H1 2014

THE ADVISERS
Prime Property

in association with Knight Frank

ROMANIA MARKET OVERVIEW

REVIEW & OUTLOOK

HIGHLIGHTS

Bucharest is consolidating its status as a key outsourcing location in CEE.

Office, retail and residential developers continue to seek land plots across Romania.

The new strength of investment demand has caused prime office yields to harden to 8.00%.

Cover photo: Dorobanti 239, Bucharest

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"Last year Romania has transformed itself into a true land of opportunity for real estate developers.
The currently tough competition has an equally significant return. Romania has recorded one of the highest rates of GDP growth in Europe. The government monetary policies to reduce financing costs and favorable inflation dynamics have facilitated the increase in real estate demand. As a result, the office market activity in particular hit its highest level of since the crisis. Considerable investment volumes in Romanian commercial property will most probably continue next year. Our Group trusts in the positive evolution of the local real estate and this is reflected by the market feedback. We prove our trust by further investing in the country and moving forward with the development of our projects."

AFFAN YILDIRIM
Administrator and Chief Financial Officer
ANCHOR GROUP

"So far feedback and figures in 2014 indicate an obvious improvement compared to the market last year. H1 2014 has shown an increase of tenants coming to the Bucharest office market, further decreasing the vacancy rate, particularly in Dimitrie-Pompeiu area. There is a positive outlook for the second half of the year as well, with forecasted volume of transactions similar to H1. Fewer, but larger transactions are expected, in high profile buildings with improved technical specifications."

SVEN LEMMES
Country Manager
ATENOR GROUP

"The overall condition of the real estate markets is definitely improving with notably large office deals taking place, industrial take up at a high and an upturn in residential sales.
This is having the obvious effect on respective land sales liquidity and land prices. There are still anomalies in prices but these are usually due to title and, or infrastructure issues."

ROBERT NEALE
Managing Director
PORTLAND TRUST

"2014 can be characterized as the year of maturity for retail real estate in Romania. In continuity of efforts started a couple of years ago – forced by the crisis – developers and operators have tried to transform their operations.
Those projects with good location, decent management and fare governance are performing fairly well in terms of footfall, center turnover and rental income; all others simply failed and (will) disappear. There has not been any significant change in competition due to lack of large investments materializing during the year.
Retail spending has been stable on average even though with significant deviations among retail segments; significant deviations also are witnessed among retailers within each one of these segments. In a nutshell, retailers have to differentiate and improve customer service and experience to outperform the market, if not to survive."

GEORGIOS ARGENTOPOULOS
CEO
BANEASA Developments

"The first half of 2014 has witnessed a steady growth in the real estate market and was dominated by the office market. Important projects were delivered, including AFI Park 2 which was fully leased to Electronic Arts, significant deals were signed and there is a noticeable renewed interest from banks to offer financing when examining well located and designed office projects.
The main driver of the demand for office spaces is the IT&C sector, but we are expecting to see growth in other industries as well in the following period.

There is an increased demand for new projects, as companies are taking into account new Class A facilities that can provide the technical specifications they require. In addition, tenants have now more focus on important aspects and benefits for their employees, such as the accessibility to the location and the proximity to a commercial centre, which offers them shopping, food and entertainment options."

DAVID HAY
CEO
AFI Europe

"All the segments of the real estate sector indicate a positive evolution this year. Stejarii Residential Club registered a significant increase regarding the number of transactions in the first eight months of 2014, by approximately 25%. For next year, we foresee this trend will continue, estimating a superior evolution to the one from the last quarter of 2014."

TOMÁS MANJÓN
Operational Director
TIRIAC IMOBILIARE

BCR

ROMANIAN ECONOMY, CAUGHT BETWEEN STRONG CONSUMPTION AND WEAK INVESTMENTS

by Eugen Sinca, Senior Analyst, BCR

HIGHLIGHTS

Consumption is favored at present by low inflation, stronger lending in local currency and minor improvement on labor market, but investments are at record lows, which raises doubts about how sustainable the economic recovery is.

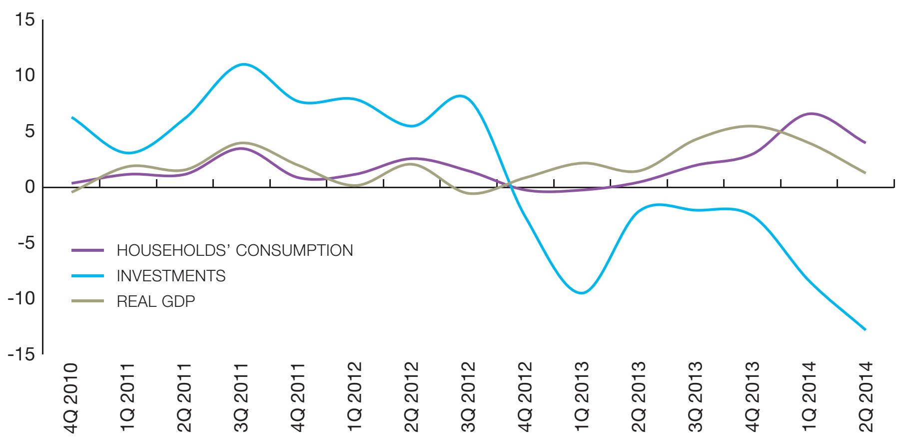
Overview

The first half of 2014 brought a series of notable macroeconomic developments. Inflation hit an all-time low in June at 0.7% y/y (1.5% if we look at HICP average inflation used for cross-country comparison in Europe) and Romania finally met all of the Maastricht criteria, including that concerning the movement of consumer prices. While not yet a member of the ERM2 FX mechanism, Romania succeeded in keeping leu fluctuations well below the ±15% required by the nominal convergence criterion. Interest rates fell to record-low levels, with the 3M ROBOR hovering around 2.8% and 10-year government bond yields falling as low as 4.5%. The budget deficit and public debt remained under control, with comfortable margins to the Maastricht criteria of 3% of GDP and 60% of GDP, respectively.

Household consumption was strong, with retail sales rising more than 10% y/y in the first half of 2014 in the context of a very good performance for durables sales, which advanced an outstanding 14% in real terms. Gradual recovery of local currency consumer loans amid the central bank's monetary easing, the very low inflationary environment, which helped real income growth, and improvements in terms of new jobs created in the economy were the top drivers of household consumption. In the first six months of this year, employers added almost 110,000 new payrolls, concentrated mainly in export-oriented industries. The unemployment rate was 7.1% in June, marginally below the 7.3% seen at the beginning of the year.

Building on the low inflation, stable financial markets and predictable political environment, the central bank eased the monetary policy through cuts

FIGURE 1
Consumption, investments and real GDP
y/y, %



Source: National Institute of Statistics, BCR Research in the key rate and minimum reserves. Money market liquidity was abundant most of the time, enabling a gradual decline in interest rates on new loans to customers. Lending in local currency accelerated gradually throughout 1H14 and reached 7.3% y/y in June, with faster growth for the retail segment.

But all of these positives were accompanied by a number of disappointing economic developments, with the extremely low investment level the most important. In the second quarter, gross fixed capital formation contracted for the seventh quarter in a row and pushed the economy into technical recession. The government seemed inclined to follow a strategy of saving money in the first half of the year and boosting public expenditure just ahead of the November presidential election.

Public capital expenditures shrank to the tune of 30% y/y in the first six months of 2014, while private investments in equipment and construction work did only slightly better, contracting 10% in annual terms. Absorption of EU structural and cohesion funds was better than in previous years (EUR 1.7bn absorbed between December 2013 and June 2014 for all seven operational programs), but this came at a moment when the government drastically cut domestic funding for infrastructure projects and focused almost entirely on EU funds. At the same time, reimbursements from the European Commission were made for projects dating back to earlier years, while the launch of large-scale infrastructure projects like the first highway across the Carpathians is still awaited by investors and the public.

