



2012 ROMANIA MARKET OVERVIEW

Review & outlook

HIGHLIGHTS

- Office take-up in Bucharest amounted to a record 240,000 sq m in 2011. Prime rents remained stable over the course of the year, but are forecast to increase by the end of 2012 as a result of a limited development pipeline.
- Several major new retail developments came to the Romanian market in the second half of 2011. International fashion retailers have been an increasingly important source of demand for high quality retail space.
- Take-up of approximately 100,000 sq m of class A logistics and industrial space was recorded in 2011, a similar level to 2010. Vacancy rates in this sector have been falling due to a lack of new development completions.
- A number of important new infrastructure developments, including the Basarab Bridge and the Pipera overpass, have opened up new areas of Bucharest as attractive property locations. This has increased the interest of developers and investors in these areas.

Contents

1. Office Market	3
2. Retail Market	8
3. Industrial Market	10
4. Land Market	12
5. Investment Market	14
6. Valuations	16
7. IFRS and Deferred Taxes	17

I. OFFICE MARKET



The upward trend in office market demand continued in 2011, with take-up amounting to a record high of approximately 240,000 sq m. Conversely, the amount of new space brought to the market was the lowest level seen in recent years. Prime office rents remained broadly stable, maintaining the same level that has been recorded over the last 18 months.

Supply

In 2011, the Bucharest market saw the delivery of only 115,000 sq m of new class A office space. This increased the total modern office stock of the city to almost 1.63 million sq m.

Over 70% of the space delivered was in the periphery, while the semi-central and central areas only registered around 25% of the total. This was mainly due to two large scale projects, namely Swan Office Park and Platinum Business & Convention Center, in the North of the city, that together account for approximately 60% of the total new space.

A single large scale project was delivered in the central area, Crystal Tower, the first office development in Bucharest which benefits from a double skin façade and heliport.

All three of these projects are green certificated buildings. This reveals an obvious shift in developers' behavior and an increased orientation towards sustainable and energy saving developments.

The global recession continued to affect tenants and landlords alike. Bank financing became even more difficult, which was reflected in a lack of new projects being started.

Table 1
Bucharest facts & figures

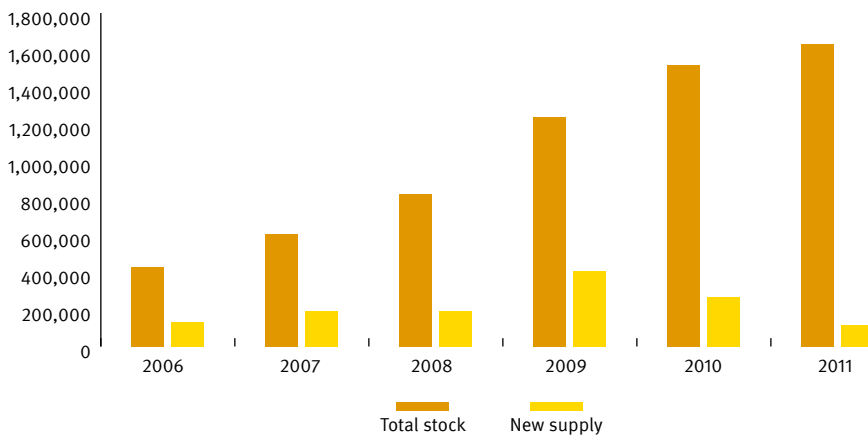
Modern office stock	1.63 million sq m
Completions in 2011	115,000 sq m
Take-up in 2011	240,000 sq m
Rents trend	Stable
Completions forecast in the next 6 months	50,000 sq m

Source: The Advisers/Knight Frank

Bucharest map



Figure 1
Evolution of office stock
sq m



Source: The Advisers/Knight Frank

THE AMOUNT OF NEW OFFICE SUPPLY ENTERING THE BUCHAREST OFFICE MARKET IN 2011 WAS 70% DOWN ON THE PREVIOUS YEAR.

This has pushed developers to look at small office schemes, which minimize risk. In 2011, small developments such as Romana Offices, Barbu Vacarescu Offices, Frumoasa Office and Herastrau Offices were delivered in the central area. With leasable surfaces of approximately 3,000 sq m, these projects are well located and fit perfectly into this new mindset.

In comparison with the previous year, when almost 265,000 sq m were brought to the market, 2011 saw a significant decrease, of over 70%. This fall is a consequence of the worldwide economic crisis which caused a

significant decrease in the number of new projects started during the last two years.

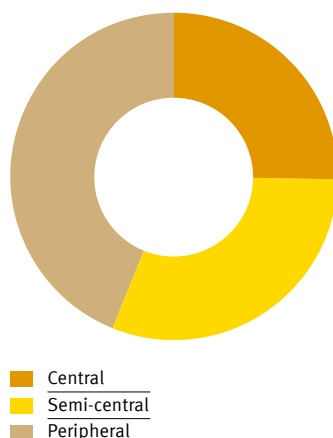
Only four large scale projects are currently under construction, with estimated delivery dates in H2 2012 and H1 2013. AFI Europe will deliver the first phase of AFI Business Park in summer 2012, developed adjacent to AFI Palace Cotroceni Mall. The business park will consist of five office towers, amounting to a leasable area of 70,000 sq m. The other projects are Sky Tower (37,000 sq m GLA), the first phase of Hermes Business Campus

(18,000 sq m GLA) and Expoziei Project (15,000 sq m GLA). Additionally, several other smaller buildings such as Aviatorilor Offices and Monolit Offices are currently being developed in prime locations throughout the city.

