property being valued, absence of comparable transactions or an extensive period between a comparable transaction and the date of valuation). In order to calculate the present value of a property's future cash flows, the appraiser has to forecast the property's future rental income (including rental per 1 square metre and the occupancy rate) and operating expenses. Depending on the terms of the lease (whether and how easily the lease can be terminated by the lessee), the appraiser will base the projections on either the property's existing cash flows or the market's current average cash flows for similar properties. The present value of the future net cash flow is found by applying a discount rate which best reflects the current market assessments of the time value of money and the risks specific to the asset. The discount rate is selected based on the market's average capital structure.
- Sales comparison method. The sales comparison method is applied to properties that do not generate rental cash flow and are held for future development or capital appreciation. Under this method, the market value of a property is determined by reference to the price per square metre agreed in transactions performed with similar properties. As the transactions selected for comparison are practically never identical with the property being valued, their prices are adjusted to reflect differences in time, location, size and detailed plan. Where necessary, another valuation technique is applied (e.g. the discounted cash flow analysis) if management believes that the latter can measure the fair value of the property more reliably.
- Existence of a sales contract under the law of obligations. In the case of properties which at the reporting date have been sold based on a contract under the law of obligations but in respect of which the real right contract has not been signed (title has not transferred), fair value is determined by reference to the sales price of the property in the contract under the law of obligations. The sales price agreed in the contract under the law of obligations is used for determining the fair value of a property only when the Group has reasonable assurance that the related real right contract will be concluded under the same terms and conditions (e.g. the buyer has made a substantial prepayment for the property by the reporting date or the real right contract is concluded after the reporting date but before the date management approves the financial statements for issue).

Gains and losses arising from changes in the fair value of investment property are recognised in profit or loss in the period in which they arise (in other income and other expenses respectively).

An investment property is derecognised on disposal or when the property is permanently withdrawn from use and no future economic benefits are expected from its disposal. Gains and losses arising from the retirement or disposal of investment property are recognised in profit or loss in the period of retirement or disposal (in other income or other expenses respectively).

Transfers to and from investment property are made when there is a change in use. From the date of transfer, an asset is accounted for using the policies applied to the class of assets to which it has been transferred. For a transfer from investment property to inventories or property, plant and equipment, the property's deemed cost for subsequent accounting is its fair value at the date of transfer.

When an item of property, plant and equipment is transferred to investment property, any positive difference between the fair value and carrying amount of the property at the date of transfer is recognised in the revaluation reserve in equity. Any negative difference is recognised as an impairment loss. When a property is transferred from inventories to investment property, any difference between fair value and carrying amount is recognised in profit or loss, in other income or other expenses as appropriate.

Property, plant and equipment

Assets are classified as items of property, plant and equipment when their useful life extends beyond one year.

An item of property, plant and equipment is initially recognised at cost. The cost of an item of property, plant and equipment comprises its purchase price and any costs directly attributable to its acquisition. The cost of items of real estate, which are carried as items of property, plant and equipment, includes borrowing costs (interest charges, amortisation of contract fees, etc) incurred in financing their construction. For the principles of capitalising borrowing costs, see the policy *Inventories*.

After recognition, an item of property, plant and equipment is carried at cost less any accumulated depreciation and any accumulated impairment losses.

If an item of property, plant and equipment consists of significant parts that have different useful lives, the parts are accounted for separately and assigned depreciation rates that correspond to their useful lives.

Subsequent expenditure on an item of property, plant and equipment (e.g. the costs of replacing a part of an item) is added to the carrying amount of the item, provided that it meets the following criteria: (a) it is probable that future economic benefits associated with the item will flow to the Group; and (b) the cost of the item can be measured reliably. The carrying amounts of the parts that are replaced are derecognised. All other subsequent expenditures related to items of property, plant and equipment are recognised as an expense in the period in which they are incurred.

Items of property, plant and equipment are depreciated on a straight-line basis. Each part of an item of property, plant and equipment is assigned a depreciation rate that corresponds to its useful life. The following annual depreciation rates are applied:

- Buildings and structures 2–18%
- Plant and equipment 8–20%
- Vehicles 15–25%
- Other equipment and fixtures 20–40%

Items of property, plant and equipment are depreciated until their residual value exceeds their carrying amount. The residual value is the estimated amount that the Group would currently obtain from the disposal of the asset if the asset were already of the age and in the condition expected at the end of its useful life.

Depreciation methods, depreciation rates and residual values are reviewed at least at each reporting date. When measurement bases are revised, the revisions are applied prospectively.

The carrying amounts of items of property, plant and equipment are reviewed for impairment when there is evidence that the carrying amount of an asset may exceed its recoverable amount. Impairment testing is described in more detail below (see the policy *Impairment of assets*).

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. Gains and losses arising from the derecognition of items of property, plant and equipment are recognised in profit or loss, in other income and other expenses respectively, in the period in which the item is derecognised.

Items of property, plant and equipment that are available for immediate sale and whose sale within the next 12 months is highly probable, are reclassified to non-current assets held for sale. Non-current assets held for sale are presented separately from other assets in the statement of financial position and their depreciation is discontinued. A non-current asset held for sale is measured at the lower of its carrying amount and fair value less costs to sell.

Intangible assets

An intangible asset is recognised when it is controlled by the Group, future economic benefits from the asset are expected to flow to the Group and its cost can be measured reliably. Intangible assets comprise computer software that is not an integral part of the related hardware.

Intangible assets are initially measured at cost. Following initial recognition, intangible assets (except for intangible assets with an indefinite useful life) are measured at cost less any accumulated amortisation and any accumulated impairment losses.

The Group's intangible assets comprise assets with finite useful lives only. Intangible assets with finite useful lives are amortised on a straight-line basis over their estimated useful lives (generally three to six years). Amortisation expense is recognised in profit or loss for the period, in the expense category consistent with the function of the underlying asset. The amortisation periods and amortisation methods of intangible assets with a finite useful life are reviewed at each financial year-end. Changes in the expected useful life of an asset and the pattern in which the asset's future economic benefits are expected to be consumed are accounted for as changes in accounting estimates and are applied prospectively.

Impairment of assets

Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate.

All impairment losses are recognised in profit or loss. If an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognised, the previously recognised impairment loss is reversed. For financial assets measured at amortised cost, the reversal is recognised as a reduction of expenses for the period.

Non-financial assets

The carrying amounts of non-financial assets (except investment properties, inventories and deferred tax assets) are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. The recoverable amounts of goodwill and intangible assets that have indefinite useful lives or are not yet available for use are estimated at each reporting date.

The recoverable amount of an asset is the higher of the fair value of the asset or its cash-generating unit less costs to sell and value in use. In measuring 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.

For the purpose of impairment testing, assets are grouped into the smallest identifiable groups that generate cash inflows that are largely independent of the cash inflows from other assets or asset groups (cash-generating units). For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units that is expected to benefit from the synergies of the combination.

An impairment loss is recognised when the carrying amount of an asset or a cash-generating unit exceeds the recoverable amount of that asset or cash-generating unit. Impairment losses are recognised in profit or loss in the period in which they are incurred. The impairment loss on a cash-generating unit is allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and then to other assets of the unit pro rata on the basis of the carrying amount of each unit (group of units).

Financial liabilities

Financial liabilities (trade and other payables, loans and borrowings and accrued expenses) are initially recognised at their fair value less any transaction costs directly attributable to their acquisition except for financial liabilities acquired for resale, which are recognised at their fair value. After initial recognition, financial liabilities are measured at amortised cost using the effective interest rate method.

Interest expenses on financial liabilities are recognised in finance expenses on an accrual basis except that interest expenses on financing the development of assets (real estate projects carried as inventories, investment properties, and items of property, plant and equipment) are capitalised and added to the carrying amount of the asset as borrowing costs.

A financial liability is classified as current when it is due to be settled within 12 months after the reporting date or the Group does not have an unconditional right to defer settlement of the liability for more than 12 months after the reporting date. Financial liabilities which are due to be settled within 12 months after reporting date are classified as current even if an agreement to refinance on a long-term basis is completed after the reporting date and before the financial statements are authorised for issue. When a contract is breached on or before the reporting date with the effect that the liability becomes payable on demand, the liability is classified as current.

A financial liability is removed from the statement of financial position when it is discharged or cancelled or expires.

Employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under short-term cash bonus plans if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

Termination benefits are recognised as an expense when the Group is demonstrably committed, without a realistic possibility of withdrawal, to a detailed formal plan to either terminate employment before the normal retirement date or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense when the Group has made an offer of voluntary redundancy, it is probable that the offer will be accepted and the number of acceptances can be estimated reliably.

Provisions and contingent liabilities

A provision is recognised only when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

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

Present obligations arising from past events which according to management's judgement will not realise or cannot be measured reliably are also disclosed as contingent liabilities.

Leases

A lease that transfers substantially all the risks and rewards incidental to ownership of the leased asset to the lessee is classified as a finance lease. All other leases are classified as operating leases.

Finance leases related to assets acquired are recognised as assets and liabilities at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Assets acquired with finance lease are depreciated over the shorter of the lease term and the useful life of the asset. Assets leased out under a finance lease are recognised in the statement of financial position and are presented as a receivable at an amount equal to the net investment in the lease. Lease payments made are apportioned between finance expense and the reduction of the outstanding liability and lease payments received are apportioned between finance income and repayment of the principal. A constant periodic rate of interest is applied throughout the lease term.

