RESEARCH

Knight Frank

ROMANIA MARKET OVERVIEW

ON THE RIGHT TRACK

H1 2016

CONTENTS

HIGHLIGHTS

Romania topped economic growth in the EU in the second quarter of 2016, with a real GDP increase of 6% y/y.

LOOKING BEYOND RECORD ECONOMIC GROWTH

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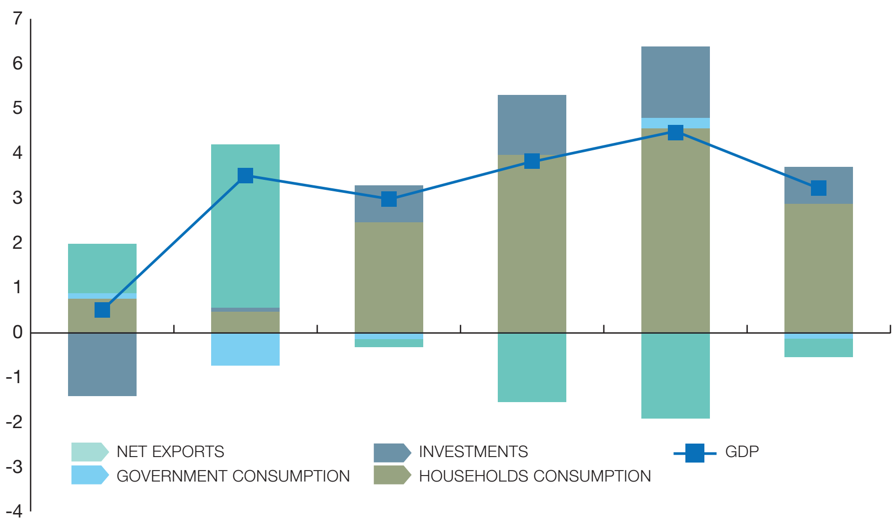
Romania topped economic growth in the EU in the second quarter of 2016, with a real GDP increase of 6% y/y. Household consumption advanced by 11.2% y/y in real terms in 2Q16, a growth rate similar to those from the economic boom years of 2001–2008, helped by good labor market conditions and healthy retail lending growth. Gross fixed capital formation recovered from a soft patch in early-2016 and went up by 10.6% y/y in 2Q16, roughly half the growth rate recorded during 2001–2008, in a sign that both private and public investments are alternating between positive and disappointing quarterly readings. Quarterly volatility of gross fixed capital formation is amplified by the erratic absorption of EU funds and the high share of investments financed by cash rich companies through internal resources instead of corporate loans. Imports were faster than exports, there by resulting in a negative contribution of foreign trade to real GDP in 2Q16.

After the release of stronger than expected GDP numbers for 2Q16, we have revised upwards our economic growth forecast for FY16 to 4.5% (+0.4pp). Our estimate is rather conservative and we do not rule out even stronger economic growth in the region of 5% in 2016 if positive trends persist until the end of this year. The main weakness in Romania's current economic growth comes from the fact that it is being driven by the government's loose fiscal and wage policy instead of the more desirablecombination of public policies aimed at improving competitiveness and the allocation of private resources to the

FIGURE 1
Contribution to real GDP growth
(pp)



Source: National Institute of Statistics, BCR Research most profitable sectors. With economic growth already above potential in 1H16, risks of future adjustment should not be ignored. A sudden increase in the budget deficit to 2.9% of GDP in 2016, from only 0.7% in 2015, makes Romania an outlier in the CEE region. The argument that budget deficits above 3% of GDP have become the new norm in Europe does not hold, because there is a difference between following a less abrupt fiscal consolidation path (as in Spain, France, Portugal or the UK) and implementing discretionary fiscal easing measures ahead of elections that lead to higher budget deficit in just a single year (as Romania did). A key question in this respect is the orientation of fiscal policy after the elections, because the prospect of additional fiscal easing in early-2017 (measures embedded in the Fiscal Code) increases the need for fiscal compensatory measures.

If the new government takes only modest action to keep the budget deficit under control after the elections, the fiscal gap could swell to 3.5% of GDP in 2017 from an estimated 2.9% in 2016. Short-term growth would be affected only to a limited extent and our forecast of a moderate economic slowdown to 3.4% in 2017 is well calibrated. The first risk deriving from this 'muddle through' scenario is that Romania would be asked by the European Commission to consolidate its public finances both in structural and nominal terms.
A structural budget deficit of 1% of GDP in 2017–2018 would be more restrictive for Romania than a headline budget deficit of 3% of GDP because the economy would grow above potential. The second risk is that Romania's rating would be cut by a major rating agency in 2017 or 2018 because of its inability to cope with the problem of rising deficits. Financing the budget deficit and refinancing maturing debt would become a serious issue at that point, forcing the government to take decisive action to keep public finances afloat. Medium and long-term economic growth would be seriously hurt at that moment.

The second scenario is that of an orderly adjustment of Romania's budget deficit in 2017–2018. Strong political will to tackle the problem of rising public expenditures and falling revenues would negatively impact short-term growth, but the advantage would be lower risks of a rating downgrade, improved investor confidence and the maintenance of a low interest rate environment. Keeping the headline budget deficit flat at 2.9–3% of GDP in 2017 would drive down economic growth to 2.5–3% next year, but this nevertheless remains a decent number, especially if one considers the chances of subsequent real GDP acceleration to be pretty high.

HIGHLIGHTS

The first half of 2016 witnessed improved occupier sentiment, registering take-up of 168,000 sq m compared to 139,000 sq m in the previous year.

Prime rent levels remain stable at €18.50/sq m/month.

Total stock in the Bucharest office market reached 2.32 million sq m at the end of H1 2016 for Class A & B office buildings.

OFFICE MARKET

Overview

Bucharest's office sector recorded a strong performance in the first half of 2016, reflected by strong take-up volumes, representing 70% of 2015 full-year take-up.

The most sought after submarket in H1 was Center-West with an impressive 63,500 sq m of leased area, representing an increase of approximately 75% year-on-year.

As expected, the IT&C sector dominated the market, occupying approximately 77,000 sq m of office space (46% of H1 2016 take-up).

Supply

In the first half of 2016, the Bucharest office market welcomed the largest volume of deliveries over the last five years (154,000 sq m), with 61% of the new supply being delivered to the northern area. Globalworth delivered two new office buildings in the Calea Floreasca-Barbu Vacarescu submarket (totaling 63,000 sq m), whilst Skanska delivered the third phase of Green Court with 15,400 sq m of office space. The largest project delivered in the Center-West submarket was AFI Park 4&5, totaling 32,000 sq m.

In terms of office space distribution, at the end of H1 2016, Calea Floreasca-Barbu Vacareascu had the largest volume of modern office stock totaling approx. 385,000 sq m, followed closely by the CBD (346,600 sq m) and Dimitrie Pompeiu (approx. 300,000 sq m).