Demand

Transactions closed during 2011 came to a total of over 240,000 sq m, bringing a 7% increase in take-up compared with 2010.

Figure 2
Distribution of office take-up, 2011



Source: The Advisers/Knight Frank



Willbrook Platinum Business and Convention Center

New demand represented almost 80%, while renegotiations/renewals accounted for the remainder. As a result of a stabilization of the economy, tenants became less cautious. They have begun looking at better buildings, being able to take on relocation costs. Moreover, many tenants with leases close to their termination have decided to relocate to more efficient buildings with better technical specifications.

Despite the higher demand, no pre-leases were signed, given the space still available in the market. In some cases, large leases were signed for buildings that were almost completed, but not delivered; these transactions do not count as pre-leases, as the space was almost ready to receive tenants.

Unusually, take-up in 2011 was split almost equally between the center (32%), semi-center (37%) and the periphery (31%). There are two main contributing factors to this.

Firstly, the market has seen several large requirements, coming mainly from healthcare providers and the IT&C industry, with companies planning to expand their activities in the local market.

Given the lack of available space in the city center, and the higher rents, most of these occupiers were oriented towards the periphery. Here they have benefited from



more flexible landlords and lower costs, due to the high amount of available space able to accommodate their large requirements.

On the other hand, the center and semi-center remained in the focus of tenants, due to their high visibility and good accessibility.

The most active players in the market remained the above mentioned IT&C and healthcare industries, together with the banking/financial sector and professional services.

Vacancy

The location, accessibility and public transportation links of a given area, together with the quality of buildings remained key factors in determining vacancy levels.

Given the lack of new deliveries in the center and semi-center during 2011, these areas have seen decreases in their vacancy rates, from almost 15% at the beginning of 2010, to 10-12% at the end of 2011. Within the central business district the current vacancy level is around 10%, while the Calea Floreasca/Barbu Vacarescu area has the lowest vacancy rate, at below 1%.

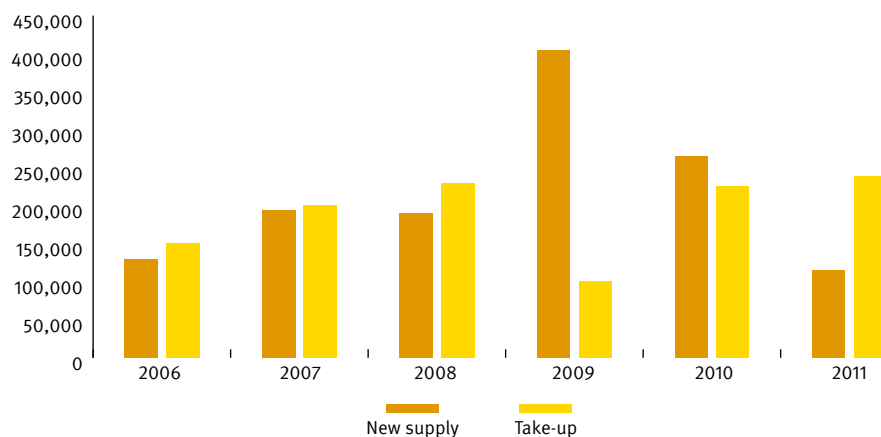
The highest vacancy rate, of around 20%, can be found in the periphery of the city. However, vacancy levels vary from one individual area to another, depending on factors such as location, accessibility and rent levels.

Rents

Prime office rents remained broadly stable, maintaining the same level that has been recorded over the last 18 months, without any major fluctuations.

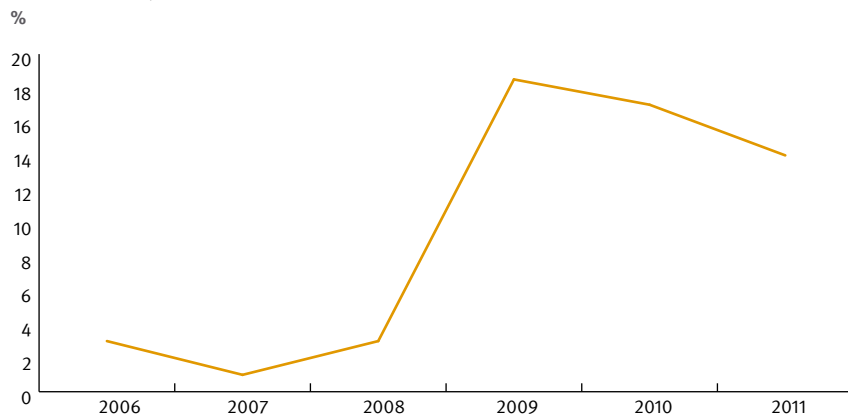
The average level of the service charge for class A buildings remained at around €4/sq m/month, while business parks have lower service charges.

Figure 3
New supply vs take-up
sq m



Source: The Advisers/Knight Frank

Figure 4

Office vacancy rates

Source: The Advisers/Knight Frank

Table 2

**Net effective rents
(€ per sq m per month)**

Central	Semi-Central	Peripheral
16-17	13-15	9-11

Source: The Advisers/Knight Frank

Forecast

The supply of new office space expected to be delivered during 2012 will be significantly lower than in previous years, amounting to less than 100,000 sq m.

The first phase of AFI Business Park (11,000 sq m) will be delivered in summer 2012. In addition, several small scale buildings are to be delivered in the central business district. Monolit will deliver a 2,250 sq m building at CDG, and another local developer will deliver 3,000 sq m of class A office space on Aviatorilor Boulevard. UniCredit will occupy their own office development (15,000 sq m), located in the North of the city, on Expozitiei Boulevard. Overall, the available supply will diminish and therefore rent levels for well located class A developments will tend to rise.

