H1 2010
ROMANIA MARKET OVERVIEW
Review & outlook

HIGHLIGHTS

- The Bucharest office market saw a revival of leasing activity during H1 2010, recording take-up of 105,000 sq m, more than the whole of 2009.
- Over 155,000 sq m of new office space came to the Bucharest market during H1, but the rate of deliveries is likely to slow considerably in H2 and 2011, which will make it increasingly difficult for occupiers to find space in new buildings.
- The first half of 2010 saw some notable events in the retail market: two shopping centers opened, H&M signed their first lease agreements for Romania and food operators and discounters continued to expand aggressively.
- The industrial market saw a modest recovery in H1, with the take-up of class A space coming to 50,000 sq m, more than double the total recorded during the same period of last year.

in association with Knight Frank

Contents

The first half of 2010 was a dynamic period with more office transactions, in terms of both their number and the area leased, than the entirety of 2009.

The market saw increased activity, whether companies required more space for expansion, wished to lower costs through consolidation or even sought to reduce their existing leased space.

1. OFFICE MARKET

Supply

The first half of the year saw over 155,000 sq m of new office space in 21 buildings delivered to the Bucharest market. This increased the total office stock in the city to almost 1.4 million sq m.

Over 90% of the space delivered was in the central and semi-central areas whereas the periphery registered only 7% of the total. Considering that in 2009 the periphery accounted for 45% of all deliveries, this situation reveals an obvious shift in developers' behavior and an increased orientation towards the central and semicentral areas.

In terms of size, almost half of the premises delivered were buildings with surfaces of less than 5,000 sq m, being mainly speculative construction projects. The rest were fairly evenly split between projects of 5,000–10,000 sq m and those over 10,000 sq m. Of the larger buildings, the majority were commenced during 2007–2008, this being the last period during which it was possible to secure financing for such projects.

The projects in highest demand were those with large floor plates. However, most of the buildings delivered this year have an average floor plate below 1,000 sq m.

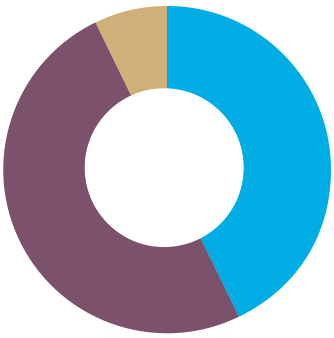
In addition to the new deliveries, the sublease offer was another source of office space on the market. Large tenants, with premises contracted prior to the crisis, faced the need to sublease as their companies downsized.

Besides the already established business districts, a new area is gaining popularity. Since 2009, when Calea Floreasca 169A was

Green Gate, with 30,000 sq m GLA, to be developed by Green Gate Development in Bucharest
Exclusive assignment of The Advisers/Knight Frank

THE NEW SUPPLY DELIVERED DURING H1 WAS CONCENTRATED LARGELY IN THE CENTRAL AND SEMI-CENTRAL AREAS.

Figure 1
Location of new supply, H1 2010
%



Source: The Advisers/Knight Frank

Figure 2
Size of new buildings delivered in H1 2010
%

Source: The Advisers/Knight Frank

delivered, and continuing this year with Lakeview and Nusco Tower, a new business hub has been emerging within Calea Floreasca - Barbu Vacarescu area. Due to its vicinity to Piata Victoriei - Charles de Gaulle area and the good accessibility towards both the city center and the international airports, this is one of the most in-demand business areas of the moment.

A premiere was the delivery of the first class A office building in the southern part of Bucharest during the second quarter of this year. Sun Plaza Offices, with 10,000 sq m gross leasable area, is adjacent to the newly opened Sun Plaza shopping center.

An increasing trend within the market is for properties to become certified as green buildings. Two of the first BREEAM certified buildings, Lakeview and Euro Tower, were delivered this year. Both are located on Barbu Vacarescu Street. Some buildings which have already been completed have also started procedures to be certified as green post construction. This situation can be explained by both the environmental protection policies adopted by multinational companies and the cost efficiency which characterizes these buildings.

The overall level of vacancy remained similar to last year, at around 19–20%. The highest vacancy rates are found in the peripheral areas of Bucharest as tenants have relocated to more central and accessible locations.

Demand

Transactions closed during the first half of the year reached approximately 105,000 sq m, exceeding by 5% the area leased in the whole of 2009, showing the positive evolution of the market.

Nevertheless, it should be noted that a significant percentage of the deals closed this year had begun negotiations in 2009, but took longer to finalize because of the difficult economic climate which pushed tenants to act cautiously and cut costs as much as possible.

Due to the more attractive financial terms offered by landlords, tenants relocated

Prime Business Center, with 50,000 sq m GLA, to be developed by Estia Group in Bucharest
Exclusive assignment of The Advisers/Knight Frank

mainly to the central and semi-central areas. Consequently, the majority of demand was equally distributed between these two zones, while only 16% of take-up occurred in the periphery. This resulted in a large amount of vacant office space in peripheral areas.

The average transaction size increased by 20% in H1 2010 compared to 2009, from 1,000 to 1,200 sq m. Nevertheless, most companies were interested in relatively small areas due to their cost cutting policies. As a consequence, 70% of deals were signed for areas of less than 1,000 sq m.