Deleveraging continued on the FX side of banks' balance sheets and credit institutions reduced their short-term external debt by another EUR 1.4bn in the first quarter of 2014. The second quarter brought a more constructive picture in this respect and banks maintained their short-term external debt unchanged. Nevertheless, the decline of FX loans intensified in mid-summer (close to -10% y/y in June) and corporate FX loans were particularly hit by the deleveraging process.

Outlook

The first event that could trigger a reaction on financial markets in the second half of 2014 is the presidential election scheduled for November. Although the local political landscape seems to have grown more mature compared to the past, we do not rule out short episodes of political turbulence, with a weaker leu and higher money market rates and bond yields at the end of 2014.

The second event that would definitely shape the Romanian banking sector and the entire economy in the second half of 2014 and beyond is the release of the results of the comprehensive stress test and asset quality review performed by the European Central Bank in the European banking sector. The assessment started in November 2013 and should be completed in October 2014, before the European Central Bank takes full responsibility for supervision under the Single Supervisory Mechanism. New mergers and acquisitions are possible and lending should gain more speed once balance sheets are repaired and confidence is rebuilt.

The third event that is likely to happen in the next months is additional monetary easing by the central bank. If markets remain calm in the middle of the cold conflict between Russia and the West and the local political environment does not deteriorate strongly before the presidential election, the National Bank of Romania could cut minimum reserves again. Lending in local currency should be favored by such a move and we could see leu loans growing at double-digit annual rates sooner than initially thought.

OFFICE MARKET

Overview

The strength of office market activity in H1 indicates that 2014 is on course to be a better year than 2013. The limited number of speculative institutional grade office developments has put downward pressure on vacancy rates, which have started to decrease in the business locations which are most sought-after by international occupiers. The overall vacancy rate has decreased to 17.4%, from a level of 19% recorded at the end of 2013.

Supply

Nine office schemes were completed in H1 2014, providing a total of 120,000 sq m. New buildings represented c. 66% of H1 2014 office completions, while refurbished offices accounted for the remaining space. The most significant new buildings delivered in H1 2014 were **Green Gate** (27,500 sq m) and **AFI Park 2** (12,200 sq m) in the Center-West and **Hermes Business Campus** (18,000 sq m) in the Dimitrie Pompeiu Area.

The new supply took the total modern office stock in Bucharest (Class A and B) to just over 2.0 million sq m (72% of which is considered Class A stock). An additional 55,000 sq m is scheduled for completion in H2 2014, in eight office buildings, of which the largest are Green Court (Phase 1), **AFI Park 3** and Ethos House.

By location, the greatest volume of new supply in H1 2014 was recorded in the Center-West, followed by the Dimitrie Pompeiu area. New deliveries in these areas will not affect vacancy levels as long as the projects have high occupancy rates upon completion.

Demand

Approximately 132,500 sq m of office space was leased in H1 2014, representing a 6% increase compared with the same period of 2013. There were 95 transactions recorded in the first half of the year, with an average size of around 1,400 sq m. With 90% of take-up being represented by Class A office premises, there is clear evidence of occupiers' preference for this type of space. By location, the greatest volumes of Class A leased space were in Calea Floreasca-Barbu Vacarescu (52%), followed by the CBD (11%), Baneasa (8%) and Center West (8%).

The two largest transactions were the pre-leases signed by the telecom companies Vodafone (16,000 sq m in Bucharest One) and Orange (13,700 sq m in Green Court Phase I). Other noteworthy transactions include the expansion of Endava (4,800 sq m) in AFI Park 3, a project where The Advisers/Knight Frank has the exclusive leasing mandate and the new operations of Allianz (3,500 sq m) in Floreasca Park, another successful project represented by The Advisers/ Knight Frank, completed at the end of 2013 and currently fully let.

Pre-leases and relocations each accounted for 29% of leasing deals in H1 2014, renewals represented 20%, while noteworthy increases were reported for expansions (14%) and new market entrants (8%). Even though leases were concluded in nine different areas of Bucharest, Calea Floreasca-Barbu Vacarescu attracted over 50% of gross take-up.

In H1 2014, the IT&C, banking, insurance and professional services sectors were the biggest sources of demand. Companies from these sectors jointly generated over 75% of the gross take-up. Active IT&C occupiers included both new entrants to the market and existing companies with upgrade requirements, thus generating new demand and commitments to lease modern office stock. H1 2014 also saw an increased number of leases signed by financial institutions such as Intesa Sanpaolo, Patria Credit, Idea Bank.

HIGHLIGHTS

Bucharest office take-up reached 132,500 sq m in H1 2014, a 6% increase on H1 2013

Bucharest continues to consolidate its status as one of the CEE region's key outsourcing locations

Speculative office development is expected to increase over the medium term

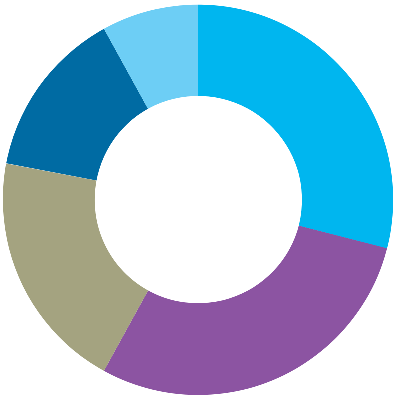
The overall pace of growth in the market will be maintained throughout the rest of 2014, with demand generally exceeding the low supply levels of good quality office space. In an attempt to bridge this gap, there have been several recent land acquisitions for future large scale office developments.

FIGURE 2
Demand by leased area
H1 2014

1,001–3,000 SQ M	30%
>5,000 SQ M	28%
<1,000 SQ M	25%
3,001–5,000 SQ M	17%

Source: The Advisers/Knight Frank

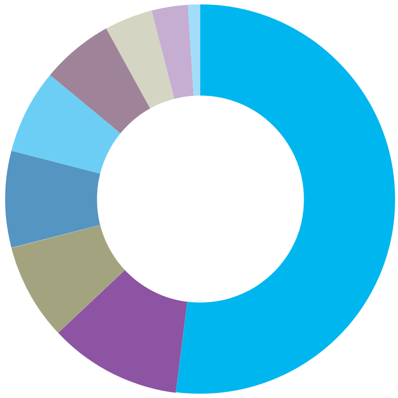
FIGURE 3
Demand by type of transaction
H1 2014



PRE-LEASE	29%
RELOCATION	29%
RENEGOTIATION/RENEWAL	20%
EXPANSION	14%
NEW DEMAND/NEW ENTRY	8%

Source: The Advisers/Knight Frank

FIGURE 4
Demand by submarket
H1 2014



CALEA FLOREASCA –BARBU VACARESCU	52%
CBD	11%
BANEASA	8%
CENTER-WEST	8%
DIMITRIE POMPEIU	7%
CENTER	6%
WEST	4%
PIPERA	3%
PRESEI LIBERE SQUARE	1%

Source: The Advisers/Knight Frank

View over Dimitrie Pompeiu area

TABLE 1
Prime headline rent by submarkets
(Euro/sq m/month)

CBD	16–19
Presei Libere Square	15–16
Calea Floreasca -Barbu Vacarescu	14–16
Center-West	14–16
Baneasa	13–14
East	12–14
Dimitrie Pompeiu	12–13
West	11–13
Pipera	9–10

Source: The Advisers/Knight Frank

Rents

Headline prime office rents currently stand in the range of €18.00–18.50/sq m/month. This represents a minor change from the end of 2013, when rents were quoted between €18.00–19.00/sq m/month. Attractive incentive packages are still available, which may decrease headline rents by €1.00–3.00/sq m/month, but landlords have started to be more selective by only granting these incentives to certain occupiers. In our opinion, this is a sign that the market is undergoing a transition from a tenant's market to a more balanced market, with a landlord's market expected to emerge in 2015–2016. Stated headline rents are subject to annual indexation.

