# BPT Baltic Opportunity Fund

Annual report for the financial year ended 31 December 2011

**Beginning of financial year**
16 December 2010

**End of financial year**
31 December 2011

**Management Company**
BPTAM Estonia AS

**Depositary**
Swedbank AS

**Address of the fund**
Rävala pst 5
Tallinn 10143

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**Audit**
AS Ernst & Young Baltic

# BPT Baltic Opportunity Fund

NON-PUBLIC CLOSED-ENDED CONTRACTUAL REAL ESTATE FUND

**Consolidated Financial Statements**

and

**Independent Auditor's Report**

as at

31 December 2011

# Contents

# Management Statement

The management board of the Management Company has prepared the financial statements of BPT Baltic Opportunity Fund for the financial year ended 31 December 2011 on 30 March 2012.

The financial statements have been prepared in compliance with the requirements set out in the Investment Funds Act and the International Financial Reporting Standards (IFRS) as adopted by European Union and they give a true and fair view of the assets, liabilities, net value and performance results of the BPT Baltic Opportunity Fund. In the opinion of the management board of the Management Company, BPT Baltic Opportunity Fund is a going concern.

The financial statements of BPT Baltic Opportunity Fund have been approved by the management board of the Management Company and the fund manager.

Tallinn, 30 March 2012

BOARD OF DIRECTORS

**Indrek Hääl**

Chairman of the Management Board

**Lina Mališauskaitė**

Member of the Management Board

**Algirdas Jonas Vaitiekūnas**

Member of the Management Board

# Independent Auditor's Report

**To the Shareholder of BPT Baltic Opportunity Fund**

We have audited the accompanying financial statements of BPT Baltic Opportunity Fund (further "fund"), managed by BPTAM Estonia AS (further "fund management company), which comprise the balance sheet and statement of investment as at 31 December 2011, the statement of income and expense and the statement of changes in net assets for the year then ended, and a summary of significant accounting policies and other explanatory information.

## THE FUND MANAGEMENT COMPANY`S MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management of the Fund Management Company is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union and Investment Funds Act, and for such internal control as management determines is necessary to enable the preparation and fair presentation 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 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 about 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 financial statements present fairly, in all material respects, the financial position of BPT Baltic Opportunity Fund as at 31 December 2011, and its financial performance for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union and Investments Funds Act.

Tallinn, 30 March 2012

**Ernst & Young Baltic AS**
**Audit Company's Registration number 58**

**Ivar Kiigemägi**
Authorised Auditor's number 527

**Urmo Kallakas**
Authorised Auditor's number 542

# Definitions of key terms and abbreviations

| | |
|---|---|
| Direct property yield | NOI divided by acquisition value of a property |
| FSA | the Estonian Financial Supervision Authority (in Estonian: *Finantsinspektsioon*) |
| Fund | BPT Baltic Opportunity Fund (REIF) |
| IFRS | International Financial Reporting Standards |
| INREV | European Association for Investors in Non-listed Real Estate Vehicles |
| INREV NAV | NAV, adjusted to comply with INREV guidelines |
| Management Company | BPTAM Estonia AS, register code 11025345, registered address at Rävala pst 5, Tallinn 10143, Estonia |
| NAV | Net asset value for the Fund |
| NAV per unit | NAV divided by the amount of units in the Fund at the moment of determination |
| Net initial yield | NOI divided by market value of a property |
| NOI | Net operating income |

# Manager's report

BPT Baltic Opportunity Fund (REIF) focuses on a value-added strategy aiming to acquire and actively manage core cash-flow generating office, retail and logistics properties which are centrally and strategically well located in the Baltic countries. The prime objective of the Fund is to purchase the investment projects, which hold realizable future potential. Through effectively managing the investments, the Management Company aims to actualize all the upsides and complete the exit as planned. In addition, up to 20% of the final fund size can be allocated to forward funding or forward commitment investment project in collaboration with strong tenants and established developers.

Year 2011 was the inauguration year for BPT Baltic Opportunity Fund. Its fund rules were first registered at the FSA on 1 September 2010. First capital call took place in December 2010 while the fund management team was actively pursuing first investments to the Fund.

In the course of setting up the Fund during 2010, the Fund became fully compliant with Estonian FSA, had elected Swedbank as administrator and depositary bank, Ernst & Young as auditor and completed the selection and appointment of qualified members to the investment committee.

The Fund's investment principles are in complete conformity with internationally accepted ethical and socially responsible investment principals. The Fund's activities are monitored by the FSA, the investment committee and Swedbank on a regular basis. In addition, the management team of the Fund is continuously in close contact with FSA and Ministry of Finance to further enhance the Estonian REIF fund structure.

## MACROECONOMIC FACTORS IN THE BALTIC STATES

During 2011, the Baltic States continued to recover from recession generated by the excessively leveraged households, the asset-bubbles and the reduced domestic competitiveness that prevailed during the middle of the last decade. Budget cuts were implemented by governments and after the ruthless drop of domestic market demand, companies had to abruptly realign their sales strategies. Renewed focus on efficiency and closeness to the strong Nordic markets has been the main reason of the quick Baltic recovery from early 2010, starting in Estonia with Latvia and Lithuania quickly following suit.

Estonia demonstrated impressive economic growth in 2011 (estimated at 8%), mainly fuelled by growth in exports, albeit supported by stronger domestic demand as well. Job creation and investments was boosted by recovered foreign demand. Latvia successfully finished implementation of an IMF/EC-supported bailout program in December 2011. The GDP growth during 2011 exceeded expectations, with the same drivers as in the Estonian case: exports, investment, and household consumption. In Lithuania, the main benefactors to GDP growth were consumption and investments. The wage growth was still negative, despite a decrease in unemployment. The overall economic growth in all Baltic States ensured decreasing office vacancies during the year. Picking-up consumer demand practically eliminated vacancies of the top-rank shopping centres in Baltic retail market. Nevertheless, the prospects of rising rents are rather abstract.

