Corinthia Palace Hotel, Attard

Thursday 19th October, 2006

KAMRA TAL-PERITI

Real estate markets' potential in emerging European countries

THE PROFESSIONAL CENTRE
SLIEMA ROAD
GZIRA GZR 06 – MALTA
TEL/FAX (+356) 2131 4265
E-mail: kamratalperiti@nextgen.net.mt
Website: kamratalperiti.malta.com

K A M R A T A L - P E R I T I

RE - "REAL ESTATE MARKETS' POTENTIAL IN THE EMERGING EUROPEAN COUNTRIES

Property development has long been considered a preferred investment in the Maltese Islands. However, with the price of local Real Estate having hiked over the recent years, investors are considering overseas ventures. Indeed, a local hotel company has expanded into a chain of hotels in various countries. The Kamra tal-Periti has felt it opportune to organize a n afternoon Conference on the above theme. This is being held on Thursday the 19th October at Corinthia Palace Hotel Attard.

The following comparative table gives indicators for an advanced economy such as Luxemburg, together with Malta considered a developing economy as compared with the emerging markets of Bulgaria, Romania, Hungary and Slovenia. These are classified as emerging markets as they are shifting from a totalitarian regime to a free economy, previously identified as Eastern European, although some form part of Central Europe. To be noted however, that Slovenia and Hungary afford a comparable economic standing as Malta's, with Slovenia according to its 26th HDI ranking having surpassed Malta's 32nd ranking.

Table – Indicator's of advanced, developing economies and emerging markets.

	GDP(PPP)$/capita	GDP- %growth rate pa	Wages Euro/hr	Inflation %	HDI* ranking
Malta	19,739	1.7	7.77	2.47	32
Bulgaria	9,223	5.4	1.45	4.80	55
Romania	8,785	5.5	1.76	8.32	64
Hungary	16,823	4.6	5.54	3.37	35
Slovenia	21,808	4.3	10.54	2.40	26
Luxemburg	69,800	2.2	28.33	2.10	4

As, the GDP standing of a country does not tell the whole story, a better indicator could be the Human Development Index (HDI)*, to assess the level of social development. The United Nations Development Programme UNDP, to assess and compare development, has developed this index since 1990. Besides the wealth of the Nation it consists of 3 combined major indices, namely: life expectancy, educational attainment and income.

From the above table it is further noted that the emerging market countries are presently witnessing a higher annual economic growth, although the annual inflation rate is also correspondingly higher. Wages in Luxembourg are 4 times those earned in Malta, Whilst Slovenian wages are a 1/3 higher than Malta's, with Hungary's wages being a 1/3 lower. Wages in Bulgaria and Romania are presently a 1/5th of those in Malta. To be further noted that these emerging markets also possess a skilful labour force. These labour force details are to be taken note of for foreign contractors embarking on projects in these countries.

Although wages in these emerging markets are generally lower than Malta's, construction costs in these countries could be comparable to Malta's at Lm120/sqm. This being possibly due to the higher building specifications required. It is in the land values that the real estate differential occurs, as the price of a normal plot in Malta could fetch a rate Lm700/sqm with annual growth rates over the past 25 year period of 16% pa. Malta's corresponding real estate value growth rate over the same 25 year period averages out at 7.5% pa, although over the immediate past 3 year period, real estate growth rate has been in the double figure range.

This Conference is to highlight the additional implications pertinent to overseas developments in these European emerging markets with Bulgaria, Romania, Slovenia and Hungary to be considered, such as planning, legal and fiscal measures.

With the vast amount of land ripe for development in these countries, is the planning process less stringent and beauracratic, thus reducing risk to developers and hence enchancing expected profits? However does a foreign developer encounter other risks along the planning route peculiar to foreigners?

Are the cadastral mapped records encountered in these markets of greater benefit than the sporadic registration system encountered in Malta, not encompassing the whole Island? Although foreign citizens may acquire real estate in some of these emerging markets, ownership may be limited if the land on which it is built is not considered to be part of the real estate. Does Malta's new Trust legislation offer significant advantages to Maltese investors in Real estate projects?