Service charges increase monthly occupational costs by an average of €3.50–4.50/sq m/month, but in exceptional cases can be quoted at around €2.50–3.00/sq m/month or in excess of €5.00/sq m/month. Service charges are usually on an open-book basis, being subject to annual reconciliation.

Parking spaces are offered either underground with monthly rents ranging between €60–130/space or secured off-street for monthly rents of €30–40/space.

Vacancy

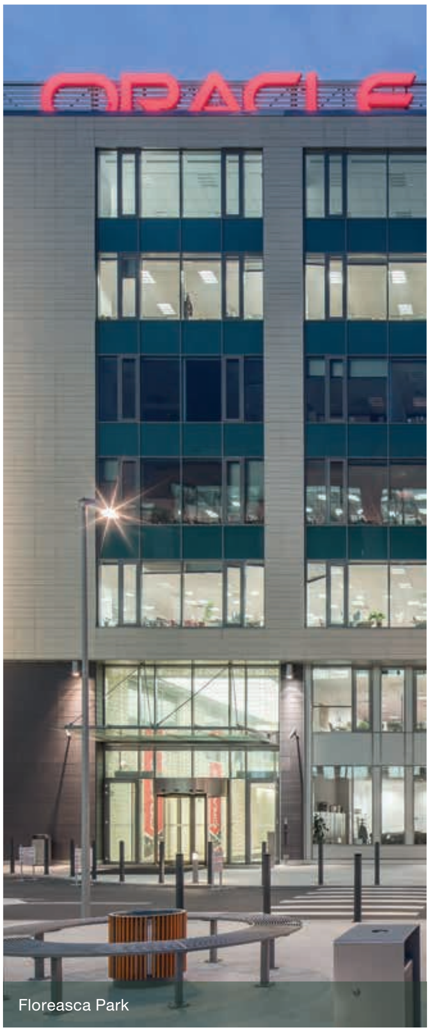
At the end of H1 2014, the overall vacancy rate (for Class A and B stock) stood at 17.4%, with the highest rate recorded in the Pipera area and the lowest vacancy rates in Dimitrie Pompeiu, Center-West and in the CBD areas. Historically, the Pipera area has had persistently high vacancy rates. If this area is excluded from the total stock, Bucharest's overall vacancy rate decreases to 15.4%. In contrast to Pipera, the vacancy rate in the CBD is estimated at 9.5%, while the Class A vacancy rate is estimated at 7.8%. The long-awaited decrease in the CBD's vacancy rate is currently occurring, with further decreases expected in the coming months due to the limited development pipeline.

Forecast

A total of 55,000 sq m of new office space is scheduled for completion in the second half of 2014, with no delays expected to occur. This will bring the new office supply for 2014 to c. 175,000 sq m, representing a 40% year-on-year increase.

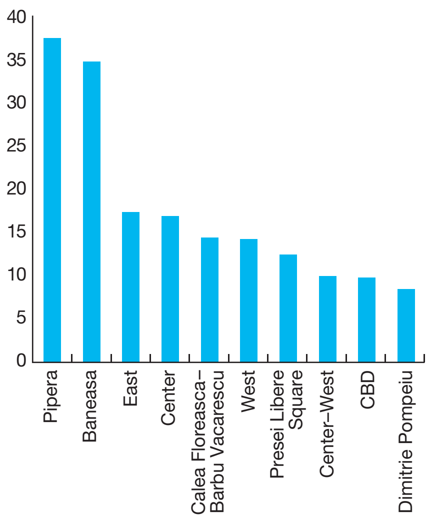
In light of both the rising demand and the limited number of office projects currently scheduled for delivery in 2015–2016, we expect increased speculative office development by established local and regional developers over the coming years.

Headline rents are expected to remain stable across the main office submarkets until the end of 2014 and the beginning of 2015. Office take-up is projected to reach 280,000–300,000 sq m in 2014, with increased contributions from new demand and expansions. The vacancy rate will decline over the coming months, but there is still considerable room for further decreases before the vacancy rate reaches single digits.



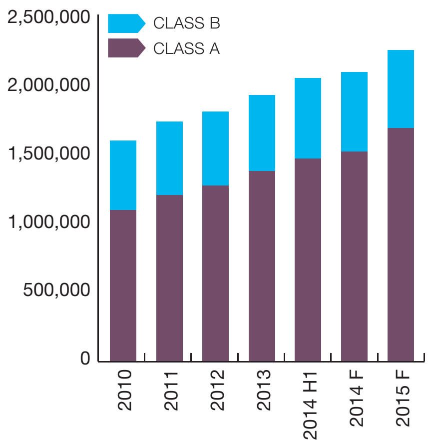
Floreasca Park

FIGURE 5
Vacancy rate by submarkets
H1 2014



Source: The Advisers/Knight Frank

FIGURE 6
Modern office stock
Yearly evolution and forecast



Source: The Advisers/Knight Frank

LAND MARKET

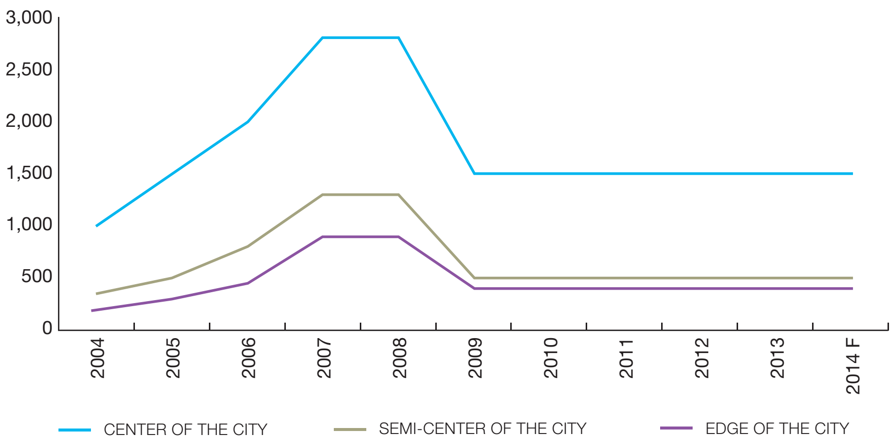
Overview

Increased interest in the Romanian land market continued throughout H1 2014. A sign of the confidence underpinning the market is the recent acquisition of a four hectare land plot by Portland Trust for a major new office development in the Center-North of Bucharest.

Supply

The availability of quality land plots has increased, as major banks and former state-owned companies have put up for sale portfolios of distressed assets or non-performing loans. A number of planned or ongoing infrastructure projects, such as new roads, have increased the appeal of previously unnoticed land plots in certain areas of Bucharest. Moreover, an increased number of owners have taken a flexible approach in order to facilitate transactions. However, supply continues to outstrip demand, although few prime retail plots are available for development in the capital city.

FIGURE 7
Land price evolution



Source: The Advisers/Knight Frank

Demand

H1 2014 proved to be one of the most active periods for land acquisitions since the crisis started. Demand was driven by office, retail and residential developers. As far as the retail sector is concerned, demand comes from the developers of big boxes (e.g. Dedeman and Kaufland), small retail schemes (supermarkets, discounters and gas stations) and shopping centers (in locations with limited or no competition).