Despite a weakening global outlook, further growth is expected in main macro-economic parameters of all the Baltic States. Due to further increase in investments and consumption, Estonian and Lithuanian economies should continue recovering. Latvian economy is expected to lag behind somewhat, as main trading partners for Latvia may cut into Latvian exports, and weaker confidence may dampen consumption and investments.

Euro adoption for Latvia and Lithuania is one of the key agenda issues in coming years. The governments of both countries express a commitment to achieving euro adoption as fast as 2014. This may be obstructed somewhat by the euro zone's ability to accept new members. In addition, worsening global outlook may dampen the possibility for the economies to meet euro adoption formal criteria.

LINCONA OFFICE COMPLEX
In July 2011, BPT Baltic Opportunity Fund made its first investment, the Lincona Office Complex in Tallinn. The property is located on the arterial Pärnu Road, just 4 km from Tallinn Old Town in a strong office submarket location. It has a net rentable area of 11 336 sqm (75% offices, 25% retail) with Swedbank as the anchor tenant. The complex consists of 3 connected office buildings and 1 standalone retail unit with redevelopment potential. The complex also includes a 5-floor parking house for approx. 400 vehicles.

**Table 1: Main macro-economic indicators for the Baltic States**

| Indicator | Actual 2009 | Actual 2010 | Estimate 2011 | Forecast 2012 | Forecast 2013 |
|---|---|---|---|---|---|
| **Economic growth (annual change of real GDP), %** | | | | | |
| Estonia | -13.9 | 2.3 | 8.0 | 2.7 | 4.0 |
| Latvia | -18.0 | -0.3 | 5.4 | 2.0 | 3.2 |
| Lithuania | -14.7 | 1.4 | 6.3 | 3.3 | 4.0 |
| **Average consumer price growth, %** | | | | | |
| Estonia | -0.1 | 3.0 | 5.0 | 3.2 | 3.0 |
| Latvia | 3.6 | -1.1 | 4.4 | 2.4 | 2.5 |
| Lithuania | 4.2 | 1.3 | 4.1 | 2.5 | 3.0 |
| **Unemployment rate, %** | | | | | |
| Estonia | 13.8 | 16.9 | 12.5 | 10.7 | 8.6 |
| Latvia | 17.1 | 18.7 | 15.4 | 13.7 | 12.0 |
| Lithuania | 13.7 | 17.8 | 15.5 | 13.5 | 11.5 |

Source: Swedbank, “Swedbank Economic Outlook”, 24 January 2012

## REAL ESTATE INDUSTRY DEVELOPMENT

Investments into property are increasing due to tenant stability in commercial properties over past 12 months throughout 2011. Market investment yield levels have been established between 8-10% and are slowly contracting as economies continue to grow. Banks are also lending again up to 60% at a total cost of 4-6% p.a.

In general, real estate market during the course of 2011 was driven by 4 principle factors:

- Beginning of 2011 brought a larger supply of investment opportunities to the market whereas number of buyers remained limited, especially for objects with market values in excess of EUR 10 million;
- Growing interest from companies and government institutions in sales and lease-back transactions to increase liquidity;
- Supermarket chains planning further expansion throughout the Baltic States;
- Vacancies in established commercial centres continued to drop, rental levels have remained stable with pressures to increase in selected cases.

After strong correction, rental rates have remained stable throughout 2011. The office vacancy in Baltic CBDs has been decreasing gradually but surely since 2010 and was at the end of September 2011 estimated to be less than 5% with available for lease areas normally not exceeding 300 sqm a premise. The retail market in the Baltic States has shown stable signs of recovery since the middle of 2010. The previous fall in retail trade turnover came to a halt in early 2010 and turnover has increased steadily from the start of 2011 especially in Lithuania. With gradually increasing wages and slowly diminishing unemployment in the Baltic States, private consumption was on an upward trend throughout 2011, although retail sales in comparison to the activity before the financial crisis still remain modest.

**Table 2: Baltic vs. Nordic real estate market**

| | Core locations | Stockholm | Helsinki | Tallinn | Riga | Vilnius |
|---|---|---|---|---|---|---|
| | Total office stock (sqm) | 11.8 million | 8 million | 0.5 million | 0.5 million | 0.4 million |
| OFFICE | Prime rents | EUR 400-450 | EUR 300-340 | EUR 150-190 | EUR 120-150 | EUR 130-170 |
| OFFICE | Prime yields | 5.0%-5.25% | 5.8%-6.0% | 8.0%-8.5% | 8.5%-9.5% | 8.0%-9.0% |
| RETAIL | Prime rents | EUR 850-1 500 | EUR 900-1 500 | EUR 190-250 | EUR 180-230 | EUR 170-220 |
| RETAIL | Prime yields | 4.75%-5.0% | 5.5% | 8.0%-8.5% | 8.75%-9.0% | 8.5%-8.75% |

Source: BPT, Newsec

All in all, the Baltic region's competitiveness has improved and its internal imbalances have been solved creating a solid base, thus the region is expected to continue its progress up the economic ladder giving further support to the gradual recovery of the real estate markets.

## FUND PERFORMANCE

### Financial position of the Fund

2011 was the first full year for BPT Baltic Opportunity Fund. For the first closing on 21 December 2010, the Fund was able to raise seed capital in the amount of EUR 5 470 000. In April 2011, the Fund was successful in bringing its first institutional investor on board with an additional commitment of EUR 5 500 000 which subsequently was doubled in October.

At 31 December 2011, the Fund's paid in capital from investors amounts to EUR 10 970 000. The maximum amount allowed in fund rules is EUR 100 000 000. The capital which has been called in and not yet invested is placed into term deposit usually for 2 month periods earning market level interest.