Demand

Total take-up in Bucharest reached 168,000 sq m for Class A & B office space in the first half of 2016. This volume represents 70% of the total take-up achieved in 2015. The total number of transactions concluded in the first six months was comparable to the same period last year, while the average size of transactions increased to 1,700 sq m from 1,250 sq m in 2015. In terms of size, larger transactions (over 5,000 sq m) dominated, accounting for a 43% share of the total take-up; a significant increase from previous years (36% in 2015 and 32% in 2014).

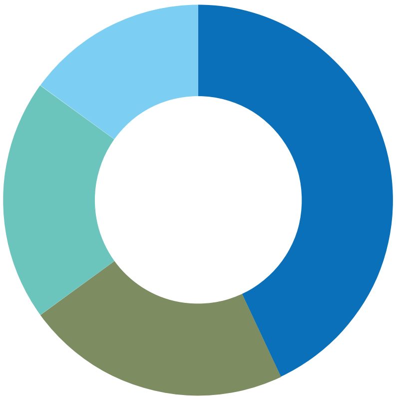
In terms of location, the Center-West submarket registered significant demand as take-up reached 63,500 sq m (38% of the total). This was well above the average and is comparable to the total volume achieved for the submarket over the three preceding years. The Calea Floreasca-Barbu Vacarescu submarket accounted for 14% of the total take-up followed closely by Dimitrie Pompeiu at 11%. These two submarkets have attracted the highest demand in the last six years. The CBD area underperformed in H1 2016; only 16,000 sq m of office space was leased.

The Center-West area is expected to evolve to become a major hub and is already host to two major pre-leases: BCR in The Bridge (20,000 sq m) and Misys in Orhideea Towers (8,000 sq m). Several other significant transactions were renegotiations, including Telekom in City Gate, IBM in GBC and Adobe in Anchor Plaza.

Relocations were of particular significance, reaching a volume of 57,300 sq m in H1 2016. The relocation of Intact Media Group was the main contributor in the Dimitrie Pompeiu area.

Similar to previous years, the **IT&C** industry was the main demand driver accounting for 46% of the total take-up. This share exceeded 2015, when the sector accounted for a 43% share. Six of the top ten transactions were deals in this sector, and there was a diverse range of transaction types including pre-leases and renewals. The finance and banking sector came in second at 20% of the total demand, followed by professional services and FMCG at 8% and 4% respectively.

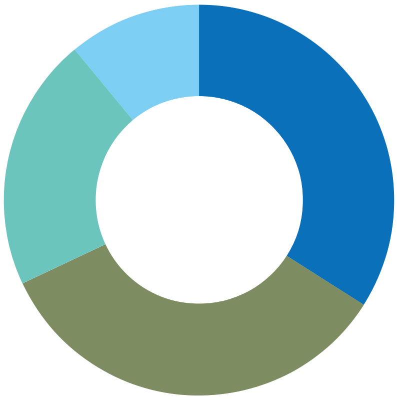
FIGURE 2
Demand by leased area
H1 2016



>5,000 SQ M	43%
1,000–3,000 SQ M	22%
3,000–5,000 SQ M	20%
<1,000 SQ M	15%

Source: Knight Frank

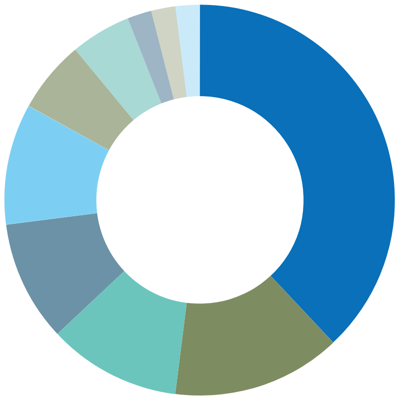
FIGURE 3
Demand by type of transaction
H1 2016



RELOCATION	34%
RENEGOTIATION/RENEWAL	34%
PRE-LEASE	21%
EXPANSION	11%

Source: Knight Frank

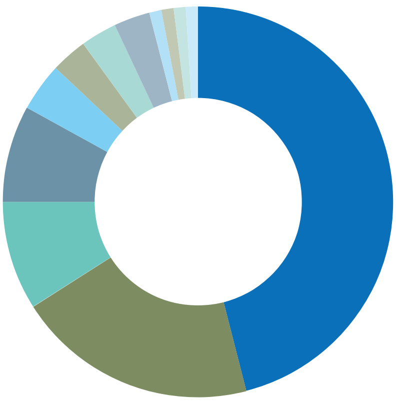
FIGURE 4
Demand by submarket
H1 2016



CENTER-WEST	38%
CALEA FLOREASCA-BARBU VACARESCU	14%
DIMITRIE POMPEIU	11%
PRESEI LIBERE SQUARE	10%
CBD	10%
WEST	6%
CENTER	5%
SOUTH	2%
PIPERA	2%
BANEASA	2%

Source: Knight Frank

FIGURE 5
Demand by tenant activity sector
H1 2016



IT&COMMUNICATION	46%
FINANCE/BANKING/INSURANCE	20%
OTHER	9%
PROFESSIONAL SERVICES	8%
FMCG	4%
MANUFACTURING INDUSTRIAL & ENERGY	3%
MEDICAL & PHARMA	3%
RETAIL	3%
MEDIA & MARKETING	1%
CONSTRUCTION & REAL ESTATE	1%
TRANSPORT&CARGO	1%
CONSUMER SERVICES&LEISURE	1%

Source: Knight Frank

The Bridge

Rents

Rents were in line with previous years. Prime headline rents remained unchanged and were reported at around €18–18.50/sq m/month.

Service charges have followed the same stable trend, ranging between €3.50–4.50/sq m/month.

Vacancy

The vacancy rate for Class A & B office buildings registered a small increase from 11.7% at the end of 2015 to 12% at the end of H1 2016.

The highest vacancy rates in Bucharest were recorded in the South, Pipera and Baneasa areas, with vacancy rates above 25%. At the opposite end, the CBD had the lowest vacancy rate below 5%.

Despite continuing strong demand, significant supply additions are expected to lead to an increase in the vacancy rate over the coming months.