Some newly available space, especially in the central area, is expected to come to the market during 2012 and 2013 due to several companies announcing the consolidation of

their existing operations. As new buildings will be scarce, this vacant space is likely to be leased fairly quickly, thus not significantly affecting the vacancy rate.

As infrastructure is key to the overall development of the city's real estate, new infrastructure projects will influence the evolution of some specific areas. The opening of Basarab Bridge together with the future delivery of Pipera overpass will ease traffic and improve access to these areas, and therefore make buildings located in nearby locations more attractive.

As a direct consequence of the current worldwide economic climate, the banking sector is still reluctant towards the financing of real estate developments in emerging markets. Thus, because of the continued difficulties in obtaining financing, the only projects likely to be started during 2012 and 2013 are the ones which can secure pre-leases. As only a few projects were commenced during 2010 and 2011, the next two years are likely to see a considerable decrease in the delivery of new buildings.

Take-up will be at similar levels with 2011, continuing the trend of the last two years, driven by companies looking for better buildings, with high efficiency of space and access to public transportation. With fast-growing segments of the economy such as the professional services industry, the

healthcare industry and the IT sector pushing demand for class A office premises upwards, we estimate that take-up will reach a level close to the 250,000 sq m mark during 2012.

Given the lack of general supply and the high demand, vacancy will diminish. The CBD will witness a decrease of the vacancy rate to below 10%, and overall vacancy levels will be situated around 12-13%.

As a result of this, medium and large scale requests for office space (larger than 2,500 sq m) will face difficulties in finding available space in developments within the central and semi-central areas.

The first half of 2012 will continue to follow the market trend of the last year, with tenants having significant leverage in negotiations with landlords. However, as good quality office space will start to become more scarce, the tables will turn, and once again we will witness a market where the landlords are pushing their own terms, especially for buildings with good public transportation and technical specifications.

Given the fact that it takes up to 18-24 months for a building to be delivered, during the next two years, companies planning to relocate or consolidate might need to wait in order to secure a good location. In light of this, we estimate that both 2012 and 2013 will see an increased volume of pre-leases in the market.

We estimate that rental levels will start to increase in the second half of 2012, by approximately 10-15%, due to the lack of new developments. Landlords that still have vacant office premises located in the CBD will push rental levels upwards. The same trend will also be seen in other areas with good accessibility and efficient links to public transportation.

2. RETAIL MARKET

The second half of 2011 proved to be quite eventful in terms of new deliveries to the retail market. However, some of the retail schemes that had been announced for delivery in H2 2011, such as Palas Iasi, have been rescheduled for H1 2012.

Supply

In Bucharest, Baneasa Shopping City celebrated an extension of 14,000 sq m which completed their tenant mix with a modern cinema. Colosseum Retail Park (53,000 sq m) hosted the opening of the first Leroy Merlin store in Romania, as well as a Carrefour unit.

Outside of Bucharest, H2 2011 saw the opening of important retail developments such as Electroputere Craiova (71,000 sq m), Maritimo Shopping Center in Constanta (50,000 sq m), Galleria in Arad (33,600 sq m) and Oradea Shopping City in Oradea (30,000 sq m).

Demand

The increase in demand due to retail sales turnover continued to gather pace throughout the second half of 2011 and retailers have shown sustained interest in expanding their chains of stores. H&M opened its sixth Bucharest store in Sun Plaza, followed by its tenth and eleventh stores in Romania, in Lotus Center Oradea and Maritimo Shopping Center, Constanta (all in November).

Also restructuring their networks both in the capital and countrywide are electronic retailers such as Altex, Flanco and Domo, which have continued to reassess opportunities.

Throughout the country, demand has come from international fashion retailers who have focused on existing shopping centers, as well as those that are close to completion.

New retailers have also entered the market. Besides Leroy Merlin, retailers such as New Look, Pandora and Rene Derhy opened their first stores in Romania during 2011.

Rents

Successful shopping centers that were able to constantly attract good traffic of visitors were

also able to stabilize rents, and compromise less when negotiating with new tenants.

However, for the new and soon to be delivered retail space, rents were negotiated depending on the characteristics of each local market. For example, areas such as Constanta and Arad were more challenging for the recently developed shopping centers, as they were coming to markets with already operating retail centers.

The newer and the less powerful shopping centers rely on fit-out contributions, stepped rents or even turnover-only rent periods in order to attract international retailers as anchor tenants to both existing and soon to be delivered retail schemes.

Forecast

2012 will feature the construction of limited modern retail stock in Bucharest. Two hypermarket-anchored shopping galleries are scheduled to open: Cora on Alexandriei Road and Kaufland on Mihai Bravu Road.

The coming period of 2-3 years also has deliveries scheduled for projects totalling around 140,000 sq m throughout the country, such as Corall in Constanta and NEPI's retail park in Brasov. Palas in Iasi is scheduled to open in April 2012.

High Street

The strongest demand in the second half of 2011 came from supermarkets, pharmacies and food operators (fast food, restaurants), while banks have continued the trend of relocations and renegotiations.

Inditex consolidated their position in the only true high street destination in Bucharest by opening Pull&Bear and Stradivarius next to Zara, Bershka and H&M on the ground floor of Unirea Shopping Center.

The Old City Center maintains a high level of activity, registering strong demand, with



Paul, Regina Elisabeta Blvd

several restaurant and bar operators looking to secure locations and cash in on the high footfall.