The largest transaction registered in the first half of 2010 was a 15,000 sq m pre-lease for an office building located on Expozitiei Boulevard, signed as a direct deal by UniCredit Tiriac Bank. However, the majority of transactions closed in the first six months were renewals or relocations. The reduced number of pre-leases was caused mainly by the difficult economic environment which made most companies uncertain of what the future will bring. Moreover, tenants could relocate without waiting 6–18 months to secure a location given the sufficient number of alternative existing buildings.

Continuing last year's trend, the office market still favored tenants, which was seen in the strength of the bargaining positions that they had during negotiations with landlords.

The most active sectors were finance/banking/insurance and professional services, both generating around 20% of the total take-up. These were followed by pharmaceuticals and healthcare and IT&C,

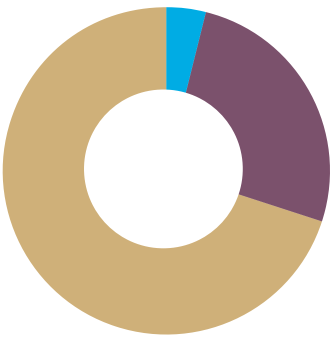

Peripheral Area
Tunari Forest
Baneasa
Forest
E60
Sector 1
Semi-Central
Sector 2
E60
E60
E85
Sector 6
Sector 3
Central
Mill Lake
Sector 5
Sector 4
Lake Cernica
E85
E60
E81
A2
Lake
Vacaresti
E70
E70
DN5
DN4
Cornetu
Forest

OFFICE RENTS DECREASED SLIGHTLY IN HI, BUT SHOULD STABILIZE OVER THE SECOND HALF OF THE YEAR.

Figure 3
Location of take-up, H1 2010
%

Source: The Advisers/Knight Frank

Figure 4
Size of leasing transactions in H1 2010
%



Source: The Advisers/Knight Frank

with approximately 12% each, while other sectors contributed less than 10% each.

Despite the fact that international companies started to obtain board approvals for their leasing decisions more quickly, the most active players on the market remained the local ones. They have simpler management structures and the advantage of knowing the market better, thus they were able to reach decisions in a shorter period of time.

Rents

Compared to the end of 2009, rents have decreased slightly, by around 5% for premises located in the central and semi-central areas and by around 15% in the outskirts of Bucharest.

The level of service charges did not change compared with the previous year. Currently, the monthly cost per sq m varies between €3.50–5.00, depending on the type of building and the services included.

Landlords continued to attract tenants by offering financial incentives such as rent-free periods (from 2–6 months depending on the length of the lease agreement), free parking spaces or fit-out contributions.

The average lease period remained at five years, and, in some cases, tenants have early break options.

Forecast

During the second half of 2010 there will only be a limited number of buildings delivered to the market, including Nusco Tower and Polona 68 Business Center. The amount of new space to be delivered over the course of this year will thus show a clear decrease on 2009.

Crystal Tower, with 16,200 sq m GLA, developed by Plaza Development in Bucharest
First office building with double skin façade and heliport

Some newly available space, especially in the central area, is expected to come to the market due to companies consolidating their existing operations. As new buildings will be scarce, this vacant space is likely to be leased rather quickly, thus not significantly affecting the vacancy rate.

Due to continued difficulties in obtaining financing, the only projects that will be started during 2011–2012 are likely to be the ones which can secure pre-leases. As no new major projects have been commenced this year, 2011 is likely to see a considerably reduced delivery of new buildings. Overall, this will help the existing available space on the market to be leased, particularly in better buildings with good accessibility.

During the next two years, companies which plan to relocate might need to wait in order to secure a good location, because of the limited amount of quality space available in the market. In light of this, 2011 will be a good year for landlords to start speculative projects.

Table 1
Net effective office rents (€/sq m/month)

	Central	Semi-Central	Peripheral
2009	16–18	14–16	10–12
H1 2010	15–17	13–15	9–11

Source: The Advisers/Knight Frank

Several of the largest buildings delivered in H1, including Metropolis, City Gate, and Euro Tower, still have available space, but due to the anticipated lack of new deliveries in H2, we expect these buildings to fill their vacant space by the end of Q1 2011.

We estimate that the combined total take-up for 2010 and Q1 2011 will reach 200,000 sq m, slightly less than it was in 2008 (230,000 sq m).

The next two years will bring a period in which pre-leases to accommodate the needs of multinational companies will become more common. Several large consolidations and expansions have already been announced and, given the lack of major deliveries during 2011–2012, companies will face a choice of either renewing the lease in their current location or relocating to existing projects on the market. A third option may be to renew their current lease for a shorter period of time, and sign a pre-lease for space in a building due for delivery in 2012 or 2013.

Currently, the office market is a tenants' market where landlords still need to offer attractive incentives. However, given current demand levels and the reduced amount of new space expected to be delivered, we expect the balance of the market to shift. During the next two years, demand will begin to exceed supply and, as a result, landlords with space available in buildings with good technical specifications and accessibility will be able to choose between tenants.