Forecast

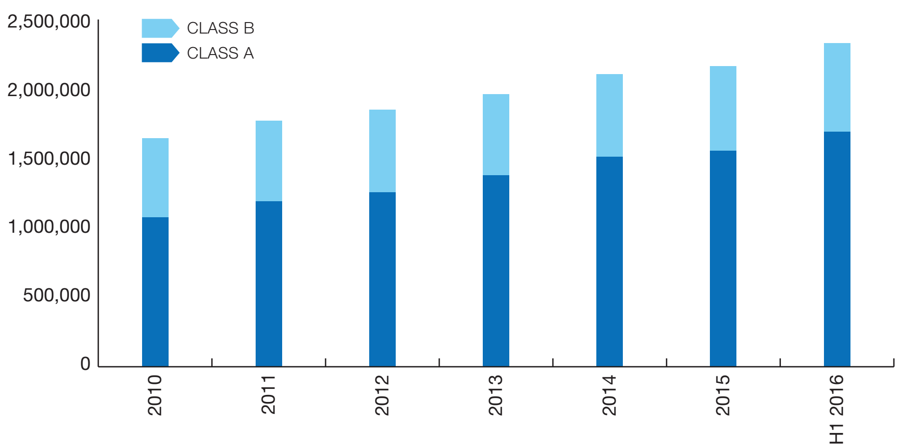
H2 2016 is expected to see 148,000 sq m of new stock delivered to the office market of which 93% is Class A. Dimitrie Pompeiu and Calea Floreasca-Barbu Vacarescu will host 64% of the future deliveries, with projects including the 1st phase of **Oregon Park** (45,000 sq m), **Metroffice** building A (20,500 sq m) and **Hermes Business Campus III** (29,000 sq m). Following two years of constrained supply, the CBD is expecting approximately 43,000 sq m of new office space in projects including **The Landmark** (20,956 sq m), **Aviatorilor 8A** (8,253 sq m), **Prezan Project** (6,000 sq m) and **Stefan cel Mare Building** (7,854 sq m).

2017 is expected to see the delivery of approximately 180,000 sq m which will increase total stock to 2.64 million sq m. Noteworthy schemes include **Anchor Plaza Metropol** (36,600 sq m), **Timpuri Noi Project** (29,560 sq m in the first two phases), **Globalworth Campus** (58,800 sq m) and **The Bridge** building A (28,500 sq m).

Despite the fact that a significant amount of new supply is planned for delivery, office demand trends are forecast to remain positive. Relocations are expected to be the main source of office take-up, as tenants will be looking to move their headquarters/back offices or consolidate their operations into new premises.

Headline rents are expected to remain stable over the next year, however net effective rents may decline as developers will need to attract tenants into their new projects.

FIGURE 6
Modern office stock
Annual evolution and forecast (sq m)



Source: Knight Frank

MAP 1
Class A & B office buildings

INVESTMENT MARKET

HIGHLIGHTS

Demand was mainly generated by established investors expanding their real estate portfolios.

The total investment volume reached €311 million in H1 2016, almost double compared with H1 2015.

Foreign funds accounted for more than 99% of the total activity.

Moderate yield compression was recorded in the first half of 2016 and this trend is expected to continue in the following 12 months.

TABLE 1

Bucharest prime yields

H1 2016 (%)

Office	Retail	Industrial
7.5	7.5	8.75
→	↓	↓

Source: Knight Frank

Overview

After a rather slow start to the year, increased activity towards the end of the first half of 2016 meant that total transaction volumes for H1 were significantly up on the same period of 2015, with a total of €311 million invested in the Romanian market. The largest transactions were in the retail sector with the sale of Sibiu Shopping City and the minority share in Mega Mall Shopping Centre to the South African Fund NEPI, together totaling slightly above 170 million.

Overall, H1 2016 relied heavily on the retail and office sectors to drive up investment volumes. During the first six months established players familiar with the market expanded their portfolios by acquiring income-producing assets. The second half of 2016 is expected to see the completion of several others significant transactions, with new players showing interest in the Romanian market as demand continues to be boosted by the favorable economic environment.

Supply

In H1 2016, there was a significant level of new supply compared with the same period of 2015 with the office market being the most active in terms of new deliveries (office space delivered to the market was almost three times higher compared with H1 2015). Banks have become more willing to provide financing for both development and acquisitions in most market sectors and the investment market now features a wide range of opportunities for investors, including income-producing, value-added or distressed assets.

Retail assets were the most sought-after type, followed by prime offices. The strongest demand came from established investors with expansion plans, which are likely to be looking for new opportunities in the next few years.

Demand

The total investment volume of €311 million in H1 2016 represented an 88%increase compared with H1 2015. Despite the rather slow start observed in Q1 2016, investment activity increased in the second quarter with several large deals closed.

In H2 2016 it is expected that investor sentiment will remain positive, mainly due to the favorable economic conditions and the stable fiscal environment.

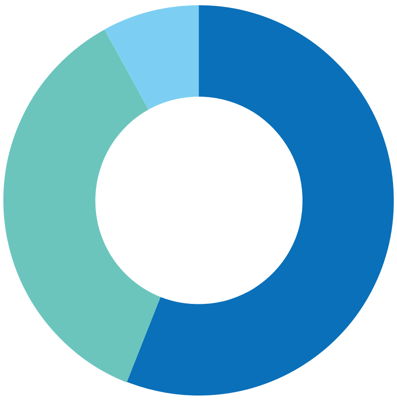
The retail sector was the main driver of activity in H1 2016 with a 56% market share. Major transactions in this sector included the sale of **Sibiu Shopping City** (79,000 sqm) by Argo Group and the 30% equity share owned by Real4You in the **Mega Mall** shopping center (75,000 sqm), which were both acquired by the South African fund NEPI for a total amount of over €170 million.

The office sector came in second, with 36%of the total investment volume. Major transactions concluded were the disposal of **Premium Point** and **Premium Plaza** (with a combined floor area of 15,000 sqm) by Volksbank Real Estate to GTC and also the sale of **Phoenix Tower** (10,000 sqm) by Aberdeen to Adamamerica.

The industrial sector was not as active as in previous periods, accounting for only 8% of the total investment activity. The main transaction was the sale of three logistics properties owned by Immofinanz to Logicor, the logistics division of Blackstone.

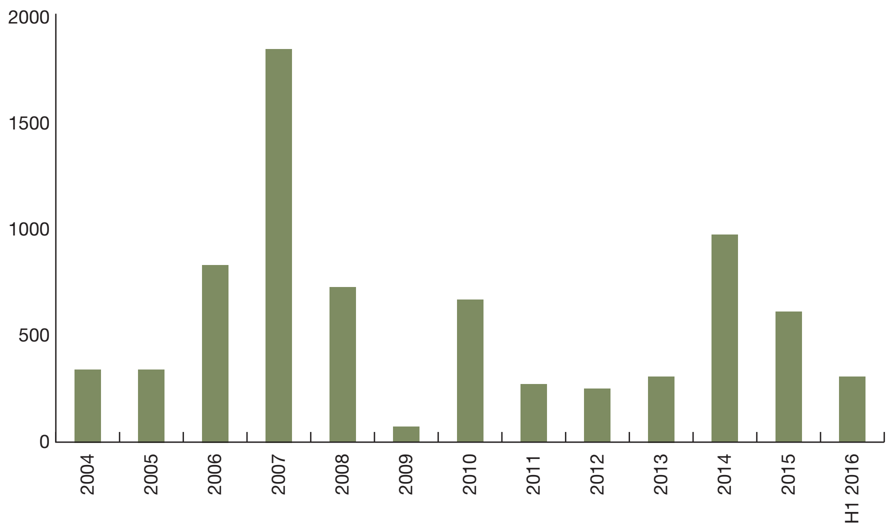
Analyzing the above, increased demand stemmed from several investors expanding their portfolios, including investors that have been both active and inactive in the market in recent years. However, some companies also exited the Romanian market. As in recent years, foreign investment was the main driver of activity, accounting for more than 99% of the investment volume.

