THE ADVISERS
Prime Property

in association with Knight Frank

2013 ROMANIA MARKET OVERVIEW

Review & outlook

HIGHLIGHTS

- The take-up of Bucharest office space amounted to 220,000 sq m in 2012. There was a significant increase in pre-lease activity, which accounted for around 30% of the total take-up. New supply was limited to only 60,000 sq m, the lowest level in the last 5 years.
- Retail development activity was relatively subdued in 2012, with difficult financing conditions acting as a barrier to the construction of large-scale projects. Several domestic and international retail chains have continued to pursue expansion plans in the Romanian market.
- Take-up in the Bucharest industrial market was recorded at 62,000 sq m in 2012, a 30% decrease on 2011. However, a number of regional markets across Romania saw increased activity.
- Romanian investment volumes in 2012 were similar to the previous year, at approximately €250 million. A number of potential deals were at advanced stage of negotiations in late 2012, which suggests that transaction volumes will increase in 2013.

Contents

1. OFFICE MARKET

Charles de Gaulle Plaza

2012 featured the highest pre-lease activity in four years, with 60% of these deals negotiated by The Advisers/Knight Frank, totalling 36,000 sq m.

Supply

Bucharest's modern office stock reached 1.7 million sq m in 2012, with new deliveries amounting to 60,000 sq m. Additionally, Bucharest Tower Center (22,000 sq m), was only made available for leasing in 2012, despite being completed several years earlier.

The majority of the buildings delivered in 2012 were small or medium sized office premises. Unicredit, for instance, relocated to a new building of 15,000 sq m GLA on Expozitiei Boulevard, which was a built-to-suit project.

THE RECORD-QUICK LEASING OF AVAILABLE SPACE IN THE LANDMARK CHARLES DE GAULLE PLAZA INDICATES THE HEALTHY LEVEL OF CURRENT DEMAND.

Floreasca Park

Another project of note is AFI Park 1, a 12,000 sq m GLA building located in Center West, which was delivered in H2 2012. The building is the first of the five phases of AFI Park, which is part of a mixed-use project alongside the AFI Palace Cotroceni shopping mall. Another building delivered as an additional phase of an existing project was West Gate Park H4, further proving developers' faith in the West and Center West of Bucharest. These two particular areas accounted for 30% of new deliveries in 2012.

Despite these new completions, the amount of new office space entering the market in 2012 decreased in comparison with 2011.

Demand

In 2012, the take-up of space in modern office buildings amounted to 195,000 sq m. Additionally, 25,000 sq m was leased in unconventional office buildings. Thus, the total take-up of 220,000 sq m registered in 2012 was fairly similar to 2011's total of 240,000 sq m.

New demand, pre-lease and renegotiation transactions accounted for similar shares of total activity in 2012, each with about 30% of the total space transacted.

Most importantly, pre-lease activity in 2012 was stronger than it was during the 2009-2011 period, when pre-leases were a rare phenomenon. Companies in the IT&C sector have had a particularly big impact on this, and have allowed the construction of a number of important projects to start. Oracle in Floreasca Park, TeamNet International in Green Gate and Microchip Technology and Endava in AFI Park 1 are pre-lease deals concluded with The Advisers/Knight Frank involvement.

There has been a reconfirmation of demand for offices in the established business areas of Bucharest, with the CBD and the Calea Floreasca-Barbu Vacarescu area between them accounting for almost 45% of the total space leased in 2012. Not far behind, the Center West area also performed well, with 20%.

Approximately 40% of the total volume of office space transacted in 2012 was leased by companies from the IT&C sector, followed by the finance and banking sector with 14% and manufacturing, industrial and energy with 12%.

At the end of 2012, prime headline rents in Bucharest's CBD were estimated at €16-19 per sq m per month. Rents are lowest in the city outskirts, especially in the Pipera area. Depending on the size of the leased area and the duration of the contract, incentives granted to tenants (rent-free months, fit out contributions) mean that net effective rents are €1-3 sq m per month lower than headline rents.

Forecast

Taking into consideration buildings that are currently under construction, a total of around 125,000 sq m of new office space is forecast to be delivered in 2013. Of this total, approximately 40% was pre-leased by the end of 2012. New delivery levels are fairly stable, with the relatively modest forecast for 2013 being similar to the totals recorded in 2011 and 2012. The projects that are currently under construction are mostly large scale, and there is a strong trend towards the construction of buildings with green certification.

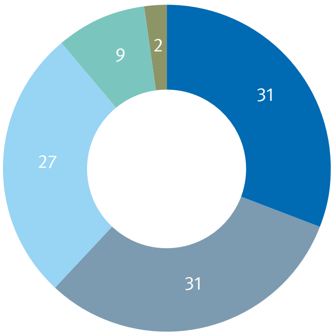
Tenant demand in 2013 is expected to remain at a similar level to 2012, while pre-leases will continue to account for a significant share of the total volume of space transacted. Rents are expected to increase slightly for prime office buildings in the CBD. Most of the prime space which has become available because of recent consolidations has already been leased, and transactions are expected to be closed in H1 2013, at the latest, for the remaining available space. Outside of Bucharest, an increase in demand is foreseen in cities such as Cluj, Iasi and Timisoara which are expected to appeal to occupiers from the IT sector.