North Point, with 24,000 sq m GLA, to be developed by Sity International
Exclusive assignment of The Advisers/Knight Frank

Nusco Tower, with 17,400 sq m GLA, developed by Nusco Group

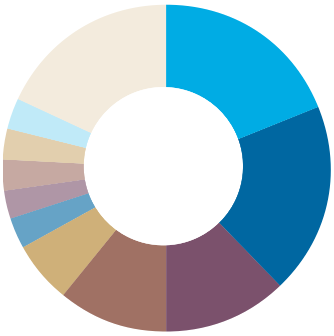
Rental levels are likely to remain broadly stable until the end of the year. In some prime locations it is possible that, because of the high demand and lack of available space, rents may actually increase.

"At the beginning of this year, the evolution of the office sector was an unknown for everyone. 2009 proved to be a year of discussions, prolonged negotiations and postponed deadlines, a year of few positive things. Despite this uncertainty, the first semester of 2010 saw a positive shift of the real estate market, especially for office leasing. Starting with the beginning of the year, negotiations became offers and offers became signed contracts. In just a few months 70% of Nusco Tower was leased. As far as the progression of the real estate market is concerned, during the second half of the year I estimate a slow but balanced evolution in demand. For new deliveries I see a regression coming up and continuing through 2011 due to the lack of any new constructions." **Michele Nusco – Nusco Group**

Figure 5

Take-up by industry, H1 2010

%



- Finance, banking & insurance
- Professional services
- Pharma & healthcare
- IT & C
- Retail
- Utilities
- Automotive
- Construction
- Media & advertising
- Oil & gas
- Other

Source: The Advisers/Knight Frank

2. RETAIL MARKET

The first half of 2010 saw some notable events: two shopping centers opened, H&M signed their first lease agreements for Romania and food operators and discounters continued to expand aggressively.

Supply

The opening of Sun Plaza in Bucharest and of Atrium Center in Arad increased the modern stock of shopping centers by 110,000 sq m of GLA. The tenant mixes of the two developments are a direct reflection of the current market situation, which is much stronger in Bucharest, and in the segment of the international retailers.

Existing schemes have been able to encourage increased demand for vacant space, due to the loyal visitor traffic that they have managed to form throughout the years through a more attractive tenant mix.

On the whole, the goal of shopping center owners in the first semester of 2010 was to maintain the occupancy rate and improve the tenant mix in order to maintain the traffic of visitors.

The vacancy rate pattern of 2009 continued into 2010, with shopping centers in Bucharest registering lower vacancy rates than those situated in other Romanian cities. Also, most of the centers which opened before 2008 have had more time to become established shopping destinations and thus have not had major occupancy issues.

Demand

The increase of VAT and other austerity measures such as the decrease in salaries for public sector employees triggered a further reduction in consumption, directly influencing retail demand. Therefore, the most active players were retailers with affordable prices.

Demand was driven mainly by food operators, discounters, and international brands backed by strong parent companies.

Due to the lower rents, space within shopping centers has become more affordable for some retailers. This also applies to plots within the city limits, since prices for land have lowered.

Goods manufacturers have seized the opportunity to open their own stores, either on high streets or in shopping centers, in order to optimize cash flow.

The highest demand from retailers is still concentrated on Bucharest, while for the rest of the country it is strongest on the discount and supermarket segments.

However, it has not been all good news for everybody: to name two, Diverta has filed for insolvency, while Benetton has decided to close all the stores which it operated directly and keep only three franchises open.

The most notable new entrant to the market this semester is H&M which signed for its first stores, although they will not be opened earlier than 2011. The fitness segment has been highly active with Pure Fitness making its way on to the Romanian market and World Class securing new units both in shopping centers and in other developments. Medical clinics have also remained very active in the first semester, continuing to expand and develop larger formats in order to better cover a wide range of services.

Rents

The leasing market conditions which emerged during 2009 continued to be evident in the first half of 2010.

The speed and the intensity of the economic downturn have attributed more complexity to the leasing process. In order to avoid heavy rent markdowns, both owners and developers are luring tenants by also bringing into discussion the real cost of the common area maintenance charges, the marketing costs, fit-out contribution, break-options, the turnover rent, the indexation, lease duration and extension options.

At the same time, retailers are trying to change the rules of the game by seeking much more advantageous terms during negotiations. Their main objective is to apply the current conditions over a longer term, while developers and owners are learning the hard way the consequent effects on financing. In the end, it is a matter of surviving and since shopping centers are a long term business, the owners are inclined to concentrate on reducing their vacancy rates and have thus become more flexible and understanding towards retailers' businesses.

Forecast

The retail sector will get a further boost with the opening of more shopping malls in Romania.

Two new schemes are due to open to the public by the end of the year – Severin Shopping Center and Gold Plaza. In addition, at least eight other retail schemes have been announced and are planned to be opened in the next year.

In spite of the challenging economic environment, shopping malls continue to expand in Romania. Three of the largest projects that are planned for Bucharest are Victoria City Center, Colosseum and Pallady Shopping Center. There are also plans for a new outlet mall to be opened in 2011, in the eastern side of the capital city – Vitan Outlet with 12,300 sq m.

After completing the full takeover of Polus Constanta, Immofinanz has confirmed the project's opening in 2011. Meanwhile, Belrom, one of the most active developers in Romania, has officially announced development procedures on Electroputere Shopping Center in Craiova. This city is one of the most appealing to developers, with two other projects already announced, but with no modern retail stock yet delivered.