### Table 3: Key capital indicators of the Fund

| Item | 31.12.2011 |
|---|---|
| Capital called into Fund's account | EUR 10 970 000 |
| Hard commitments standing by | EUR 5 500 000 |
| **Total commitments** | **Eur 16 470 000** |
| less capital invested in Lincona SPV (IC loan) | (EUR 7 400 000) |
| **Total available for investments** | **Eur 9 070 000** |

### Table 4: Key borrowing indicators of the Fund

| Item | 31.12.2011 |
|---|---|
| Total debts to banks by Fund and Fund's subsidiaries | EUR 7 800 000 |
| Total value of the properties held by the Fund and Fund's subsidiaries | EUR 15 590 000 |
| **Total LTV ratio** | **50%** |

The Fund monitors its leverage using a LTV ratio, which is total debts to banks divided by total value of the properties. The Fund's target LTV ratio is 50%.

### Financial results of the Fund

As of 31 December 2011, the Fund recorded net result of EUR 176 064. As a result, the Fund's NAV was EUR 11 146 064 (EUR 101.4021 per unit). The key driver of the results is the increase of net assets of Fund's subsidiaries (EUR 194 316) as well as interest income accrued from subsidiaries (EUR 288 339). The expenses of the Fund constituted EUR 351 180 (more details provided in the Profit / loss statement as well as note 5 to the financial statements).

The Fund also calculates INREV NAV, which as of 31 December 2011 was EUR 11 292 332 (EUR 102.7328 per unit). The INREV NAV is calculated adjusting NAV for the items summarised in the table below:

### Table 5: Adjustments for recalculating NAV to INREV NAV

| No. | Item | Amounts in EUR |
|---|---|---|
| **1.** | **NAV as of 31 December 2011** | **11 146 064** |
| 2. | Estimation of realisable transfer costs in case of sales of assets (0.5% of property value) | (77 950) |
| 3. | Estimation of realisable tax exposure in case of sales of assets | (24 962) |
| 4. | Capitalization and amortization of Fund's set-up costs* | 59 181 |
| 5. | Capitalization and amortization of property acquisition costs* | 45 455 |
| 6. | Elimination of effect of derivative revaluation reserves for the Fund and the net assets of subsidiaries | 182 966 |
| 7. | Estimation of tax effect of (6.) above | (38 423) |
| **8.** | **INREV NAV** | **11 292 332** |
| 9. | Amount of units | 109 919 |
| **10.** | **INREV NAV per unit** | **102.7328** |

* the costs are amortized for 5 years.

The INREV NAV is calculated according to Internal Rules for Determination of the Net Asset Value of Fund, of BPTAM Estonia AS, prepared in conformity of INREV guidelines.

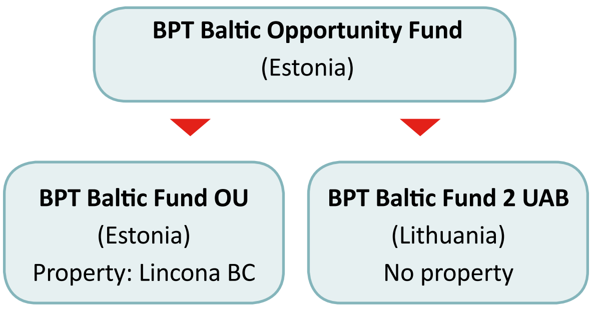
Based on the changes in NAV, the Fund's return for 2011 was 1.3% and, based on INREV NAV, it was 2.7%. The net initial yield for 2011 reached 8.6%, while the direct property yield was 8.7%. The difference is due to the fact that for the net initial yield market value of the property is used, which increased during 2011, whereas direct property yield is based on acquisition value of the property.

### Acquisitions

In July 2011, the fund management team was able to close its first investment in Tallinn, Estonia. The property acquired was Lincona Office Complex, which is located on the arterial Pärnu road, just 4 km from Tallinn Old Town. The location is known as a strong office submarket location. The complex has a net rentable area of 11 336 sqm divided as 75% office space and 25% retail space (ground floor). The complex consists of 3 connected office buildings and 1 standalone retail unit with redevelopment potential. The complex also includes a 5-floor parking house for approx. 400 vehicles. The anchor tenant is Swedbank. On the retail side the complex has established itself as the preferred location for high quality home decor stores.

The property was acquired and is owned through specially created subsidiary BPT Baltic Fund 1 OÜ (SPV 1). The acquisition was financed by regionally operating bank and hedged cost of financing is below 5% p.a.

Current legal structure of the Fund is provided below:




## PROPERTY PERFORMANCE

At the end of 2011, 100% of the real estate assets of the Fund were located in Estonia, consisting of single property Lincona office complex, owned via BPT Baltic Fund 1 OÜ (SPV 1). The financial performance of SPV 1 is described below.

The operational figures in the second half of 2011 were at par with expectations. The average direct property rental yield achieved by the property in 2011 was 8.7% which was as expected due to the rental guarantee obtained from the seller of the property.

Average occupancy rate of the property for the year was 100% given the abovementioned rental guarantee, which is in place until the end of 2012. Actual occupancy of Lincona office complex was 94% throughout the second half of 2011.

The average monthly rental rate in general remained the same in the second half of 2011 amounting to EUR 10 per sqm for office areas and EUR 8.4 per sqm for retail areas. The fund management team sees good long term potential in retail rents as well as newly generate income from the 378 place parking house within the Lincona office complex. Payment discipline of tenants is good except for two smaller retail tenants (6% of total rentable area) who the management team is looking to replace in the coming period.

Average expiry of all leases is estimated to be approximately 2.2 years with the shortest premature termination being 3 months and the longest unbreakable term 7.5 years. As of 31 December 2011, Swedbank as a tenant made up approximately 50% of the total rental income.

Due to improvements in the reasonably expected future prospects of the property, an annual capital gain was achieved as of the end of the year in the amount of EUR 194 385. As a result the Lincona office complex was valued at EUR 15 590 000 as of 31 December 2011. The independent appraisals of the properties were performed by Colliers International Advisors and their valuation method used in 2011 is the discounted cash flow ("DCF"). Under the DCF method, the discount rate used was 9.5%. Exit yield assumed was 8%.

## OUTLOOK FOR 2012

At the end of 2011, the fund management team was able to initiate several promising negotiations involving new acquisitions for the Fund. Objective is to diversify investment portfolio both geographically and across segments with a special focus on retail assets. The fund management team aims to close the next real estate deal which is in line with the Fund's strategy by end of April 2012.