THERE WAS A SIGNIFICANT INCREASE IN PRE-LEASE ACTIVITY IN 2012.

Figure 1

Office leasing transactions by type, 2012

%

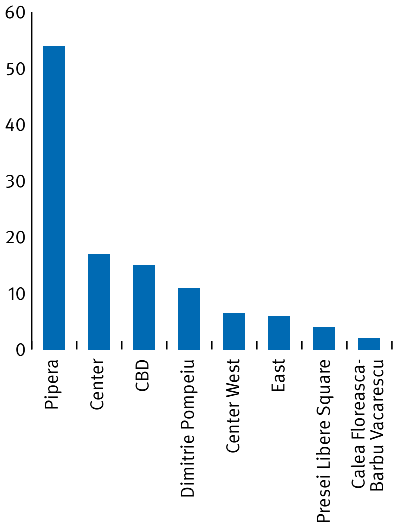


Source: The Advisers/Knight Frank

Figure 2

Class A office vacancy rates by district

%

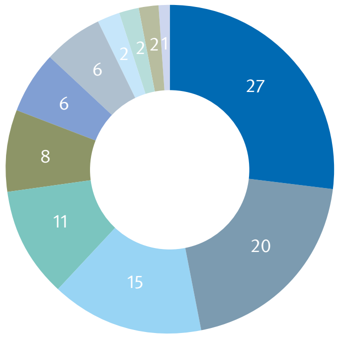


Source: The Advisers/Knight Frank

Figure 3

Bucharest office take-up by district

%



Source: The Advisers/Knight Frank

AFI Park 1

Table 1

Prime headline rents by district

District	Rent (€/sq m/month)
CBD	16-19
Calea Floreasca - Barbu Vacarescu	16
Presei Libere Square	15-16
Center West	14-16
Baneasa	14-15
Dimitrie Pompeiu	12-14
East	12-14
West	11-13
Pipera	10

Source: The Advisers/Knight Frank

THE CENTER WEST AREA OF BUCHAREST HAS CONSOLIDATED ITS POSITION AS A MAJOR OFFICE HUB.

Cora Alexandriei

2. RETAIL MARKET

Overview

Despite a significant increase in the amount of new retail stock delivered in H2 2012 compared with H1, the overall level of new completions in 2012 was well below that of recent years.

Supply

As a general trend, 2012 was characterized by the opening of more shopping galleries attached to "big-box" developments, rather than the opening of stand-alone shopping malls. However, two major retail projects opened their doors in 2012: Palas Iasi, delivered by Iulius Group in H1 and Ploiesti Shopping City, delivered by NEPI in H2. The latter is the first shopping mall to be opened in the Prahova region, north of Bucharest. In the second half of 2012, Bucharest saw the delivery of new retail schemes such as Cora Alexandriei, Auchan City Crangasi and InterCora Mihai Bravu, making the new supply in H2 greater than in H1.

Demand

Shopping centers that were able to maintain a high or satisfactory level of footfall have improved or made few changes to their tenant mix. No new major retailers entered the market in the second half of 2012, in contrast with the first which saw the entry of retailers including Subway, CCC and Oggi. Demand has been mainly driven by hypermarkets and big fashion retailers. Throughout 2012, H&M, the Inditex Group, New Yorker, Deichmann and Humanic have pursued expansion plans, strengthening their presence in the Romanian market.

Rents

There was good news for retailers in the form of a slight decrease in rental levels for projects which are currently under development, with rents falling by 10-20% in some cases, as a result of a weakening consumer outlook. For existing projects, rents have slightly decreased, although there are naturally differences between the rents achieved in the best performing shopping centers and less attractive schemes.

Table 2

Average shopping center rents

City	Rent (€/sq m/month)	
	H1 2102	H2 2012
Bucharest	17-24	17-23
Cities with more than 200,000 inhabitants	14-18	12-17
Cities with 150,000-200,000 inhabitants	10-14	9-13

Source: The Advisers/Knight Frank

Table 3

Retail projects under construction

Project	City
Promenada Mall	Bucharest
Uvertura Mall	Botosani
Coresi Shopping City (phase 1)	Brasov
Corall	Constanta
AFI Palace Ploiesti	Ploiesti

Source: The Advisers/Knight Frank

Table 4

Retail projects delivered in 2012

	City	Delivered
Palas Mall	Iasi	H1
Cora Alexandriei	Bucharest	H2
Crangasi Shopping Center	Bucharest	H2
InterCora Mihai Bravu	Bucharest	H2
Cora Bacau	Bacau	H2
Ploiesti Shopping City	Ploiesti	H2

Source: The Advisers/Knight Frank

Forecast

Difficult financing conditions, concerns about the local economy and the Eurozone crisis' impact on public spending have made shopping mall development less attractive. The development of major retail schemes has also been discouraged by banks requiring pre-lease levels of up to 70% before financing projects and by the exacting requirements of retailers. However, the 2013 pipeline includes new projects such as Promenada Mall in Bucharest and AFI Palace in Ploiesti. A series of other developments have also been announced but have not yet started construction, so are unlikely to be completed in the coming year. Big box schemes are also due throughout the country in 2013, such as Corall in Constanta.

High street retail

Overview

High street retail activity in Bucharest maintained its pace throughout 2012. The Old City Center remains a major focus of demand, while retail space in office developments has become increasingly popular.