The retail sector is a leading indicator for when things are not well in the economy, but is also one of the first to improve when things start going right. It is very difficult to anticipate when the market will stabilize given the volatile general environment. However, the expansion plans of both developers and retailers seem to indicate improving confidence in the retail sector.

High Street

High street retail was one of the most dynamic segments of the retail market in the first half of 2010. Strong demand came from convenience stores as well as from goods manufacturers. These retailers targeted the secondary areas of Bucharest, especially residential neighborhoods and the most heavily populated areas.

Another highlight of the first half was the increased activity from luxury and high end brands. This trend has been set by Victoria 46 Men, opened in April, as well as Emporio Armani, Gucci and Montblanc who have secured prime locations on Calea Victoriei and will open by the end of the year.

DESPITE THE UNCERTAIN ECONOMIC CLIMATE, NEW SHOPPING CENTER DEVELOPMENTS CONTINUE TO BE COMPLETED.

Vitan Outlet, to be developed by TC Real Estate in Bucharest
Exclusive assignment of The Advisers/Knight Frank

HIGH STREET RETAIL WAS ONE OF THE MOST DYNAMIC SEGMENTS OF THE RETAIL MARKET IN BUCHAREST IN THE FIRST HALF OF 2010.

Moschino store, recently opened in Bucharest

The only pedestrian area in Bucharest, the Old Downtown, was very active this year with an increasing number of restaurants and cafes being opened, witnessing an increased traffic of visitors. Although they have stopped expansion in the past year, banks are still actively looking to relocate to units available at reduced rents or to better locations at similar rents.

Rents have continued decreasing in the first half of the year due to high vacancy rates, although the best locations have registered only slight falls and will probably remain stable during the rest of the year.

"The last six months' trend of the Romanian real estate market – felt especially in the retail sector – was similar to the decline that we saw during 2008 and 2009. In the second half I believe that the results will be better on a comparative basis with the decline felt in the first half. On the other hand, it would be unrealistic to say that things have stabilized in the Romanian market yet", **Ali Capa –** CFO, **Anchor Group**

Table 2
High street rents

Area	€/sq m/month
Prime	50–100
Secondary	25–50
Peripheral	15–35

Source: The Advisers/Knight Frank

3. INDUSTRIAL MARKET

The first six months of 2010 brought a modest recovery of the industrial market in Bucharest. The total take-up of class A space increased to almost 50,000 sq m, more than double the total recorded during the same period of last year. However, both tenants and developers are continuing to be very cautious; developers kept new projects on hold, while tenants were prudent with their moves. A stabilization of rents was observed, while the vacancy rate slightly increased.

Supply

In terms of the supply of class A space, the first half of 2010 did not bring any major changes to the industrial and logistics sector. Since no new projects were delivered this semester, the stock of 920,000 sq m registered in Bucharest at the end of 2009 remained unchanged.

This situation was due mainly to the difficult conditions characterizing the market, which have caused developers to be very cautious and avoid speculative projects. Currently, there are two projects under development, which means that approximately 20,000 sq m of speculative facilities could be ready by the end of the second semester. Both projects are located in the Southeastern part of Bucharest, very close to the ring road, in the Popesti Leordeni area.

The improvement of the national infrastructure continues to be a sensitive issue affecting some landlords' development schemes, as they have to plan their strategy according to any changes in traffic patterns. Since good accessibility is one of the most important aspects for tenants, landlords are focusing on improving this for their projects. Thus, new warehouses and logistics parks are located close to major roads and incorporate all the utilities. An important issue that has to be taken into consideration is that the power supply and railway connections are able to meet tenants' requirements.

Overall, the western part of the city remained in the spotlight of both developers and tenants and continued to be the preferred destination for industrial developments, retaining a concentration of over 85% of the existing stock on the market. The construction works which are currently under way on the ring road of Bucharest and on the bridge linking Soseaua Odaii and Chitila will ease the traffic, increasing the attractiveness of the area even more.

A second cluster of industrial properties is being developed in the eastern part of Bucharest, due to the proximity to the A2 Bucharest - Constanta Highway, but for the moment this accounts for only 10% of the current stock.

Demand

As far as demand is concerned, the industrial market started showing signs of recovery in the first half of the year, with approximately 50,000 sq m leased. This was more than two times higher than last year's H1, when transactions amounted to 20,000 sq m.

The average deal size remained similar to last year, at around 2,500 sq m. The biggest deal closed this year was a 10,000 sq m pre-lease signed by an automotive company for a project located in the western area of Bucharest.

Another important aspect worth mentioning is that there are several outstanding requirements on the market which cannot currently be met because of the size of the tenants' demands.

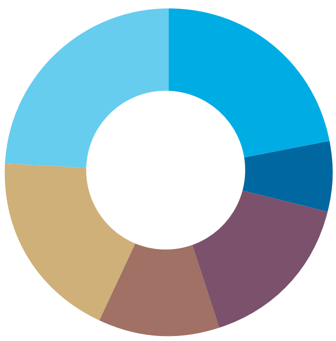
The highest demand came from companies in the food (FMCG) and printing sectors. Compared to 2009, transactions closed by logistics companies have accounted for a smaller percentage, registering only 13% of the total.