Additionally, there is an increased appetite for agricultural land across the whole of the country, largely as a result of Romania's attractive and affordable prices per hectare, as compared with other European countries.

The main factors that influence the sale of a land plot include building permits, price, competition in the area, access and public transportation, and the identification of an end user (buyer or tenant).

In the residential sector, buyers tend to focus on traditional residential neighborhoods, preferably served by the metro. The new government-backed „Noua Casa" scheme continues to be highly attractive to the Romanian private buyers, and has stimulated strong demand for land plots suitable for residential development.

Prices

Land prices remained relatively stable in H1 2014, both in Bucharest and the rest of the country. Thus, the steady pace of the market's recovery since the crisis has continued. Variations in prices are only a consequence of the seller's subjectivity. Looking forward, prices are expected to rise on the back of continued strong demand, and based on the evidence of the latest and ongoing transactions.

Forecast

For H2 2014, it is forecast that transactional activity will continue at a similar pace to the first half of the year. We expect the strongest demand to come from office developers seeking to buy land plots for new developments. In addition, retailers are likely to continue their expansion in the second half of 2014, whilst demand for agricultural land will further increase.

INVESTMENT MARKET

Overview

The first half of 2014 saw a marked increase in property investment activity, with total volumes reaching a remarkable €460 million. Activity for 2014 already exceeds volumes seen in 2013 and, with several trophy assets on the market, is not expected to slow in the second half of the year. 2014 is on track to surpass the total amount transacted over the last two years, potentially breaking 2010's record of €543 million.

Supply

While the current strong economic backdrop is attracting greater investor interest, the limited availability of prime office stock across major markets has proven to be a hindrance to activity. However, this is set to change, as Bucharest's stock of Class A buildings continues to increase, helping to improve office market conditions and offering a wider range of opportunities to international investors.

Another important driver of activity is the sale of assets placed on the market by the financing banks. The example was set by the forced sale of Swan Office & Technology Park (currently insolvent) which received first round bids from reputable real estate companies active in Bucharest such as Globalworth, GTC and Neocity Group. We expect to see a trend of increased numbers of forced sales of properties located throughout Romania, not only in Bucharest.

Demand

While transaction activity was dominated by domestic restructuring deals, investment demand remains robust, with both domestic and international interest largely focused on office and retail assets in Bucharest.

The largest deal in H1 2014 was the purchase of the Upground complex in Pipera from Deutsche Bank's RREEF for approximately €200 million. The deal included the sale of both BOC and BOB towers for €110 million and €42 million respectively, plus the mixed use Upground Towers consisting of 446 apartments and 25 retail units.

Other key transactions concluded in H1 2014 included those involving Tower Center International which was purchased by Globalworth, CDG Plaza and Casa Stega sold by Accession Fund to Hannover RE, and Timisoara Airport Park sold by Invest4SEE to Globalworth.

Romania, however, is still an emerging investment market compared with many of its CEE peers and more mature Western European markets. Romanian property investment volumes currently include deals of below €5 million and significant residential transactions. Additionally, in H1 2014, close to €30 million was invested in vacant buildings which attracted the interest of various local and international parties (see charts); the largest of these was Moldova Mall, which was sold by Equest Balkan Properties to a local investor for an estimated €20 million.

Yields

As a result of the strength of recent investment activity, prime office yields in Bucharest have seen moderate compression over the last twelve months, hardening by 25bps to stand at 8.00%. Sustained investment demand over the second half of the year is likely to drive prime yields below 8.00%.

Forecast

As commercial stock improves, we can expect to see greater investor diversity. Meanwhile, 2014 is on course to set a new post-recession record for transaction volumes by which future years will be compared.

HIGHLIGHTS

A total of €460 million was invested in Romanian property in H1 2014, surpassing the full-year total for 2013

The recent strength of investment demand has caused prime office yields to harden to 8.00%

TABLE 2
Bucharest prime yields
%

Office	Retail	Industrial
8.00–8.25	8.00–8.50	10.00–11.00
⬇	⬇	⬇

Source: The Advisers/Knight Frank

HIGHLIGHTS

Development activity has slowed, with no new shopping centers completed in Romania in H1 2014

Three new shopping centers are currently under construction in the east of Bucharest

RETAIL MARKET
SHOPPING CENTERS

Overview

With no new shopping centers delivered in Romania in the first half of the year, 2014 is likely to witness the lowest level of annual completions recorded in the national market in the past 5 years.

H1 2014 saw only the completion of the refurbishment works of Winmarkt Dunarea, a 6,200 sq m GLA shopping center located in Braila. However, three new schemes are scheduled to be completed by the year-end, two of which are located in Bucharest (Vulcan Value Center developed by NEPI and Ghencea Shopping City developed by Immochan), and one project developed by NEPI (Shopping City Târgu Jiu) in a tertiary regional city, Târgu Jiu, which has a population of 82,000 inhabitants.

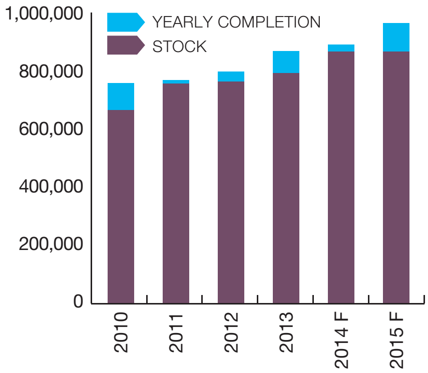
Demand for retail space remains strongest in Bucharest and the largest regional cities in Romania. The most active retailers have remained food operators, followed by fashion retailers owned by international groups.

Supply

The modern retail supply in Bucharest currently stands at c. 870,000 sq m, while the rest of the country is home to another 1.97 million sq m of retail space. Recent data shows that shopping centers represent approximately 63% of Romania's modern retail stock, while retail parks represent 20% of the stock and shopping galleries contribute 16%. The remaining 1% is composed of the only outlet center in Romania, Fashion House Outlet Center Bucharest, part of the West Park Militari complex developed by Liebrecht&wooD. Notably a third of the modern retail stock in Romania is currently owned by five companies: NEPI, Argo Real Estate Opportunities Fund, Iulius Group, Immofinanz and Baneasa.

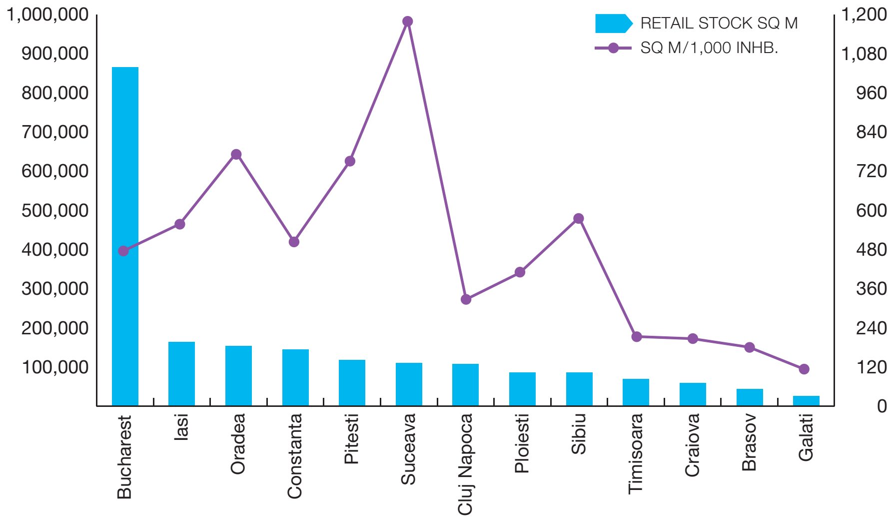
Retail developers' interest is most strongly focused on the western half of Bucharest, which has a high population density. Numerous and diverse retail developments have been completed in this area over the last 15 years. In contrast, the eastern half of the city will receive its first large shopping center