FIGURE 7
Transaction distribution by property type
Q1 2016



Source: Knight Frank

FIGURE 8
Romania investment transaction volumes
Annual evolution (€mn)



Source: Knight Frank

Yields

Despite the improved levels of activity registered in H1 2016 compared with the same period of 2015, yields have not registered a significant decline but, nevertheless, the general trend of yield compression seems to be maintained.

The gap between the local market and the leading markets in the region (Prague and Warsaw) is still around 200 bps indicating that there is potential for moderate yield compression in the second half of 2016 and most likely also in 2017, especially in the office sector.

Forecast

The increased activity in the Romanian real estate investment market indicates the growing confidence in Romania's macroeconomic environment. In H2 2016, investor demand is expected to remain focused on top quality assets. New investors may remain reluctant to enter the market, as a result of the precariousness of previous fiscal policies and the wider political backdrop coupled also with the upcoming parliamentary elections. However, established investors will continue to seek to expand their portfolios, using their own equity or with the help of external partners.

Silver Mountain, Poiana Brasov

HIGHLIGHTS

Deliveries in the first six months of 2016 were mainly extensions to existing schemes.

RETAIL MARKET
SHOPPING CENTERS

Parklake Plaza, Bucharest

Overview

In the first six months of 2016, the modern retail stock in Romania increased by approx. 93,500 sq m, while several major projects outside Bucharest remained in the pipeline for the next two years.

The increase in consumption and consumer confidence provided a strong incentive for retailers to continue their expansion plans, especially in the regional cities where the deliveries were registered.

Supply

The first half of the year saw the delivery of approx. 93,500 sq m in four projects, all of them located outside Bucharest. Three were extensions to existing projects: City Park Constanta (19,500 sq m), Coresi Shopping City Brasov (13,500 sq m) and Timisoara Shopping City (40,500 sq m), whereas the other project was the refurbishment of Mercur (20,000 sq m) in Craiova.

TABLE 2

Retail schemes delivered in H1 2016

Project	City	Developer	GLA (sq m)
Timisoara Shopping City	Timisoara	NEPI	40,500
Mercur (refurbishment)	Craiova	Local company	20,000
City Park (extension)	Constanta	NEPI	19,500
Coresi Shopping City (II)	Brasov	Immochan	13,500

Source: Knight Frank

Demand

Occupier demand in H1 2016 continued to be generated by well-known food and fashion brands. Continuing the trend from 2014 and 2015, many new entries were registered in the first six months of 2016 including Pupa Milano, Tezenis, Boggi, Takumi, Motiko, Caffe Ritazza, Chanel Beauty and Kahve Dunyasi.

Rents

In the first six months of 2016, prime rents for the leading schemes remained relatively stable. For 100 sq m units, rents were in the region of €60/sq m/month in shopping centers in Bucharest and between €25–35/sq m/month throughout the rest of the country.

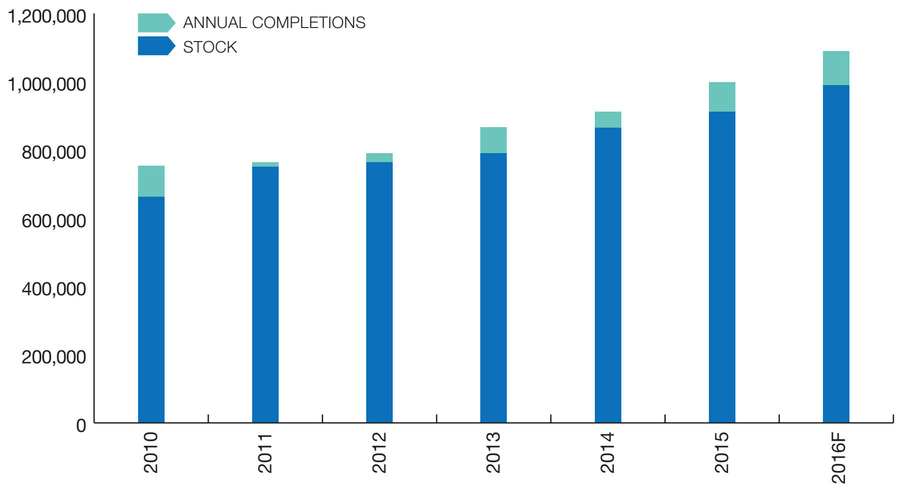
Forecast

By the end of 2016, another 95,000 sq m will be opened in Bucharest, in two projects: ParkLake Plaza (70,000 sq m) and Veranda Mall (25,000 sq m).

In the rest of the country, Timisoara has captured the strongest interest of developers, accounting for 50% of the total announced supply outside of Bucharest, due to two projects – Timisoara Centrum, a shopping center with a GLA of 65,000 sq m, and Timisoara Plaza, with almost 40,000 sq m. In Brasov, AFI Europe has plans to develop a shopping center with a GLA of 45,000 sq m, which is due to be delivered in the second half of 2017 and is expected to be the main competitor to the newly opened Coresi Shopping City.

Given the volume of new deliveries due in the next two years, we expect to see many new market entrants. Aside from those already announced, Forever21 will be opening their first shop in ParkLake Plaza and brands like Cerutti 1881 and LA Woman are expected to enter Romania.

FIGURE 9
Bucharest shopping center stock and pipeline
(sq m)



Source: Knight Frank

TABLE 3
Projects announced to be delivered in H2 2016 and 2017

Project	City	Developer	GLA (sq m)	Delivery
ParkLake Plaza	Bucharest	Caelum Development / Sonae Sierra	70,000	2016
Mega Mall Satu Mare	Satu Mare	NEPI	27,000	2016
Veranda Mall Obor	Bucharest	Prodplast Imobiliare	25,000	2016
Piatra Neamt Shopping City	Piatra Neamt	NEPI	25,000	2016
Platinia Shopping Center	Cluj-Napoca	Platinia	13,000	2016
Timisoara Centrum	Timisoara	Alpha Group Investments	65,000	2017
AFI Palace Brasov	Brasov	AFI Europe	45,000	2017
Timisoara Plaza	Timisoara	Plaza Centers	39,800	2017

Source: Knight Frank

HIGHLIGHTS

The Center-West part of Bucharest has confirmed its status as a new office hub and has witnessed a new entrant, Hanner Holding, with its acquisition of part of the land plot of the former Grivi a Beer Factory.

