REAL ESTATE MARKETS' POTENTIAL IN THE EMERGING EUROPEAN COUNTRIES

Proceedings of a conference held on 19.10.2006

By Denis H. Camilleri - Conference Co-ordinator

This conference was well attended by a number of people including periti, accountants, estate agents, developers, lawyers and students amongst others. The introduction was given by the President of the Kamra Perit David Pace, who introduced the speakers, welcomed the TEGoVA representative and gave an outline of the work undertaken by the sub-committee over the past years.

Keynote speaker valuer Mr. John Hockey, recommended by The European Group of Valuers' Associations (TEGoVA, www.tegova.org), presented the paper "Valuation: Risk and Uncertainty. Thoughts for home and abroad." It was outlined that last year's property gain achieved from the emerging markets varied from 36.6% in Bulgaria, to 30% in Turkey and 20% in Poland. This was compared to 6.74% in the UK, 7.3% in Italy, 7.9% in Greece and up to 12% in Spain (as outlined in the table below).

However, the real estate market of Bulgaria is considered presently to have an oversupply of property, letting demand is poor, whilst returns have been reduced by 50%. In Romania the real estate market is considered more stable over the past 3 years with, however, profit rates having decreased. The flooding threat of the Danube was further referred to.

On investing in the emerging markets further points to be considered are the existing corruption due to low salaries noted in the above table enticing bribes, previous state ownership, together with the real demand from the domestic market amongst other matters. It was further specifically mentioned to beware of purchases in Russia.

The following speaker, Lawyer Geoffrey Mifsud Farrugia who has hands on experience in the Bulgarian market, dwelt on "Legal Frameworks in the Balkans: Bulgaria – a case study." The ownership of real estate by foreign nationals / foreign legal entities may not directly acquire ownership rights on land. This restriction however does not apply to a Bulgarian company, irrespective of its percentage share of foreign participation. The legalities of forming a Company were then delved into, with legal and financial advice

being a requisite. With EU accession planned for 2007, the land ownership restriction for EU nationals will be eased over a 7–year period.

Land in Bulgaria is defined as regulated and unregulated, with unregulated land not being presently earmarked for development. A good cadastre system is in operation where speculation is being undertaken, whilst preliminary agreement safeguards, as in Malta, are also in place. No VAT is paid on land transfer, but VAT on fees amounts to 20% after discounting taxes and fees mentioned below. Companies carrying out business are liable to a corporate income tax of 15%, whilst withholding tax on capital gains from transfer of shares in Companies amounts to 15%.

Tax measures include a 2% stamp duty on purchase, with capital gains tax paid at 15% if the property is sold within 5 years from acquisition. A double tax agreement treaty is in force with Malta. Once a paid tax certificate is in place, liberal regime repatriates after-tax profit and capital.

Trusts lawyer Robert D'Alessandro, from CREDALTRUST Management Ltd., introduced Romania as part of his presentation entitled "Managing Central and Eastern European Property Investment Risk via Maltese Trust and Corporate Solutions." He indicated various safeguards that investors may neglect such as securing title and zoning status of their investment, seeking professional legal advice from top consultants in completing all due diligence procedures including the track-record of the developer, dealing in Euro rather than local currencies, and planning for resale of the investment.

Dr. D'Alessandro noted that Maltese legislation provides one of Europe's most tax efficient and versatile company and trust solutions offering significant advantages to both Maltese and foreign real estate investors. The Malta solution not only offers the asset protection and tax efficiency of a Malta Investment Structure for purchase of an overseas company owning land, but thanks to Malta's extensive double tax treaty network the Maltese company doubles as an attractive cost effective international sales vehicle for when an investor wishes to divest.

COUNTRY	MINIMUM HOURLY WAGE LM/hr	TYPICAL PRICE LM	MINIMUM DEPOSIT	GROSS RENTAL YIELD	CAPITAL GAIN LAST YEAR	RETURN ON CASH INVESTED*	INFLATION
Bulgaria	0.65	31,900	35%	12%	36.6%	105%	5%
Poland	2,05	31,900	30%	7%	20%	61%	2.15%
Turkey	-	38,250	100%	10%	30%	34%	8.15%
UK	10.75	95,600	15%	5.8%	6.74%	43%	2.05%
Italy	9.25	76,500	20%	8%	7.3%	29%	2.27%
Spain	6.50	95,600	20%	8%	12%	49%	3.49%
Greece	5.75	63,700	20%	12%	7.9%	26%	3.49%
Cyprus	4.75	76,500	15%	8%	10%	60%	2.04%
Malta	3.25	75,000	10%	3.75%	17%	170%	2.53%

*The return on cash invested is calculated on the return obtained on the actual amount of personal money fed into the development. In the case of Bulgaria for a minimum deposit of Lm35 for every Lm100 invested, Lm65 may be loaned out, thus the real personal cash flow equates to Lm35 over a year with a capital appreciation given at 36.6%. The Lm100 originally invested are now valued at Lm136.60. The return on capital invested now works out at Lm36.60/Lm35*100 = 105%.