The objective in 2012 shall also be on managing tenant mix in the Lincona property and start the execution of the income enhancement plan developed for the following 3 years.

Furthermore, the Management Company is executing a pan-European strategy to increase awareness of BPT Baltic Opportunity Fund and plans to achieve full committed status for the Fund by Q2 2012.

## PRINCIPAL RISKS AND UNCERTAINTIES FACING THE FUND

The economies of all three Baltic States have commenced a turnaround in a positive way. The latest euro zone and sovereign debt problems affecting many European countries economies are likely to have a negative impact of the Baltic States' economic growth in 2012. However, nearly all analysts agree that this would be reflected as a slowdown of economic growth in 2012 without seeing any negative growth. The real estate sectors in the Baltic States are still stabilizing and starting to show signs of sustainable recovery. Provided that the economic slowdown in 2012 is not more dramatic than what is predicted, the market levels of rent and occupancy should remain on a growth path throughout 2012.

As of 31 December 2011, the Fund has a single loan contract outstanding, which is locked against a fixed level of interest by interest rate swap contract. The contract is in the same currency (EUR) as is the rental income as well as expenses of the related property. The loan contract matures in January 2016.

The cash flow generated in the Fund's subsidiaries was positive during 2011. The Management Company makes its best efforts to ensure sufficient liquidity by efficient cash management, mainly by maintaining a "liquidity buffer" in Fund's subsidiaries and the Fund itself.

The Fund is operating in the Baltic States, of which Estonia has already adopted EUR as its main currency, and Lithuania and Latvia have their local currencies pegged to EUR. After the successful recovery of the latter two countries, the devaluation of LTL or LVL is off the table.

# Income Statement

| Euros | Note | 16.12.2010 - 31.12.2011 |
|---|---|---|
| **Income** | | |
| **Net result on investments** | | |
| **From investments into equity and units** | | |
| Unrealised profit | | 194 316 |
| **Total on investments** | | **194 316** |
| **Net result on financial activities** | | |
| Interest income on loans | 7 | 288 339 |
| Interest income on deposits | | 44 615 |
| Other financial income | | 8 |
| **Total on financial activities** | | **332 962** |
| **Total income** | | **527 278** |
| **Expenses** | | |
| **Operating expenses** | | |
| Management fee | | (217 402) |
| Depository fee | | (13 313) |
| Transaction costs | | (150) |
| Other operating expenses | 5 | (120 315) |
| **Total operating expenses** | | **(351 180)** |
| **Other expenses** | | |
| Foreign currency loss | | (34) |
| **Total other expenses** | | **(34)** |
| **Total expenses** | | **(351 214)** |
| **Net result of the fund** | | **176 064** |

# Balance Sheet

| Euros | Note | 31.12.2011 |
|---|---|---|
| **Assets** | | |
| Loans | 7 | 7 400 000 |
| Securities | 2 | 199 711 |
| Deposits | 2 | 3 398 948 |
| Accrued income | 7 | 288 360 |
| **Total assets** | | **11 287 019** |
| **Liabilities and fund's net asset value** | | |
| Management fee payable | | 57 909 |
| Payable to depository | | 3 386 |
| Other liabilities | | 79 660 |
| **Total liabilities** | | **140 955** |
| Fund's net asset value | 4 | 11 146 064 |
| **Total liabilities and Fund's net asset value** | | **11 287 019** |

# Notes to the financial statements

NOTE 1. ACCOUTING POLICIES

**1. Corporate Information**

BPT Baltic Opportunity Fund (REIF) is a direct real estate fund investing in commercial properties in the Baltic States (Estonia, Latvia and Lithuania). The Fund is a non-public closed-ended contractual investment fund (i.e. the Units will not be redeemed at the request of an Investor) founded on 1 September 2010. The Fund is a fixed-term fund with duration of 5 years from the First Closing.

The Fund's registered office is at Rävala pst 5, Tallinn, Estonia.

The objective of the Fund is to combine attractive income yields with medium to long-term value appreciation by identifying and investing in primarily commercial real estate, portfolios of real estate, and/or real estate companies and making exits from these investments. The objective of the Fund is to provide its Investors with consistent and above average risk-adjusted returns by acquiring high quality cash flow-generating commercial properties with the potential for adding value through active management, thereby creating a stable income stream of high yielding current income combined with capital gains at exit. Although the objective of the Fund is to generate positive returns to the Investors, the profitability of the Fund is not guaranteed to the Investors.

The Fund is managed by BPTAM Estonia AS. The depositary of the Fund is Swedbank AS.

**2.1. Basis of preparations.**

The financial statements of the Fund have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and adopted by European Union and Investment Fund Act.

The financial statements have been prepared on a historical cost basis, except for financial assets and financial liabilities held at fair value through profit or loss, that have been measured at fair value.

The financial statements are presented in euros and all values are rounded to the nearest euros.

**2.2 Summary of significant accounting policies**

**Financial instruments**

*(i) Classification*

The Fund classifies its financial assets and financial liabilities into the following categories in accordance with IAS39.

**Financial assets and liabilities at fair value through profit or loss**

The category of financial assets and liabilities at fair value through the profit or loss is sub-divided into:

*Financial assets and liabilities held for trading:* financial assets are classified as held for trading if they are acquired for the purpose of selling and repurchasing in the near term. This category includes equity securities, investments in managed funds and debt instruments. These assets are acquired principally for the purpose of generating a profit from short-term fluctuation in price. All derivatives and liabilities from short sales of financial instruments are classified as held for trading. The Fund's policy is not to apply hedge accounting.

*Financial instruments designated as at fair value through profit or loss upon initial recognition:* these include equity securities and debt instruments that are not held for trading. These financial assets are designated on the basis that they are part of a group of financial assets which are managed and have their performance evaluated on a fair value basis, in accordance with the risk management and investment strategies of the Fund, as set out in the Fund's offering document**.** The financial information about these financial assets is provided internally on that basis to the Investment Manager and to the Board of Directors.