LAND MARKET

Overview

The first half of 2016 maintained the dynamic pace of the previous year, with several key transactions concluded for future mixed developments.

Supply

There were no notable changes to land supply, however we have identified several opportunities that show the potential of the market-data included in the map below.

Demand

In H1 2016, demand trends have remained positive, with high volumes of activity witnessed across all market segments.

Hanner Holding is expanding in the local market by acquiring an 11,000 sq m land plot from Forte Partners located in the Grozavesti area, close to Grozavesti and Basarab metro stations. This transaction marks Hanner's entrance into the Romanian office sector, highlighting its continued plans for growth following the success of its residential developments – The Park, Carol Park Residence and City Center. Knight Frank Romania intermediated the €5 million transaction.

Another notable transaction was the 48 ha site acquisition in Siseti by Vastint Romania, as part of a strategic long-term investment, with a view to develop a mixed use development (predominantly residential).

Prices

Prices were unaffected by the increased demand for residential and office land plots, and remained at a constant level throughout H1 2016.

Forecast

The supply of land plots suitable for good projects is expected to decrease, while demand is growing for land plots suitable for residential and office use, particularly those located in close proximity to metro stations with development and planning approvals already in place given the lengthy and arduous process of obtaining building permits.

TABLE 4

Land plot prices by use

(€/sq m)

Office	Calea Floreasca -Barbu Vacarescu	1,000
	Center-West	700–800
Residential	Prime areas	1,000–1,200
	Periphery	200–250
Retail	Bucharest	350–500
	Countryside	100–250

Source: Knight Frank

TABLE 5

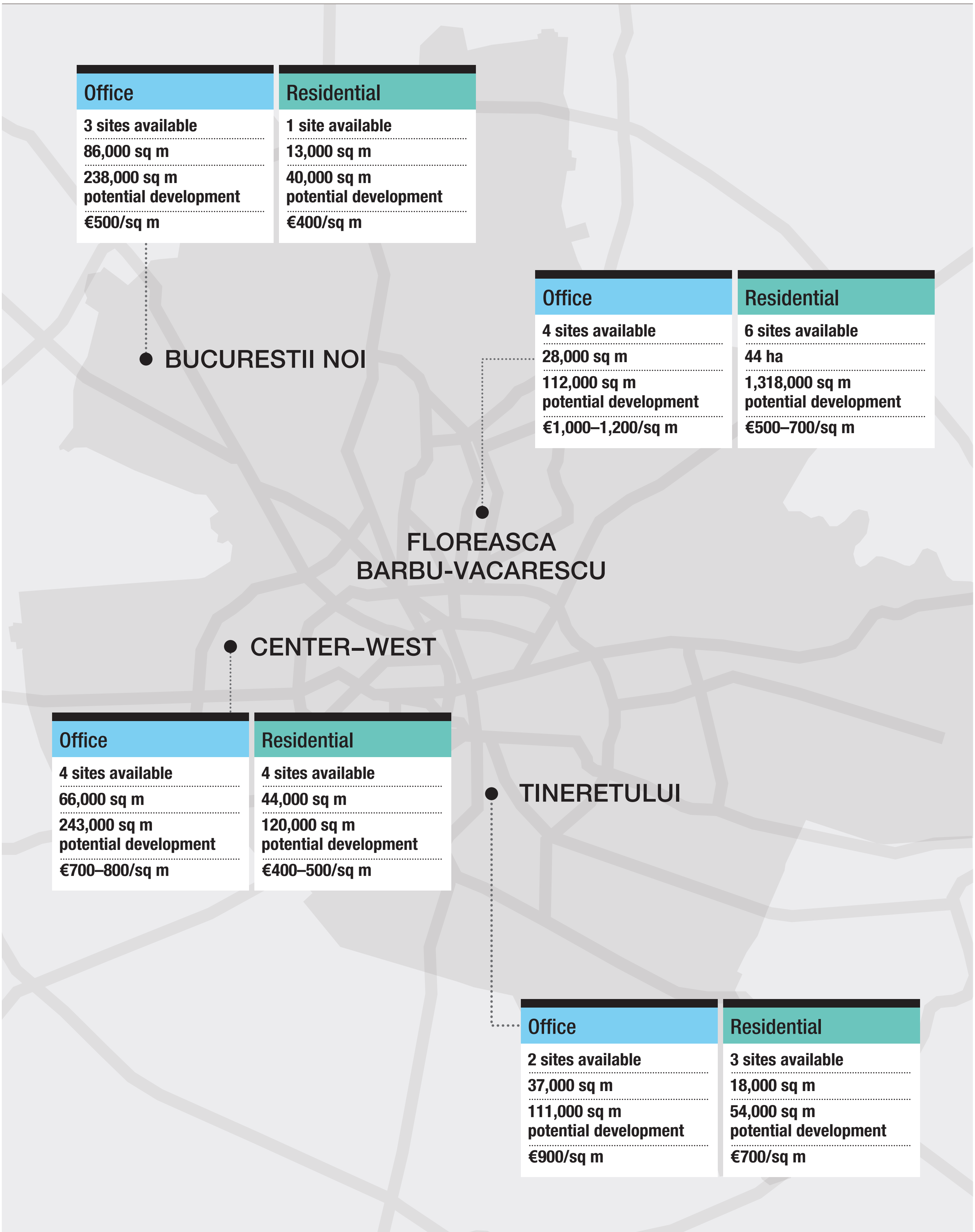
Relevant land transactions

(ha, sq m)

Location	Buyer	Size	Use
Sisesti	Vastint	48 ha	Residential
Grozavesti	Hanner Holding	11,000 sq m	Office
Barbu Vacarescu	One United Properties	8,400 sq m	Residential

Source: Knight Frank

MAP 2
Land opportunities



HIGHLIGHTS

In Bucharest, total take-up in H1 2016 was around 152,000 sq m, almost the level achieved for the entire previous year.

INDUSTRIAL & LOGISTICS MARKET

Overview

The first half of 2016 witnessed strong activity in terms of take-up in Bucharest, reaching approx. 152,000 sq m while the vacancy level continued its decline.

Meanwhile, the rest of the country registered 15,000 sq m in deliveries, which was 83% less than for the same period last year, when new supply accounted for 88,500 sq m of modern industrial space.

Supply

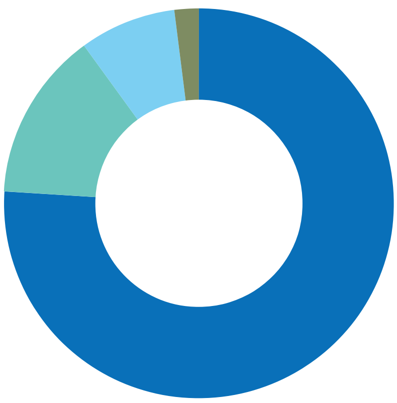
After three years of stagnation, total modern industrial stock in Bucharest increased slightly by around 4% in the first half of 2016 to 1.06 million sq m. Regarding the distribution of modern industrial space in the capital, the majority is located along the A1 (80%), which is considered the main industrial area. The only project delivered in Bucharest in the first half of the year was Logicor, part of the US fund Blackstone's logistics portfolio.
It consisted of an area of 40,000 sq m delivered in Mogosoaia.