Assets subject to operating leases are recognised in the lessor's statement of financial position. Operating lease payments received and made are recognised as income and expenses respectively on a straight-line basis over the lease term

Statutory capital reserve

According to the Estonian Commercial Code, the statutory capital reserve has to amount to at least 10% of the company's share capital. Accordingly, the Parent company transfers at least 5% of its net profit for the period to the capital reserve until the required level has been achieved. The capital reserve may not be distributed as dividends but it may be used for covering accumulated losses if the latter cannot be covered with unrestricted equity, and for increasing share capital through a bonus issue.

Finance income and expenses

The Group's finance income comprises of interest income (mainly interest income on loans granted and term deposits with commercial banks), gains on sale of investments in subsidiaries and joint ventures and gains on sale of other investments.

Interest income is recognised on an accrual basis using the effective interest rate method. Dividend income is recognised when the right to receive payment is established.

The Group's finance expenses include mainly interest expense on loans received and losses on sale of investments in subsidiaries and joint ventures.

Borrowing costs that are not directly related to real estate development (and which are not capitalised and added to the cost of assets under development) are recognised on an accrual basis using the effective interest rate method.

Income tax

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

Parent company and subsidiaries registered in Estonia

Pursuant to the Estonian Income Tax Act, companies do not have to pay income tax on their earnings (profit for the period). Instead, income tax is levied on profit distributions (dividends). The amount of tax payable is calculated as 21/79 of the amount distributed as the net dividend. The income tax payable on a dividend distribution is recognised as the income tax expense of the period in which the dividends are declared (the payment obligation arises).

Because of the specific nature of the taxation system, deferred income tax liabilities and assets do not arise for companies registered in Estonia. The contingent tax liability that might be incurred on the distribution of the entire retained earnings as dividends is not recognised in the statement of financial position. Instead, the income tax liability which would arise if all of the unrestricted equity were distributed as dividends has been disclosed in note 30.

Latvian, Lithuanian and Bulgarian subsidiaries

In Latvia, Lithuania and Bulgaria the profit earned by companies is subject to income tax. The tax rate in Latvia and Lithuania is 15% and in Bulgaria 10% of taxable income. Taxable income is identified by adjusting profit before tax for the temporary and permanent differences permitted by the local tax laws.

In the case of foreign subsidiaries, deferred income tax assets and deferred income tax liabilities are recognised for all temporary differences between the carrying amounts and tax bases of assets and liabilities. A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Investments in subsidiaries and joint ventures in the Parent's unconsolidated financial statements presented in accordance with the Estonian Accounting Act

The Parent's unconsolidated primary financial statements (note 34) represent supplementary information which is presented in accordance with the Estonian Accounting Act and they do not constitute separate financial statements as defined in IAS 27.

In the Parent's unconsolidated primary financial statements, investments in subsidiaries and joint ventures are measured using the cost method whereby an investment is initially recognised at cost, i.e. at the fair value of the consideration paid for it on acquisition and after initial recognition it is carried at cost less any impairment losses.

Investments are tested for impairment by measuring their recoverable amounts whenever there is any indication of impairment or at least as at the reporting date (see accounting policy *Impairment of assets*). Impairment losses are recognised within finance expenses.

Dividends received and receivable from subsidiaries and joint ventures are recognised within finance income when the right to receive payment has been established. The dividends distributed from the retained earnings accumulated by a subsidiary or joint venture before the date of acquisition are not recognised as income. Instead, such dividends are recognised as a reduction of the investment.

5 Segment reporting – business segments

The Group is organised into the following business segments:

Service – real estate services: real estate brokerage, valuation, management and short-term investment in real estate.

Development – real estate development: development of residential and commercial environments and long-term investment in real estate.

Construction – general and sub-contracting and construction supervision in the field of building construction and civil and environmental engineering.

Inter-segment transactions are conducted at market prices and priced on the same basis as transactions with external counterparties. A significant proportion of inter-segment transactions is generated by the Service segment that sells real estate brokerage services to the Development segment. Brokerage fees range from 2.5% to 5% and in the case of major transactions and public procurements from 1% to 1.5% of the cost of the brokered property across all geographical markets.

Segment	Service		Development		Construction		Unallocated items		Eliminations		Consolidated	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
EUR, thousands												
External revenue ¹	22,941	10,917	2,086	1,605	18,102	8,604	3	7	0	0	43,132	21,133
<i>Change</i>	110%	50%	30%	-19%	110%	-43%					104%	-14%
Inter-segment revenue	73	101	318	291	0	56	0	0	-391	-448	0	0
Total revenue	23,014	11,018	2,404	1,896	18,102	8,660	3	7	-391	-448	43,132	21,133
Operating profit/loss	2,262	1,494	140	-358	-2,859	-518	-1,348	-1,234	313	487	-1,492	-129
<i>Of which inventory write-downs and reversals of inventory write-downs, net (note 8)</i>	-1,214	1,397	0	0	0	0	0	0	0	0	-1,214	1,397
<i>Changes in the value of investment properties, net (note 21)</i>	2,998	-1,639	0	-72	0	0	0	0	0	0	2,998	-1,711

¹ The Development segment's revenue for 2011 includes revenue of 8,309 thousand euros earned on the sale of inventory to the Group's joint venture Tivoli Arendus OÜ on 18 March 2011. Excluding that transaction, the Development segment's revenue for 2011 would have been 34% larger than the corresponding figure for 2010. Another major transaction conducted by the Development segment was a block apartment sale transaction of 3,542 thousand euros, which was effected in the fourth quarter.

Segment	Service		Development		Construction		Unallocated assets and liabilities		Consolidated	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
EUR, thousands										
Assets	405	598	52,588	61,752	5,460	2,935	1,560	5,298	60,013	70,583
Liabilities	281	320	29,716	37,901	5,932	2,039	101	2,495	36,030	42,755

6 Geographical information

Revenue by country of origin	2011	2010
EUR, thousands		
Estonia	34,750	16,433
Bulgaria	6,424	2,079
Latvia	1,958	2,621
Total revenue	43,132	21,133

Properties (real estate) by location ¹	2011	2010
EUR, thousands		
Bulgaria	27,498	28,414
Estonia	11,100	23,218
Latvia	6,271	6,768
Lithuania	575	575
Total properties	45,444	58,975

¹ Comprises properties held for sale in the category of inventories, investment properties, and land and buildings classified as property, plant and equipment (notes 18, 21 and 22).

7 Changes in the structure of Arco Vara group

7.1 Scope of consolidation and summary of changes in the Group's ownership interests

At 31 December 2011, Arco Vara group comprised 28 consolidated entities (31 December 2010: 27): 15 in Estonia (31 December 2010: 15), 5 in Latvia (31 December 2010: 4), 2 in Lithuania (31 December 2010: 2), 1 in Ukraine (31 December 2010: 1), 4 in Bulgaria (31 December 2010: 4) and 1 in Romania (31 December 2010: 1). In addition, at 31 December 2011 the Group had investments in 5 joint ventures and 1 associate (31 December 2010: 5 joint ventures). Two joint ventures are domiciled in Estonia, 3 joint ventures and 1 associate are domiciled in Latvia.

In 2011 the number of consolidated entities increased by one as the Group disposed of two subsidiaries (note 7.3) and established three subsidiaries (one of them was subsequently sold, see note 7.5). The Group's interest in one subsidiary decreased from 100% to 50% as a result of which the subsidiary became an investment in a joint venture (see note 7.3). In addition, the Group reduced its interest in three subsidiaries (note 7.4) and increased its interest in a joint venture from 50% to 100% as a result of which the latter became a subsidiary (note 7.2). The Group also acquired an investment in an associate (note 7.4).

The structure of Arco Vara Group is presented in note 33.

7.2 Acquisition of a subsidiary

On 27 May 2011, Arco Vara Kinnisvarabüroo AS increased its interest in Koduküla OÜ from 50% to 100%. The additional stake was acquired for 1 euro. The effect on the Group's assets and liabilities of 464 thousand euros has been recognised within equity, as a reduction of retained earnings, because the transaction may be regarded as a transaction between entities under common control.

Effect of the acquisition on the Group's assets and liabilities	
EUR, thousands	
Increase in other current assets	9
Increase in inventories	360
Increase in investment property (note 21)	55
Increase in short-term loans and borrowings	-952
Release of provisions (note 26)	64
Total effect on the Group's assets and liabilities	-464

7.3 Disposals of subsidiaries

On 18 March 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, sold 50% of its stake in Tivoli Arendus OÜ. As a result of the transaction, the interest of Arco Investeeringute AS in Tivoli Arendus OÜ decreased from 100% to 50%. Following the transaction, the investment in Tivoli Arendus OÜ is accounted for as an investment in a joint venture. The transaction was conducted at the nominal value of the shares, which was 1,278 euros.

On 15 June 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, sold its 100% interest in Alasniidu LA OÜ for 361 thousand euros. In addition, the buyer paid 530 thousand euros for the Group's receivables from Alasniidu LA OÜ. The transaction resulted in sales gain of 275 thousand euros.

On 15 September 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, divested its investment in Lilletee LA OÜ. The total value of the transaction was 68 thousand euros including 65 thousand euros paid for the Group's receivables from Lilletee LA OÜ.

Effect of disposals of subsidiaries on the Group's assets and liabilities		
	2011	2010
EUR, thousands		
Cash and cash equivalents	-156	-6
Inventories	-575	0
Other current assets	-176	-7
Investment property (note 21)	-1,650	-1,292
Other short-term payables	-8	-8
Long-term loans and borrowings	-1,862	0

7.4 Changes in the Group's ownership interests

On 7 February 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, sold 29.99% of its interest in the Latvian subsidiary Arco Development SIA to SL Development SIA, which has a related party relationship with the Group. The sales price of the shares was 104 euros.