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Fund includes in this category amounts relating to reverse repurchase agreements, cash collateral on securities borrowed and other short-term receivables.

**Other financial liabilities**

This category includes all financial liabilities, other than those classified as held for trading. The Fund includes in this category amounts relating to repurchase agreements, cash collateral on securities lent and other short-term payables.

The Fund's accounting policy regarding the redeemable participating shares is described in section below.

*(ii) Recognition*

The Fund recognises a financial asset or a financial liability when, and only when, it becomes a party to the contractual provisions of the instrument.

Purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e., the date that the Fund commits to purchase or sell the asset.

*(iii) Initial measurement*

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. All transaction costs for such instruments are recognised directly in profit or loss.

Derivatives embedded in other financial instruments are treated as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract, and the host contract is not itself classified as held for trading or designated as at fair value through profit or loss. Embedded derivatives separated from the host are carried at fair value with changes in fair value recognised in profit or loss.

Loans and receivables and financial liabilities (other than those classified as held for trading) are measured initially at their fair value plus any directly attributable incremental costs of acquisition or issue.

*(iv) Subsequent measurement*

After initial measurement, the Fund measures financial instruments which are classified as at fair value through profit or loss at fair value. Subsequent changes in the fair value of those financial instruments are recorded in '*Net gain or loss on financial assets and liabilities at fair value through profit or loss'*. Interest earned and dividend revenue elements of such instruments are recorded separately in *'Interest revenue'* and *'Dividend revenue'*, respectively. Dividend expenses related to short positions are recognised in *'Dividends on securities sold not yet purchased'*.

Loans and receivables are carried at amortised cost using the effective interest method less any allowance for impairment. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Financial liabilities, other than those classified as at fair value through profit or loss, are measured at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the liabilities are derecognised, as well as through the amortisation process. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Fund estimates cash flows considering all contractual terms of the financial instruments, but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

*(v) Derecognition*

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- The rights to receive cash flows from the asset have expired;

Or

- The Fund has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement

And

- Either (a) the Fund has transferred substantially all the risks and rewards of the asset, or (b) the Fund has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Fund has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Fund's continuing involvement in the asset.

The Fund derecognises a financial liability when the obligation under the liability is discharged, cancelled or expires.

### Determination of fair value

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted price or binding dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

Where the Fund has assets and liabilities with offsetting market risks, it uses mid-market prices as a basis for establishing fair values for the offsetting risk positions and applies the bid or ask price to the net open position as appropriate.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include: using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models making as much use of available and supportable market data as possible.

### Impairment of financial assets

The Fund assesses at each reporting date whether a financial asset or group of financial assets classified as loans and receivables is impaired. Evidence of impairment may include indications that the debtor, or a group of debtors, is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and, where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred) discounted using the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss as a *'Credit loss expense'*.

Impaired debts, together with the associated allowance, are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Fund. If, in a subsequent period, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a previous write-off is later recovered, the recovery is credited to the *'Credit loss expense'*.

Interest revenue on impaired financial assets is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

### Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### Functional and presentation currency

The Fund's functional and presentation currency is the euro, which is the currency of the primary economic environment in which it operates. The Fund's performance is evaluated and its liquidity is managed in euros. Therefore, the euro is considered as the currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. The fund's presentation currency is also the euro.

### Foreign currency translations

Transactions during the period, including purchases and sales of securities, income and expenses, are translated at the rate of exchange prevailing on the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Foreign currency transaction gains and losses on financial instruments classified as at fair value through profit or loss are included in profit or loss in the statement of comprehensive income as part of the *'Net gain or loss on financial assets and liabilities at fair value through profit or loss'*. Foreign exchange differences on other financial instruments are included in profit or loss in the statement of comprehensive income as *'Net foreign exchange gains (losses)'*.

**Distributions to shareholders**

Dividend distributions are the discretion of the Fund. A dividend distribution to the Fund's shareholders is accounted for as a deduction from retained earnings. A proposed dividend is recognised as a liability in the period in which it is approved by the annual general meeting of shareholders.

**Cash and cash equivalents**

Cash and cash equivalents in the statement of financial position comprise cash on hand, demand deposits, short-term deposits in banks and short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value, with original maturities of three months or less.

Short-term investments that are not held for the purpose of meeting short-term cash commitments and restricted margin accounts are not considered as 'cash and cash equivalents'.

For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

**Interest revenue and expense**

Interest revenue and expense are recognised in the statement of comprehensive income for all interest-bearing financial instruments using the effective interest method.

**Dividend revenue and expense**

Dividend revenue is recognised when the Fund's right to receive the payment is established. Dividend revenue is presented gross of any non-recoverable withholding taxes, which are disclosed separately in the statement of comprehensive income. Dividend expense relating to equity securities sold short is recognised when the shareholders' right to receive the payment is established.

**Net gain or loss on financial assets and liabilities at fair value through profit or loss**

This item includes changes in the fair value of financial assets and liabilities held for trading or designated upon initial recognition as 'at fair value through profit or loss' and excludes interest and dividend income and expense.

Unrealised gains and losses comprise changes in the fair value of financial instruments for the period and from reversal of prior period's unrealised gains and losses for financial instruments which were realised in the reporting period.

Realised gains and losses on disposals of financial instruments classified as 'at fair value through profit or loss' are calculated using the First-In, First-Out (FIFO) method. They represent the difference between an instrument's initial carrying amount and disposal amount, or cash payments or receipts made on derivative contracts (excluding payments or receipts on collateral margin accounts for such instruments).

**Fees and commissions**

Unless included in the effective interest calculation, fees and commissions are recognised on an accrual basis. Legal and audit fees are included within 'other general expenses'.