Demand

In Bucharest, total take-up in H1 2016 was around 152,000 sq m, almost the level achieved for the entire previous year. Industrial take-up across the remainder of the country in the first six months of 2016 reached approx. 48,000 sq m, representing only 37% of the amount recorded in the same period last year.

A total of 19 leasing transactions were recorded in 2015 with an average lease size of 10,500 sq m and only five transactions were larger than

FIGURE 10
Take-up by region
H1 2016



BUCHAREST	76%
BRAILA	14%
TIMISOARA	8%
ORADEA	2%

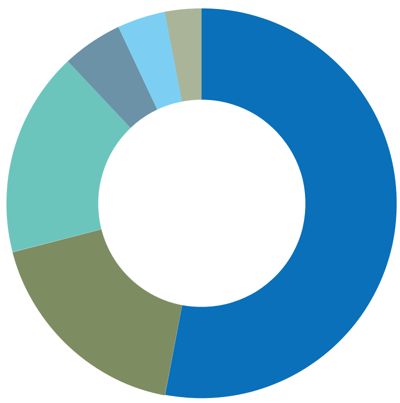
Source: Knight Frank

FIGURE 11
Take-up by type of transaction
H1 2016

RENEWAL/RENEGOTIATION	42%
PRE-LEASE	24%
EXPANSION	19%
NEW LEASE	15%

Source: Knight Frank

FIGURE 12
Take-up by tenant activity sector
H1 2016



RETAIL	53%
LOGISTICS	18%
AUTOMOTIVE	17%
PRODUCTION	5%
OTHER	4%
MEDICAL&PHARMA	3%

Source: Knight Frank

15,000 sq m. During the first half of the year, notable transactions included the lease renewals and pre-leases signed by Carrefour in P3 Bucharest Logistic Park (71,000 sq m overall in H1 2016), the expansion signed by Yazaki in Braila (29,000 sq m) and the renewals signed by Emag in Ruukki Building (25,000 sq m).

Although Bucharest accounted for 40% of total take-up, Braila and Timisoara were the most sought-after regional locations accounting for a further 14% and 8% respectively of the total volume.

In general, the main sources of demand were renewals/renegotiations accounting for 42% of the total take-up. The other types of transactions were rather evenly distributed with pre-leases, expansions and new demand registering 24%, 19% and 14% respectively of the overall leasing volume.

In terms of tenant profile, the retail sector was the most active, accounting for 53% of the total demand followed by logistics with 18% and automotive with a further 17%.

Vacancy

As a result of the recent volume of transactions along with limited new deliveries, the vacancy rate dropped to 1.5% in Bucharest, representing the lowest recorded vacancy in the last ten years.

Rents

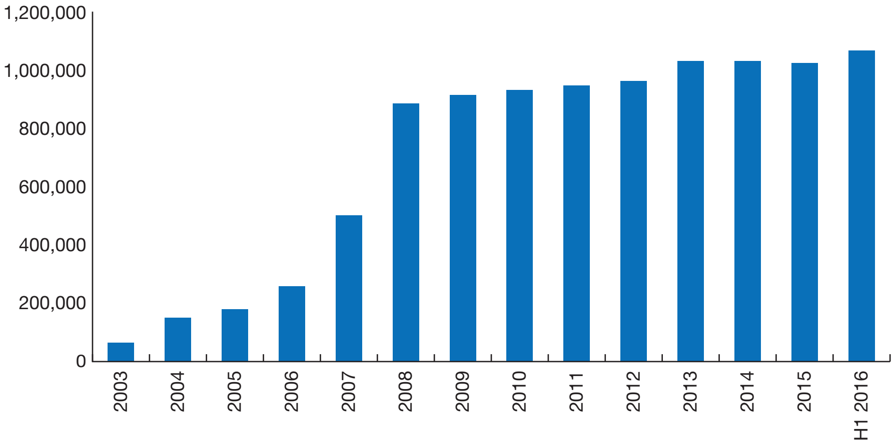
Due to growing demand and the decrease in space availability, rent levels registered a small increase.

Forecast

Assuming that the positive economic conditions prevail, we expect that demand for industrial space will continue the same trend as in the first six months of 2016.

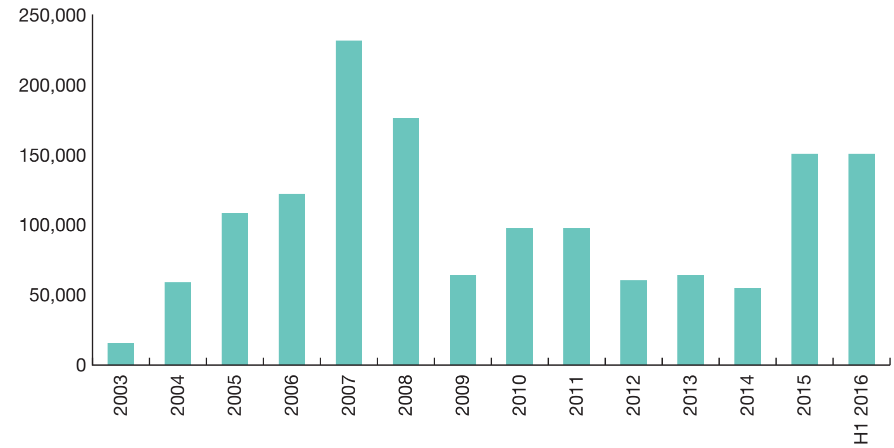
The positive economic environment characterized by strong demand and decline in space availability, is likely to see the delivery of new projects in the market in the short term.

FIGURE 13
Bucharest modern industrial stock
Annual evolution (sq m)



Source: Knight Frank

FIGURE 14
Bucharest industrial take-up
Annual evolution (sq m)



Source: Knight Frank

TABLE 6
Prime rental and service charge ranges

Rent €/sq m/ month	Bucharest	Rest of the country
Logistics (<3,000 sq m)	€4.00–€4.20	€3.80–€4.00
Logistics (3,000 –10,000 sq m)	€3.75–€4.00	€3.50–€3.580
Logistics (>10,000 sq m)	€3.30–€3.75	€3.00–€3.50
Manufacturing	€3.50–€4.25	€3.50–€4.00
Service charge	€0.50–€0.95	

Source: Knight Frank

HIGHLIGHTS

The most noteworthy trend of 2016 in Bucharest centered on extensions to residential developments following on from the success of the initial phase of new schemes. Examples include InCity, Cosmopolis, Greenfield and City Point, which are all in their new phases of development.