FIGURE 8
Shopping center stock and pipeline in Bucharest



Source: The Advisers/Knight Frank

FIGURE 9
Retail stock in various Romanian cities
Stock/1,000 Inhabitants



Source: The Advisers/Knight Frank

in 2015, when the completion of the 70,000 sq m Mega Mall is scheduled. This will soon be followed by ParkLake Plaza (70,000 sq m) and Veranda Shopping Center (25,000 sq m) by Prodplast. There is a degree of concern within the market regarding the performance of these centers considering the short time period in which they will be delivered and consumers' increasingly sophisticated tastes for modern retailing. It is envisaged that the success of these schemes will be supported by the inclusion of large entertainment areas, as has been the case for the successful AFI Palace Cotroceni and Baneasa Shopping City.

Demand

The main source of demand for modern retail space is established food retailers. At the beginning of the year, Carrefour committed to lease space at Veranda Shopping City, planned to be developed in Obor, an area of Bucharest with a long history of retailing. At the other centers that are currently under construction, food retailers were secured as tenants at early stages of construction.

However, larger supermarkets and hypermarkets have limited options to expand their networks within existing shopping centers or those in the pipeline. As a result, they have adapted their formats to smaller concepts and are occupying spaces in newly developed residential compounds, street units or even office buildings. Food retailers considering these alternative expansion options include Mega Image, Billa and Carrefour Express. Recently, Auchan announced plans to test the local market with a compact hypermarket, a format that is already successful in other Eastern European markets.

Jumbo, a Greek toy retailer which has recently entered the Romanian market, announced in H1 2014 that it plans to occupy five units previously occupied by do-it-yourself retailer OBI.

After a rather hectic period of new entries and exits in the Romanian market, a more sustainable level of change is now being witnessed, with, for example, transfers in the ownership of international brands from local franchisees to their parent companies. This has happened in the case of the Greek group Marinopoulos, which formerly held the franchises to operate a large portfolio of international brands in Romania, but which lost the franchise for Marks & Spencer in 2012 and has more recently lost franchises for Sephora, Starbucks and GAP. However, some brands are expected to perform better under their parent companies' management. This is the case for the British fashion retailer Debenhams, which recently announced that it is considering a return to the Romanian market and directly controlling its own stores.

Rents

Leading shopping center developers are able to maintain prime rents at a level ranging between €50–60/sq m/month. However, slight decreases in average rents have been observed at less well-performing centers located either in Bucharest or outside of the capital, as anchor tenants have aggressively negotiated commercial terms. Rents are also under downward pressure in projects under construction due to the large fit-out contributions required by retailers.

Service charges range between €5–8/sq m/month, with the higher values being charged in shopping centers, while lower charges are evident at retail parks, as marketing fees are less expensive.

There is an increased trend to charge for parking after two hours of grace. This is applicable to retail developments with central locations or in areas with numerous office developments in the close vicinity.

Forecast

In H2 2014, we expect the completion of the Vulcan Value Center (25,200 sq m GLA) in Bucharest and Shopping City Târgu Jiu (26,800 sq m GLA) developed by NEPI.

Six projects are currently in the pipeline or close to the start of construction in Bucharest. At the national level, additional commitment exists for three to five further projects.

AFI Palace

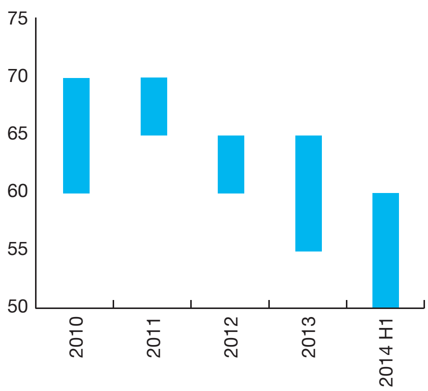
HIGHLIGHTS

Calea Victoriei is expected to benefit from the completion of major infrastructure improvements

Food retailers and restaurants remain key drivers of high street activity

Moschino Boutique Bucharest

FIGURE 10
High street prime rents evolution
range



Source: The Advisers/Knight Frank

HIGH STREET

Overview

In H1 2014, the Bucharest high street market maintained a similar level of activity to the previous year. The key high street locations that are home to most of the major brands continue to be Calea Victoriei, known as a luxury destination for Bucharest, and the Old City Center. Another important location for the high street sector, Calea Dorobantilor, has seen significant changes during H1 2014.

Supply

Calea Victoriei has undergone a series of infrastructure upgrades, therefore very few units were vacated or refurbished in the first half of the year. However, one notable exit was Hugo Boss, which vacated a store in the ground floor level of Victoria Center, a modern business center located at the northern edge of Calea Victoriei. Nonetheless, the completion of the infrastructure works, which will see the enlargement of the pedestrian area on both sides of the avenue from Victoriei to Natiunilor Unite Square, should generate increased interest for retail locations along the boulevard and for high street retail in Bucharest in general.

In H1 2014, Calea Dorobantilor saw the reconfiguration of Mario Plaza shopping gallery as a result of change in ownership. The transformation included offering direct access to the front retail units, which are occupied by existing retailers (Elleganza, Marius Musat and Stefanel) as well as new retailers (Sartoria, Opticris and Yankee Land).

Demand

Demand for retail space in Bucharest's high street market has maintained a similar level to last year. Investment activity has gained momentum, as significantly more investors have looked towards prime retail space for acquisitions.

The Old City Center remains an attractive high street location, where the retail landscape is enriched by new entries, such as Carturesti and Vodafone which are expected to open stores in this location in the near future.

In the food retail sector, supermarkets have maintained their rate of expansion, with Mega Image completing the acquisition of 20 stores from the local chain Angst. In addition, fast food retailers and restaurants have been very active, targeting the northern part of Bucharest, the downtown and other densely populated neighborhoods. However, a shift in their expansion plans has been noted, as they turn their attention away from traditional areas such as the Old City Center and focus on new opportunities. The most active retailers in the segment were La Placinte, Subway, Calif and Starbucks which has resumed its expansion on the high street and already announced the opening of two new locations, in the Old City Center and in the Novo Park office project in Pipera.

Rents

There were no significant changes to prime high street rents in H1 2014. However, we expect a gradual increase in rents in prime retail areas.

Forecast

For H2 2014, we forecast an active Bucharest high street investment market, as a number of large high street retail portfolios are currently up for sale. The most sought-after area for leasing will remain the Old City Center.

INDUSTRIAL MARKET

Overview

The industrial and logistics market has not witnessed any significant new speculative development in the first half of the year. Industrial demand was primarily driven by occupiers seeking space in West Romania, with Continental's pre-lease in Timisoara (45,000 sq m) being the largest transaction of H1 2014.

Supply

The modern industrial stock in Bucharest currently stands at slightly over 1 million sq m.

A revised analysis of Bucharest's industrial stock distribution shows that over 85% is located along the A1 Highway, considered the main industrial artery of the city. The second leading location is in the East Ring Road, which, despite its favorable location, has only 6% of the modern stock. Although the industrial market is suffering from a severe lack of speculative development, the vacancy rate is still elevated at approximately 12–14%, partly as a result of the vacant space in Prologis Park Bucharest A1. Recently H.Essers relocated nearby in an owner-occupied industrial park. Meanwhile, supply outside of Bucharest has been delivered mostly on a built-to-suit basis, with occupiers being mainly interested in occupying light production facilities.