Table 3
Prime rental and service charge ranges

	Size (sq m)	(€/sq m/month)
Rent	‹ 3,000	4.10–4.50
	3,000–10,000	3.70–4.10
	› 10,000	3.40–3.70
Service charge	–	0.70–0.95

Source: The Advisers/Knight Frank

Figure 6
Take up by sector
%



Source: The Advisers/Knight Frank

Despite the positive evolution of the market, potential tenants remained cautious and their decisions were based mainly on the cost efficiency of projects. Moreover, although the existing stock volume remained unchanged, the vacancy rate increased by 20% compared to the previous semester, from 10% to 12%.

Rents

Headline rents were relatively stable during the first half of 2010. However, in order to attract new tenants, developers started offering increased incentives such as rent-free months, contributions to service charges and other financial incentives. As a result, net effective rents fell by 10–20% from the levels recorded at the end of 2009.

Compared to last year, the level of service charges remained unchanged, at approximately €0.5–1.00/sq m/month, depending on the quality of services offered and the level of local property taxes.

Forecast

Assuming that financing will remain difficult to obtain and potential tenants' interest will stay at the current level, the total industrial stock is not expected to exceed a volume of 1 million sq m this year.

In the short term, both rental and service charges are expected to remain in the same range as in H1.

Ploiesti will continue to be an attractive location for both logistics and manufacturing companies, and is likely to become an increasingly important industrial and logistics center in Romania.

"Although the Romanian economy was difficult in 2009 and remained difficult in 2010, we received renewed interest from end-users during the first half of 2010 as a lot of companies are preparing for the recovery expected in 2011. The fundamentals of Romania remain strong and more companies are starting to see this. Due to the uncertainty regarding the time of recovery, the first half of 2010 was a period of few transactions."
Ivan Lokere – CEO, **Alinso Group**

Ploiesti West Park, with 30,000 sq m GLA, developed by Alinso Group in Ploiesti

4. LAND MARKET

The land market in H1 2010 continued to perform poorly compared to the boom years of 2005–2008. The few buyers still active in the market had many options and the land prices were adjusted significantly by landlords. Even so, several land transactions confirmed the confidence of companies with long term strategies towards the Romanian economic environment. A number of buyers concentrated their attention not only on Bucharest but on the rest of the country as well.

Many companies have struggled to survive during this difficult period. Others, though, seized the opportunity to consolidate their core business and acquired land plots that were not in their reach during the boom of the real estate market. This was the case for many retailers which were very active and acquired premium sites in semi-central locations in all major Romanian cities. Bucharest, Craiova, Constanta, Brasov, Arad and most of the cities over 70,000 inhabitants registered large deals for sites suitable for different retail developments; hypermarkets, discount stores, shopping centers, etc. Probably the most notable transaction in the countryside was done by the experienced developer Belrom, which bought a large stake of Electroputere Craiova with the intention of converting some of the old industrial units into a modern shopping facility.

Besides retailers, other buyers were medical companies interested in acquiring plots for hospitals and clinics, and manufacturers which bought sites suitable for industrial development on the outskirts of cities. In this second category, we can mention the purchase of a 33 hectare site in Ploiesti by Lufkin, in order to develop a €100 million factory.

A surprising transaction was the sale of Timpuri Noi factory situated close to Unirii Square to the real estate arm of IKEA - Interprime Properties. The shareholders of Timpuri Noi put the 51,000 sq m property up for sale several years ago but the high price prevented the identification of a buyer at that time. Interprime Properties took advantage of the landlord's decreasing sale price expectations and acquired Timpuri Noi for €34.6 million. The deal is the largest concluded so far in 2010.

In terms of supply, we can mention that land sites suitable for all types of developments have been put up for sale, some of which benefit from very good features. Some landlords that acquired large land plots within the city with the intention of developing mixed projects decided to sell parts of the sites to retailers in order to generate some liquidity. They will have to readjust their projects on the remaining plots.

Buyers have been able to set the conditions of the market. Thus, many of them requested that sellers obtain the zoning as the new regulations prove more challenging.

Owners' asking prices decreased by 10% during the first six months. However, the number of transactions has been insufficient to provide a clear understanding of the price evolution.

In conclusion, in terms of the transaction volume, the first half of 2010 saw a small recovery of the land market, but prices fell slightly.

We expect similar patterns to be followed over the next year, but the type of buyers active in the market should widen. While sites suitable for retail and industrial uses were the main targets during the first six months of 2010, we expect that land appropriate for office schemes will be in greater demand in the future.