On 29 November 2011, in connection with the increase of the share capital of Arco Real Estate SIA that is a subsidiary of Arco Real Estate AS (a wholly-owned subsidiary of Arco Vara AS), Arco Real Estate AS's interest in the subsidiary decreased from 80% to 78.5%. The transaction also lowered the Group's interest in Arco Real Estate SIA's subsidiary Adepto SIA from 80% to 78.5%.

On 21 December 2011, Arco Real Estate SIA that is a subsidiary of Arco Real Estate AS (a wholly-owned subsidiary of Arco Vara AS) acquired a 40% stake in Arco Property Management SIA. The entity is a Latvian property management company whose other shareholder is Viktors Savins who has a related party relationship with Arco Vara AS.

7.5 Establishment of subsidiaries

On 26 April 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established Fineprojekti OÜ, a wholly-owned subsidiary with a share capital of 2,500 euros.

On 5 July 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established a wholly-owned subsidiary, SIA Mārsili II, with a share capital of 1,524 thousand euros (1,071 thousand Latvian lats). The subsidiary's share capital was paid in with a non-monetary contribution consisting of the plots of the Baltezers 5 project that belonged to Arco Investeeringute AS. The transaction did not have a significant impact on the Group's operations.

On 29 July 2011, Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, established a 70% subsidiary, Prime Capital SIA, whose share capital is 3 thousand euros (2 thousand Latvian lats). On 25 August 2011, Arco Investeeringute AS transferred its 70% stake in Prime Capital SIA to a related party, Dreilīņi-Uibroka-1 SIA, which is connected to Viktors Savins. The stake was transferred at its nominal value of 2 thousand euros (1,400 Latvian lats). The transactions did not have a significant impact on the Group's operations.

7.6 Changes in investments in joint ventures

In 2011 there were two changes in the Group's investments in joint ventures:

1) The Group divested of a 50% stake in the former subsidiary Tivoli Arendus OÜ by which the latter became a joint venture. See also note 7.3.

2) Kodukūla OÜ, in which the Group had a 50% interest and which was accounted for as an investment in a joint venture, became a subsidiary because the Group acquired the remaining 50% stake in it. See note 7.2.

The Group accounts for investments in joint ventures using the equity method. In 2011, the Group's share of loss of equity-accounted investees was 914 thousand euros. In 2010, the share of loss of equity-accounted investees was 181 thousand euros.

The list of joint ventures as at 31 December 2011 is provided in note 33.

Notes to the statement of comprehensive income

8 Cost of sales

	2011	2010
EUR, thousands		
Cost of construction services purchased	-20,330	-7,555
Cost of properties sold ¹	-18,095	-7,481
Personnel expenses	-2,042	-1,523
Inventory write-downs and reversals of inventory write-downs (note 18)	-1,214	1,397
Management and administration costs	-773	-768
Vehicle expenses	-203	-182
Depreciation, amortisation and impairment losses	-13	-11
Other costs	-120	-114
Total cost of sales	-42,790	-16,237

¹ Includes the acquisition cost of inventories sold to the Group's joint venture Tivoli Arendus OÜ on 18 March 2011 of 8,300 thousand euros.

9 Other income and other expenses

Other income	2011	2010
EUR, thousands		
Gains on fair value adjustments to investment property (note 21) ¹	2,998	429
Gains on sale of investment property	0	48
Gains on sale of property, plant and equipment	3	0
Release of provisions	0	1,043
Miscellaneous income	48	192
Total other income	3,049	1,712

Other expenses	2011	2010
EUR, thousands		
Losses on fair value adjustments to investment property (note 21)	0	-2,140
Losses on sale of investment property ²	-92	-70
Losses on write-down and disposal of property, plant and equipment	-28	-3
Late payment interest and penalty charges	-457	-75
Miscellaneous expenses	-57	-106
Total other expenses	-634	-2,394

¹ In 2011, gains on fair value adjustments to investment property resulted from the assets of the Madrid project in Bulgaria.

² In 2011, losses on fair value adjustments to investment property resulted from the sale of the Laeva 2 property in December 2011.

10 Distribution expenses

	2011	2010
EUR, thousands		
Advertising expenses	-199	-164
Corporate marketing expenses	-74	-23
Personnel expenses	-48	-67
Market research expenses	-22	-5
Brokerage fees	-3	-43
Total distribution expenses	-346	-302

11 Administrative expenses

	2011	2010
EUR, thousands		
Personnel expenses	-1,697	-1,911
Legal and consulting fees	-1,088	-807
Office expenses	-507	-554
Vehicle expenses	-168	-206
Depreciation, amortisation and impairment losses	-86	-124
Expenses from write-down of doubtful receivables	-131	-318
Other expenses	-226	-121
Total administrative expenses	-3,903	-4,041

12 Finance income and finance expenses

Finance income

	2011	2010
EUR, thousands		
Gain on sale of subsidiaries	285	230
Interest income	298	205
Foreign exchange gains	2	76
Income on other long-term investments	0	1,166
Other finance income	1	0
Total finance income	586	1,677

Finance expenses

	2011	2010
EUR, thousands		
Interest expense	-1,679	-1,367
Foreign exchange losses	-9	-9
Losses on sale of investments in joint ventures	0	-145
Other finance expenses	-123	-114
Total finance expenses	-1,811	-1,635

Interest expense consists mainly of interest expense on loans taken for acquiring and building real estate projects. Interest expense on loans taken for financing development projects in progress is capitalised. In 2011 capitalised interest expenses totalled 225 thousand euros (2010: 742 thousand euros).

13 Income tax

	2011	2010
EUR, thousands		
Income tax expense from Bulgarian subsidiaries	0	-26
Change in deferred income tax expense	250	0
Total income tax income/expense	250	-26

As at 31 December 2011 the Group's Bulgarian subsidiary recognised a deferred income tax asset of 250 thousand euros, which can be used against the income tax payable on the profit of subsequent years.

14 Earnings per share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary equity holders of the Parent by the weighted average number of ordinary shares outstanding during the period.

	2011	2010
Weighted average number of ordinary shares outstanding during the period	4,741,707	4,741,707
Net loss attributable to equity holders of the parent (EUR, thousands)	-3,371	-281
Earnings per share (EUR per share)	-0.71	-0.06

Diluted earnings per share are calculated by adjusting the profit or loss attributable to equity holders of the Parent and the weighted average number of shares outstanding for the effects of all dilutive potential ordinary shares. At the reporting date the Group did not have any dilutive potential ordinary shares. Therefore, diluted earnings per share equalled basic earnings per share.

15 Operating lease expenses

In the reporting period the Group leased office premises, vehicles and office equipment under operating leases.

Operating lease expenses on	2011	2010
EUR, thousands		
Premises	161	140
Vehicles	128	158
Office equipment	41	52
Total	330	350

Future minimum lease rentals payable under non-cancellable operating leases are as follows:

Future operating lease rentals payable	2011	2010
As at 31 December		
EUR, thousands		
No later than 1 year	191	146
Later than 1 year and no later than 5 years	493	28
Later than 5 years	356	0
Total	1,040	174

Notes to the statement of financial position

16 Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and cash in the Group's bank accounts. In accordance with IAS 7 *Statement of Cash Flows*, the Group recognises within cash and cash equivalents also demand deposits and term deposits with a maturity of up to three months.

As at 31 December	2011	2010
EUR, thousands		
Cash on hand and demand deposits	1,915	879
Term deposits	294	3,330
Total cash and cash equivalents	2,209	4,209

At 31 December 2011, the interest rates of term deposits ranged from 1.85% to 4.3% (31 December 2010: 0.66% to 7.5%) per year. In addition to deposits that qualified for recognition as cash and cash equivalents, at 31 December 2011 the Group had deposits of 65 thousand euros that were reported as other short-term receivables and other long-term receivables (see note 17).

Out of the year-end cash and cash equivalents balance 1,579 thousand euros (31 December 2010: 455 thousand euros) was in accounts with a designated purpose limited to the cash flows of specific projects (mostly receipts from customers and loan and interest payments to banks). See note 29.

17 Trade and other receivables

Short-term trade and other receivables

As at 31 December	2011	2010
EUR, thousands		
Trade receivables		
Receivables from customers	4,874	2,320
Allowance for doubtful trade receivables	-130	-320
Total trade receivables	4,744	2,000
Other receivables		
Loans granted	634	1,753
Miscellaneous receivables	517	659
Total other receivables	1,151	2,412
Accrued income		
Accrued interest	200	198
Due from customers under long-term construction contracts (note 25)	425	429
Prepaid and recoverable taxes	491	548
Other accrued income	1	173
Total accrued income	1,117	1,348
Total short-term trade and other receivables	7,012	5,760

Long-term trade and other receivables

As at 31 December	2011	2010
EUR, thousands		
Loans granted ¹	2,981	1
Long-term interest receivables	17	0
Other long-term receivables	60	75
Total long-term trade and other receivables	3,058	76

¹ Includes a long-term loan of 2,876 thousand euros given to the Group's joint venture Tivoli Arendus OÜ on the sale of the Tivoli project inventory to Tivoli Arendus OÜ in March 2011.

Allowance for doubtful trade receivables

	2011	2010
EUR, thousands		
Balance at beginning of year	-320	-190
Receivables considered doubtful during the year	-64	-224
Receivables considered irrecoverable during the year	254	91
Recovery of receivables previously classified as doubtful	0	3
Balance at end of year	-130	-320

18 Inventories

As at 31 December	2011	2010
EUR, thousands		
Properties purchased and being developed for resale	20,604	35,486
Materials and finished goods	155	32
Prepayments for inventories	805	0
Total inventories	21,564	35,518

In 2011 the net realisable values of some inventories decreased below their carrying amount. As a result, the Group wrote inventories down by 1,412 thousand euros (2010: 280 thousand euros). During the year the Group reversed prior period inventory write-downs of 198 thousand euros (2010: 1,677 thousand euros). See also note 8.