Despite the slow pace of recovery, the outlook for the second half of 2014 is encouraging. If part of the current active demand translates into new take-up, this may encourage a renewed trend of speculative development, especially in the well-established industrial hubs of Romania.

Demand

The total industrial take-up in Romania in H1 2014 is estimated at 200,000 sq m. Over the past 2–3 years, take-up has been largely driven by food retailers, e-commerce retailers and manufacturing companies. Noteworthy examples are the lease renewals signed by Carrefour in Bucharest's Europolis Park (45,000 sq m in H1 2013) and the Deva Logistics Center (20,000 sq m in H1 2014).

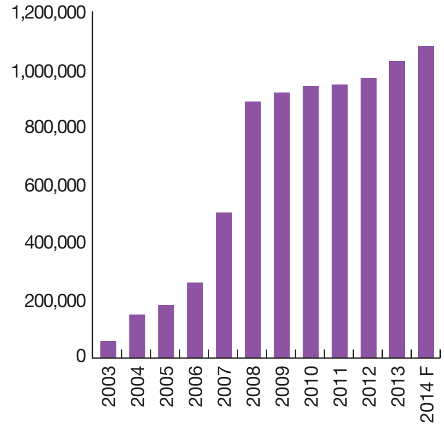
In H1 2014, industrial activity was recorded in Bucharest and in five regional Romanian cities: Arad, Timisoara, Deva and Ploiesti. By far the largest industrial transaction recorded in the first half of the year was the pre-lease signed by the German company Continental; an agreement for 45,000 sq m in Timisoara Airport Park, developed by Invest4SEE and recently purchased by the most active investor in Romania, Globalworth. At a regional level a furniture company bought from Hanil a unit of 26,000 sq m in Biharia, at an estimated price of approximately 4.8 mil.

In addition to the traditional industrial occupiers, renewed demand for space has been noted from agrochemical companies, although these occupiers require highly specialized industrial facilities, numerous complex authorizations and sophisticated compliance, in order to be able to handle the majority of ADR classes of goods (agriculture, pharma, etc.). Another source of demand is financial occupiers, which are actively looking for modern industrial storage/archive space in order to meet Central Bank's licensing regulations. Most active companies in the industrial market were automotive suppliers. The focus remains on industrial hubs such as Timisoara and Arad, preferred by light production and 3PL's companies for their proximity to Western Europe; Pitesti – favored by the automotive and spare parts companies that work closely with Ford or Renault Dacia, Ploiesti – well known hub for production and 3PL, chosen mainly for its good road infrastructure and plenty of available industrial projects; and Bucharest, an established 3PL and 4PL main hub.

HIGHLIGHTS

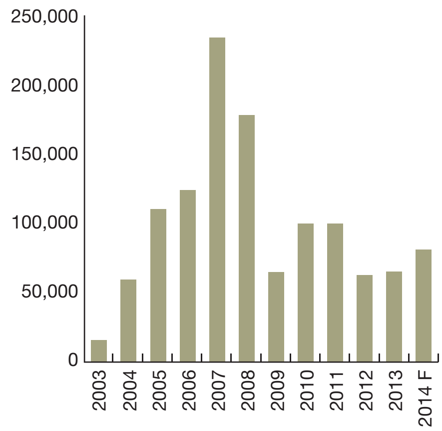
Romanian industrial take-up reached 100,000 sq m in H1, boosted by Continental's pre-lease of 45,000 sq m in Timisoara

FIGURE 11
Bucharest modern industrial stock yearly evolution
sq m



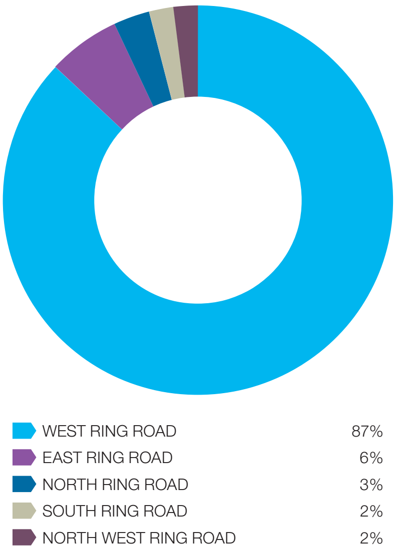
Source: The Advisers/Knight Frank

FIGURE 12
Bucharest industrial take up
sq m



Source: The Advisers/Knight Frank

FIGURE 13
Bucharest modern industrial stock distribution



Source: The Advisers/Knight Frank

TABLE 3
Bucharest prime rental and service charge ranges

	size	€/sq m/ month
Rent	< 3k sq m	3.90–4.20
	3k–10k sq m	3.75–4.25
	> 10k sq m	3.30–3.60
Service charge	0.5–0.95	

Source: The Advisers/Knight Frank

Rents

Rental levels were stable during the first half of the year. However, there is increased interest in additional handling services such as picking, packing and labeling, which may significantly increase overall occupational costs. Service charges also remained unchanged, at between €0.75–1.00/sq m/month, depending mostly on the level of local property taxes. Rents level in Bucharest for prime Logistics location stands between 3.6–4.0 €/ sq m in comparison to the rest of the country where the headline is at 3.25–3.5 €/ sq m. For production companies the rent is at a lower level, mainly for the longer period signed by this companies: 3.5–4.0 €/ sq m for Bucharest and 3.25–3.75 €/sq m for the rest of the country.

Forecast

It is forecasted that the industrial market will benefit from the ongoing economic recovery. The sector should be boosted by the growth of exports, manufacturing activity and e-commerce, as well as the recovery of consumer demand. Improving confidence in the Romanian economy may enhance industrial leasing activity to such an extent that total industrial take-up in 2014 could well exceed forecasts.

West Park Ploiesti

RESIDENTIAL MARKET*

Overview

The Bucharest residential market started to pick up in the first half of 2014, as the gap between supply and demand narrowed.

On a different scale, the residential market is also witnessing an increase in the number of smaller, boutique upscale projects started by local developers, especially in central and semi-central locations.

Supply

After a timid market recovery in 2012, and a more active 2013, the first half of 2014 saw a reduction in the number of vacant units in previously completed residential projects. The revival of the market is also indicated by the expansion of well-performing projects. For instance, City Point, a major project announced and initiated at the bottom of the market, began the construction of a second phase, due for completion in mid 2015. Other projects such as Cosmopolis and Militari Residence are still vigorously marketing their properties whilst continuing to expand by adding new units. Vitan Residence is also going forward with its third phase. Another major new project, Onix Residence, recently announced the completion of its first block, from a total of 5 blocks which will comprise 456 units.

In contrast with previous years when new supply mainly consisted of new phases of existing projects, 2014 has seen a number of completely new schemes approaching delivery date.

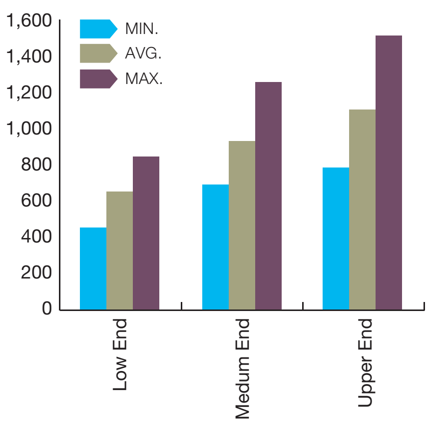
The recovery of the market is further signaled by projects which have managed to exit bankruptcy, such as Cortina Residence, which changed ownership and resumed construction of its 270 units in H1 2014. Investor interest in distressed residential projects has increased and both finished and uncompleted projects have been, and may continue to be, taken over by interested parties. A number of residential projects have been brought out of insolvency, and have been able to resume the sales process, such as Asmita Gardens, Citadella Titan and Ibiza Sol, all of which are now selling around 4–6 units per month.