If a loan is to be undertaken, how far would a Maltese Bank help out, or is it best or possible to outsource a Bank from the country of purchase, which then involves foreign exchange risks? What is the amount of stamp duty due on purchase, do capital gains apply and is a property tax levied?

These and other queries are to be addressed by a panel of speakers with hands on experience in these markets. The speakers, around which this Conference is to be based, are the following.

1. Mr. John Hockey valuer keynote speaker, recommended by The European Group of Valuers TEGoVA, has a vast experience in various European offices, with a hands-on involvement in new build and regeneration projects, coordinating the activities of developers, investors, banks and advisors is to present

“Valuation: Risk and Uncertainty. Thoughts for home and abroad “

Real Estate professionals across Europe are constantly asked how long the current development boom in many countries can last. With growing evidence of oversupply and allegations of corruption in certain countries, the wheel of fortune continues to turn, leaving valuers and investors debating value and return. Discussing these and many other leading issues from a valuer’s perspective we will review reporting requirements and examine verifiable indicators that illustrate how and why the market is changing.

2. A banker Alfred Attard from BOV, who heads one of the corporate lending teams, specialising in property developments, to present "A Banking perspective to financing property development abroad."

3. Lawyer Geoffrey Mifsud Farrugia who has experience in the legal restrictions aspect of property dealings in Bulgaria. This with reference to tax implications, entry to the EU, regulated and unregulated land and other aspects of the Real Estate Market.

4. Auditor John Zarb a representative from the Malta Institute of Accountants will delve into the auditors’ expectations from emerging markets valuation reports, and problems currently encountered in this regard.

5. Lawyer Robert D'Alessandro, Chairman CREDALTRUST Management Ltd, is to delve into protection of investments for Hungary, Romania and Slovakia Real Estate Projects. Developer Phil Stapley CEO Investment Solutions SRL follows with Operations, problems and recommended approaches for the Romanian market with particular reference for the small investor.

The proceedings of this Conference will be looked upon as guidelines to be delved into by future developers. This Conference should be of interest to Periti, Accountants & Auditors, estate agents, financial intermediaties and property developers amongst others.

Denis H. Camilleri A&CE
KTP Conference Co-ordinator.
e-mail: kamratalperiti@nextgen.net.mt

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Real estate markets' potential in emerging European countries

by **Denis H. Camilleri**

Table – Indicators of advanced, developing economies and emerging markets

	GDP (PPP) $/capita	GDP-%growth rate pa	Wages Euro/hr	Inflation %	HDI*ranking
Malta	19,739	1.7	7.77	2.47	32
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PROPERTY DEVELOPMENT has long been considered a preferred investment in the Maltese islands. However, with the price of local real estate having soared in recent years, investors are considering overseas ventures.

Indeed, a local hotel company has expanded into a chain of hotels in various countries. The *Kamra tal-Periti* (Chamber of Architects) has felt it opportune to organise an afternoon conference on this theme, which is being held on Thursday at Corinthia Palace Hotel, Attard.

The comparative table gives indicators for an advanced economy, such as Luxembourg, together with Malta considered a developing economy as compared with the emerging markets of Bulgaria, Romania, Hungary and Slovenia.

These are classified as emerging markets as they are shifting from a totalitarian regime to a free economy, previously identified as Eastern European, although some form part of central Europe.

To be noted however, that Slovenia and Hungary afford a comparable economic standing as Malta's, with Slovenia according to its 26th HDI ranking having surpassed Malta's 32nd ranking.

As the GDP standing of a country does not tell the whole story, a better indicator could be the Human Development Index (HDI)*, to assess the level of social development. The United Nations Development Programme (UNDP), to assess and compare development, has developed this index since 1990. Besides the wealth of the nation the UNDP consists of three combined major indices, namely life expectancy, educational attainment and income.

From the table it is further noted that the emerging market countries are presently witnessing a higher annual economic growth, although the annual inflation rate is also correspondingly higher.

Wages in Luxembourg are four times those earned in Malta, while Slovenian wages are a third higher than Malta's, with Hungary's wages being a third lower. Wages in Bulgaria and Romania are presently a fifth of those in Malta.