"With one of the most negative impacts of the financial crisis on real estate lending, i.e. a significant reduction in general LTC ratios, most likely remaining for the long term the real estate development market is back to its old normal of limited to zero land financing. This is not new to experienced real estate developers, but brings particularly to the Romanian land market an additional damper. The old prices were solely justified by the abundance of both land financing and strong speculation fueled by direct foreign investment. With both sources being canceled for the long term, land prices will remain under continued pressure or land owners will have to share significantly the risk of future developments." **Sven Lemmes –** Country Manager, **AIG Lincoln**

5. INVESTMENT MARKET

68th Polona Business Center, with 10,000 sq m GLA, developed by EEC Invest in the center of Bucharest

The first half of 2010 saw an increase in investment activity, however it is important to note that the transactions which occurred were mainly between companies within the same group or non-cash, debt takeovers. A general lack of financing from wary banks and the frequent legislative modifications by the Romanian government have meant that the recovery of the investment market has been slow. An important aspect of the current situation is the fact that a large number of prime properties have been offered for sale in every sector of the market. Regardless of this, investors have shown a heightened interest in smaller, less costly properties which they can acquire without financing, keeping the yield higher than most landlords wish to exit at. The transactions that were closed in the first half of the year were all from experienced purchasers on the local market. While new investors considered purchases, they have postponed entering the market until more favorable conditions develop.

The transaction volume in Bucharest in H1 2010 was as high as that for the whole of 2009, yet it is important to note the types of deals that were closed. The retail sector has been the preferred target for investment so far this year. Veteran investor NEPI acquired Auchan and Bricostore Pitesti from Avrig 35, two years after the purchase of a retail portfolio from the same seller. The construction company Arcadom, a Trigranit subsidiary, purchased half of the shares in Atrium Centre in Arad from Carpathian. Trigranit also acted as seller to Immoeast of the debt of €40 million for Polus Center Constanta. An important transaction was seen in the Western part of the country as Tiago Mall Oradea was the first large property publicly auctioned by a bank on the Romanian market. Such transactions are atypical as banks in Romania have continuously registered profits and have not needed to auction off large properties at discounted prices.

In the office sector, investors are mainly looking to acquire small properties for now, using their own cash rather than bank financing. A transaction typical of the market is the sale of a small office building in Piata Victoriei at a yield of approximately 9%.

At the CEE regional level, investment activity has been mostly subdued, with Poland being the exception. The Warsaw market has seen a significant increase in transactions, in spite of the difficult economic climate, proving that more mature markets are still attractive to investors.

One notable transaction at the regional level was CA Immo's purchase of the Europolis portfolio, valued at €1.5 billion. The closing of this deal will not take place until Q1 2011, however. With the addition of Europolis' properties, CA Immo solidifies its position on the Romanian market.

The limited amount of transactions in H1 2010 emphasized the difference between the price expectations of sellers and buyers, which has led to the reluctance to invest. This is especially true as decreasing headline rents have resulted in uncertainty regarding the sustainability of current rent levels. Landlords have adjusted prices on some properties, but more needs to be done to help the Bucharest investment market regain momentum.

"Despite the lack of new developments in the office sector, the projects that will be delivered in the immediate future represent a positive direction for the market. Problems may arise when these new buildings need to start "producing" to ensure their profitability and to reimburse their loans, as the market has contracted significantly.

I am convinced that each of us is hoping to see a comeback of the market and an increase in investment activity. Nevertheless, without the existence of demand resulting from the improvement of the economic climate generally favorable for new infusions of capital, it will be difficult to attract investors' interest.

However, the effort displayed by many local factors can send out positive messages and a re-launch can occur, with an accent on the fact that Romania represents an important work force and distribution market within the EU."
Florin Popescu – Asset Management Director, **CA Immo International**

THE INVESTMENT TRANSACTION VOLUME IN BUCHAREST IN H1 CAME TO AS MUCH AS THE TOTAL RECORDED DURING THE WHOLE OF 2009.

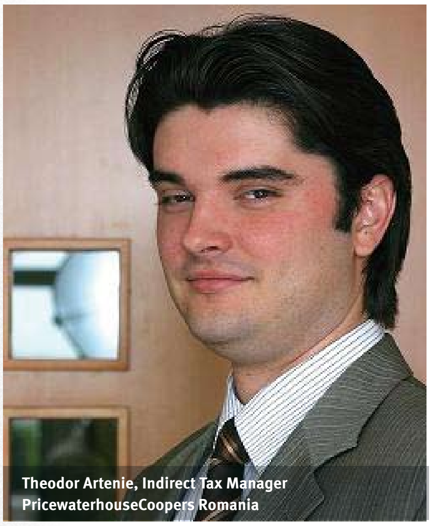
Euro Tower, Bucharest, developed by Cascade Group, with 16,500 sq m GLA

6. INVESTMENT PROPERTY – ACCOUNTING AND TAX MATTERS

PRICEWATERHOUSECOOPERS

HOW VAT CAN HELP TO WIN THE "PRICE/SQ M" WAR

**Authors: Theodor Artenie and Brian Arnold,
PricewaterhouseCoopers Romania**



Theodor Artenie, Indirect Tax Manager
PricewaterhouseCoopers Romania

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After an unprecedented period of expansion just before 2008, the Romanian real estate market essentially came to an abrupt halt due to the worldwide economic sentiment and related investor uncertainty towards the real estate market both in Romania and across the globe.

While the sentiment may have improved elsewhere, buyers still appear to be cautious when looking at the Romanian market. The bottom line is that the Romanian real estate market is plagued by a perception (reality?) that assets are still overvalued. The clear lack of a sufficient continuous transaction flow further adds to uncertainty by leaving investors guessing what the "real" prices should be.