For information on inventories pledged as loan collateral, see note 29.

For the most important properties classified as inventories, a valuation report was commissioned from an independent real estate appraiser. At 31 December 2011, the carrying amount of inventories tested for impairment using the discounted cash flow method and measured at net realisable value was 19,772 thousand euros. The corresponding figure for 2010 was 34,028 thousand euros. In 2011, the discount rates applied in the analysis fell between 9% and 12% and in 2010 between 11% and 13%.

At 31 December 2011, the sensitivity of the carrying amount of inventories tested for impairment using the discounted cash flow method to the key valuation assumptions applied was as follows:

- a 1 percentage point increase, on average, in the discount rate would have caused a decrease of 417 thousand euros in the net realisable value of inventories (31 December 2010: 1,280 thousand euros);
- a 1 percentage point decrease, on average, in the discount rate would have caused an increase of 429 thousand euros in the net realisable value of inventories (31 December 2010: 1,360 thousand euros);
- a 5% decrease, on average, in the forecasted sales price of apartments/plots would have caused a decrease of 1,442 thousand euros in the net realisable value of inventories (31 December 2010: 3,848 thousand euros);
- a 5% increase on average, in the forecasted sales price of apartments/plots would have caused an increase of 1,442 thousand euros in the net realisable value of inventories (31 December 2010: 3,848 thousand euros).

19 Non-current assets held for sale

At 31 December 2011, the Group classified as held for sale a property located at Odra 16 in Tallinn. Previously part of the property was classified as an item of property, plant and equipment with a carrying amount of 160 thousand euros (note 22) and part of it was classified as an investment property of 309 thousand euros (note 21). The property was sold in January 2012.

20 Other investments

As at 31 December	EUR	
	2011	2010
EUR, thousands		
Long-term investments in equities – measured at cost ¹	8	995
Total other investments	8	995

¹ Long-term investments in equities consisted, for the most part, of a 12.5% investment in Floriston Group OÜ (value at 31 December 2010: 986 thousand euros). In December 2011 the interest was transferred to EPRI Invest OÜ (see note 30).

21 Investment property

Investment properties comprise commercial buildings that have been leased out and properties that have development potential but whose future use is still uncertain.

EUR, thousands	
Balance at 31 December 2009	14,005
Acquisitions	1,793
Reclassification from inventories	11,833
Sales	-1,568
Reclassification to property, plant and equipment (note 22)	-173
Disposals through disposal of subsidiaries (note 7)	-1,292
Net loss on changes in fair value (note 9)	-1,711
Balance at 31 December 2010	22,887
Acquisitions	640
Additions through acquisition of subsidiaries (note 7)	55
Capitalised development costs	1,047
Net gain on changes in fair value (note 9)	2,998
Reclassification from inventories	501
Sales	-1,739
Disposals through disposal of subsidiaries (note 7)	-1,650
Reclassification to non-current assets held for sale (note 19)	-309
Reclassification to property, plant and equipment (note 22)	-384
Balance at 31 December 2011	24,046

For information on investment properties pledged as loan collateral, see note 29.

At 31 December 2011, the carrying amount of investment properties measured to fair value and tested for impairment using the discounted cash flow method was 21,822 thousand euros (31 December 2010: 17,263 thousand euros).

In measuring the fair value of properties generating rental cash flow, the following assumptions were applied:

%	2011	2010
Growth in rental income per year	0-3	0-3
Growth in property management expenses per year	0-3	0-3
Vacancy rate of premises leased out	0-10	0-20
Discount rate	9-15	9-15

At 31 December 2011, the sensitivity of the carrying amount of investment properties measured using the discounted cash flow method to the key valuation assumptions applied was as follows:

- a 1 percentage point increase, on average, in the discount rate would have caused a decrease of 839 thousand euros in the fair value of investment property (31 December 2010: 1,368 thousand euros);
- a 1 percentage point decrease, on average, in the discount rate would have caused an increase of 860 thousand euros in the fair value of investment property (31 December 2010: 1,473 thousand euros);
- a 5% decrease, on average, in the forecasted net operating cash flows would have caused a decrease of 1,037 thousand euros in the fair value of investment property (31 December 2010: 1,039 thousand euros);
- a 5% increase, on average, in the forecasted net operating cash flows would have caused an increase of 1,038 thousand euros in the fair value of investment property (31 December 2010: 1,040 thousand euros).

Operating leases: the Group as a lessor

In 2011 the Group's rental income on investment properties amounted to 1,667 thousand euros (2010: 1,197 thousand euros). Direct property management expenses totalled 423 thousand euros (2010: 412 thousand euros).

As at 31 December 2011, future operating lease rentals receivable under non-cancellable contracts were as follows:

As at 31 December	2011	2010
EUR, thousands		
No later than 1 year	395	1,477
Later than 1 year and no later than 5 years	708	3,448
Later than 5 years	564	2,053
Total	1,667	6,978

22 Property, plant and equipment

	Land and buildings	Plant and equipment	Other items of property, plant and equipment	Assets under construction and prepayments	Total property, plant and equipment
EUR, thousands					
Carrying amount at 31 December 2009	534	68	59	13	674
<i>Of which cost</i>	940	274	398	13	1,625
<i>Of which accumulated depreciation</i>	-406	-206	-339	0	-951
Additions	0	20	7	0	27
Disposals	0	-2	-2	0	-4
Reclassification from investment property (note 21)	173	0	0	0	173
Reclassification to inventories	-74	0	0	0	-74
Reclassification within property, plant and equipment	0	-23	23	0	0
Depreciation for the year	-31	-22	-37	-3	-93
Carrying amount at 31 December 2010	602	41	50	10	703
<i>Of which cost</i>	1,039	268	418	10	1,735
<i>Of which accumulated depreciation</i>	-437	-227	-368	0	-1,032
Additions	6	12	81	0	99
Disposals	0	0	-3	-1	-4
Reclassification from investment property (note 21)	384	0	0	0	384
Reclassification to non-current assets held for sale (note 19)	-160	0	0	0	-160
Depreciation for the year	-38	-22	-28	0	-88
Carrying amount at 31 December 2011	794	31	100	9	934
<i>Of which cost</i>	1,247	221	485	9	1,962
<i>Of which accumulated depreciation</i>	-453	-190	-385	0	-1,028

For information on items of property, plant and equipment pledged as loan collateral, see note 29.

23 Loans and borrowings

Loans and borrowings comprise the following items:

As at 31 December	2011			2010		
	Total	Of which current portion	Of which non-current portion	Total	Of which current portion	Of which non-current portion
EUR, thousands						
Bank loans	22,019	7,381	14,638	29,235	26,775	2,460
Finance lease liabilities	49	12	37	45	12	33
Other loans	2,269	2,269	0	1,701	339	1,362
Total	24,337	9,662	14,675	30,981	27,126	3,855

At 31 December 2011 the weighted average interest rate of the Group's loans and borrowings was 7.41% (31 December 2010: 6.38%) per year.

At 31 December 2011 other loans included loans from related parties of 411 thousand euros (31 December 2010: 290 thousand euros). For further information on related parties, see note 31.

Amounts, interest rates and maturity dates of individually significant loans:

As at 31 December	Maturity date (month/year)	Loan amount in EUR, thousands		Interest rate, %		Type of interest
		2011	2010	2011	2010	
Bank loan, development	6/2015	13,455	15,216	7.9	7.5	3M Euribor
Bank loan, development ¹	12/2013	3,793	2,193	7.9	7.5	3M Euribor
Bank loan, cash flow	4/2012	2,200	1,523	8	4.7	Fixed
Other loan, development	2/2013	1,304	1,362	6.5	6.5	Fixed
Bank loan, development	1/2013	761	1,632	5.1	4.5	3M Euribor
Bank loan, cash flow	8/2021	663	560	7.8	5.1	6M Euribor
Other loan, working capital	1/2012	553	-	8	-	Fixed
Other loan, working capital	3/2013	408	285	5	5	Fixed
Bank loan, development	10/2014	400	-	7.7	-	6M Euribor
Bank loan, acquisition of land	12/2012	350	350	5.2	4.8	3M Euribor
Bank loan, acquisition of land	11/2012	343	-	6.2	-	6M Euribor
Bank loan, working capital ²	2/2013	54	265	10	10	Fixed

¹ As at 31 December 2011 the subsidiary that had received the loan was not in compliance with all the loan covenants. The loan was repaid in full in the first quarter of 2012. See also note 32.

² The base currency of the loan is the Bulgarian lev (BGN). The base currency of the rest of the loans is the euro.

Information on the contractual maturities of the Group's loans and borrowings is presented in note 28. Information on assets pledged as loan collateral is presented in note 29.

24 Trade and other payables

Current trade and other payables

As at 31 December	2011	2010
EUR, thousands		
Trade payables	6,040	2,412
Miscellaneous payables	103	1,180
Taxes payable		
Value added tax	143	66
Corporate income tax	210	157
Personal income tax	68	61
Social security tax	106	103

Other taxes	13	10
Total taxes payable	540	397
Accrued expenses		
Interest payable	3	127
Payables to employees	256	281
Accrued expenses from service contracts	649	293
Other accruals	144	123
Total accrued expenses	1,052	824
Total current trade and other payables	7,735	4,813

Non-current trade and other payables

As at 31 December	2011	2010
EUR, thousands		
Interest payable	35	4
Retentions and deposits received	65	79
Other non-current payables ¹	641	641
Total non-current trade and other payables	741	724

¹ Includes an item of 639 thousand euros payable for an investment property acquired in 2010. The maturity date of the payable is November 2012 but the Group has an unconditional right to defer settlement for one year.