Demand

As in previous years, the **Prima Casa** government program is still a major driver of demand, along with the 5% VAT scheme, which applies to units under 120 sq m and up to €85,000. The rising demand for new affordable dwellings has convinced developers to pursue expansion plans, by proposing either new phases for existing projects or new residential schemes.

In the first six months of 2014, approximately 11,000 loans were granted in Romania through the **Prima Casa** program, according to FNGCIMM. Bucharest and the adjacent Ilfov county accounted for 35% of the total, followed by Cluj with 8.1%, and Timis county with 5.8%. As a general observation, the Prima Casa program was mainly accessed by people in the 26–35 age range buying one-bedroom apartments. Between 2008 and H1 2014, c. 119,200 **Prima Casa** loans were approved, with a total value of over €4.5 billion. The average loan is €38,300.

FIGURE 14
Average prices
Selling Price: €/usable sq m 1 bedroom apartment



Source: The Advisers/Knight Frank

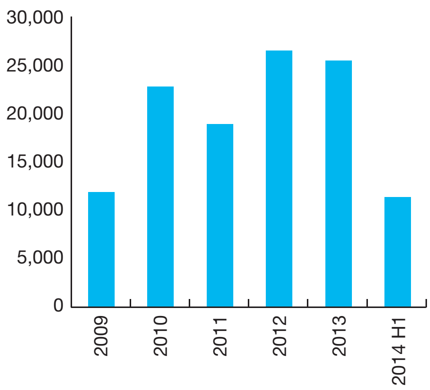
HIGHLIGHTS

The residential market shows signs of recovery, with the announcement of new projects on the market and new phases of successful schemes

Positive outlook for medium scale residential schemes

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

FIGURE 15
Loan guarantees
H1 2014



Source: FNGCIMM

Prices

Prices for newly built dwellings have remained stable; however, developers are now slightly less willing to negotiate, as compared with previous years when buyers received more attractive deals. Residential projects are classified as low, medium and high-end projects according to a number of criteria such as location, finishing and neighborhood. Average selling prices vary between €672–1,098/built sq m, with medium-range projects recording an average of €906/built sq m.

Rental

Apart from rent-to-buy programs and loans directly from the developer (both spanning a maximum period of 3 years), 20% of the projects that are included in this study have allowed the renting of their units. These projects are mainly above the medium-range in terms of asking price and rent. For instance, since 2010, the developer of Stejarii Residential Club, located in the north of Bucharest, has focused its strategy solely on renting their units.

Forecast

New supply will continue to be delivered mainly in Bucharest's peripheral areas (e.g. Rosu, Stefanesti and Bragadiru) where demand has picked up, fuelled by the Prima Casa government-backed program and the 5% VAT scheme. Cosmopolis will deliver three new blocks of apartments by the end of 2014, adding to the 1,400 units that have been already delivered and mainly sold out. Following this success, the developer of the Cosmopolis compound, the Turkish-based group Opus Land Development, acquired a 2,000 sq m land plot in the Barbu Vacarescu area for a future mid-size residential compound.

Stejarii Residential Club

trendhospitality CONSULTING & MANAGEMENT

HOTEL MARKET

by Lucian Marinescu, Senior Associate
TrendHospitality

Overview

Overall hotel activity marked a positive evolution with increase in both number of arrivals and overnights, even more, overnights increased more than arrivals – reversing a long time of decrease for the average length of stay: 2.15 days comparing to 2.11 days, last year same time.

Supply

Following a long period of very slow activity for the investments in hotel industry, number of hotel opened in 2014 was almost insignificant: 17 new hotels opened during first semester of 2014 meaning an increase of 0.9% comparing to last semester, up to 1,429 hotels cumulating 182,284 beds. Evolution of demand had opposite evolution on different destinations: while balneary resort and Black Sea seaside hotels registered increases in number of hotels (+4.4% respectively +1.6%) all the other destinations, mountain resorts, Danube Delta, Bucharest and secondary cities, registered decreases in hotel number of a cumulated 6.4%.

In terms of classification, the biggest share is represented by 2-star hotels 35.25%, most of them located on the seaside and balneary resorts, decreasing from 37.25% comparing to last period mainly due to renovations and increase in classification, followed by three star hotels 38.6% increasing from 36.29 comparing to last period. Most dramatic decrease was for the 1 star hotel (-35%) mainly because of the conversion or close down of this type of hotels. Also 5-star hotels decreased in number but this is most of the time due to voluntary de-classification for better access on different client segments.

The presence of international hotel groups has not changed for the last 6 months, although about 6 hotel projects are in the pipeline. The international hotel chain account for 7.4% of total room inventory, a level well below the European average which is close to 30%. There are 12 hotel groups present in Romania, as per the ranking presented in the table below.

TABLE 4
Hotel Groups present in Romania

	Hotel Groups	Rooms	Hotels
1	Wyndham	1,857	11
2	Accor	1,221	6
3	Hilton	728	5
4	Best Western	635	10
5	Group de Louvre	632	5
6	IHG	447	2
7	Rezidor	424	1
8	Marriott	402	1
9	Vienna International	177	1
10	NH Hoteles	161	2
11	Europa Group	90	1
12	K+K Hotels	67	1
	Total	**6,841**	**46**

Source: The Advisers/Knight Frank

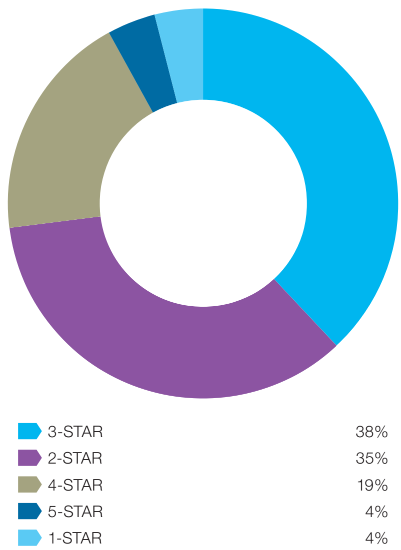
Demand

First semester of 2014 registered an increased level of activity in real terms considering that, after a long time overnights increased more than arrivals leading to better average length of stay. Arrivals increased by 5.1% comparing to same period last year while overnight marked a 6.4% increase comparing to first semester of 2013.

