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DEAR COLLIERS FRIENDS,

It’s been said that “The future rewards those who press on”. That’s why, first of all, I want to thank you for taking your time to browse through our annual report, probably the most comprehensive research material about the real estate market. We hope it will bring you fresh useful information and help you when you are thinking about the Romanian real estate market, either out of curiosity or because you’ve already invested here (or are planning to do this soon).

We at Colliers firmly believe that Romania is on a one-way road to progress, with no way back, that the local businesses have taken destiny into their own hands and they can take care of themselves. Still, if I were to describe in a few words what 2019 looks like, I would say that we are caught up in a balancing act between some short-term risks and real long-term opportunities, which you will discover in the pages that follow. Many of the people whom I spoke with about last year were saying that it was a good year and they were confident about 2019; if they were to have one wish fulfilled, that would be predictability.

Romania direly needs an educational system adapted to today’s demands and which can successfully face future challenges, the country’s infrastructure needs a major upgrade, while the health system should become truly viable. Addressing these three elements would directly help solve two major issues: the external migration process and cutting back the living standards discrepancies between various social classes and between different areas of Romania.

We place great value on education, which is the only ingredient that can truly change Romania for the better. This is the reason why we chose to support it both within our company and externally and I urge you to do the same. Those of you who are active in the real estate market, I hope you adhere to our conviction about the importance of education and I look forward to you joining us in making the market more professional, more respected and “cleaner”. I would very much hope that we can prove Dr. Wayne W. Dyer right when he said that “when given the choice between being right or being kind, choose kind.”

I wish for us to continue to walk alongside you, to become stronger and better together, to remain passionate about what we do each and every day and, why not, to remain cheerful.

And as Barack Obama once said: “The future rewards those who press on. I don’t have time to feel sorry, I don’t have time to complain. I’m going to press on”.

Best wishes,
Laurentiu Lazar
Turnover in the real estate market was more or less flat last year compared to 2017, at almost EUR950mn and a bit below our call for EUR1bn, but still decent. For 2019, we are moderately optimistic. The economy is set to continue expanding around its potential growth rate, which is double the EU’s average. This is thanks to a robust private sector, with diversified inputs from both manufacturing and services (including IT). Normally, this, alongside a juicy yield gap between Romanian products and those in other CEE countries, would be enough, especially given that office pipeline suggests over half a billion euros. Still, the bigger risks (both economic- and political noise-related) are a source of concern. So is the fact that a new tax slapped on bank assets might tighten lending conditions significantly.

UNEMPLOYMENT HAVING ENDED 2018 AT RECORD LOWS, BELOW 4%, AND CENTRAL BANK ESTIMATES SUGGESTING GROWING SUPPLY-DEMAND SKILLS MISMATCHES IN THE LABOUR MARKET, VARIOUS REAL ESTATE SEGMENTS ARE LIKELY TO HAVE A TOUGHER TIME IN 2019. FOR OFFICE LANDLORDS, THIS MEANS FIGHTING MORE FOR TENANTS AS THEY WILL HAVE A HARDER TIME TO FIND EMPLOYEES, WHILE INDUSTRIAL MARKET PLAYERS (MOSTLY IN CENTRAL AND WESTERN ROMANIA) WILL HAVE TO RELY INCREASINGLY MORE ON “IMPORTED” WORKFORCE FROM OTHER PARTS OF ROMANIA OR EVEN OTHER COUNTRIES. AS A POSITIVE, THIS CONTEXT WILL BRING UPWARD PRESSURES ON WAGES, WHICH MEANS FURTHER UPSIDE FOR RETAILERS. THAT SAID, A TOO TIGHT LABOUR MARKET IS A SIGN OF A FUTURE CORRECTION.