RESIDENTIAL MARKET

Supply

Given the favourable financing conditions available to both developers and buyers, the residential market experienced continued growth in H1 2016, with an increase in new project deliveries adapted to buyers' requirements. Although the South of Bucharest led the market in terms of newly delivered projects in 2015, the West of the city has taken over the lead, with projects including the extension of Militari Residence, the launching of a new phase in Politehnica Park Residence, the announcement of Rotar Park Residence as well as the imminent completion of the first phase of Gran Via Park.

The large volume of new project deliveries is in response to the mass demand for residential property, particularly in accessible locations that are close to public transportation and commercial areas such as shopping malls. New projects like Vivenda Residence, City Point and Metropolitan Residence are expected to better match consumer demands in terms of partitioning and on site leisure and sports facilities. Developers are also catering for lower-end requirements, offering apartments in less accessible locations, such as Cosmopolis or Cartierul Solar. Meanwhile, increased supply delivery is also in progress in the high-end areas, with luxury residential projects including Londra 27 and Primaverii 30.

There has been increased appetite among large commercial property developers and owners in the residential sector, such as AFI and Vastint. Furthermore, the success of InCity has encouraged its developer, Anchor Group, to start new phases of this project. There are likely to be delays to the 2016 supply pipeline; for example Gafencu 49, a landmark tower close to Herastrau Park, which was due to be finalized in Q1 2016 has been postponed to H1 2017.

Demand

In terms of the supply of prime property, although projects are being delivered for sale, it is estimated that 25% of acquired luxury apartments will be offered for lease. Investors are attracted to high gross yields, with the average gross yield for luxury residential properties in the range of 6–7%, which is significantly higher than the returns likely to be obtained currently from bank deposits.

While most of the market demand is derived from the Prima Casa financial programme, which provides governmental guarantee and a deposit to first home buyers, the middle class sector has also been increasingly active, looking at location upgrades as well as access to on site facilities.

Prices

Lower-end product prices average at approx. €700–800/built sq m although projects such as Militari Residence are as low as €450/sq m. Medium range property prices average between approx. €1,000–1,500/built sq m while high-end properties such as Primaverii 30 have reached a new peak, at €3,000/built sq m. The VAT for apartments in new developments is capped at 5% for residential properties priced up to 450,000 RON, and at 20% VAT for residential properties priced higher than 450,000 RON. It should be noted that all reported data is based on asking prices, as opposed to final transaction rates that are available for developed markets.

Corporate Residential Lettings

Corporate residential lettings demand in Bucharest continues to be led by expats of multinational companies and entrepreneurs who are drawn to the city's business opportunities, as well as foreign diplomatic missions (embassies, consulates). While professional expats lease premises for minimum (1 year) to medium (2–3 years) term contracts, foreign diplomatic missions prefer to lease their premises for medium (3 years) to long term (5–10 years) contracts.

Traditionally the headquarters of embassies were in villas, most commonly in the Centre-North area of Bucharest. However, over the last two years, there has been a shift towards demand for embassies in office buildings. Consequently villas that were previously occupied (for the long term in most cases) have become available, increasing the corporate residential lettings offer within well-located, large properties. In most cases, however, these properties need modernizing and pricing adjustments as, although the non-foreign diplomatic mission is drawn to the exclusive location of these houses, they are also spoiled for modern stock choice in more suburban areas and have restricted budgets. These restrictions are in line with residential property price adjustments that were made due to the economic changes of the past 10 years, when the above mentioned villas were under contractual terms in line with the prices of the last residential market boom of Bucharest.

Second and even third tier cities saw the development of several commercial projects. Most notably, these were for offices but also shopping malls, which in turn increased demand for residential property. Rental demand in these locations is led by students and young professionals, who are considering buying property but might not have the financial capability at this stage. Foreign management of multinationals present in these locations is often conducted from the headquarter cities of these subsidiaries, decreasing the demand for prime rental property in these cities.

While previous years saw expat demand derive almost entirely from multinational top management, 2016 has seen a shift in this, as multinationals have started to hire specialists from abroad for non-management positions. Consequently, corporate residential requests are expected to increase for properties in the medium price range, particularly for those that are centrally located in new developments, in close proximity to main business hubs and well connected to public transportation and commercial areas.

HIGHLIGHTS

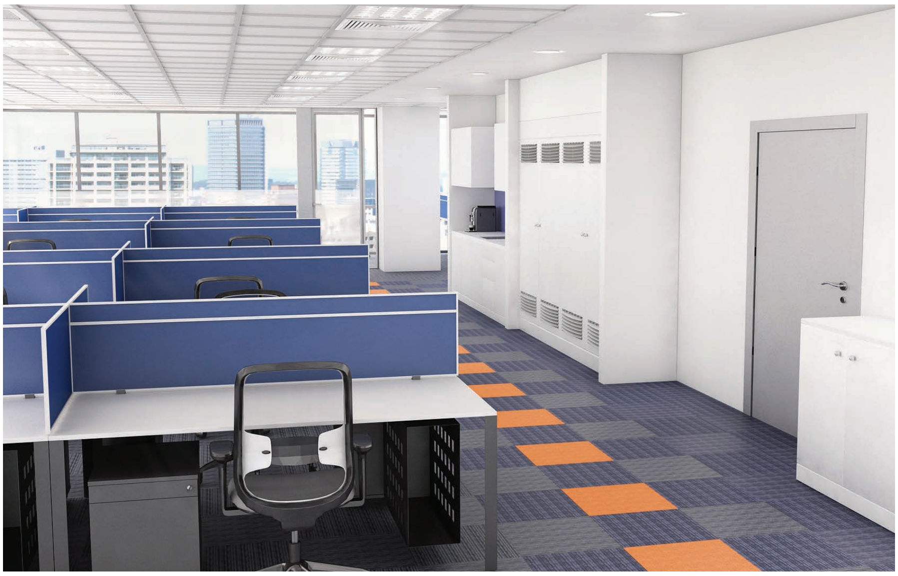
The goal is to find a balance between design and functionality

PROJECT MANAGEMENT

Overview

Following the trend of other countries and also that of 2015, the main goal for many companies in Romania was to create an open and bright office space.

Companies wanted to provide creative and diverse office spaces, as employees with high job satisfaction will make positive contributions to the company.



Office area makes way for creative activity.

Many companies let architects use their imagination in creating modern concepts for their office spaces as long as designs reflected their values and branding.

Looking at projects completed over the last few months, all companies wanted to provide employees not only with office desks but also with areas dedicated to rest and coffee breaks.

Important things considered by companies:

Light that dominates the office area
Floor coverings should reflect the bright colors of each company. The carpet offers a wide range of shades and colors, so individual vibrant colors highlight the brand of each company. The greatest emphasis was put in the relaxation and kitchen areas, keeping the office space classical but sometimes the architects designed interesting atypical cabinets in order to complement the pure white workplace.