25 Deferred income

As at 31 December	2011	2010
EUR, thousands		
Advances received in connection with sale of real estate	1,596	4,604
Deferred income from long-term service contracts	305	225
Other deferred income	111	30
Total deferred income	2,012	4,859

Amounts due from and amounts due to customers under long-term construction contracts

As at 31 December	2011	2010
EUR, thousands		
Costs under the stage of completion method	5,963	9,693
Estimated gross profit of projects	588	68
Revenue under the stage of completion method	6,551	9,761
Progress billings	6,431	9,557
Difference between progress billings and revenue recognised under the stage of completion method	120	204
Due from customers (note 17)	425	429
Due to customers	-305	-225

26 Provisions

	Warranties provisions ¹	Other provisions related to operating activities ²	Total provisions
EUR, thousands			
Provisions at 31 December 2009	803	2,052	2,855
<i>Of which non-current portion</i>	<i>0</i>	<i>70</i>	<i>70</i>
Provisions utilised and released	-731	-1,029	-1,760
Provisions created	283	0	283
Provisions at 31 December 2010	355	1,023	1,378
Provisions utilised and released	-287	-64	-351
Provisions created	178	0	178
Provisions at 31 December 2011	246	959	1,205

¹ The warranties provisions of the subsidiary Arco Ehitus OÜ are recognised based on management's best estimates, i.e. by reference to the terms and conditions of each construction contract (whether the Group acts as a general contractor or uses own labour, who the subcontractors are, how complicated the project is, where the project is performed, etc). A provision amounts to up to 1% of the cost of the contract. Warranties provisions are recognised for covering the costs which may be incurred during the warranty period. A warranty period lasts for two years from the delivery of work performed. At 31 December 2011 the subsidiary's warranties provisions totalled 190 thousand euros (31 December 2010: 123 thousand euros).

The Group's Bulgarian development company has also created a builder's warranty provision. At 31 December 2011 the provision amounted to 56 thousand euros (31 December 2010: 232 thousand euros).

² At 31 December 2011 other provisions related to operating activities of 959 thousand euros consisted of a provision made for the surety commitment assumed by the Group on securing a bank loan taken by a joint venture. The provision amounts to 50% of the total surety commitment (see note 30).

In 2011 the Group released provisions of 64 thousand euros because a former joint venture, Koduküla OÜ, became a subsidiary (see note 7).

27 Share capital

As at 31 December	2011	2010
Number of issued shares fully paid up	4,741,707	4,741,707
Share capital (EUR, thousands)	3,319	3,030
Statutory capital reserve (EUR, thousands)	2,011	2,011

Based on the resolution of the annual general meeting of shareholders held on 12 May 2011, the par value of the shares in Arco Vara AS was increased through a bonus issue to 0.7 euros per share. The bonus issue was conducted using retained earnings. As a result, share capital grew by 288,632 euros to 3,319,195 euros. The change in the share capital of Arco Vara AS was registered in the Commercial Register on 31 August 2011. The transaction was undertaken to convert the par value of the company's shares from Estonian kroons into euros.

The company's articles of association have to set forth the size of share capital or the minimum and maximum amount of authorised share capital. In accordance with its articles of association, the company's minimum and maximum authorised share capital amount to 2,500 thousand euros and 10,000 thousand euros respectively. The company has issued registered ordinary shares of one class. The par value of a share is 70 cents and each share carries one vote. A share provides the holder with the right to participate in the company's general meetings, the allocation of the company's profit, and the distribution of remaining assets on the dissolution of the company as well as with other rights provided by law and the company's articles of association.

Under the Commercial Code of the Republic of Estonia, a limited company has to transfer to the capital reserve at least 5% of its profit for the period until the capital reserve amounts to at least 10% of its share capital. At 31 December 2011, the capital reserve of the Group's Parent was in compliance with the regulatory requirement, amounting to 61% of share capital.

28 Financial instruments and financial risk management

The Group's activities expose it to various financial risks: credit risk, liquidity risk and market risk.

The Group's overall risk management programme is based on the assumption that the financial markets are unpredictable and appropriate measures have to be adopted to minimise potential adverse impacts on the Group's financial activities. The Group may use derivative financial instruments to hedge certain risk exposures.

The Group's risk management process is based on the premise that the Group's success depends on constant monitoring, careful analysis and effective management of the risks faced by the Group. Centralised financial risk management is the responsibility of the Group's financial team. The main objective of financial risk management is to prevent any damage or financial loss that could jeopardise the Group's equity and ability to continue as a going concern. The Group designs and implements risk management policies and activities that are aimed at identifying and evaluating risks and spreading risks across time, activities and geographical areas. Risk management policies and activities are implemented by the managers of Group entities.

In managing its financial risks, the Group's main focus is on monitoring the risk exposures of the Development segment because a significant proportion of the Group's liquidity and interest rate risks are concentrated in one segment, the Development segment, and in two geographical areas, Estonia and Bulgaria. The main reasons are the extensive capital needs of development operations and the fact that several major investment projects may fall in the same time period.

Financial instruments by category

As at 31 December	2011	2010
EUR, thousands		
Cash and cash equivalents (note 16)	2,209	4,209
<i>Cash and cash equivalents</i>	<i>2,209</i>	<i>4,209</i>
Receivables	9,579	5,288
<i>Loans and receivables</i>	<i>9,579</i>	<i>5,288</i>
Other investments (note 19)	8	995
<i>Available-for-sale financial assets</i>	<i>8</i>	<i>995</i>
Total financial assets	11,796	10,492
Loans and borrowings (note 23)	24,337	30,981
<i>Financial liabilities measured at amortised cost</i>	<i>24,337</i>	<i>30,981</i>
Trade and other payables (including provisions)	9,141	6,518
<i>Financial liabilities measured at amortised cost</i>	<i>9,141</i>	<i>6,518</i>
Total financial liabilities	33,478	37,499

Income and expenses and gains and losses on financial instruments by category are as follows:

	2011			
	Loans and receivables	Assets at fair value through profit or loss	Financial liabilities measured at amortised cost	Total
EUR, thousands				
Interest income (note 12)	298	0	0	298
Interest expense (note 12)	0	0	-1,679	-1,679
Net result	298	0	-1,679	-1,381

	2010			
	Loans and receivables	Assets at fair value through profit or loss	Financial liabilities measured at amortised cost	Total
EUR, thousands				
Interest income (note 12)	205	0	0	205
Interest expense (note 12)	0	0	-1,367	-1,367
Gains and losses on other long-term investments (note 12)	1,166	0	0	1,166
Net result	1,371	0	-1,367	4

Credit risk

Credit risk is the risk that the other party to a financial instrument will cause a financial loss to the Group by failing to discharge an obligation. The Group's credit risk exposures result from cash placed in bank deposits and trade and other receivables.

The Group's cash and cash equivalents are held at different banks, which reduces the risk associated with deposits. The free funds of the Group's Estonian entities are deposited with the largest banks operating in Estonia, which are owned by large Finnish, Swedish and Danish banking groups whose credit rating according to Moody's is at least A2. For further information on cash and cash equivalents, see note 16.

Credit risk is managed by making sure that there are no major concentrations of credit risk. Group entities prevent and minimize credit risk by monitoring and managing customers' settlement behaviour on a daily basis so that appropriate measures could be applied on a timely basis. In addition, sales and construction activities are partly financed with customer prepayments and in real estate transactions, where the counterparty is often financed by a credit institution, the Group cooperates with banks. Consequently, the Group considers the risks arising from customer insolvency to be, in all material respects, mitigated.

Allowances are made for potential losses. Potential losses are estimated based on historical experience, the counterparty's ability to meet existing obligations in the short term, and developments in the economic environment.

Group entities perform transactions only with counterparties who are considered creditworthy. As a rule, immediate payment is demanded. Credit is granted against additional collateral. Accordingly, management believes that the need for additional hedging of credit risk is minimal.

Ageing of receivables

The Group has receivables that are past due but have not been provided for. Management has estimated the value of such receivables on an individual basis and has determined that the items are recoverable.

The structure of the Group's past due receivables is as follows:

As at 31 December	2011	2010
EUR, thousands		
Past due up to 3 months	579	1 482
Past due 3 to 6 months	196	93
Past due 6 to 12 months	181	117
Past due over 12 months	753	308
Total past due trade receivables	1,709	2,000

In 2011 receivables were written down by 131 thousand euros (2010: 318 thousand euros).

Liquidity risk

Liquidity risk is the risk that a change in its financial position will cause the Group to encounter difficulty in meeting the obligations associated with its financial liabilities in a due and timely manner, or that the Group will be unable to realise its assets at market price and within the desired timeframe. Above all, the Group's liquidity is affected by the following factors:

- Group entities' ability to generate independent positive net operating cash flows and the volatility of those cash flows;
- mismatch in the maturities of assets and liabilities and flexibility in adjusting it;
- marketability of long-term assets;
- volume and pace of real estate development activities;
- financing structure.

Short-term liquidity management is based mainly on Group entities' continuously monitored quarterly cash flow forecasts. The purpose of short-term liquidity management is to guarantee the availability of sufficient highly liquid funds (i.e. cash and cash equivalents and highly liquid investments in financial instruments). The main tools for short-term liquidity management are the group account (the Group's cash pool), which pools the funds of Group entities, and, in the case of foreign Group entities, loans from the Parent.

Long-term liquidity is primarily influenced by investment decisions. The Group observes the principle that Group entities' net cash inflows from operating and investing activities have to cover the Group's cash outflows from financing activities. Accordingly, the purpose of long-term liquidity management is to ensure sufficient liquidity of the real estate investment portfolio, to harmonize the timing of cash flows from investing and financing activities, and determine the optimal financing structure. Long-term projects are monitored to ensure that the timing and amounts of investing cash flows do not differ significantly from the timing and amounts of financing cash flows. The following table illustrates the Group's exposure to refinancing risk.