It is estimated that Romania is among the countries worldwide that have attracted the most significant foreign direct investment in the last 12 months and the demand for all types of property is set to rise not only because of EU accession next year. The rapid growth of Bucharest together with the existing limited supply of quality accommodation provides significant opportunities for investment in residential land and developments.

Property developer Philip Stapley, a UK national who has lived in Romania for a substantial number of years, provided a supply and demand analysis of property in Bucharest from his perspective as CEO of Investment Solutions Europe, a Maltese company with international investors. Fuelled by a fast growing middle and professional class, as well as a 70% rate of home ownership, in securing the value of already limited available land within the city limits together with the growing demand for improved quality of life by locals and ex-pats alike, has led to a reorientation of the residential developments towards the city's outskirts.

Mr. Stapley then provided a check-list of requirements for both buyers and sellers of real estate in this country, with the downside including a high fragmentation of land, length of acquisition process and lack of cadastre and registration with initial owners.

Banker Alfred Attard from BOV, who heads one of the corporate lending teams, specialising in property developments, then presented "A Banking perspective to financing property development abroad." BOV has a loan portfolio in excess of Lm1 billion, 43% of which go into property development and home loans. The Bank considers the low cost of land in these countries will lead to potential capital appreciation in the short to medium term, as consistent demand exists from investors across Europe to acquire investment property here.

The Bank will look into the economic conditions, including the state of the economy, market transparency and level of demand. It will also look at socio-cultural trends, including the perception towards private ownership of real estate, as opposed to commercial ownership. The different jurisdiction may determine whether the real estate market can function effectively, together with a procedure to register a charge over the development as collateral, and finally the costs to procure a local law firm.

The Bank will consider financing up to 60% of the total estimated cost of a development project in an emerging country to a known customer with property development experience. The source of repayment should be proven to be generated from the project, with further evidence brought forward that funds are also available locally in a fallback situation. Preferably lending is secured by local assets.

Auditor John Zarb, a representative from the Malta Institute of Accountants, presented "Valuation of properties in emerging European markets – An Accountant's Perspective." This presentation outlined the various valuation requirements according to the relevant International Accountancy Standards, IAS's and what is expected of valuers from these accounting clauses, including the valuers' competence. Here various definitions of open market value arise, according to the present use of premises, but this generally equates to fair value. These rules apply to all markets irrespectively, but when a valuer is undertaking an emerging market, further risks come into play.

The points to emphasise include adequate market knowledge and fast moving markets susceptible to a high element of speculation. Occasionally their may be a differentiation between local and overseas buyers. The entry into the EU is possibly pushing up prices in anticipation. In currency conversions, is there a secondary exchange rate which probably applies to the repatriation of sales' proceeds and can sales proceeds be repatriated? Does an active market for such property exist? If not, calculating fair value by reference to future expected increases in market value, spread over a period, is not permissible.

Perit Denis H Camilleri, Conference organiser summed up the conference by delving close to home. A decision should be taken after it is noted that over the past 30 year period there has been in Malta's real estate market a 7.5% average annual growth on real estate, with the recent immediate 4 year period going into double figure annual growths. Investment in land on the other hand has seen an average 16% annual growth over the past 30 year period.

Within Europe the strongest price growth was recorded in central and eastern Europe. The average global house price growth for 2006 stands at 8.5% pa, a slow down from the 2004 peak of 12.3%. The highest growth recorded was in Latvia at 45.3% with the lowest growth of -5.1% in Serbia. The forecast is for continued slowing of average global house price growths with masking in regional hot-spots.

Furthermore in Malta, funds may be obtained in the 90% region, which further improves the rate of return obtained on the money invested, as outlined in the table, which quotes a 170% return on cash invested for a 90% loan, with a property capital gain of 17%. This is to be compared with Bulgaria's return on cash invested at 105% as opposed to capital gain of 30%. If an investor is considering purchasing a Malta holiday home, a 90% loan is feasible.

The Maltese investor after the capital markets' crash at the turn of the Century has grown wiser in the notion that the higher the yield the higher the risk. However, clients remain return orientated. The client is not happy to hover around the bottom of the performance table because he has a commensurately low level of risk. Competition will not be removed from the market – therefore, RETURN will always be king. It is considered that due to Bulgaria's and Romania's accession to the EU in January 2007, these countries have an edge over the other emerging countries out of the EU, as the EU recently signalled that it is to slow down its programme for admitting new member states. Thus investors will consider these emerging property markets, but should be well guided by valuers, lawyers, accountants and their bankers amongst others.

For those who did not attend the Conference, a CD of papers presented may be purchased for the nominal sum of Lm2.00. Kindly contact the Kamra tal-Periti for further information. Following requests from members, who did not have the opportunity to attend previous CPDs, another CPD course for periti, "Real Estate Valuation Updates - the essential guide forward", is in the pipeline, and will also be organised by the Kamra tal-Periti.

Some related websites:
www.tegova.org
www.rics.org
www.government.bg
www.bcci.bg
www.biba.bg
www.investbg.government.bg
www.bnb.bg
www.bgmaps.com