A great mind once said that a crisis situation should not be regarded as a negative phenomenon but rather as an opportunity to re-invent oneself, to adapt, to develop new abilities in order to survive. Under the current circumstances, real estate developers need to start investigating solutions that might not have been considered before the crisis because they were more difficult to implement or because at that time such "solutions" were not necessary as the market accepted certain norms.

One such area to look at relates to the Value Added Tax implications of real estate transactions. It is common knowledge that the Romanian real estate market is intensely affected by the VAT legislation in force which in itself could be a burden but, during these times, can also be an important opportunity as well. Companies and private individuals alike are looking to control costs in these difficult times – while VAT may have previously been viewed as a necessary cost of dealing, perhaps now is time to look for ways to reduce the cost of VAT in relation to real estate transactions.

For example, according to the legal provisions in force, the sale of buildings which are not considered "new" (and this distinction could apply to, e.g., apartments completed in 2008 and still on stock) can be made without application of VAT because applying VAT on these transactions is optional for the seller. The same rule holds true for the leasing of buildings.

Indeed there is the matter of the tag-along VAT costs for the seller/lessor if they do not charge VAT on sales/rentals. This is because if the seller incurred VAT on development or acquisition, but then sold or rented the property with exemption, the VAT they had previously paid would then become unrecoverable. Thus, in the “boom days” of the market, the seller’s view was that VAT, if applicable, was the buyer’s cost, and the seller would simply charge VAT if that created the best answer in terms of recoverability. It would seem that this attitude still largely prevails in the current market, but perhaps it is time for a change?

At first glance it may seem that applying the VAT exemption for real estate transactions is not the right choice for a developer to make in these times. However, one needs to consider the benefit that comes along with it… what better way to reduce the prices of real estate assets and make them more appealing for potential customers than to sell/rent them without an extra 24% added to the price?

In the current even higher rate VAT regime, for a buyer/renter that is not able to recover input VAT (e.g. financial institutions, private individuals) this represents an added saving of 24% on the purchase/rental price. On the other hand, the financial “loss” to the developer/lessor on forfeiting the VAT is potentially based on a lower cost base (e.g. development costs vs sales price) and also is applicable to VAT incurred at a time when the VAT rate was only 19%. Thus, it may make more sense for the developer to negotiate with the buyer/lessee in order to maximise the price (including VAT costs if any) for all the parties.

In addition to the VAT exemption mentioned, there may be additional opportunities to reduce prices based on VAT savings. For example, the Romanian VAT legislation allows the application of a reduced VAT rate of 5% to the sale of certain real estate assets (e.g. the sale of the apartments with a surface lower than 120 sq m and a price below RON 380,000 to private individuals).

Under the circumstances, while much of the supply on the market might not fit these requirements, it may be possible to consider creative solutions – for example certain larger apartments on stock could be re-arranged and divided into several smaller individual units in such a way so as to fulfil the conditions for applying the reduced 5% VAT rate. In this case also, the application of the reduced VAT rate can turn into a competitive price advantage that will help attract potential buyers for the existing stock of apartments.

To summarise, in winning the price/sq m war, developers should consider every tool available – and thus can’t afford to ignore the effect of VAT on transaction costs, especially given the recent increase in the VAT rate to 24%. There may be opportunities to arbitrage the old vs new rates, or to adjust the size of apartments sold, to find the solution that works best in the market – the winners will be those best able to reduce the “real cost” that VAT adds to the price.

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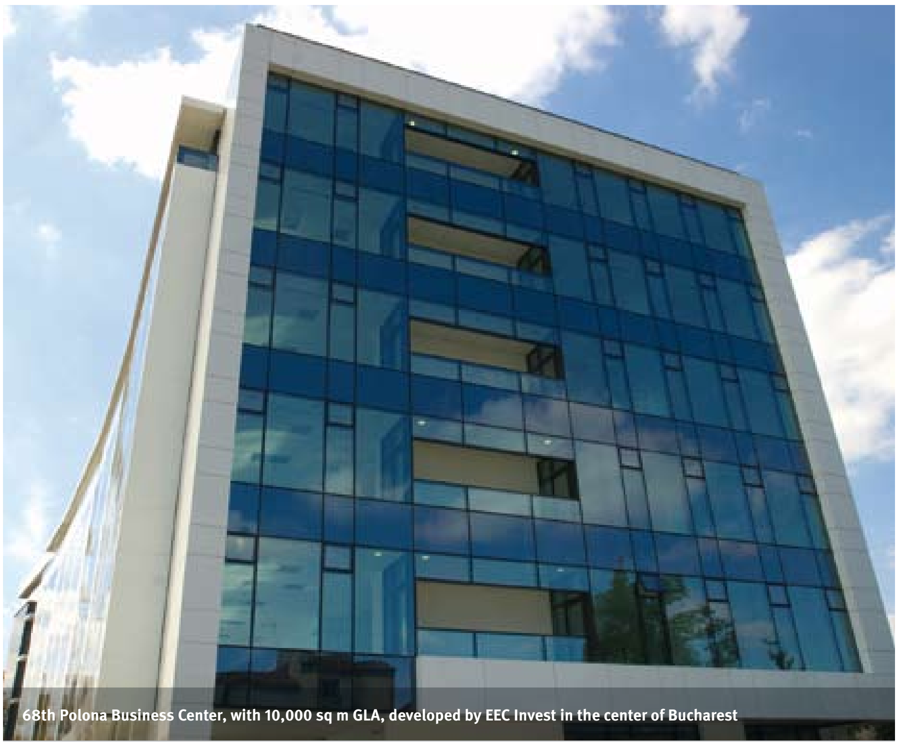

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7. TAX ISSUES RELATED TO REAL ESTATE TRANSACTIONS

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CERTAIN TAX AND LEGAL ISSUES OF THE DAY

Mihaela Pohaci, Tax Partner, Popovici Nitu & Asociatii

While the global economic crisis has significantly impacted the real estate business, the gloomy prognosis for the year 2010 being confirmed to a large extent, the demand for a better tax structuring of transactions has considerably increased.