Supply

New deliveries to the Bucharest high street retail market have been limited. Most of these have been in the Old City Center and mainly consist of renovated buildings which have been redelivered to the market. Future deliveries are also expected in this area, with new projects on Selari Street and Lipscani Street either under construction or close to being finalized. Retail property within office developments was very active throughout 2012, and this part of the market has evolved from small food shops to supermarkets, coffee shops, fast food restaurants, gyms and even to full commercial galleries occupying the whole ground floor of office buildings. For example, the America House office building in Victoriei Square renewed the retail mix of its commercial gallery, which takes up the whole of its ground floor.

Demand

Following the trend seen in H1, the second half of 2012 saw significant demand from supermarket chains continuing their expansion. Restaurants, pubs and clubs in the Old City Center have also been very popular, and this location remains the most active in the high street market. Demand from fashion retailers is still mainly directed towards shopping malls due to lack of proper high street locations and Romanian consumers' preference for shopping in retail centers. However, the Old City Center still offers significant exposure and thus well-known fashion brands are expected to enter this area in the near future. In the luxury segment, Roberto Cavalli opened its doors to the public at the end of 2012, in the JW Marriot shopping gallery which also accommodates Louis Vuitton, Escada and Valentino. Also, Victoria 46 relocated from its eponymous address to a significantly larger space on Calea Dorobantilor Street.

Escada Store

Rents

With the exception of the Old City Center, which still registers the strongest level of demand, high street rents across Bucharest have recorded a slight decrease. Two relevant examples are Magheru Boulevard and Nicolae Balcescu Boulevard, which both currently have relatively high vacancy rates in spite of their central locations.

Forecast

The trends seen in the high street market during 2012 are expected to continue in 2013. Given that retail activity reflects the strength of the country's economy and consumption levels, retailers will have to adapt their businesses in order to maintain or strengthen their positions in the market. Examples of this are food retailers that are considering different store formats in terms of both size and concept.

3. INDUSTRIAL & LOGISTICS MARKET

Supply

Throughout 2012, the industrial and logistics market was characterized by almost a complete lack of speculative development and few new deliveries, aside from Bucharest West Park (20,000 sq m) by Portland Trust in H2.

The total stock of industrial space in Bucharest remained almost unchanged at 970,000 sq m, as compared with 940,000 sq m in 2011.

Demand

In 2012, the Bucharest market saw the take-up of approximately 62,000 sq m of industrial space, including the pre-lease of DSV in Bucharest West Park. Take-up was 30% down compared with the previous year. However, the decreased activity in Bucharest was balanced out by improvements in other major industrial markets such as Ploiesti, Pitesti, Brasov, Timisoara, Cluj and Craiova.

Tenants maintained a cautious outlook throughout the year and carried out bolder negotiations in order to secure high quality warehouse/production facilities at the lowest possible rents.

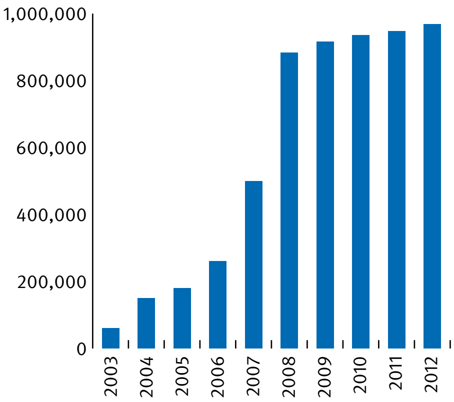
The logistics sector and the retail industry were most active in 2012, followed by construction companies, IT&C and the healthcare sector. The overall vacancy rate in the Bucharest industrial market increased moderately, from 10% to 12%.

Rents

Average rents for industrial and logistics space remained stable during 2012, ranging between €3.40-4.30 per sq m per month, depending on the size and duration of the lease, as well as the location. Service charges also remained stable, in the €0.50-0.95 per