Maturity structure of financial assets and financial liabilities

	As at 31 December 2011				Total
	3 months or less	3-12 months	1-5 years	More than 5 years	
EUR, thousands					
Cash and cash equivalents	2,209	0	0	0	2,209
Receivables	4,627	1,894	3,058	0	9,579
Other investments	0	0	8	0	8
Total assets	6,836	1,894	3,066	0	11,796
Loans and borrowings	3,627	7,453	16,534	440	28,054
Payables	6,697	1,038	741	0	8,476
Provisions	0	1,205	0	0	1,205
Total liabilities	10,324	9,696	17,275	440	37,735

	As at 31 December 2010				Total
	3 months or less	3-12 months	1-5 years	More than 5 years	
EUR, thousands					
Cash and cash equivalents	4,209	0	0	0	4,209
Receivables	2,030	3,730	76	0	5,836
Other investments	0	0	996	0	996
Total assets	6,239	3,730	1,072	0	11,041
Loans and borrowings	25,169	3,235	5,498	227	34,129
Payables	3,090	1,722	725	0	5,537
Provisions	0	1,378	0	0	1,378
Total liabilities	28,259	6,335	6,223	227	41,044

Based on the maturities of liabilities included in the Group's loan portfolio, at 31 December 2011 the average weighted maturity of loans and borrowings was 2.2 years (31 December 2010: 0.8 years). At 31 December 2011 the maturity structure of loans and borrowings was as follows:

EUR, thousands	
2012	9,662
2013	2,903
2014	940
2015	10,384
2016	65
2017 - ...	383
Total loans and borrowings (note 23)	24,337

Refinancing risk is managed by monitoring the liquidity position on a daily basis, analysing different financing options on an ongoing basis and involving partner banks from different countries already in the initial stage of the process.

Principal amounts of loans and borrowings falling due in 2012 total 9,662 thousand euros. Out of short-term loans and borrowings, 965 thousand euros is mainly made up of loans from related parties that can generally be extended without a problem. In addition, in the first quarter of 2012 Kerberon OÜ disposed of a right of superficies as a result of which the Group could repay a short-term bank loan of 2,200 thousand euros.

Out of short-term loans and borrowings, 5,744 thousand euros is made up of loans related to active development projects whose settlement is linked to sales transactions. Those loans do generally not require refinancing because their due dates are mostly linked to the completion dates of the projects.

Refinancing risk is higher in the case of loans taken for the purchase of land in projects where the commencement of development operations has been postponed. Such short-term loan liabilities total 693 thousand euros. The Group deals actively with minimising the refinancing risk of the loans by holding negotiations with various credit institutions and potential investors.

Market risk

Interest rate risk

Interest rate risk is the risk that a rise in market interest rates will increase interest expense to an extent that will have a significant impact on the Group's performance. Exposure to interest rate risk results from two factors:

- use of loans and borrowings with a floating interest rate, and;
- the need for refinancing in connection with the arrival of the due dates of liabilities or the raising of new loans in connection with the realisation of an investment plan in a situation where the volatility of financial markets is increasing and the economic environment is changing.

The Group's long-term loans and borrowings are linked to Euribor. Therefore, the Group is exposed to developments in the international financial markets. Interest rate risk is managed, among other things, by monitoring movements in the money market interest rate curve, which reflects the market participants' expectations of market interest rates and allows estimating a trend for euro-denominated interest rates. In 2011, 6 month Euribor rose by 0.4 percentage points (2010: +0.2 percentage points) but in the first quarter of 2012 it has already decreased by 0.8 percentage points.

The sensitivity analysis of the Group's profit before tax and cash flows for 2011, which was conducted based on the balance of loans and borrowings as at 31 December 2011, indicated that a 1 percentage point change (increase or decrease) in interest rates would have affected (increased or reduced) the Group's annual net cash flow by 199 thousand euros (2010: 316 thousand euros).

The sensitivity analysis of profit before tax indicated that a 1 percentage point change (increase or decrease) in interest rates would have affected (increased or reduced) profit before tax by 189 thousand euros (2010: 217 thousand euros).

In managing its short-term interest rate risks, the Group regularly compares potential losses from changes in interest rates against corresponding risk hedging expenses. To date, no financial instruments have been used to hedge short-term interest rate risks because according to management's assessment hedging expenses would exceed the losses that might be incurred from changes in interest rates.

The Group's interest-bearing financial assets and liabilities

By maturity	As at 31 December 2011				
	3 months or less	3-12 months	1-5 years	More than 5 years	Total
EUR, thousands					
Interest-bearing assets	18	634	3,026	0	3,678
Interest-bearing liabilities	3,209	6,453	14,292	383	24,337
Net exposure	-3,191	-5,819	-11,266	-383	-20,659

By maturity	As at 31 December 2010				
	3 months or less	3-12 months	1-5 years	More than 5 years	Total
EUR, thousands					
Interest-bearing assets	3,330	1,868	47	0	5,245
Interest-bearing liabilities	24,751	2,375	3,639	216	30,981
Net exposure	-21,421	-507	-3,592	-216	-25,736

Currency risk

Currency risks are mitigated by conducting most transactions and signing most agreements and contracts in euros or currencies pegged to the euro. The main currency risk is the risk that the local currency may be devalued against the euro. In view of the fact that the Group's liabilities are mainly euro-based and the main operations are conducted in countries where the local currency is the euro or currencies pegged to the euro (the largest deviation, 1% from the central rate, is permitted in the case of the Latvian lats), the Group's management considers currency risk to be insignificant. Currency risks arising from open positions are mitigated with euro-based transactions between countries and matching the maturities of receivables and payables in the country involved.

Capital management

The objective of capital management is to maintain a capital base which ensures the Group's continuous operation and development and to prevent risks which could jeopardise the Group's equity.

The Group finances its operations with both debt and equity capital. Property development is very capital intensive. Therefore, related investment projects are financed on the assumption that, as a rule, equity financing should amount to at least 30% of the cost of the project.

In designing the optimal financing structure and identifying and evaluating risks, the Group monitors its equity to assets ratio. At 31 December 2011, equity accounted for 40.0% (31 December 2010: 39.4%) of total assets.

Fair value of financial instruments

All financial assets and financial liabilities of Group entities are recognised in the Group's statement of financial position or disclosed as contingent assets and liabilities in the notes to the consolidated financial statements. Because of the accounting and reporting principles applied, the carrying amounts of the Group entities' financial assets and financial liabilities do not differ significantly from their fair values.

The fair values of assets and liabilities with a fixed interest rate are not significantly different from their carrying amounts because the fixed interest rate does not differ significantly from current market interest rates.

Other notes

29 Assets pledged as collateral

The Group has secured its loans and borrowings (see also note 23) by pledging the following assets:

As at 31 December	2011	2010
EUR, thousands		
Mortgages		
Real estate recognised within inventories (note 18)	19,942	33,591
Investment property (note 21)	19,468	18,079
Property, plant and equipment (note 22)	338	338
Total carrying value of real estate encumbered with mortgages	39,748	52,008
Other pledges		
Cash and cash equivalents (note 16)	1,579	455
Receivables (note 17)	198	360
Total carrying amount of assets encumbered with other pledges	1,777	815
Total carrying value of assets pledged as collateral	41,525	52,823

In addition, the entire assets of the Group's Bulgarian entity Arco Invest EOOD have been pledged to the lending bank. The pledge is a commercial pledge.

Share pledges

Arco Investeeringute AS, a wholly-owned subsidiary of Arco Vara AS, has pledged its 100% interest in the subsidiary Arco Invest EOOD to Piraeus bank. The shares have been pledged to secure investment loans of 17,248 thousand euros.

30 Contingent assets and liabilities

Contingent income tax liability on profit distributions

At 31 December 2011 the retained earnings of Arco Vara AS group amounted to 18,653 thousand euros (31 December 2010: 22,787 thousand euros). Upon the distribution of dividends to shareholders, there arises an income tax liability calculated as 21/79 of the amount of the net dividend distribution. The maximum contingent income tax liability that could arise upon the distribution of the entire retained earnings as dividends amounts to 3,917 thousand euros (31 December 2010: 4,785 thousand euros). The maximum contingent income tax liability has been calculated on the assumption that the net dividend and the associated dividend tax expense may not exceed distributable profit as at 31 December 2011.

Surety granted to joint venture Arco HCE OÜ

The Group's subsidiary Arco Investeeringute AS has agreed to stand surety for a bank loan of 1,917 thousand euros taken by the Group's joint venture Arco HCE OÜ. The Group's management board has estimated the probability of the realisation of the obligation and has made a provision extending to 50% of the surety obligation, i.e. 959 thousand euros (see note 26).

Action brought by Indrek Porila against Arco Vara AS

On 13 May 2010, Indrek Porila, a former employee of Arco Vara AS, brought an action against Arco Vara AS at Harju County Court, claiming settlement of a principal liability of 1,342,000 euros and associated late payment interest of 401,000 euros, i.e. 1,743,000 euros in aggregate. In addition, Indrek Porila claimed transfer of a 12.5% stake in Floriston Grupp OÜ that belonged to Arco Vara AS.

On 6 December 2011, Harju County Court approved a compromise agreement between Arco Vara AS, Indrek Porila and EPRI Invest OÜ under which Arco Vara AS undertook to satisfy the claim of Indrek Porila by transferring to EPRI Invest OÜ a stake in Floriston Grupp OÜ, which had a par value of 5,000 Estonian kroons (319.6 euros) and accounted for 12.5% of the entity's share capital. Indrek Porila is the sole shareholder and member of the management board of EPRI Invest OÜ.