HIGHLIGHTS

The first half of 2014 had two different faces: while the first 3 months were not that promising with results comparable with last year, the last three months of the first semester posted good activity for the hotel industry

FIGURE 16
Hotels in Romania by classification



Source: The Advisers/Knight Frank

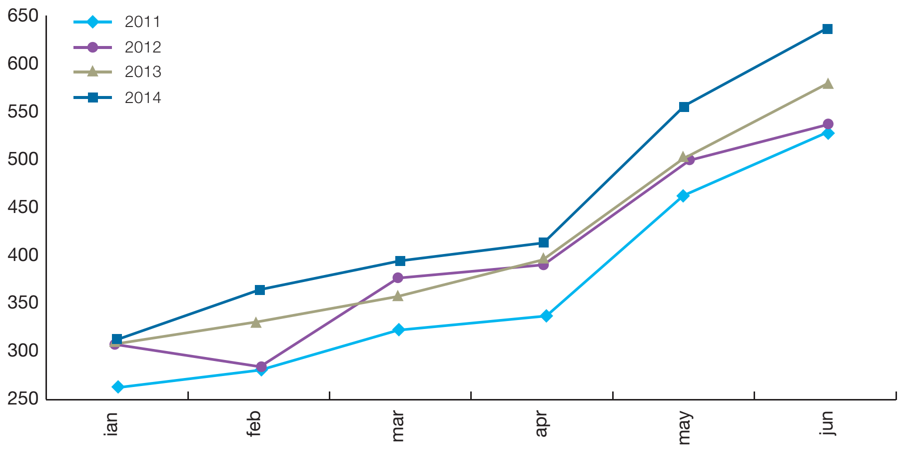
In terms of destination Bucharest and the main secondary cities registered the best evolution (+2.5%) comparing to last year indicating that this revival of arrivals was fueled by the business and MICE segments of clients. At the other end we have balneary resorts and seaside resorts with a decrease of -1.8% due to the cold and rainy weather on May and June.

Arrivals of international tourists increased from 22.6% to 23.9%, while overnights generated by the international tourists decreased from 22.3% to 21.8% meaning that the overall increase in overnights is due to the domestic tourists. Most of the international tourists are coming from Europe (77.8%), the main countries that generate tourists to Romania are: Germany (12.4%), Italy (10.1%) and France (6.7%). Regarding non-European countries, main tourist generators are: Israel (6.5%) and USA (6.1%).

FIGURE 17

Arrivals by month

H1 2014



Source: The Advisers/Knight Frank

Ramada Majestic Bucharest Hotel

Forecast

First half of 2014 ended on a positive trend, and operators are looking forward for the second part of the year to see if this trend is continuing or was just a conjectural phenomenon. Continuation of increase in arrivals and overnights will create the premises for the hoteliers to raise the rates.

Improvement of the main KPI of the hotels activity will also generate an increased attention from the investors, and so, on medium term, we expect to see some new projects coming into the market.

pwc

CONSTRUCTION TAX — WHERE TO?

by Mihaela Mitroi, Tax and Legal Services Leader
and Alexandra Smedoiu, CFA, Senior Manager
PwC Romania

With the newly introduced construction tax, which is still subject to fervent debate, tenants and landlords alike are advised to pay attention to correctly assessing their construction tax liabilities.

The construction tax, introduced at the beginning of 2014, was one of the hottest tax topics throughout the year. Although originally aimed at capital intensive industries, its effects spanned to a larger array of taxpayers and, ultimately, to the real estate industry. As a refresher, the construction tax is a 1.5% tax applied to the gross book value of constructions, other than those that are already subject to building tax.

One of the issues raised by the business community about the current construction tax is the taxable basis. As you may know, the tax is computed on the gross book value of the assets shown in the accounting books at 31 December of the previous year. Therefore, the tax is applied to a historical value that does not take into account the perceived reduction in value of assets in time (i.e. this would be the case if, for instance, depreciation would be allowed as a deduction from the gross book value). Moreover, since the tax applies to book values and not to tax values, which may be significantly different than the book value due to, e.g., different depreciation methods, this may create distortions between taxpayers applying different tax treatments for the same assets.

Also, where assets have been sold or dismantled immediately after year-end, the tax is still due since the taxable basis is assessed at 31 December of the previous year. In practice, dismantling is quite a long process and thus there may be a significant time delay until the actual realisation of those assets (e.g. a complex construction is sold or dismantled in a longer time period than equipment).

Another area where the construction tax has had a significant and, may I add, a collateral impact is the fit-outs to rented buildings. Fit-outs are made at either the expense of the tenant or the landlord, but are prominently recorded in the books of the tenant. Fit-outs that do not increase by more than 25% the value of the building to which they are attached to should not be notified to the landlord and thus are not subject to building tax. The reality is that, at least in the case of large office or commercial buildings, the value of the fit-outs never exceed 25% of the building's value. Since such fit-outs are not subject to building tax on the landlord's side, as per the wording of the law, they become subject to construction tax at the tenant's side.

Arguably however, such fit-outs are taken into consideration when the buildings are revalued by their landlords and become at some point subject to building tax. The landlords normally proceed to such revaluations every three years, for reasons related to the applicable building tax quota. Also, when the space is rented from individuals, in which case the notification of fit-outs made is not mandatory, the construction tax will apply at the tenant's level, no matter the value of the fit-outs. Depending on the circumstances, certain alternatives may be available to minimise the impact for tenants and landlords coming from this construction tax.

The construction tax has been subject to a lot of debate and the business community has provided many comments and suggestions to improve the current law. It is expected that some of these changes will become effective starting or during next year, such as the reduction of the tax value to 1%, or the computation of the tax related to the net book value of the constructions. Until then, tenants and landlords alike are advised to pay attention to correctly assessing their construction tax liabilities and to seek advice for identifying solutions to efficiently associate the tax liabilities to their economic realities.

HARDSHIP IN LEASE AGREEMENTS

by Simona Chirica, Partner
and Madalina Mitan, Senior Associate
Schoenherr & Associates SCA

Tenants facing with excessively burdensome execution of lease agreements caused by exceptional events occurred after the conclusion of the contracts, may try to re-balance the contractual terms and conditions by recourse to hardship.

During lifetime of the lease agreements, the tenants may be affected by several factors outside their sphere of control, such as financial crisis depreciation of the national currency, decrease of the demand for the products and services offered by them. Following the crisis, the landlords decreased the level of the rent, but only for the new leases, while the same financial terms negotiated during the real estate market boom were maintained for the ongoing lease agreements. Many tenants attempted either to renegotiate the terms and conditions of their lease agreements or to terminate the contracts on the ground that when entering into the lease agreements they were not able to foresee the change of the economic situation that was about to occur.

In such a case the theory of hardship may be invoked by the tenants, however under the limited conditions provided by the Romanian Civil Code. Until the entry into force of the new Romanian Civil Code in October 2011, the theory of hardship was recognized only by the Romanian doctrine while the Romanian legislation did not contain an express application of the hardship. The hardship may be defined as the situation where the occurrence of exceptional events subsequent to the conclusion of the contract fundamentally alters the balance of the parties' contractual obligations.

The tenant may invoke hardship if the following premises exist, respectively the following conditions are cumulatively fulfilled:

1 — the execution of the lease agreement becomes too burdensome for the tenant;

2 — the hardship event occurs after the conclusion of the contract;

3 — the hardship event could not reasonably have been taken into account at the signing of the contract and is beyond the control of the tenant;

4 — the risk of hardship has not been assumed by the tenant.

When the parties have set the rent in other currency, with the obligation of the tenant to pay the rent in Ron at the rent's maturity irrespective of its variation in time, the tenant may not invoke the risks associated with the depreciation of the RON, as the application of the hardship has been indirectly excluded by the parties.

Moreover, invoking the hardship is not admissible where the lease agreement incorporates (i) a clause providing for the automatic indexation of the rent, or (ii) a clause referring to the renegotiation by the parties or by recourse to the court of the lease conditions in case certain events occur or (iii) a clause expressly excluding the application of the hardship theory with respect to the lease agreement.

5 — the tenant should have attempted in good faith and within a reasonable time the renegotiation of the original terms of the contract.

If the negotiation of the parties fails, the tenant will address the issue to the court and the latter may rule either the adaptation of the agreement with a view to restoring the balance of the parties by fairly distributing the losses between the parties or the termination of the agreement.

In the end, it comes to the court discretion to determine if the execution of the contract became burdensome on the tenant and to decide on whether the agreement should be rebalanced or terminated.

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