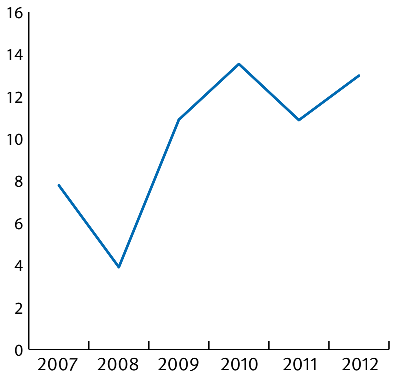
Bucharest West

Figure 4
Bucharest industrial stock
sq m



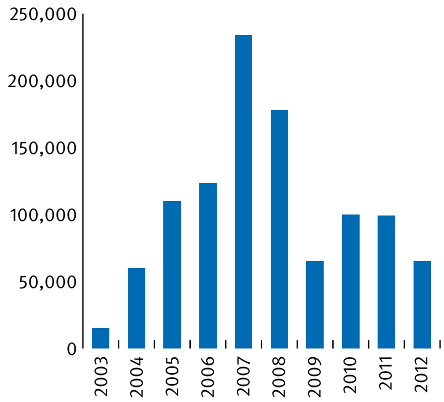
Source: The Advisers/Knight Frank

Figure 5
Bucharest industrial vacancy rates
%



Source: The Advisers/Knight Frank

Figure 6
Bucharest industrial take-up
sq m



Source: The Advisers/Knight Frank

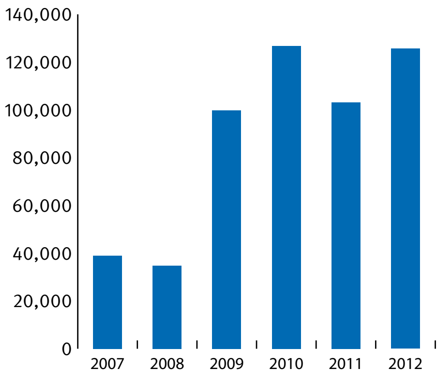
sq m per month range. The average lease period is between 3-5 years, rising to 7-10 years for built-to-suit projects. It also worth noting that it is now an established market practice for landlords to offer a significant package of incentives to tenants.

Forecast

Compared with 2011 and 2012, new supply is only likely to reach higher levels in 2013 if there is a clear increase in industrial market demand. As in recent years, tenants will continue to be cautious and the number of transactions will remain low, while rents will remain stable. The commencement of new developments is expected to remain limited, with the exception of built-to-suit projects. However, manufacturing industry, in particular automotive manufacturing plants, may have a positive effect on the industrial and logistics market in light of the low supply for this sector.

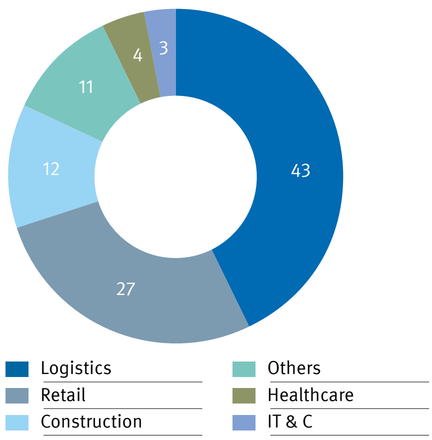
THE BUCHAREST INDUSTRIAL VACANCY RATE ROSE A LITTLE IN 2012, REACHING 12%.

Figure 7
Bucharest industrial availability
sq m



Source: The Advisers/Knight Frank

Figure 8
Industrial leasing transactions by type, 2012
%



Source: The Advisers/Knight Frank

Table 5
Prime rents and service charge ranges

Size (sq m)	Rent (€/sq m/month)	Service charge (€/sq m/month)
‹3k sq m	4.00-4.30	0.50 – 0.95
3k-10k sq m	3.70-4.00	0.50 – 0.95
›10k sq m	3.40-3.70	0.50 – 0.95

Source: The Advisers/Knight Frank

4. LAND MARKET

Overview

Following the stabilization of prices in 2011 and 2012, and a trend towards greater caution in the planning of real estate development, the land market has entered a more mature phase. Nevertheless, there are plenty of land plots throughout Romania which will offer interesting opportunities for developers and investors in 2013, as well as in the years to come.

Supply

Supply is expected to increase in the Romanian land market. It is foreseen that banks will put high quality land plots up for sale as distressed properties. Unlike other countries in the CEE region, Romania still presents many opportunities for development, as there are a high number of brownfield properties in very good locations, which provide land suitable for developments with multiple end uses.

In order to facilitate transactions, the current market practice is for landlords to be flexibile in the selling process, managing building permits on behalf of buyers and even being open to splitting land plots.

Demand

In Bucharest, demand has mostly been driven by development in the office sector. Skanska, one of the world's leading project development and construction groups, purchased a land plot of 1.5 ha on Gara Herastrau Street, in the Calea Floreasca-Barbu Vacarescu office hub. Also, the 7.7 ha Vulcan factory in south west Bucharest was sold to Benevo Capital, a Canadian real estate investment company, for an estimated price of €23 million.

Demand was also directed towards smaller land plots with areas of 500-600 sq m in prime locations. Such land plots were sold at prices ranging from €1,500-2,000 per sq m, when benefitting from approved building permits.

Retailers remained active buyers throughout the country in 2012, although their demand did not reach the level seen in 2011. An example of a company expanding strongly is the Romanian DIY chain, Dedeman, with 30 stores spread throughout Romania. The latest addition to the retailer's portfolio is a 3.3 ha land plot in Galati purchased from GTC in H2 2012, in a transaction intermediated by The Advisers/Knight Frank. While the hotel industry is also generating increased interest for land, demand from the residential sector was focused on smaller land plots rather than large sites. It is also worth mentioning that the joint-venture trend gradually lost its popularity, given the difficulty of managing complex collaborations in the current business climate.

Prices

Prices remained at constant levels throughout 2012, continuing the trend of stabilization seen in recent years. Potential buyers were more cautious mainly due to the current market conditions, rather than the level of prices.

Table 6

Average land prices by location (€ per sq m)

	Progresului	Timpuri Noi	Barbu Vacarescu/ Calea Floreasca	Lujerului	Bucurestii Noi
2010-2012	500-600	450-500	900-1,100	400-450	400-500

Source: The Advisers/Knight Frank

Forecast

Price levels for land plots are expected to remain stable in 2013. In Bucharest, demand is likely to increase slightly in well developed areas benefitting from good infrastructure. The office sector is expected to witness most interest, followed closely by retail developments.