Infrastructure works have been completed in the second half of 2011, making the area even more attractive and, although the foot traffic decreased towards the end of the year due to the cold season, business has been maintained at a satisfactory level compared to previous years.

Following the trend set by other luxury and high fashion brands, Burberry and Max Mara have signed on Calea Victoriei and in the vicinity, in the area close to Radisson hotel. Calea Victoriei maintains the status of a luxury

destination, followed closely behind by the Marriot hotel retail gallery which continues to attract well-known brands such as Valentino.

Magheru and Balcescu Blvd, which were among the most expensive and sought after locations before 2008, have registered high vacancy rates as these areas have encountered difficulties in finding appropriate retailers to fill the empty spaces.

The most active players on the market, supermarkets such as Mega Image, Carrefour, Profi and Billa, have looked to consolidate and take advantage of the current lower rental levels.

Rents have kept their levels, with no significant fluctuations being registered, but pressure is high from retailers for rents to drop, especially in central locations where retail units over 200-300 sq m struggle to find tenants.

Table 3
Prime high street rents

Area	€/sq m/month
Calea Victoriei	50-60
Magheru/Balcescu Blvd	70
Calea Dorobantilor	50

Source: The Advisers/Knight Frank

3. INDUSTRIAL MARKET

In 2011, the industrial/logistics sector was marked by two important openings. The first one was the first phase of the inter-modal rail terminal built near Ploiesti by Alinso Group, with a track length of 1,130 meters and a total capacity of 1,028 TEU. This terminal delivers strategic access to some important transport corridors in Western Europe. The other important opening was the launch of the inter-modal terminal at Europolis Park in Bucharest. The first stage has 12,000 sq m of platform, 2.5 km of rail track and a capacity of approximately 1,200 TEU.

Supply

Similar to 2010, 2011 was a challenging year for both landlords and tenants. Heavily influenced by the economic conditions, most of the market players remained cautious.

Continuing the trend that started in 2010, during 2011 the balance of the market moved away from Bucharest, towards cities like Ploiesti, Pitesti, Craiova, Timisoara and Cluj, where demand for modern warehouses increased, for both production and logistics.

The Bucharest stock remained at a similar level to 2010, as no new deliveries were brought to the market during 2011. Thus, the current modern industrial stock of the city amounts to approximately 940,000 sq m.

Demand

As far as demand is concerned, take-up in Bucharest in 2011 reached a similar level to

2010, with approximately 100,000 sq m of class A space leased.

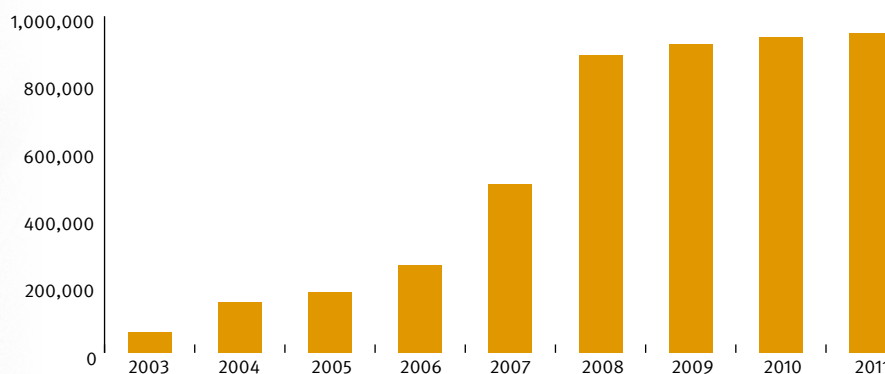
Net absorption was driven mainly by retailers and logistics companies through new leases and extensions in the existing space, although consumer spending remained low. As a result of the improved absorption, the vacancy rate decreased to 10.8%, representing a drop of almost 20%. Given the lack of new developments, the vacancy rate is expected to dip into single digits by the end of 2012.

In terms of location preferences, the focus in 2011 remained clearly on the West and North-West areas followed by the South-East part of Bucharest.

Rents

Prime rents for class A warehouses remained unchanged during 2011. Leasing conditions

Figure 5
Total industrial stock
sq m



Source: The Advisers/Knight Frank

remained very favorable for tenants, with strong incentives still available, especially for long-term contracts. As a result, rents are anticipated to remain stable and vacancy rates in prime locations are expected to fall during 2012.

The level of service charge remained unchanged, at approximately €0.50-0.95/sq m/month, depending on the quality of services offered and the level of local property taxes.

Forecast

In light of the above mentioned trends, we anticipate that the current market conditions will continue during 2012.

The interest of developers is expected to remain stable, as they will continue to act cautiously, carefully analyzing the market to assess the best time to start a new construction. They are still at the point where they will not take the risk to build on a speculative basis.

The demand for intermodal services will further increase.

In terms of class A developments, we are already witnessing the growth of regional hubs due to demand from both logistics and production activities (for example, Timisoara-Arad, Cluj-Turda, Ploiesti, Pitesti and Oradea). This kind of development represents a confirmation of the healthy growth of the industrial and logistics market in Romania,



which is following a similar trend to other countries in the region, such as the Czech Republic and Poland.

Nonetheless, Bucharest will not see any

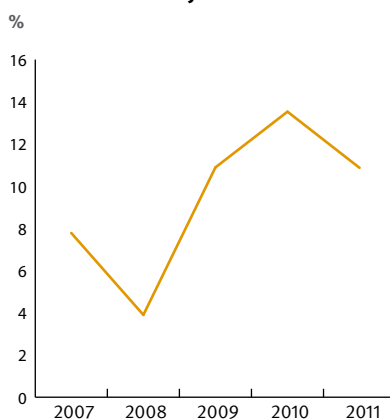
speculative deliveries during 2012, while the rest of the country will only see one new speculative project, VGP Park Timisoara, which is set to deliver 10,200 sq m in Q1 2012.