This year is set to more than double on the deliveries of modern office spaces in Bucharest. Meanwhile, our baseline scenario assumes new demand for modern office spaces in Bucharest to remain robust in 2019 (around the cycle average), but given the tight labour market, it will likely trend lower versus recent years, which marked cyclical peaks. We expect vacancy to climb to multi-year highs, towards 13% by year end (most of this to be caused by relocations from older buildings to new ones, as buildings due in 2019 already have a pre-lease ratio of well over 60%). Still, Bucharest is a heterogenous market, so certain buildings or areas might actually clinch bigger rents despite the overall context shifting to a tenant market. IT&C and BPO&SSC are likely to remain at the forefront of new demand.
The warehouse segment is coming after, arguably, its best couple of years ever if we look at deliveries, with manufacturing activities also faring nicely. The modern warehouse spaces stock expanded c.40% in 2017-2018, to over 4.2 million sqm nationwide, but activity is likely to cool a bit in 2019. Outside Bucharest, towns in central and western Romania will remain very interesting, but economic hubs like Ploiesti, Iasi or Constanta should also fare well. As Romania has been in the spotlight on a regional level, we could see notable entries in 2019 (maybe even some of the biggest global names); furthermore, developers traditionally active on other segments in Romania (office, residential or retail) are eying the market.

The residential market was already slowing down in 2018 as the central bank’s tightening cycle (starting late 2017) kicked in. A further blow will come from the new debt limits for loans promoted by the central bank starting this year; together with the gloomier economic outlook, fiscal uncertainties and strong construction appetite for new units, a storm is brewing. Even though consumers have more money amid rising disposable income and the cultural inclination to own a home, a wait-and-see mood might prevail given the foggy context. Furthermore, the tighter lending conditions might also shut off some customers from loans. As such, unchanged prices in 2019 might actually look like a feat; a price dip (maybe in the 5% region) looks more likely.

The favourable perception that some regional cities enjoy continues, with the most dynamic counties (Cluj, Timis and Iasi) adding more jobs last year than Bucharest, even though their total workforce represents just two thirds of the Capital’s. This is just another sign of the fast convergence taking place, with growing attention from employers also for second-tier/smaller regional cities. This overperformance relative to Bucharest is likely to remain in place over the longer term, but some cities risk hitting glass ceilings as local authorities might not be best prepared for the booming economy. Local infrastructure constrains and tight labour markets are among the growing issues, but the good news is that these are not insurmountable challenges.

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With the Romanian socialist-led government increasingly at odds with EU institutions, investors will likely be closely looking at upcoming elections for any hints on what the future may hold, especially in light of the erratic fiscal changes promoted by the ruling coalition. The European Parliament elections in May and the November/December presidential elections may be just the warm-up round for the all-important late 2020 general elections. In this context, we do not expect any material progress regarding vital structural reforms; on the contrary, backwards steps seem more likely, with new populist measures potentially on the agenda. Elections for the EU Parliament will also serve as a “referendum” on the vitality of Eurosceptics and Europhiles throughout all of Europe.
EY TAX
Asistență fiscală

Asistență fiscală generală
Asistență fiscală internațională
Asistență fiscală privind tranzacțiile
Contabilitate și conformitate fiscală
Asistență juridică

Asistență fiscală privind impozitele indirecte
Asistență impozit pe venit și contribuții sociale
Prețuri de transfer
Litigii și dispute fiscale
Tehnologie și transformare fiscală

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REAL DEPTH.

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ECONOMIC OVERVIEW

Balancing short-term risks and long-term returns

2018: ANOTHER YEAR WITH A ROBUST ECONOMY

The last decade has probably been the best period in terms of economic development in Romania’s 100-year history, even when taking into account the boom-bust 2007-2009 cycle, with the 2015-2018 period especially supporting this outcome. Last year ended with economic growth of a bit over 4%. This is a slowdown from the surprising 7% figure in 2017, but nevertheless, it is still one of the better results in the EU, where growth hovered around 2% on an aggregate level. Private consumption continued to play a leading role (likely up by around 5%), albeit expanding less than in the previous year (a bit over 10% in 2017) and generated close to three quarters of economic growth; this slowdown came amid higher inflation, tighter monetary policy, fiscal policy uncertainties and slight softening of the RON, all of which impacted consumer optimism to an extent. Other details of growth numbers were even less encouraging, as investments returned to negative territory, the negative impact of net exports swelled a bit and inventories (often a volatile component) had a significant positive contribution to GDP growth.