As in the last few years, central land plots with good development prospects will continue to be among the most attractive for investors. A novelty in the market is the interest in new, emerging areas of Bucharest, rather than those which have been preferred in past years. The Bucurestii Noi area is appealing to investors for many reasons, including the limited current supply of retail, office or even residential projects, lower prices than established areas, the existing infrastructure in place, good transportation and easy access to National Road 1. Thus, 2013 is expected to see increased development activity in this location across all real estate sectors.

LAND PLOTS IN THE BUCURESTII NOI AREA ARE ATTRACTING INCREASED INTEREST FROM DEVELOPERS.

5. INVESTMENT MARKET

2012 was another modest year for the Romanian real estate investment market, with limited activity both in terms of transactions and the number of investors showing interest in the market.

Limited financing options and the overall political uncertainty prevented many new investors from entering the market. Thus, the total investment volume remained at a similar level to 2011, at approximately €250 million. However, at the end of the year, there were promising signs for 2013 with a number of transactions being closed and several advanced discussions underway.

Supply

Institutional investment product is available for sale in each sector of the real estate market. Such product offers the required criteria of long leases, sustainable rents, solid tenants and good technical specifications.

Victoriei Square and the Calea Floreasca-Barbu Vacarescu areas are the most soughtafter locations for investments in the office sector. This is due to their emerging profiles as important business hubs supported by significant infrastructure works carried out recently, such as the Basarab Bridge.

Another area of interest, albeit less so for institutional investors, is the Old City Center of Bucharest which also saw the delivery of new underground parking, which will further facilitate access for visitors. With the recent renaissance of the Old City Center, the area between University Square and Romana Square has also become increasingly attractive to retailers and developers.

Demand

Several investors already present in the market remained the main drivers of the activity in 2012. NEPI acquired City Business Center from Ovidiu Sandor in Timisoara, while a company owned by Ioannis Papalekas and Dragos Bilteanu purchased Bucharest Tower Center, a landmark office building in Bucharest.

A number of new investors started to become more active by familiarizing themselves with the Romanian market and performing their market due diligence. Some attempted to acquire properties and are in negotiations for prime assets but, with transaction processes taking longer than has previously been the case, no deals were closed. The limited availability of senior debt remains a significant barrier to activity, but new investors also remain cautious about certain country risks relating to the legal environment and political volatility. Demand is strongest for prime offices located in central and semi-central areas of Bucharest and other major cities, as well as big boxes occupied by food retailers.

Table 7
Key investment transactions, 2012

Property	City	GLA (sq m)	Date
Litexco office building	Bucharest	2,500	H1 2012
City Business Center	Timisoara	43,000	H1 2012
Bucharest Tower Center	Bucharest	22,000	H2 2012
Nova Building	Bucharest	6,800	H2 2012
HQ Victoriei	Bucharest	5,000	H2 2012

Source: The Advisers/Knight Frank

Yields

Prime yields remained relatively stable throughout 2012.

Forecast

Table 8
Prime yields (%)

Office	Retail	Industrial
8.25-8.75	9.00-9.50	10.00-11.00

Source: The Advisers/Knight Frank


Bucharest Tower Center

The increased negotiation activity seen in late 2012, following the stabilization of the political situation, should drive the number of transactions upwards in 2013. Several prime office buildings in Bucharest are expected to change ownership in H1 2013. Moreover, by the end of the year, new entries to the market are expected to further boost investment volumes.

INCREASED INVESTOR INTEREST IN LATE 2012 BODES WELL FOR IMPROVED TRANSACTION VOLUMES IN 2013.

6. RESIDENTIAL MARKET

This analysis only considers new developments with more than 100 announced units, located within the capital's city limits or in landmark projects in satellite locations. The research addresses more than 70 active residential projects, both existing schemes and projects under construction.

Supply

The residential stock of Bucharest barely changed throughout 2012, with new deliveries consisting of just 1,500 apartments in 11 different projects. This represents only a 0.15% increase in Bucharest's total apartment stock, which is estimated at 1,000,000 apartments. According to international standards, it is recommended that a city replaces 1-2% of its housing stock annually (10,000–20,000 units in the case of Bucharest) in order to maintain its housing standards. Romania's low rate of new deliveries can be correlated to the effects of the international financial turmoil on the local real estate market.

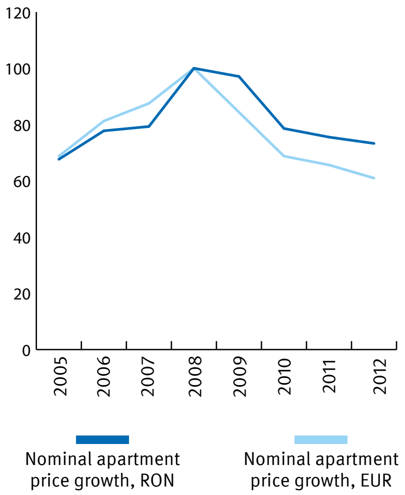
Adding 2012's new completions to others delivered in recent years, the total stock of new apartments in the capital is approximately 25,000 units, of which 25% are still up for sale directly from developers. However, if units that are currently up for a second sale and smaller residential projects are also taken into account, Bucharest has a residential offer of somewhere between 8,000-10,000 new apartments.