**Income taxes**

The Fund is exempt from all forms of taxation in Estonia (including income, capital gains and withholding taxes) provided the shareholders are currently entitled to the income of the Fund and the Fund fully distributes its net taxable income. However, in some jurisdictions, investment income and capital gains are subject to withholding tax deducted at the source of the income. The Fund presents the withholding tax separately from the gross investment income in the statement of comprehensive income. For the purpose of the statement of cash flows, cash inflows from investments are presented net of withholding taxes, when applicable.

**2.3 Changes in accounting policy and disclosures**

*New and amended standards and interpretations*

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRS and IFRIC interpretations effective as of 1 January 2011:

- IAS 24 *Related Party Disclosures (amendment)* effective 1 January 2011
- IAS 32 *Financial Instruments: Presentation (amendment)* effective 1 February 2010
- IFRIC 14 *Prepayments of Minimum Funding Requirement (amendment)* effective 1 January 2011
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* effective 1 July 2010
- Improvements to IFRSs (May 2010) effective either 1 July 2010 or 1 January 2011

**IAS 24 *Related Party Transactions* (Amendment)**

The IASB issued an amendment to IAS24 that clarifies the definition of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect the related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. The adoption of the amendment did not have any impact on the financial position or performance of the Fund.

**IAS 32 *Financial Instruments: Presentation* (Amendment)**

The IASB issued an amendment that alters the definition of financial liability in IAS 32 to enable entities to classify rights issues and certain options or warrants as equity instruments. The amendment is applicable if the rights are given *pro rata* to all existing owners of the same class of an entity's non-derivative equity instruments, to acquire a fixed number of entity's own equity instruments for a fixed amount in any currency. The amendment has had no effect on the financial position or performance of the Fund because Fund does not have these types of instruments.

**IFRIC 14 *Prepayments of a Minimum Funding Requirement* (Amendment)**

The amendment removes an unintended consequence when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover such requirements. The amendment permits a prepayment of future service cost by entity to be recognised as pension asset. The amendment as had no effect on the financial position or performance of the Fund because Fund does not have employee benefit schemes.

**IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments***

In November 2009, the IASB issued IFRIC 19 *Extinguishing Financial Liabilities with Equity*. The interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case that this cannot be reliably measured, the instruments are measured at their fair value of the liability extinguished. Any gain or loss is recognised immediately in profit or loss. The adoption of this interpretation has had no effect on the financial statements of the Fund.

**Improvements to IFRS**

In May 2010, the IASB issued its third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard.

The adoption of the following amendments resulted in no changes to accounting policies, and did not have any impact on the financial position or performance of the Fund.

IFRS 7 *Financial Instruments – Disclosures:* The amendment was intended to simplify the disclosures provided, by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context.

Other amendments resulting from Improvements to IFRSs to following standards and interpretations did not have any impact on the accounting policies, financial position or performance of the Fund:

- IAS 1 *Presentation of Financial Statements* (Presentation of analysis of each component of other comprehensive income)
- IFRS 3 *Business Combinations* (Contingent consideration arising from business combination prior to adoption of IFRS 3 (as revised in 2008))
- IFRS 3 *Business Combinations* (Un-replaced and voluntarily replaced share-based payments awards)
- IAS 27 *Consolidated and Separate Financial Statements*
- IAS 34 *Interim Financial Statements*
- IFRIC 13 *Customer Loyalty Programmes* (determining their fair value of award credits).

### 3. Significant accounting judgements, estimates and assumptions

The preparation of the Fund's financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts recognised in the financial statements and disclosure of contingent liabilities. However, uncertainty about these assumptions and estimates could result in outcomes that could require a material adjustment to the carrying amount of the asset or liability affected in future period.

#### Judgements

In the process of applying the Fund's accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognised in the financial statements:

*Going Concern*

The Fund's management has made an assessment of the Fund's ability to continue as a going concern and is satisfied that the Fund has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Fund's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

*Functional currency*

The primary objective of the Fund is to generate returns in euro, its capital-raising currency. The liquidity of the Fund is managed on a day-to-day basis in euros in order to handle the issue, acquisition and resale of the Fund's redeemable units. The Fund's performance is evaluated in euro. Therefore, the management considers the euro as the currency that most faithfully represents the economic effects of the underlying transactions, events and condition.

*Estimates and assumptions*

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below. The Fund based its assumptions and estimates on parameters available when the financial statements were prepared. However, existing circumstances and assumptions about future developments may change due to market changes or circumstances arising beyond the control of the Fund. Such changes are reflected in the assumptions when they occur.

*Fair value of financial instruments*

When the fair value of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required in establishing fair values. The estimates include considerations of liquidity and model inputs such as credit risk (both own and counterparty's), correlation and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments in the statement of financial position and the level where the instruments are disclosed in the fair value hierarchy. The models are calibrated regularly and tested for validity using prices from any observable current market transactions in the same instrument (without modification or repackaging) or based on any available observable market data. IFRS 7 requires disclosures relating to fair value measurement using a three-level fair value hierarchy. The level which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. Assessing the significance of particular input requires judgement, considering factors specific to the asset or liability. To assess the significance of particular input to the entire measurement, the fund performs sensitivity analysis or stress testing techniques.

*Taxes*

Uncertainties exist with respect to the interpretation of complex tax regulations and changes in tax laws on foreign withholding tax. Given the wide range of international investments, differences arising between the actual investment income and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax expense already recorded. The Fund establishes provisions, based on reasonable estimates, for possible consequences of audits by the tax authorities of the respective countries in which it invests. The amounts of such provisions are based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the responsible tax authority. Such differences of interpretation may arise on a wide variety of issues depending on the conditions prevailing in the respective investment's domicile.  As the Fund assesses the probability for litigation and subsequent cash outflow with respect to taxes as remote, no contingent liability has been recognised.

#### 4. Standards, Interpretations and amendments issued but not yet effective

Standards issued but not yet effective at the date of issuance of the Fund's financial statements are listed below. The Fund intends to adopt applicable standards when they become effective.

**IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income**

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or "recycled") to profit or loss at future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has there no impact on the Fund's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

**IAS 19 Employee Benefits**

The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing corridor mechanism and the concept of excepted returns on plan assets to simple clarifications and re-wording. The amendment becomes effective for annual periods beginning on or after 1 January 2013. The fund has no employee benefits which would be affected by these amendments.