On the supply side, economic growth came from varied sectors, with industry adding close to a quarter of the c.4% figure for 2018, whereas services added around a third. Agriculture and net taxes were also quite relevant, generating close to a third of growth together. Financial markets were more or less well behaved (or at least, they did not offer any surprises). The EUR/RON had a quiet year, though it was quoted a bit higher than the previous year, around 4.65, as the central bank continued to guide the foreign exchange (FX) pair towards a new comfort zone that would offer some respite for external price competitiveness/exports. On the other hand, monetary policy was tightened last year, particularly in the first part of the year. This came amid inflation hitting multi-year highs of 5% mid-2018, though by year end, as some statistical effects disappeared, it dropped to 3.3% in December.

2019: NAVIGATE WITH CARE, INCREASED RISKS ON THE HORIZON

Peering into the crystal ball to predict the future is becoming more and more difficult due to higher uncertainties on the horizon, but unfortunately, one thing is certain, at least regarding 2019: there are more potential negatives than reasons for optimism. While we will be referring here mostly to the near-term outlook, our take on Romania’s long-term story is still very positive: after outpacing peers in terms of growth in recent years, there is still a lot of untapped potential. The country has some of the best differentials between labour costs and productivity in the CEE, while at the same time having a big chunk of the population economically inactive; furthermore, the favourable results seen in the last decade have been achieved with somewhat limited progress on vital areas like infrastructure, so we imagine that some incremental and predictable progress in the future would do wonders for Romania. Even so, the country outpaces all its CEE peers in terms of sustainable GDP growth rate (potential GDP), which is a bit over 4% presently.

Returning to the near-term outlook, we note that as the second semester in 2018 looked quite good thanks to robust consumption (leading to favourable statistical effects for 2019), GDP growth could very well print in...
the 4% region this year, which would still be one of the better results in the European Union. Local workforce remains attractive on a cost basis compared to regional peers, though not as much as a few years ago. Despite the fact that unemployment remains around record lows of below 4%, European Commission surveys suggest that companies in Romania (both in industry and services) do not face such a difficult task in finding employees as in other CEE countries, so there might still be some room to grow on this front. On the other hand, private consumption looks set to remain the major driver, but there are some question marks about its viability. Up until now, the increase of the average wage (c.13% in 2018) has been more than enough to guarantee a decent improvement of real earnings, even amid an inflation rate as high as 5%. The c.10% increase of the minimum wage in 2019 for most employees (even more for people in the construction segment or for those with tertiary education) should offer some support going forward.

On the other hand, compared to past years, there are more and more risks. First of all, in order to see wage hikes in the private sector, it is vital for the companies to continue expanding and hire; it is this competition for employees in a tight labour market like Romania currently has that then leads to bigger pay checks. Meanwhile, European Commission surveys suggest that hiring intentions for local companies over the very short term (the next 3 months) deteriorated throughout 2018 and closed in on 3-year lows by the end of the year, though the index staged a recovery in January 2019. In this context, it is important to point out the recent tax changes that confounded domestic businesses (the levy on bank assets and taxes on the revenues for telecom and energy companies), which were published in the Official Gazette in the final days of 2018. These should lead to less enthusiasm for expanding in the future, but it is difficult to gauge their impact as things stand now. Furthermore, the bank tax is especially damaging given the level that the central bank estimates suggest that skills mismatches on the labour market have been steadily rising in recent years (i.e. current unemployed are not what companies are looking for), so we take positive news like the previously mentioned surveys with a pinch of salt. Private consumption looks set to remain the major driver, but there are some question marks about its viability. Up until now, the increase of the average wage (c.13% in 2018) has been more than enough to guarantee a decent improvement of real earnings, even amid an inflation rate as high as 5%. The c.10% increase of the minimum wage in 2019 for most employees (even more for people in the construction segment or for those with tertiary education) should offer some support going forward.

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Data Source: Eurostat, Colliers International

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There have been some signs that the government might be open to sweeten a bit the levy, but as of mid-February, nothing concrete came of this.