The litigation ended with a compromise agreement which fully complied with the proposal made by Arco Vara before the commencement of the litigation.

Action brought by Arco Ehitus OÜ through the Ministry of Education and Research against the Republic of Estonia and action brought by the Republic of Estonia through the Ministry of Education and Research against Arco Ehitus OÜ

In 2010, Järvamaa Education Centre, a state-owned vocational educational institution administered by the Ministry of Education and Research, and Arco Ehitus OÜ (together with OÜ Kristiine Ehitus) signed general public procurement contract for the renovation of the Paide academic building of Järvamaa Education Centre (the Contract). Arco Ehitus OÜ presented to Järvamaa Education Centre a letter of guarantee of 88 thousand euros as required by the Contract. During construction, it appeared that the documents Järvamaa Education Centre had submitted to the contractor contained a number of deficiencies and Arco Ehitus OÜ and OÜ Kristiine Ehitus cancelled the contract. In response, Järvamaa Education Centre sent AS SEB Pank a letter of claim for payment of the guaranteed amount, i.e. 88 thousand euros.

In 2010, Arco Ehitus OÜ filed a statement of claim against the Republic of Estonia through the Ministry of Education and Research, seeking recognition of the cancellation of the Contract and settlement of a principal claim of 889 thousand euros and a fixed amount of late payment interest of 42 thousand euros plus further late payment interest accruing during the judicial proceedings.

In 2011, the Republic of Estonia brought a counter-action against Arco Ehitus OÜ, seeking payment of damages of 508 thousand euros, a contractual penalty of 4 thousand euros and late payment interest of 0.0266% per day from the filing of the counter-action until due satisfaction of the claims. Arco Ehitus OÜ has contested the claim.

The litigation is pending.

In the Group's statement of financial position, the amount of the letter of guarantee (88 thousand euros) is recognised within other short-term receivables. The Group considers it highly probable that the litigations will have a positive outcome.

Arco Ehitus OÜ cancelled the contract with the Estonian University of Life Sciences

In July 2010, a consortium consisting of Arco Ehitus OÜ, OÜ Wolmreks Ehitus and OÜ Kristiine Ehitus signed a general contract for construction services with the Estonian University of Life Sciences. The authorised representative of the consortium was OÜ Wolmreks Ehitus that was assigned by the consortium to perform the entire construction work. In November 2010 it appeared that OÜ Wolmreks Ehitus and OÜ Kristiine Ehitus were in financial difficulty and the work agreed with the Estonian University of Life Sciences had not been performed in line with the agreed dates and the construction schedule. Arco Ehitus OÜ became the lead partner and authorised representative of the consortium from December 2010. In February 2011, OÜ Wolmreks Ehitus was declared bankrupt and Arco Ehitus OÜ became solely responsible for the performance of the contract.

The price calculations for the contract with the Estonian University of Life Sciences were prepared by OÜ Wolmreks Ehitus. Since the preparation of the original bid, the prices of construction services had increased significantly and according to the new calculations prepared by Arco Ehitus OÜ the cost of the contract would have increased by 447 thousand euros. The Estonian University of Life Sciences refused to compensate the increase in the cost of the contract. Thus, in July 2011 Arco Ehitus OÜ sent a notice of cancellation of contract. The Estonian University of Life Sciences took the position that the notice of cancellation sent by Arco Ehitus OÜ was void and that the Estonian University of Life Sciences itself would cancel the general contract for construction services.

Arco Ehitus OÜ is of the opinion that the cancellation of the contract was completely lawful. To date the Estonian University of Life Sciences has not filed any claim against Arco Ehitus OÜ. Neither has it asked the court to determine the lawfulness of the cancellation.

Arco Ehitus OÜ's claims against AS K&H and AS Tamsalu Vesi

In June 2011, Arco Ehitus OÜ and AS K&H signed a compromise agreement by which AS K&H accepted the claims arising from two contracts between Arco Ehitus OÜ and AS K&H of 713 thousand euros in aggregate. The parties also agreed that Arco Ehitus OÜ had no additional or collateral claims against AS K&H. Under an agreement on the discharge and transfer of claim, AS K&H transferred to Arco Ehitus OÜ a claim of 201 thousand euros and associated collateral claims, which AS K&H had against AS Tamsalu Vesi.

In April 2011, AS K&H signed a real right contract by which it mortgaged some of its properties under a combined mortgage of 1,000,000 euros to Arco Ehitus OÜ.

In July 2011, Tartu County Court declared AS K&H bankrupt and Arco Ehitus OÜ submitted a statement of claim to the bankruptcy trustee in which it requested that the claim of Arco Ehitus OÜ should be recognised in the bankruptcy proceedings of AS K&H in an amount of 512 thousand euros.

After the reporting date, on 14 March 2012, an agreement was signed in the bankruptcy proceedings under which Arco Ehitus OÜ waived the mortgages and the bankruptcy trustee and the bankruptcy committee confirmed that there was no basis for retracting or otherwise contesting the contracts signed in June 2011 and that the transfer of claim to Arco Ehitus OÜ was valid and AS Tamsalu Vesi has to satisfy the claim in full.

Arco Ehitus OÜ has repeatedly sent AS Tamsalu Vesi AS proofs of claim for settlement of a claim of 181 thousand euros.

Bankruptcy proceedings are pending and Tamsalu Vesi AS has not settled its debt.

Merkton Ehitus OÜ's (bankrupt) claim against Arco Ehitus OÜ

In December 2011, the bankruptcy trustee of Merkton Ehitus OÜ (bankrupt) sent a claim to Arco Ehitus OÜ in which he demanded repayment of 986 thousand euros. The payments outlined in the claim were made to Arco Ehitus OÜ by Merkton Ehitus OÜ based on and for proper performance of a contract signed between Arco Ehitus OÜ and Merkton Ehitus OÜ.

After the reporting date, on 3 February 2012, Arco Ehitus OÜ sent a response to the bankruptcy trustee in which it took the position that the claim for returning the payments was baseless. The bankruptcy trustee has not responded nor has any action been brought against Arco Ehitus OÜ in this matter.

Arco Ehitus OÜ's claims against the bankrupt Wolmreks Ehitus OÜ, OÜ Kristiine Ehitus and Plastitehase AS

In 2011 three companies, OÜ Wolmreks Ehitus, OÜ Kristiine Ehitus and Plastitehase AS against which Group company Arco Ehitus OÜ had claims, were declared bankrupt. The total amount of claims submitted to the bankruptcy trustees is 334 thousand euros. Arco Ehitus OÜ has written all those receivables down in full. At the reporting date, the bankruptcy proceedings were pending.

31 Transactions with related parties

Related parties with whom transactions were conducted in 2011 or 2010 fall into the following categories:

- the Group's joint ventures;
- companies that have a significant interest in the Group's Parent company;
- the Group's key management personnel - the member of the management board and the members of the supervisory board of the Group's Parent company, and companies controlled by the key management personnel;
- Viktor Savins, who has significant minority interests in the Group's Latvian entities, and companies under his control.

	For year 2011 or as at 31 December 2011	For year 2010 or as at 31 December 2010
EUR, thousands		
Transactions and balances with joint ventures		
Revenue	8,311	3
Short-term loan receivables	0	1,029
Long-term loan receivables	2,981	0
Trade receivables	36	5
Short-term interest receivables	85	13
Long-term interest receivables	17	0
Transactions with companies that have a significant interest in the Group's Parent company		
Revenue	1	0
Short-term loan receivables	376	376
Short-term interest receivables	114	92
Transactions and balances with other related parties		
Revenue	13	427
Services purchased	304	154
Acquisition of investment properties	0	192
Trade receivables	0	15
Short-term loan receivables	233	182
Short-term interest receivables	84	75

Prepayments for inventories	445	0
Trade payables	12	7
Other payables	309	332
Short-term loans and borrowings	408	285
Short-term interest payables	3	2

Arco Vara AS decided to change the definition of key management personnel. From now on the Group's key management personnel are members of the management board and supervisory board of Arco Vara AS, because only those persons have real and significant authority to influence the operation of the Group. In 2011, the remuneration of the Group's key management personnel including relevant taxes amounted to 220 thousand euros (2010: 228 thousand euros). The remuneration of the member of the management board is paid in line with his service contract and the remuneration of the members of the supervisory board is based on a resolution adopted by the general meeting. In 2011 and 2010, the Group's key management personnel did not receive any other remuneration.

The information disclosed in the Group's annual report for 2010 regarding the Group's key management personnel was incomplete. Accordingly, we present a correction:

- In the annual reports of Arco Vara AS for 2009 and 2010 the definition of the Group's key management personnel was not correct. In the annual report for 2010 the Group defined as its key management personnel the member of the management board and the members of the supervisory board of the Group's Parent company as well as the members of the management boards of the Group's subsidiaries. Based on that definition, Arco Vara AS should have disclosed in the annual report for 2010 the total amount of remuneration provided to its key management personnel, i.e. the amount should have included the remuneration of the members of the management boards of the Group's subsidiaries.

- Based on the definition of key management personnel presented in the annual report for 2010, the remuneration of key management personnel including relevant taxes should have been 445 thousand euros for 2010 and 500 thousand euros for 2009.

- Arco Vara AS did not disclose in the annual report for 2010 that the remuneration of key management personnel included termination benefits with relevant taxes: 5 thousand euros for 2010 and 51 thousand euros for 2009.

- The remuneration of key management personnel disclosed in the annual report of Arco Vara AS for 2010 differs from the amount of the remuneration of key management personnel that ought to have been disclosed in line with the definition of key management personnel to the extent of the remuneration of the members of the management boards of the subsidiaries of Arco Vara AS.