Although wages in these emerging markets are generally lower than Malta's, construction costs in these countries could be comparable to Malta's at Lm120/m^2 – this being possibly due to the higher building specifications required.

It is in the land values that the real estate differential occurs, as the price of a normal plot in Malta could fetch a rate Lm700/m^2 with annual growth rates over the past 25 years of 16 per cent per annum.

Malta's corresponding real estate value growth rate over the same 25 year-period averages out at 7.5 per cent per annum, although over the immediate past three years, the real estate growth rate has been in the double figure range.

This conference is to highlight the additional implications pertinent to overseas developments in these European emerging markets, such as planning, legal and fiscal measures.

With the vast amount of land ripe for development in these countries, is the planning process less stringent and beauracratic, thus reducing risk to developers and hence enchancing expected profits? However, does a foreign developer encounter other risks along the planning route peculiar to foreigners?

Are the cadastral mapped records encountered in these markets of greater benefit than the sporadic registration system encountered in Malta, not encompassing the whole island? Although foreign citizens may acquire real estate in some of these emerging markets, ownership may be limited if the land on which it is built is not considered to be part of the real estate.

Does Malta's new trust legislation offer significant advantages to Maltese investors in real estate projects?

If a loan is to be undertaken, how far would a Maltese bank help out, or is it best or possible to outsource a bank from the country of purchase, which then involves foreign exchange risks? What is the amount of stamp duty due on purchase, do capital gains apply and is a property tax levied?

These and other queries are to be addressed by a panel of speakers with hands-on experience in these markets. The speakers, around which this conference is to be based, include John Hockey, recommended by The European Group of Valuers TEGoVA, who has a vast experience in various European offices, with hands-on involvement in new build and regeneration projects, co-ordinating activities by developers, investors, banks and advisers. Mr Hockey will talk about "Valuation: risk and uncertainty. Thoughts for home and abroad".

Real estate professionals across Europe are constantly asked how long the current development boom in many countries can last. With growing evidence of oversupply and allegations of corruption in certain countries, the wheel of fortune continues to turn, leaving valuers and investors debating value and return.

Discussing these and many other leading issues from a valuer's perspective, we will review reporting requirements and examine verifiable indicators that illustrate how and why the market is changing.

Banker Alfred Attard from BoV, who heads one of the corporate lending teams, specialising in property developments, will present "A banking perspective to financing property development abroad."

Lawyer Geoffrey Mifsud Farrugia, who has experience in the legal restrictions aspect of property dealings in Bulgaria, will also be a speaker. This with reference to tax implications, entry to the EU, regulated and unregulated land and other aspects of the real estate market.

Auditor John Zarb, a representative from the Malta Institute of Accountants, will delve into the auditors' expectations from emerging markets valuation reports, and problems currently encountered in this regard.

Lawyer Robert D'Alessandro, chairman of Credaltrust Management Ltd, is to delve into protection of investments for Hungary, Romania and Slovakia real estate projects. Developer Phil Stapley, CEO of Investment Solutions SRL, follows with operations, problems and recommended approaches for the Romanian market, with particular reference to the small investor.

The proceedings of this conference will be considered as guidelines to be delved into by future developers. This conference should be of interest to architects, accountants and auditors, estate agents, financial intermediaries and property developers, among others.

Denis Camilleri, A&CE, is conference co-ordinator, on behalf of Kamra tal-Periti.
kamratalperiti@nextgen.net.mt

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.

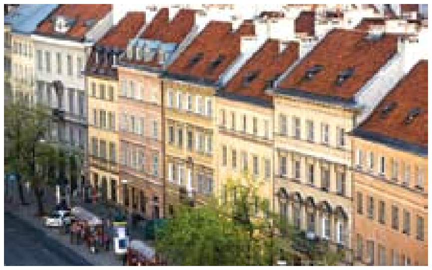
The following speaker, Lawyer Geoffrey Mifsud Farrugia who has hands on experience in the Bulgarian market, dwelt on "Legal Frameworks in the Balkans: Bulgaria – a case study." The ownership of real estate by foreign nationals / foreign legal entities may not directly acquire ownership rights on land. 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