Table 4
Prime rental 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

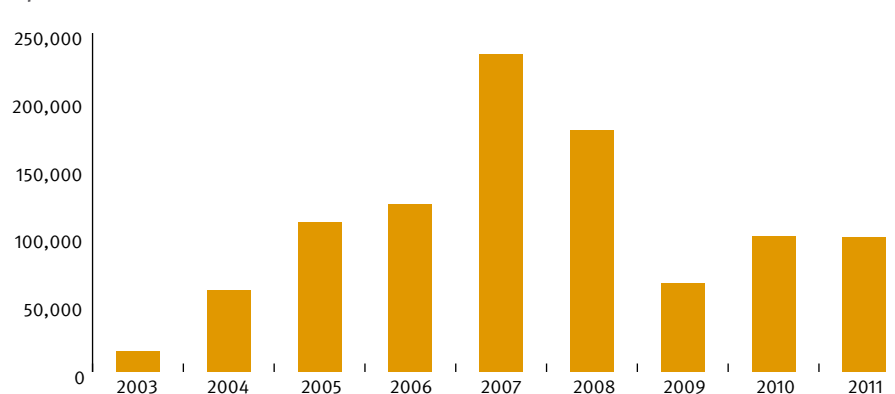
Source: The Advisers/Knight Frank

Figure 6
Industrial vacancy rates



Source: The Advisers/Knight Frank

Figure 7
Industrial take-up



Source: The Advisers/Knight Frank

4. LAND MARKET

2011 was characterized by stability and improved demand, but also by cautiousness regarding the signing of new transactions.

Although still not reaching its highest potential, the market has shown a certain vibrancy in terms of potential deals and interested parties. The active players included end-users such as retailers, gas station chains, pharmaceutical and manufacturing companies.

A very powerful driver of the land market came from office space developers. Their requirements were focused on some specific areas, such as the Barbu Vacarescu/Calea Floreasca area, which has become the most sought-after business district in Bucharest during the last two years. After two years of inactivity, potential buyers became more interested in buying the available land plots here, driven by the low vacancy rates in certain districts. However, they are still cautious in signing transactions. This was also confirmed by the longer period

of negotiations, with it taking up to 6-9 months in order for the parties to complete a transaction. Because of the zoning and planning issues faced by developers, the majority of buyers expect that all documentation for a land site is settled before closing a transaction, including building permits and other necessary papers.

Nevertheless, the big retailers such as Cora, Kaufland and Auchan remained the most active players in the land market. They have focused in buying strategic land plots in key locations, which were impossible to acquire in the booming period due to the very high prices. Dedeman was by far the biggest investor in land in the DIY segment, expanding throughout the country in cities like Constanta and Baia Mare, with its total chain reaching 26 stores, varying from 6,000 to 18,000 sq m.



Basarab Bridge, Bucharest

Table 5
Average land prices by location (€ per sq m)

	Progresului	Timpuri Noi	Barbu Vacarescu/ Calea Floreasca	Lujerului
2004	450-550	500-600	600-650	350-400
2008	1,200-1,500	1,200-1,500	1,400-1,600	800-900
2010-2011	500-600	450-500	900-1,100	400-450

Source: The Advisers/Knight Frank

The largest transaction seen by the market in 2011 was the acquisition of Chimopar platform for €18 million from Maveco Holdings by Jaffal Imad. The second largest transaction was the sale of a land plot owned by Baduc in Calea Plevnei to IKEA. The sale price of this plot was €13 million.

Very few residential developers with the capacity to commit their own equity showed interest in signing joint ventures with land owners which acquired land without financing prior to the crisis. The joint ventures would enable these developers to avoid land financing and the owners to amortize the initial cost of the land.

During 2011, land prices have maintained the level registered at the end of 2010. After two years of decline, 2011 brought the stabilization of prices for plots located within central and semi-central areas of Bucharest. This has raised the interest of a few prime regional investors which have entered the Romanian market. However, areas situated outside or at the periphery of the city have not benefited from the same treatment.

In terms of the negotiation flexibility encountered in the market, the average is around 10% to 15%, however each transaction has its own particularities.

Forecast

Given the high impact that infrastructure developments have on particular geographic areas, the projects developed throughout 2011 will increase the selling prices and demand for some districts. Such projects are the Basarab Bridge (facilitating access in the West area of the city from the North side), the Pipera overpass (facilitating access in Pipera) and the two new metro stations (facilitating

access further in the North-West area of the city).

In terms of demand, a slight increase is expected, generated by office space developers or big retailers which do not rely on bank financing. An important aspect which will have repercussions on the market is the Basel III global regulatory standard on bank capital adequacy, which will limit bank financing in 2012.

Following a similar trend to 2011, we expect to see large retailers remaining active, especially throughout the country. Besides

DEVELOPERS AND RETAILERS HAVE ACQUIRED LAND PLOTS IN KEY LOCATIONS AT MUCH LOWER PRICES THAN WERE ASKED DURING THE BOOM PERIOD.

the low land prices asked in these areas, another local trait, appealing to retailers, is the possibility to build “big boxes” inside the city. In contrast to other European markets, Romania does not have legal regulations which limit the construction of large retail centers to be exclusively outside of towns.