With a high percentage of newly delivered apartments remaining unsold, developers have used a range of marketing methods in order to make their apartments more attractive to buyers. For example, a parking space or storage box may be included in the price of the apartment, or different purchasing schemes may be made available to buyers, such as rent-to-buy or move now and pay in a year schemes. Another trend which has been strongly adopted by developers is to make apartments available for rent instead of only considering selling them. In this way, developers have hedged the monthly costs of their premises, while holding the properties for an expected capital gain after the rental period.

Figure 9

Evolution of average apartment prices

Indexed, 2008=100



Source: The Advisers/Knight Frank

Most of the deliveries in 2012 were new phases of existing developments, such as Cosmopolis, Felicity, Militari Residence and NewTown Residence. Approximately 70% of the new offer is located in peripheral areas of the city, in standard residential compounds. This distribution of the new offer towards the periphery is a result of demand being focused on dwellings which are suitable for government programs.

Regarding future new supply, the experienced residential developer Adama has announced the construction of new phases of Edenia and Evocasa Optima, two existing projects in eastern Bucharest. Another important source of new deliveries that has been noted in the market is high net worth individuals (HNWIs), who have invested in real estate development without necessarily needing to resort to financing.

A POSITIVE NET ABSORPTION WAS RECORDED IN BUCHAREST'S RESIDENTIAL MARKET IN 2012.

Demand

As in the last few years, demand was mostly driven by the "Prima Casa" (First Home) and 5% VAT social programs. Financing conditions toughened after the crisis emerged, but the "Prima Casa" program helped to sustain demand for residential property. The 24% VAT to be applied to sales of new dwellings is a barrier to entry in the residential development market, as properties to which 5% VAT is applicable are the only solution for most buyers.

Having said this, the total sales of units purchased directly from developers in 2012 is estimated at approximately 2,000 apartments, indicating a positive absorption when compared to deliveries. The number of unsold existing apartments did not decrease significantly during the year, as a result of growing sales in projects that are yet to be delivered.

As for the pace of sales, 3-5 units were purchased on average each month, depending on location and type of the project. Thus, projects with market based prices sold consistently each month, while developers who were unrealistic on pricing achieved limited sales.

Developers who owned schemes designed before the crisis found themselves in the position of selling most of their studios and one bedroom apartments (dwellings suitable for the government programs), but are now struggling to dispose of their larger units, on which 24% VAT is imposed.

Off-plan sales have become an important part of the take-up, especially in the case of projects which have existing completed phases and have thus gained the confidence of buyers. Nevertheless, the current buyer is well-researched and expects guarantees for signing off-plan, as well as incentives in terms of price reductions.

Prices

In terms of prices, 2012 brought a further decrease of around 5-10%, or even more in the case of projects that have reached insolvency and entered a process of reorganization.

Several such apartment projects announced significant price reductions after valuations, thus generating increased demand.

The weighted average price of apartments in the monitored projects currently stands at approximately €975 per built sq m. This all-time low threshold might still be under passed if financing conditions do not improve. During 2012, several banks announced their intentions to only grant RON based mortgages, which are more expensive than the previously used EUR anchored debts. This might result in a decreased demand and consequently lead to further falls in residential prices.

Forecast

In the short-to-medium term, the evolution of the residential market is dependent on both developments in the wider economy and the availability of financing. Prices are expected to stabilize once the economy shows signs of improvement and financing is available at affordable prices.

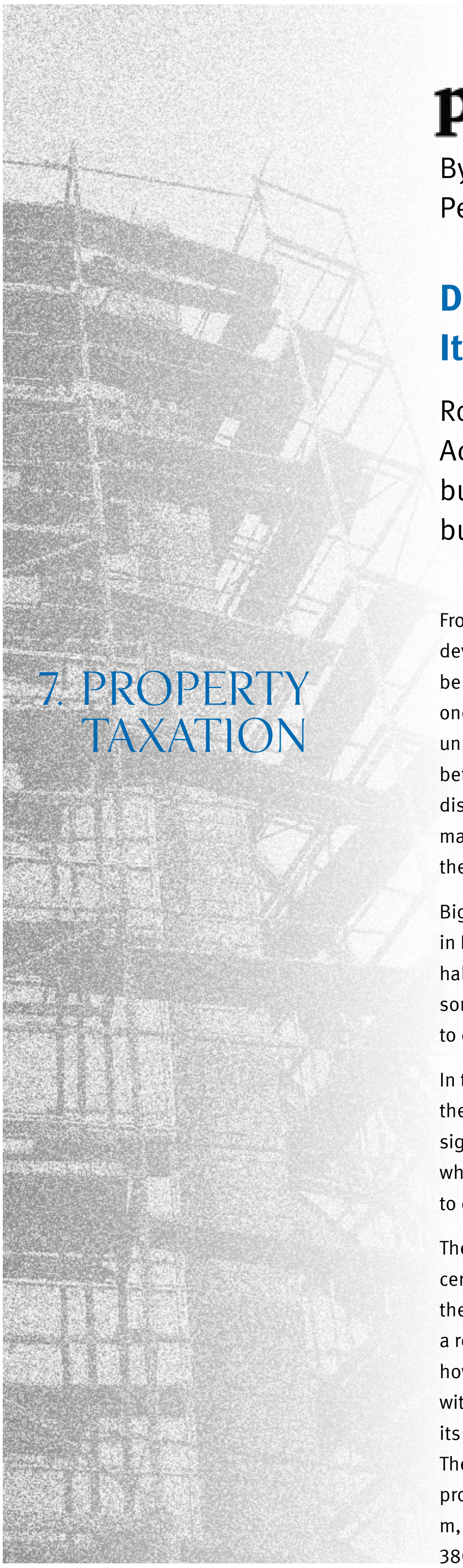
The government's announced plans to introduce the "Noua Casa" ("The New House") program were a very good sign for the residential market, especially in Bucharest. By offering state guarantees only for new dwellings as a change, this program could considerably impact the residential market by boosting construction, thus reducing the barriers to entry into the local residential development market.