From a large variety of aspects related to the acquisition/development of real estate, we will explore here a few different issues which may impact, from a tax perspective, the business development, as well as the exit of the shareholders. It may be noted why it is important to learn from past experience/mistakes and to develop scenario planning as an integral part of corporate planning.

The choice of the shareholding jurisdiction

While a non-resident investor often has a large number of subsidiaries worldwide, the choice of the shareholding jurisdiction can be influenced by many legal, commercial or cultural factors. Not in the least it should be taken into account that the tax residency of the shareholder could efficiently influence the transaction if properly contemplated in advance. This is applicable in all businesses, however real estate investments could be even more impacted.

In general, a more favorable tax treatment is available whenever the shareholder is located in a state with which Romania has concluded a convention for the avoidance of double taxation ("Convention"). Thus, payments made by the Romanian subsidiaries to their parent (in the form of dividend income, services, royalties, interest, etc) would benefit from a lower taxation (or even nil) at source. If the shareholder is located in the EU and specific conditions are met (mainly at least 10% shareholding maintained for at least 2 years) the Parent Subsidiary Directive can be applied and no tax on dividends will be withheld in Romania. Also, starting with January 1, 2011, for interest and royalty payments made to shareholders (beneficial owners owning at least 25% shares for a period of minimum 2 years at payment date) no withholding tax is payable in Romania.

The taxation of capital gains could make the difference in choosing the shareholders' location in the case of subsidiaries owning real estate. Based on the domestic provisions, income from immovable property situated in Romania is taxed in Romania. Such immovable property includes inter-alia rental income, gains from the sale/assignment of immovable property, and gains from the sale/alienation of shares of an entity, if 50% of the value of its fixed assets consist directly or indirectly of immovable property situated in Romania. A tax efficient structuring tool is the use of the appropriate Convention, taking into consideration that there are certain jurisdictions which do have a similar (not identical, though) provision (e.g. Austria, Germany), while other Conventions do not provide for such conditions. At exit, the capital gains derived by the sale of shares would be subject to such tax analysis and the tax obligations, if any, should be undertaken thereof.

Taxation of unrealized gains

The treatment of appreciation in the value of a property has changed several times during the years. Currently, Romania taxes the appreciation, which is reflected in the books during a year-end revaluation of assets. There were times when such an increase in value was only accounted for in reserves, but the taxation was deferred to the moment when a change of the reserve destination has taken place. As such, change of destination (i.e. under certain conditions, this may happen during a merger, spin off, or in case of an offset of the accounting loss, liquidation of the company or any other distribution to the shareholder) could have been, in principle, postponed "sine die", but the current regulations provide that the taxation occurs for such appreciation upon depreciation or sale of the buildings, respectively sale of the land. At this moment a detailed analysis of the revaluation reserves (with respect to immovable properties) should be performed, whenever acquisitions or reorganizations of companies take place, in order to correctly and efficiently settle the issue.

VAT deduction right on construction demolition

Talking about "learning from past experiences", not necessarily mistakes, a good example often noticed in real estate transactions relates to the VAT treatment of demolished constructions. As known, a lot of transactions involve the acquisition of land as well as of some buildings (many of them out of use, or without a valid environmental permit, or other permits). The scope of the transaction is the development of new buildings and this obviously requires the demolition of the existing constructions. While it is clear that the transaction price is paid in consideration of the land, for accounting and local tax purposes a certain value must be allocated to the "old" constructions, which will further be demolished. In practice, such operation is not considered by the tax authorities to be part of one single project (i.e. the development of a new building), but two separate transactions are analyzed. As a consequence, the VAT related to the existing building is not allowed for deduction, on the grounds that the acquired building was not used for business purposes. Although serious arguments do exist against such approach, it is worth structuring the transaction upfront, in order to optimize the tax burden and avoid potential disputes.

VAT related to "supply of services carried out free of charge"

Another frequent, arguable situation relates to the case when the acquired buildings are left for a limited period of time at the disposal of the seller (usually, until he is able to relocate his activity). Thus, although the buyer has taken over only the right of disposal of the property (the right of use being transmitted at a later date), the approach is that for the period concerned, the buyer has supplied services without consideration, therefore VAT shall be charged at an estimated basis.

The practical cases briefly presented in this article are only few "slices of the pie" regarding the adverse situations that may arise in case of real estate transactions, if not properly analyzed and tax wise structured. The good news is that everybody can be successful if proper consideration is given to the tax aspects of the business.

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