2012 is expected to see the continued stabilization of the market, with prices being maintained at similar values. The only areas which might be faced with reduced demand and falling prices are those which are situated outside of town, with difficult accessibility and poorly developed infrastructure.

There was increased activity in the investment market in 2011. While the total volume of investment decreased compared with the previous year, many transactions were initiated during 2011 but will be concluded at the beginning of 2012.



5. INVESTMENT MARKET

An important aspect of this period was the fact that current market conditions have enabled prime properties to become available for sale. Prices stabilized and will remain constant throughout 2012.

The time taken to negotiate and close transactions increased due to the more difficult financing conditions. Investors targeted properties with financing in place in order to avoid this issue.

Demand

Demand is driven by the same international companies who have maintained their confidence and interest in the Romanian market ever since they entered it in 2004-2005. NEPI listed at the Bucharest stock exchange and continued to be aggressive in buying properties while CA Immo finalized the takeover of Europolis.

A number of smaller properties of a value of up to €15 million have been acquired by Romanian entrepreneurs redirecting investments from other businesses.

Supply

There is a good supply of stock in office and retail schemes with long sustainable lease contracts. The most sought-after properties were big box units (with unbreakable lease contracts for a minimum of 7 years) and fully leased office buildings with international tenants in central or semi central locations.

An effect of the current world economic situation was seen in the fact that the majority of deals did not involve cash – they were either joint ventures or share deals.

Financing became even more difficult to access in 2011, which inevitably led to some negotiations being postponed until further notice. However, it is expected that solutions to make financing easier will be found in 2012.

The yields registered in 2011 have remained similar to the ones from 2010. The sale of Floreasca Business Park at the end of 2010 has set the benchmark for the office sector at between 8% and 8.5%.

Table 6
Prime property yields (%)

Offices	Retail	Industrial
8.00-8.50	9.00-9.50	9.50-10.50

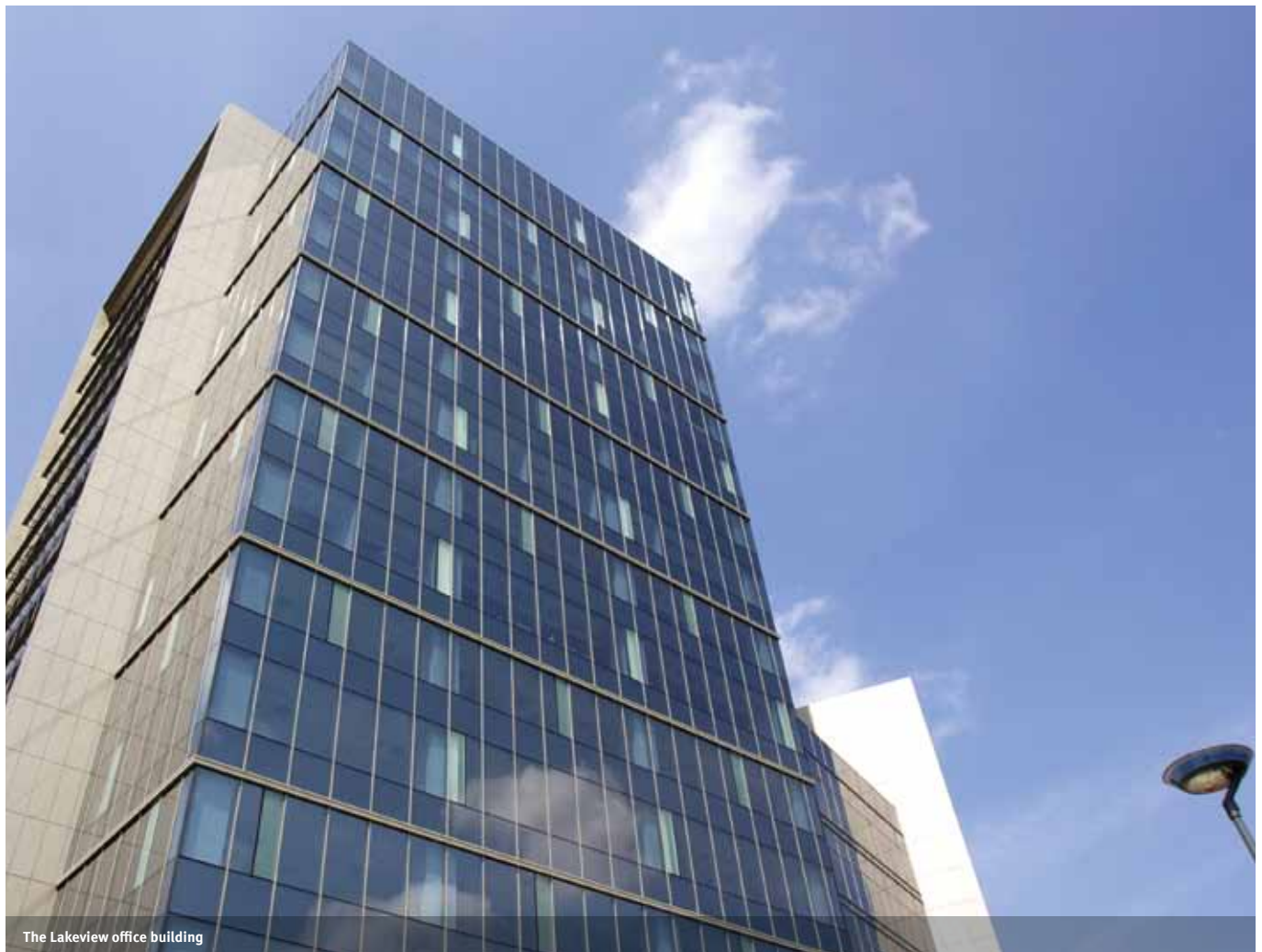
Source: The Advisers/Knight Frank

Infrastructure works in the city have helped the investment market and improved aspects such as accessibility and traffic in important areas, leading to increased interest in properties in the surrounding locations. The Basarab Bridge and the Pipera overpass are significant examples.