**IAS27 Separate Financial Statements (as revised in 2011)**

As a consequence of the new IFRS 10 and IFRS 12, what remains in IAS27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. As the fund has no subsidiaries, this amendment has no impact on the Fund's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

**IAS28 Investments in Associates and Joint Ventures (as revised in 2011)**

As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. As the fund has no associates or joint venture investments, this amendment has no impact on the Fund's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

**IFRS 7 Financial instruments: Disclosures – Enhanced Derecognition Disclosure Requirements**

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the financial statements to understand the relationship with those assets that have been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment becomes effective for annual periods beginning on or after 1 July 2011. The amendment affects disclosure only and has no impact on the Fund's financial position or performance.

**IFRS 9 Financial Instruments: Classification and Measurement**

IFRS 9 as issued reflects the first phase of the Board's work on the replacement of IAS 39 and applies to classification and measurement of financial assets as defined in IAS 39. The standard is effective for annual periods beginning on or after 1 January 2013. In subsequent phases, the IASB will address hedge accounting and impairment of financial asset. The completion of this project is expected over the course of 2011 or the first half of 2012. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Fund's financial assets but will potentially have no impact on classification and measurements of financial liabilities. The Fund will quantify the effect in conjunction with other phases, when issued, to present comprehensive picture.

**IFRS 10 Consolidated Financial Statements**

IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also replaces SIC-12 Consolidation – Special Purpose Entities. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 will require management to exercise significant judgement to determine which entities are controlled, and therefore required to be consolidated by a parent, compared with the requirements that were in IAS 27. This standard becomes effective for annual periods beginning on or after 1 January 2013. This amendment has no impact on the Fund's financial position or performance.

**IFRS 11 Joint Arrangements**

IFRS 11 replaces IAS 31 Interest in Joint Ventures and SIC-13 Jointly-controlled Entities-Non-monetary Contributions by Venturers. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead JCEs that meet the definition of a joint venture must be accounted for using the equity method. The application of this new standard will not impact the financial position of the Fund. This standard becomes effective for annual periods beginning on or after 1 January 2013.

**IFRS 12 Disclosure of Involvement with Other Entities**

IFRS 12 includes all of the disclosures that were previously in IAS 27 related to the consolidated financial statements, as well as of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard becomes effective for annual periods beginning on or after 1 January 2013.

**IFRS 13 – Fair Value measurement**

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use a fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Fund is currently assessing the impact that this standard will have on the financial positions and performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.

NOTE 2. INVESTMENTS REPORT

**Fund's investments report as of 31 December 2011**

| Name | Issuer | Country | Maturity | Nominal | Currency | Quantity | Average acquisition cost per item | Average acquisition cost total | Market value per item | Market value total | Interest rate | Proportion of fund assets market value |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Equities and units** | | | | | | | | | | | | |
| BPT Baltic Fund 1 OÜ | BPT Baltic Fund 1 OÜ | EE | - | 1 | EUR | 1 | 2 500 | 2 500 | 196 816 | 196 816 | - | 1.74% |
| BPT Baltic Fund 2 UAB | BPT Baltic Fund 2 UAB | LT | - | 1 | LTL | 1 | 2 895 | 2 895 | 2 895 | 2 895 | - | 0.03% |
| **Total equities and units** | | | | | | | | **5 395** | | **199 711** | | **1.77%** |
| **Long Term Loans*** | | | | | | | | | | | | |
| BPT Baltic Fund 1 8.5% EUR 30.12.2015 | BPT Baltic Fund 1 OÜ | EE | 30.12.2015 | 1 000 | EUR | 7 400 000 | 100 | 7 400 000 | 103.90 | 7 688 339 | 8.50 | 68.12% |
| **Total Long Term Loans** | | | | | | | | **7 400 000** | | **7 688 339** | | **68.12%** |
| **TOTAL SECURITIES** | | | | | | | | | | **7 888 049** | | **69.89%** |
| **Deposits*** | | | | | | | | | | | | |
| OVERNIGHT DEPOSITS-SWEDBANK (EUR) | SWEDBANK AS | EE | 2011.12.31 | | EUR | | | 3 398 948 | | 3 398 969 | 0.23 | 30.11% |
| **Total deposits** | | | | | | | | **3 398 948** | | **3 398 969** | | **30.11%** |
| **TOTAL** | | | | | | | | | | **11 287 019** | | **100.00%** |

**Accrued interest in the amount of 288 339 euros has been added to the value of long term loans; the accrued interest is recorded in the balance sheet under "Accrued income"*

**Accrued interest in the amount of 21.43 euros has been added to the value of deposits; the accrued interest is recorded in the balance sheet under "Accrued income"*

**Distribution of investments as of 31.12.2011**

| Euros | Amount | Proportion |
|---|---|---|
| Other securities | 7 888 049 | 69.89% |
| Deposits | 3 398 969 | 30.11% |
| **Total** | **11 287 019** | **100.00%** |

## NOTE 3. STATEMENT OF CHANGE IN NET ASSETS

| | 16.12.2010-31.12.2011 |
|---|---|
| **Total Fund net asset value** | |
| **- at the beginning of the period** | **-** |
| **- at the end of the period** | **11 146 064** |
| Cash received for fund units issued | 10 970 000 |
| Net result for the financial year | 176 064 |
| Number of units outstanding | 109 919 |
| NAV per Fund's unit | 101.4021 |

## NOTE 4. COMPARATIVE ANALYSIS OF THE NET ASSETS VALUE

| | 16.12.2010 | 31.12.2011 |
|---|---|---|
| **Net asset value of the Fund** | - | 11 146 064 |
| **Net asset value of Fund's unit** | - | 101.4021 |