Table 9

Asking price by project type

Project type	% of total new stock	Asking price range (€/built sq m)
Low	47%	600-900
Medium	23%	900-1,100
High	27%	1,000-1,400
Upper	3%	1,500-2,000

Source: The Advisers/Knight Frank



7. PROPERTY TAXATION

By Theodor Artenie, Senior Manager PwC,
Peter de Ruiter, Partner PwC, Daniel Anghel, Partner PwC.

Do not be afraid of the VAT exemption... It may be good for you!

Romania has one of the highest VAT rates in Europe, at 24%. Adding this percentage to current prices can create quite a burden for your average day-to-day customer who is looking to buy and for whom VAT is an additional cost.

From this perspective, being a real estate developer in Romania nowadays may not be so appetizing anymore, especially if one's main business is residential. The unprecedented period of expansion just before 2008, remains a bittersweet and distant memory for the Romanian real estate market, as well as other markets across the globe.

Big cities, whether Bucharest or any other city in Romania, are plagued by empty buildings, halted development projects which are sometimes more expensive to preserve than to demolish and untapped land plots.

In the aftermath of the real estate bubble, there are developers who were left with significant stock of residential properties which are now simply gathering dust. What to do?

The Romanian regulatory bodies introduced certain fiscal measures aimed at alleviating the burden of VAT on end consumers, namely a reduced VAT rate of 5%. The downside, however, was that this reduced rate came with a set of restrictions that reduced greatly its applicability to existing properties. These restrictions referred to the size of the property, which had to be less than 120 sq m, and the price, which had to be below RON 380,000.

In addition, each developer had his own package to offer (some offered storage spaces and/or parking places, others offered amenities such as furniture and appliances, etc). Under these circumstances, it would have been quite difficult to apply 5% VAT to the entire package, particularly as the legal framework for the reduced rate was (and still is) not very clear.

That did not stop Romanian developers from coming up with all sort of creative solutions to apply the reduced VAT rate to their own stock of apartments. Some of these solutions were defendable based on the existing legal framework, others were not, but none of them were bullet proof.

As you might expect, creativity is proportional to the level of risk to which one is exposing oneself. The more creative one is the riskier it gets. The Romanian tax authorities are quite thorough when it comes to reduced VAT rates as they have an impact on the revenue generated for the public purse. Under these circumstances, a lot of the above mentioned solutions were challenged and a number of developers found themselves slapped with significant VAT assessments, penalties and late payment interest.

Someone once said that running a business is like riding on a rollercoaster. Although it is fun and exciting, there will be times when you'll feel scared, powerless and nauseated. During the bad times there isn't much you can do, other than to keep on pushing forward. If you want to win the race, you have to be in the race.

Regardless, continuously "walking on the ledge" with creative solutions to apply 5% VAT may not be a sound medium or long term business strategy.

We believe it is now time to look at other solutions which, although they are a bit more difficult to implement in practice, have the proven potential to generate price reductions and implicitly to create the pricing advantage that can make a difference in a very competitive market.

One of these solutions is to sell properties (especially residential) within the VAT exemption regime, that is to say, without VAT. According to the legal provisions in force, the sale of buildings which are not considered "new" (and this distinction could apply inter alia to apartments completed as late as 2011 and still in the stock) can be made without charging VAT. In this case, applying VAT on the transaction value is optional for the seller.

Indeed there is the matter of the tag-along VAT costs for the seller if they do not charge VAT on sales. This is because if the seller incurred VAT on development or acquisition, but then sold the property within the exemption regime, it would be required to reimburse to the state budget whatever input VAT was recovered during the investment phase. In the "boom days" of the market, the seller's view was that VAT, if applicable, was the buyer's cost, and the seller would simply charge VAT if that created the best answer in terms of recoverability.

It goes without saying that this paradigm is no longer valid. In a world where access to lending is subject to prohibitive terms, managing the buyer's costs without impacting one's profitability may prove the winning alternative. What better way to reduce the prices of real estate assets and make them more appealing for potential customers than to sell them without an extra 24% added to the price?

Of course, one must not lose sight of the tag-along VAT costs which need to be recovered from somewhere... most likely from the buyer. From that perspective, it is quite important that these costs are quantified properly and objectively so as to not match the advantage triggered by the VAT exemption. This is in fact the trick to make the VAT exemption work and we believe we have identified the necessary tools to keep the VAT cost per square meter to a minimum.

The good thing about this approach is that the legal framework is more flexible and has fewer restrictions than that relevant for the reduced VAT rate. Consequently, there is more room for risk-free innovative solutions than before.