In total, the volume of deals in the investment market in 2011 was approximately €250 million.

In spite of the difficult environment, there were still a number of notable transactions in 2011. NEPI acquired a stake in the soon-to-be-built Victoria City shopping center. Argo RE took over Omilos, the owner of two shopping centers: Era Oradea and Era Iasi, with a combined worth of approximately €150 million. Argo thus became the largest owner of shopping centers in Romania. Also of note, Adama sold its remaining stake to Immofinanz for €42.7 million.

Having gone through a setback in 2009 and 2010, 2011 did mark a slight increase in economic growth in Romania and 2012 is expected to slowly but surely follow the same trend.



The Lakeview office building

6. VALUATIONS

PROPERTY TAXATION FOR LEGAL ENTITIES

Demand

Property taxation for real estate assets owned by legal entities in Romania is split into two main elements: land and construction taxes.

For sites, the annual levy is calculated according to coefficients established by the Fiscal Code, depending on the land area, the locality classification, the use of the site according to local urbanism authorities, etc.

On the other hand, for constructions, the yearly toll level is between 0.25% and 1.50% of the gross book value of the construction, more precisely of the inventory value registered in the books of the property owner. For buildings which have been entirely depreciated, the property tax is diminished by 15%.

For calculation of the gross book value of a building, one must take into account the sum of the values of all its elements and functional installations. Thus, terraces, stairs, elevators as well as lighting, sanitary, heating installations and any other indispensable element should be part of the gross book value of the building, whereas the expendable assets such as individual air conditioned split units should not.

2011 Fiscal Code regulations

According to the 2011 issue of the Fiscal Code, the tax quota for constructions can be increased to amounts between 10% and 20% of the inventory value for buildings which have not been revalued during the last 3 years, and between 30% and 40% for buildings not revalued during the last 5 years.

If until recently, the maximum annual quota of the property tax for constructions was 10% of the gross book value in the case of buildings which were not revalued during the previous 3 years, the recently published rules contain a double ceiling in that case. Furthermore, the updated law also introduced an up to 40% tax

quota of the gross book value for constructions which were not revalued during the previous 5 years. Therefore, landlords who are not aware of the law changes might find themselves in the position of having to settle a property tax equal to the inventory value of the building during 2 and a half years.

Another important element comprised in the recent set of laws is the tax for non-operational touristic properties. For these, the duty is set at a minimum of 5% of the gross book value of the building, the exact amount being established by the local authorities.

Revaluations

According to accounting principles, once a legal entity decides to revalue a building, it needs to revalue the entire accounting class of that asset. This means that if a company wants to revalue one of its properties located for instance in Bucharest, but owns also 3 other properties throughout Romania, the legal entity must revalue all 4 properties.

In terms of valuation dates, financial reporting revaluations performed for fiscal purposes (reporting to DITL – Local Authority for Taxation) are traditionally made as of December 31. Nevertheless, local subsidiaries of multinational companies that have opted for a different fiscal period than the calendar year have to revalue their assets accordingly, at the end of the accounting year.

7. IFRS AND DEFERRED TAXES



*Author: Francesca Postolache,
Director, Real Estate Leader,
PwC.*

Every company preparing IFRS financial statements is faced with a complex matter – deferred taxes. It is a difficult concept and represents one of the differences between IFRS and statutory accounting. We will present the main principles and specific applications for Romanian companies.

The concept relies on the fact that accounting treatment and tax treatment of certain expenses and income may be different. In cases where such differences are temporary, current income tax (profit tax) might not reflect the substance of transactions and the accrual principle: the impact in profit or loss of a certain expense could be in one period, while the related current tax charges in another period.

To illustrate, we can look at the treatment of a provision for a commercial litigation that is booked based on the expected outcome of a case. While the expense might be recorded on the P&L based on the provision, such amount is not currently deductible for income tax purposes. As such, the current year income tax charge for the company does not take into account the eventual tax impact of the deduction. This means that without the deferred tax calculation, the current year income tax of the company will look high in relation to the reported income. On the other hand, when the litigation is solved and the company is liable for the settlement amount under the lawsuit, the expense becomes



deductible for current income tax purposes. However, since the related expense for the litigation outcome was already recorded in the previous period (by recording the provision) there will be a decrease of current income tax that is not reflected in the current reported profit calculation and the current tax charge would appear understated compared to the level of income.

Deferred tax addresses this matter, by recording the future impact on taxes for such type of temporary differences. In the above example, a deferred tax asset would be set up on the balance sheet, and a related deferred tax benefit would be credited in the profit or loss account in the year when the provision is recorded. Essentially what this is doing is adjusting the income effect of the expense by also recognizing the eventual tax savings associated with the deduction. To calculate this, we take the amount of provision multiplied by the applicable tax rate (which is 16% for Romania). Then, in the year when the lawsuit is finalized and the expense becomes deductible the temporary difference reverses, hence the deferred tax asset is reversed – the reversal of the deferred tax credit off-sets the deduction under current tax, thus having nil impact on the tax charge, which matches the nil expense related to the litigation.