## NOTE 5. OTHER OPERATING EXPENSES

| | 16.12.2010-31.12.2011 |
|---|---|
| Legal consultations | (20 250) |
| State fee | (187) |
| Notary fees | (119) |
| Real estate valuation | (8 683) |
| Other operating expenses | (91 076) |
| **Total other operating expenses** | **(120 315)** |

## NOTE 6. PRINCIPAL RISKS AND UNCERTAINTIES FACING THE FUND

### Market Risk

The investments are subject to the risks in relation to the ownership and operation of real estate, including risks associated with the general economic climate, local real-estate conditions, geographic or market concentration, the ability of the Management Company or third-party borrowers to manage the real properties, government regulations and fluctuations in interest rates. Since real estate, like many other types of long term investments, historically has experienced significant fluctuations and cycles in value, specific market conditions may result in occasional or permanent reductions in the value of real property interests. The marketability and value of real estate will depend on many factors, including but without limitation: (i) changes in general or local economic conditions; (ii) changes in the supply of or the demand for competing properties in an area (e.g. as a result of new construction); (iii) changes in interest rates; (iv) the promulgation and enforcement of governmental regulations relating to land use and zoning restrictions, environmental protection and occupational safety; (v) unavailability of mortgage funds or loans which may make the sale of a property difficult; (vi) the financial condition of tenants, buyers and sellers of properties; (vii) changes in real estate tax rates and other operating expenses; (viii) various uninsured or uninsurable risks; and (ix) acts of God, natural disasters and uninsurable losses.

### Credit Risk

Credit risk means primarily the risk that an issuer of the Security or counterparty to a transaction made on account of the Fund does not fulfil its obligations in part or in full.

In order to reduce credit risk, the Fund is aiming to diversify its investments and counterparties with low credit risk are preferred. Credit Risk also comprises pre-settlement and settlement risk.

Major acquisition and project finance credit risks are minimized by sharing these risks with banks and insurance companies. Credit risks related to the placement of liquid funds and to trading in financial instruments (counterparty credit risks) are minimized by making agreements only with the most reputable domestic and international banks and financial institutions.

As of 31 December 2011, the Fund had no loans, and there was one loan held by a subsidiary of the Fund, maturing in January 2016.

### Liquidity Risk

Liquidity risk means the risk of failure to liquidate open position, to realise the assets by the due time at the prescribed fair price or to refinance loan obligations.

Many of the investments will be highly illiquid and there can be no assurance that the Fund will be able to exit the investments in a timely manner. By their nature, real estate investments or interests in other non-public entities are subject to industry cyclicality, downturns in demand, market disruptions and the lack of available capital for potential purchasers and are therefore often difficult or time consuming to liquidate.

The Management Company makes its best efforts to ensure sufficient liquidity by efficient cash management, by maintaining a "liquidity buffer" and by organizing committed and uncommitted credit lines.

In order to minimise liquidity risk, a part of the Fund's assets may be invested in deposits of credit institutions, in short-term debt Securities and in other Securities with high level of liquidity. Also, derivative instruments may be used to reduce liquidity risk.

The Fund's policy is to maintain sufficient cash and cash equivalents within the Fund and its controlled entities or have available funding through an adequate amount of committed credit facilities to meet their commitments at a given date in accordance with its strategic plans.

### Interest Rate Risk

The Fund's policy is that long term loans should be hedged to a fixed rate for their whole life. This converts floating rate liabilities to fixed rate liabilities. In order to achieve this, the fund either takes fixed rate loans or swap fixed interest rates to floating using interest rate derivatives. As 1) the fund seeks to obtain financing at the best terms and conditions and 2) in the current market, fixed rate loans are often more expensive, the fund hedges interest rate exposure by using derivative instruments such as interest rate swaps, forwards and options.

The Fund and its subsidiaries acquire swaps purely for cash flow hedge purposes and not for trading.

The following table analyses the Fund's interest rate exposure. The Fund's assets and liabilities are included at fair value and categorized by maturity dates.

| As at 31 December 2011 | Up to 3 months | 1-5 years | Non-interest bearing | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Deposits | 3 398 948 | - | - | 3 398 948 |
| Loans | - | 7 400 000 | - | 7 400 000 |
| Securities | - | - | 199 711 | 199 711 |
| **Total assets** | **3 398 948** | **7 400 000** | **199 711** | **10 998 659** |

| As at 31 December 2011 | Up to 3 months | 1-5 years | Non-interest bearing | Total |
|---|---|---|---|---|
| **Liabilities** | | | | |
| Other liabilities and accruals | - | - | 140 955 | 140 955 |
| **Total liabilities** | **-** | **-** | **140 955** | **140 955** |
| **Total interest sensitivity gap** | **3 398 948** | **7 400 000** | **58 756** | **10 857 704** |

As at 31 December 2011 all Fund's subsidiaries' bank loans were fully and effectively hedged for interest rate risks.

### Foreign exchange risk

Fund's policy is to match cash flows arising from highly probable future sales and purchases in each foreign currency. The Fund does not use any financial instruments to manage their exposure to foreign exchange risk other than aiming to borrow in EUR, to which LTL, LVL are pegged.

All Fund's and its subsidiaries' assets are in local currencies or in EUR, to which local currencies are pegged. Therefore, the Fund's exposure to foreign exchange rate risks from its monetary assets and liabilities is low. In case of possible changes in LTL or LVL exchange rates, impact on the Fund's equity and profit/(loss) before tax would be immaterial.

As of 1 January 2011, after being accepted to the EMU, Estonia has started to use EUR as its main currency.

## NOTE 7. ISSUED LOANS

| Debtor | Balance 31.12.2011 | Interest rate | Accrued interest 31.12.2011 | Maturity |
|---|---|---|---|---|
| BPT Baltic Fund 1 OÜ | 7 400 000 | 8% | 288 339 | 31 December 2015 |

Accrued interest in amount of EUR 288 339 has been added to the value of long term loans. The accrued interest is recorded in the balance sheet under „Accrued income“.

## NOTE 8. ADDITIONAL NOTES

As of 31 December 2011, there were no commitments and/or contingencies issued by the Fund.

There were no significant events after the reporting period.

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