Acoustic panels
Both the office and the relaxation areas use acoustic panels/seating, again in pleasant colours. Another interesting feature is the use of acoustic panels mounted on the ceiling in the context of open space. This could be custom or a line product.

Wallpapers and printings
The meeting rooms/relaxation areas are personalized with wallpaper/printing to highlight the principles and/or theme of the respective room/area.

Offices divided into working and sitting area
Both areas should be unique and have an original look, attributes which are highlighted by standard/effective furniture complemented by coloured seats. The uniqueness of the furniture lies primarily in perfect mobility and lightness.

PROPERTY TAXES – WHAT'S NEW AND THINGS TO WATCH OUT FOR

by Alexandra Smedoiu, CFA, Director
PricewaterhouseCoopers Romania

2016 was a difficult year for real estate in terms of changes in the tax legislation. From the introduction of a VAT simplification regime to the reconfiguration of the property tax calculation base depending on the nature and usage of the property, real estate owners and investors should be familiar with the topics discussed below.

Building tax is generally one of the main ownership costs for investors – legal entities. Previously, a 1.5% tax rate applied for both residential and non-residential buildings, as long as the owner was a legal entity. As of this year, there is a split regime for residential and non-residential buildings, irrespective of the legal status of the owner, which is a major reconfiguration of the property tax system in Romania.

In short, for non-residential buildings (e.g. malls, hotels, office buildings), from 1.5% of the market value of the property per year, the building tax has decreased to 1.3%. Also, the base for calculation of the building tax has changed from market value to replacement cost (as determined by an independent valuator based on a specific valuation standard). As in the past, the tax base of the building should be updated at least every three years. Individuals need to comply with the valuation requirement as well (although with a 5-year periodicity). Companies that chose the revaluation method as a way of accounting for real estate assets in their books would need to commission two different valuations (market value and replacement cost).

For residential buildings, the rate increases from 0.1% to 0.2% of a fixed taxable value per square metre, with the main implication that developers of residential complexes will see their property tax liability decreased significantly compared with the past, where a 1.5% rate applied.

For mixed usage buildings the property tax would be determined either proportionally or the same as for residential buildings under certain situations (e.g. no deduction for utilities or no economic activity carried out).

Another good news is that the special construction tax (1% of gross book value of constructions other than buildings) is to be abolished as of 2017.

In terms of VAT, 2016 brought in simplification measures, to the benefit of developers. The VAT rate has been decreased from 24% to 20% and real estate is subject to reverse charge mechanism, meaning that there is no need to pre-finance VAT on a transaction with real estate between to VAT registered persons. Unfortunately, the simplification measure does not apply to construction costs.

In terms of real estate investment structures for foreign investors, the most common structure remains the special purpose vehicle (a limited liability company owning the specific real estate property). Exit strategies range from share deals to asset deals (with a preference for asset deals lately), the difference between the two being the deferred tax implications that both the sellers and the buyers should be aware of (deferred tax to be determined as 16% multiplied by the difference between the perceived sale price and the book value of the building).

Financing of real estate through shareholder contributions has become more problematic in the sense that the deductibility of financing costs has been reduced from 6% to 4% (on hard currency loans). Deductibility of shareholder financing cost is also limited by thin capitalisation rules (maximum 3:1 debt to equity ratio allowed) which means that the tax shield on shareholder financing is capped. Bank financing does not fall under such limitation.

What you need to watch out for in 2017 (announced measures or under discussion):

- VAT rate to be potentially further reduced to 19%
- New VAT registration requirements (new forms and conditions)
- Potential exemption from building tax for developers until first sale of buildings
- Potential exemption from valuation requirement for residential buildings owned by legal entities and non-residential buildings owned by individuals
- Administrative reclassification of cities within Romania, with consequences on building tax values for residential properties.

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HIGHLIGHTS

Registration with the Land Book of lease agreements has a very significant practical benefit, offering tenants protection against any third parties who acquire rights over the leased properties, including in case of enforcement.

LAND BOOK REGISTRATION OF LEASE AGREEMENTS

Registration with the Land Book of lease agreements (in Romanian notare) has a very significant practical benefit, offering tenants protection against any third parties who acquire rights over the leased properties, including in case of enforcement. Presently, all lease agreements, irrespective their duration, either concluded before a public notary, a lawyer or merely consensually by the parties can be registered with the Land Book against payment of a nominal fee. Any new acquirer of the leased properties would be bound to observe the terms and conditions of the leases thus registered until their expiry date.

Procedural matters

The tenant has by law the right to register its lease. Its right cannot be waived or restricted contractually and any contractual clause stating to the contrary is deemed not written, according to the New Civil Code.

The registration of a lease agreement is, typically, simple and cheap. It could be made before the local Land Book Office (in Romanian, Biroul de Cadastru si Publicitate Imobiliara) by any of the tenant or the landlord, by filing an application along with the original copy of the executed lease agreement (or a legalized copy of the translated lease agreement, in case of leases executed in other language than Romanian language). Generally, the main prerequisite for the registration of leases is that the leased building must have been registered with the Land Book. In case an interdiction to lease the building has been previously registered, the Land Book Office would require, in addition, the consent of the beneficiary of such interdiction (usually, the lenders). The registration will be made in Part III of the Land Book where the relevant building is registered.

We have often encountered in practice the situation where, leases concluded for premises in buildings which are in early development phases or are not yet completed are refused at registration by various land book offices around Romania on grounds that the leased building is not yet registered with the Land Book, hence, the lease pertaining to such building is not registrable either. Whereas such refusal may be rightfully grounded, the reality is that most of the commercial lease agreements nowadays are executed for uncompleted buildings and the tenants who lease large premises in such buildings need to protect their rights during the development phases as well.

As such, there may be various practical ways to render more feasible the registration of such leases, among which (i) the registration of the new building per phases of development, such partial completion of construction works making generally possible the registration of leases, (ii) the registration of the lease for the building in the land book kept for the land corresponding to the future building (subject to landlord’s acceptance to include in the object of the relevant lease, at least temporarily, a part of the land corresponding to the new building), or (iii) the registration of the building permit authorizing the new building with the mention in the latest case that some Land Book offices might ultimately reject the registration of leases if only grounded on the building permit registration.

Confidentiality

According to the New Civil Code, any person, even without justifying interest, can find out information and get copies of various documents that were filed with the Land Book. Despite such legal provision, Land Book offices often tend to add conditions when releasing copies of documents to persons who cannot justify legitimate interest; however, in general, once registered, leases become public and cannot be deemed confidential any longer. Therefore, redacting the sensitive commercial terms in lease agreements or registering only relevant excerpts of leases has become a practice accepted by most of the Land Book offices.

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