32 Events after the reporting date

Extraordinary general meeting of Arco Vara AS

On 10 February 2012, there was an extraordinary general meeting of the shareholders of Arco Vara AS that resolved not to recall Ragnar Meitern, Aare Tark and Kalev Tanner from the supervisory board of Arco Vara AS.

Sale of the right of superficies on Kadaka tee 131

On 23 February 2012, OÜ Kerberon, a subsidiary of Arco Investeeringute AS (100% subsidiary of Arco Vara AS) concluded a contract with AS Astro Holding for selling the right of superficies on Kadaka tee 131 in Tallinn. The buyer settled the sales price of 3,400 thousand euros at the time of the transaction. As a result of the transaction, the Group incurred a loss of 695 thousand euros, the Group's assets decreased by 2,925 thousand euros and the Group's liabilities decreased by 2,230 thousand euros (including settlement of a bank loan of 2,200 thousand euros). The transaction will reduce the Group's annual revenue by approximately 500 thousand euros. The purpose of the sale was to improve the Group's liquidity and to reduce its interest-bearing liabilities.

Changes in the composition of the supervisory board of Arco Vara AS

On 30 March 2012, members of the supervisory board of Arco Vara AS Kalev Tanner and Ragnar Meitern submitted letters of resignation stating their intent to step down from the supervisory board. In connection with this, Toletum OÜ, which is controlled by the chairman of the supervisory board Richard Tomingas and represents 21.61% of the votes determined by shares, submitted an application for calling an extraordinary general meeting for appointing Stefan David Balkin and Toomas Tool as new members of the supervisory board. The general meeting that will discuss changes in the composition of the supervisory board will take place on 30 April 2012.

33 Structure of Arco Vara group

Company	Domicile	Group's ownership interest	
		31 December 2011	31 December 2010
%			
Service segment			
Subsidiaries			
Arco Real Estate EOOD ¹	Bulgaria	100	100
Arco Real Estate AS	Estonia	100	100
Arco Vara Kinnisvarabüroo ¹	Estonia	100	100
Adepto SIA ¹	Latvia	78.5	80
Arco Real Estate SIA ¹	Latvia	78.5	80

Company	Domicile	Group's ownership interest	
		31 December 2011	31 December 2010
%			
Development segment			
Subsidiaries			
Arco Invest EOOD ¹	Bulgaria	100	100
Arco Facility Management EOOD ¹	Bulgaria	100	100
Arco Project EOOD ¹	Bulgaria	100	100
Alasniidu LA OÜ ¹	Estonia	sold	100
Arco Investeeringute AS	Estonia	100	100
AIP Projekti OÜ ¹	Estonia	100	100
Arco Vara Ärikinnistute OÜ	Estonia	100	100
Fineprojekti OÜ ¹	Estonia	100	-
Kerberon OÜ ¹	Estonia	100	100
Koduküla OÜ ¹	Estonia	100	50
Kolde AS ¹	Estonia	100	100
Lilletee LA OÜ ¹	Estonia	sold	100
Pärnu Turg OÜ ¹	Estonia	100	100
T53 Maja OÜ ¹	Estonia	100	100
Waldrop Investments OÜ ¹	Estonia	100	100
Marsili II SIA ¹	Latvia	100	0
Arco Development SIA ¹	Latvia	70	99.9
Ulmana Gatves Nami SIA ¹	Latvia	70	99.9
Arco Invest UAB ¹	Lithuania	100	100
Arco Development UAB ¹	Lithuania	100	100
Arco Capital Real Estate SRL ¹	Romania	100	100
Arco Investments TOV ¹	Ukraine	75	75
Joint ventures			
Arco HCE OÜ ¹	Estonia	50	50
Tivoli Arendus OÜ ¹	Estonia	50	100
AD Saulkrasti SIA ¹	Latvia	35	50
Bišumužas Nami SIA ¹	Latvia	49.38	49.38
Sporting Riga SIA ¹	Latvia	49.38	49.38
Construction segment			
Subsidiaries			
Arco Ehitus OÜ	Estonia	100	100
AE Ehitusjuhtimine OÜ ¹	Estonia	100	100
Tempera Ehitus OÜ ¹	Estonia	bankrupt	bankrupt

¹ Interest through a subsidiary

34 *Parent company's unconsolidated financial statements presented in accordance with the Estonian Accounting Act*

UNCONSOLIDATED INCOME STATEMENT

	2011	2010
EUR, thousands		
Revenue from rendering of services	408	442
Cost of sales	0	-14
Gross profit	408	428
Distribution expenses	-191	-124
Administrative expenses	-1,670	-1,752
Other expenses	-10	-15
Operating loss	-1,463	-1,463
Loss on investments in subsidiaries	-14,601	-31,918
Interest expense	-28	-114
Other finance income	1,309	2,853
Other finance expenses	-1	0
Net finance expense	-13,321	-29,179
Loss for the year	-14,784	-30,642

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 31 December	2011	2010
EUR, thousands		
Cash and cash equivalents	403	3,328
Trade and other receivables	24,805	38,633
Prepayments	147	3
Inventories	21	0
Total current assets	25,376	41,964
Investments ¹	4,469	657
Prepayments	145	0
Property, plant and equipment	14	19
Intangible assets	0	2
Total non-current assets	4,628	678
TOTAL ASSETS	30,004	42,642
Loans and borrowings	1,282	64
Trade and other payables	2,345	1,165
Total current liabilities	3,627	1,229
Loans and borrowings	0	252
Total non-current liabilities	0	252
Total liabilities	3,627	1,481
Share capital	3,319	3,030
Statutory capital reserve	2,011	2,011
Retained earnings	21,047	36,120
Total equity	26,377	41,161
TOTAL LIABILITIES AND EQUITY	30,004	42,642

¹ Line item *Investments* includes investments in subsidiaries, whose carrying value at 31 December 2011 was 4,461 thousand euros (31 December 2010: 0 euros). In Arco Vara AS's unconsolidated statement of financial position investments in subsidiaries are carried at cost less impairment losses.

UNCONSOLIDATED STATEMENT OF CASH FLOWS

	2011	2010
EUR, thousands		
Operating loss	-1,463	-1,463
Adjustments, comprising:	493	45
<i>Depreciation and amortisation</i>	8	45
<i>Write-down of receivables</i>	485	0
Operating loss after adjustments	-970	-1,418
Changes in receivables and prepayments	122	13,886
Changes in inventories	-21	0
Changes in payables and deferred income	990	25
NET CASH FROM OPERATING ACTIVITIES	121	12,493
Acquisition of property, plant and equipment and intangible assets	0	-1
Acquisition of investments	-145	0
Loans granted	-254	-2,526
Repayment of loans granted	23	247
Change in group account receivables	-1,611	-8,151
Interest received	6	84
NET CASH USED IN INVESTING ACTIVITIES	-1,981	-10,347
Proceeds from loans received	0	639
Repayment of loans received	-315	-1,531
Change in group account liabilities	-722	38
Interest paid	-28	-130
NET CASH USED IN FINANCING ACTIVITIES	-1,065	-984
NET CASH FLOW	-2,925	1,162
Cash and cash equivalents at beginning of year	3,328	2,166
Decrease/ increase in cash and cash equivalents	-2,925	1,162
Cash and cash equivalents at end of year	403	3,328

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital	Statutory capital reserve	Own shares	Retained earnings	Total
EUR, thousands					
Balance at 31 December 2009	60,898	2,011	-255	9,151	71,805
Reduction of share capital	-57,868	0	255	57,613	0
Loss for the year	0	0	0	-30,644	-30,644
Balance at 31 December 2010	3,030	2,011	0	36,120	41,161
Increase of share capital	289	0	0	-289	0
Loss for the year	0	0	0	-14,784	-14,784
Balance at 31 December 2011	3,319	2,011	0	21,047	26,377

Adjusted unconsolidated equity

As at 31 December	2011	2010
EUR, thousands		
Parent company's unconsolidated equity	26,377	41,161
Carrying amount of investments in subsidiaries in the Parent company's unconsolidated statement of financial position	-4,461	0
Value of investments in subsidiaries under the equity method	4,010	-8,028
Parent company's adjusted unconsolidated equity	25,926	33,133

Confirmation by the management board to the consolidated financial statements

The management board confirms that the Group's financial statements, prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU, provide a true and fair view of the assets, liabilities, financial position and financial performance of the Parent company and the Group.

/signature/

Lembit Tampere
Chief Executive Officer and Member of the Management Board

19 April 2012



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INDEPENDENT AUDITOR'S REPORT

To the shareholders of Arco Vara AS

We have audited the accompanying consolidated financial statements of Arco Vara AS, which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated statements of comprehensive income, cash flows and changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 24 to 65.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing (Estonia). 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 consolidated financial position of Arco Vara AS as of 31 December 2011, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Tallinn, 19 April 2012

KPMG Baltics OÜ
Licence No 17
Narva mnt 5, Tallinn

/signature/

Eero Kaup
Authorized Public Accountant, No 459

/signature/

Taivo Epner
Partner

Proposal for covering the loss

The member of the management board of Arco Vara AS proposes that the general meeting transfer the net loss for the year ended 31 December 2011 of 3,381 thousand euros to retained earnings.

Retained earnings as at 31 December 2011 amount to 18,653 thousand euros.

/signature/

Lembit Tampere
Chief Executive Officer and Member of the Management Board

19 April 2012

Signature of the member of the management board

I hereby affirm that the information presented in the annual report of Arco Vara AS for 2011 is true and complete.

/signature/

Lembit Tampere
Chief Executive Officer and Member of the Management Board

19 April 2012