The methodology of computation for deferred taxes, as included in the International Accounting Standard 12 'Income Taxes' ("IAS 12"), is in summary as follows:

- For all assets and liabilities the tax base is determined.
- The difference between tax base and the carrying amount (the amount for which the asset and liability is recorded in the IFRS financial statements) represents a temporary difference.
- For temporary differences, in Romania deferred tax is computed by applying the tax rate of 16% (with some exceptions specifically indicated in the standard).
- The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to the entity when it recovers the carrying amount of the asset. If those economic benefits will not be taxable, the tax base of the asset is equal to its carrying amount.
- The tax base for a liability is its carrying amount, less any amount that will be deductible for tax in respect of that liability in future periods.
- Deferred tax shall be recognised as income or an expense and included in profit or loss for the period, except to the extent that the tax arises from a transaction or event which is recognised, in the same or a different period outside profit or loss, either in other comprehensive income or directly in equity; or a business combination (when deferred tax is recognised against goodwill). An example where deferred tax is not recognised in profit or loss is related to revaluations of fixed assets – deferred tax impact of revaluations will also be recognised in revaluation reserves.

It sounds complicated, but the general principle is to record the tax effect of temporary differences between accounting profit and taxable profit so that such tax effect is matched with the corresponding year in which the income or expense is reported for accounting purposes.

One application of deferred tax that is relevant for most Romanian real estate developers or investors is in respect of revaluation of fixed assets or the sale of companies with appreciated real estate.

Starting 1 May 2009 there have been several changes in the Fiscal Code. From these changes, one of them had a significant impact on deferred tax: a change in the way the revaluations of property, plant and equipment performed after 1 January 2004 were treated for tax purposes.

This change led to a decrease in the tax base of fixed assets. The new tax base became the historical cost (or revalued amount at 1 January 2004) less accumulated depreciation on this historical cost (or revalued amount at 1 January 2004), because this is amount that is deductible for current tax purposes.

For deferred tax computations, the IFRS net book value of fixed assets needs to be compared with this lower tax base.

Two typical situations where this has significant impact are as follows:

1. IFRS - historical cost; Statutory - revaluation

Under this scenario the company has the accounting policy under IFRS to record fixed assets at historical cost less accumulated depreciation and any impairment losses, while in the statutory accounts the respective fixed assets are stated at revalued amount.

In this case, if there is no other difference between IFRS and the statutory accounts (such as different depreciation rates and methods) and no differences in fiscal depreciation, no deferred tax will be recorded, as the tax base is the historical amount, which is equal to the IFRS book value. For IFRS accounting the tax impact of depreciation is matching the depreciation expense recorded, as this amount of depreciation based on historical amount will also be the one deductible for tax purposes.

2. IFRS and Statutory – revaluation

Under this scenario the company has the same accounting policy under IFRS and statutory, respectively to record fixed assets at revalued amounts.

In this case, a deferred tax liability typically results (although with a downward valuation it is conceivable that a deferred tax asset could also arise), computed as the difference between the IFRS book value (revalued amount) and the new tax base (historical cost or revalued amount at 1 January 2004, less accumulated depreciation computed until the end of the reporting period based on this historical cost or revalued amount at 1 January 2004).

In this situation the deferred tax liability is recognized in equity (revaluation reserve) at the moment of the change in fiscal legislation (1 May 2009), as well as at any date when subsequent revaluations are performed in the IFRS financial statements. This way, every time there is a change in revaluation reserve adjusting the value of the assets, the related 16% tax charge is also recorded in revaluation reserve – the revaluation reserve will be stated net of the tax charge of 16%.

Another important consideration is when a local real estate company applies Romanian statutory accounting rules, but an offshore parent or potential acquirer applies IFRS. In case of a sale of shares in a Romanian entity with appreciated property, the offshore acquiror applying IFRS may need to reduce the carrying value of the appreciated asset for a potential capital gains tax on eventual disposal of the asset. This could have an impact on the price negotiations between foreign investors and Romanian shareholders in real estate companies.

We hope the above has shed some light on this complex accounting topic and next time you are reading a set of IFRS financial statements the deferred tax lines will be less of a mystery.

Americas

USA
Bermuda
Brazil
Canada
Caribbean
Chile

Australasia

Australia
New Zealand

Europe

UK
Austria
Belgium
Czech Republic
France
Germany
Hungary
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
Switzerland
The Netherlands
Ukraine

Africa

Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

Asia

Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

The Gulf

Bahrain
UAE

Romania

Horatiu Florescu

President & CEO

+40 21 380 85 85 - General

+40 21 380 85 35 - Fax

horatiu.florescu@theadvisers.ro

The Advisers, in association with Knight Frank, provides high standard consultancy and representation services to developers, investors, owners and tenants, within the entire array of real estate projects, in all market sectors, at both strategic and commercial levels.

Sharing resources within the Knight Frank network, our team offers to its clients international knowledge and expertise, tailored to the specific local needs.

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Knight Frank Reports are also available at www.knightfrank.com

© Knight Frank LLP 2012

This report is published for general information only. Although high standards have been used in the preparation of the information, analysis, views and projections presented in this report, no legal responsibility can be accepted by Knight Frank Research or Knight Frank LLP for any loss or damage resultant from the contents of this document. As a general report, this material does not necessarily represent the view of Knight Frank LLP in relation to particular properties or projects. Reproduction of this report in whole or in part is allowed with proper reference to Knight Frank Research.

Knight Frank LLP is a limited liability partnership registered in England with registered number OC305934. Our registered office is 55 Baker Street, London, W1U 8AN, where you may look at a list of members' names.