We already see developers starting to contemplate the VAT free sale and investigating various ways to control the VAT cost per square meter. This tells us that, when everything else fails, the hard way may very well be the best way.

Under the circumstances, it is time to put on those old racing shoes because the pricing race is back on and the market waits for no one.

8. LEGAL ISSUES

BIRIŞ·GORAN
Legal + Tax

By Victor Constantinescu, Head of Real Estate Department, Biriş Goran SCPA.

Optimizing your Facility Management agreements:

Some legal tips for owners

As owners of commercial real estate wait for market conditions in Romania to improve, they are doing their best to maintain the value of what they have. A facility manager is often a key component in this effort, ensuring the daily care of the property to meet the requirements of both occupier and owner.

But as Murphy's Law intervenes and problems invariably arise, contracts are put to the test. At the same time, with limited budgets and patience, these types of contracts are not getting the legal attention that they probably should.

With that in mind, the purpose of this article is to highlight some issues that an owner of commercial real estate should be mindful of when preparing to sign a facility management agreement ("FMA"), both from a practical perspective (issues we have seen as lawyers) and clauses from the New Civil Code (which has a new section dealing with the administration of the property of others, under which facility managers qualify) with a direct impact.

1. Have a communication process that works

This may seem obvious, but one of the biggest issues we have seen with FMAs, and property management agreements generally, is faulty communication. A facility manager will often complain that they cannot get an answer in time to resolve a pressing issue. Besides having a key contact person at the facility manager, and one that you can get along with, the owner should ensure that someone from their end is authorized to speak to the facility manager and make decisions relatively quickly. Often owners make the situation worse by having complicated internal approval processes, with multiple signatures.

We had a client manager approach us for legal advice because a fund owner had not paid electricity bills and security, and as a result the light on a construction crane was turned off, making it almost invisible at night. The crane, as it happened, was in a routine flight path of a nearby airport. Obviously we made SOS appeals to the fund owners that were thankfully answered.

But the point is that this should never have happened – the owners' procedures were too cumbersome. To the extent that owner approval procedures can be streamlined, they should be. Often, facility managers may well be absolved of liability if the owner does not respond in time, or does not follow the facility manager's advice.

2. Write it down: scope of services

The scope of services in FMAs is often ill-defined. The parties assume that they are on the same page as to what needs to be done without looking at the fine print. Services need to take into account flexibility, particularly in long-term contracts where change is likely. Relations with authorities are often an issue – who deals with them? Performance indicators – are they clear, who determines them and who pays? Does your lease contract provide for particular services, which should be reflected in your FMA? What happens in the event of variations to services? What are standard services and what are not? And another often overlooked point: what are the obligations of the facility manager upon exit?

Write down your services and brainstorm – and then share your list with the facility manager. You will be surprised how many items begin to generate questions or the response "I thought you were dealing with that."

3. Facility Manager's liability can be limited by law

Owners should be aware that the Civil Code contains a number of provisions that can benefit the facility manager in the event of a dispute. One such clause is related to the point of scope of services: Article 802(2) of the new Civil Code provides that an administrator (facility manager)

"…is not liable for loss of the property resulting from force majeure or from its age, its perishable nature or its normal and authorized use."

This may seem obvious, but the expectations of different parties can diverge as to what the facility manager should or should not be doing. Can the facility manager simply say that it is not part of his job to maintain a pipe or cable, because it's too old or it's been used too much? Although it is too soon to have Romanian case guidance because the Civil Code is too new, a recent Quebec superior court ruling (which Romanian courts have been urged to review generally at the instigation of the Romanian Ministry of Justice) provides some interesting insight. The Quebec Superior Court, for instance, relying on the same provision in the Quebec Civil Code, held that a building manager of an older apartment complex could not be held liable for damage to the property that the owners were asking for. In so deciding, the court took a number of factors into account, such as age of the building, and the fact the owners did not place funds at the manager's disposal to address issues relating to the age and usage of the apartment.

So what does this mean? Again, be specific as to what the facility manager should be doing. There should be some acknowledgement as to the current status of the building by the facility manager and whether age or usage considerations should enter the equation. Write down your expectations.

4. Beware of Facility Manager-friendly clauses in the Civil Code: try negotiating them away

There are other examples of clauses that can be friendly to the facility manager. Although debatable as to whether it is lawfully possible, these clauses should be negotiated away by the tenant expressly waiving them.

Firstly, article 847 expressly allows a manager to unilaterally renounce his mandate, with sufficient notice, to find a replacement. What if the owner does not want unilateral renunciation, or a notice term provided by the facility manager? Be very clear as to what happens. Otherwise, the facility manager can bid you adieu and you can be stuck scrambling for replacements.

Secondly, and even more importantly, the facility manager enjoys a retention right for unpaid fees under article 856(2): "an administrator may retain the administered property until payment of what is owed to him." This means that the facility manager may lawfully padlock an owner's property until such time as the owner coughs up the money. Obviously in a fee dispute, this is a powerful negotiation tool at the disposal of the facility manager. Attempt to have the facility manager expressly waive this retention right.

While seemingly self-serving, it does make sense to consult a lawyer with experience in these types of contracts for at least a quick review of any template provided by a facility manager, particularly for advice as to the impact of the Civil Code. The price tag could be far greater if a dispute arises.

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