Turning to the supply-side numbers, it is likely that business services will remain the big driver for the economy, as both IT&C and BPO&SSC activities remain highly attractive in Romania, but limitations in the labour market mean slower growth than in recent past. Manufacturing offers companies seeking to expand in Romania less headaches in finding workforce than regional countries and at lower costs, but with worse infrastructure. Still, both services and manufacturing are largely dependent on external demand and unfortunately, the news is not at all good on this front; German and Italian economies, which absorb over a third of Romania’s goods exports, have been showing signs of pronounced weakness in recent quarters.

Consequently, risks for the economy seem skewed to the downside, while the room for positive surprises is slim, in our view. Still, it is important to note that overall imbalances look well better than they did in the run-up to the 2008 global financial crisis (for more on this, please see our special report issued in September 2018, entitled “Remembering the Global Financial Crisis. 10 Years Older, 10 Years Wiser?”); this makes us believe that a potential economic correction would be softer than the one in the 2009-2010 period.

On a macroeconomic level, the most worrisome aspect is the widening of the so-called twin deficits (the budget and current account deficits). The current account deficit could close in on 5% of GDP this year, even as neighbouring countries have surpluses; several years ago, it stood at below 1% of GDP. This deficit, which highlights net FX outflows from the economy, is also more difficult to finance, as foreign direct investments (inflows of hard currency) barely covered half of it during last year. The fiscal gap has been kept under control by the government with greater difficulty after years of pension and state wage hikes – the controversial taxes are a testament to this. It is also possible that based on the European Commission’s accounting standards, it already moved in 2018 past the 3% of GDP threshold, which might lead to the start of the excessive deficit procedure against Romania. This would lead to the further worsening of Romania’s risk perception, even as the country’s credit default swap climbed some 80 basis points already in 2018. That said, we do not expect a downgrade of the country’s rating this year; we might see, at most, in the second part of the year, a change of the rating’s outlook from stable to negative.
Due to these widening imbalances, Romania is perhaps the most vulnerable to external shocks among the major CEE economies. And looking at the risks balance, there are quite a lot of things to take stock of that could impact Romania at least indirectly if they materialize: 1) the rise in global risk aversion due to the Federal Reserve’s tighter policy; 2) further weakening of European economies; 3) uncertainties about the US’s trade policy; 4) Brexit cliff-edge; 5) China’s slower growth path; 6) various geopolitical shifts; 7) growing dissensions on the east-west axis of the European Union, particularly related to rule of law.

2019 is also a year with elections: a ballot for European Parliament due this spring and presidential elections late in the year. As such, it is difficult to expect Romania to progress significantly with respect to vital structural reforms. On the contrary, some backwards steps might actually take place, as populist measures usually pop up more on the agenda than reforms in election years. The first ballot will also be especially relevant as it will serve as a census on Eurosceptics and Europhiles both in Romania and in other member states.

We also want to underscore the fact that not just in Romania, but in the wider Eastern Europe, investors do not explicitly show that they are feeling the pinch of the rising tide of populism in recent years. Business has moved forward as certain red lines (like introducing laws with a retroactive character that impact businesses) have not been crossed and this is positive as it highlights the investors’ trust in the long-term potential of the region. That said, should the populist rhetoric gain even more traction, it might become damaging.

FINANCIAL MARKETS: FAIRLY QUIET, BUT WATCH OUT FOR SHOCKS

Romania has been losing ground in terms of external competitiveness due to the material wage hikes seen in recent years and this was something that the central bank took stock of. As such, there was a consensus among local analysts that the RON would weaken at one point in 2019, as this was justified by the wider current account deficit alone. A such episode took place just at the start of 2019, also amid worries about the fiscal policies, with the EUR/RON testing record highs of over 4.76. With some central bank persuasion (the EUR/RON is actively managed by the National Bank, which limited weakening pressures in the past), it might settle around 4.75-4.80 for most of 2019, just as in 2018 it was very stable around 4.65. On the other hand, there is little in terms of reasonable arguments for a stronger RON given Romania’s rising imbalances.

Having said this, the risks mentioned throughout this comment suggest that there might be periods when the EUR/RON might test higher levels, especially as the central bank is in a “catch 22”-type situation: with the bank tax active and a potential net liquidity deficit in the money market, protecting the RON too heavily would push ROBOR rates much higher and maybe lead to issues with Romania’s financial system stability. On the other hand, a move sharply higher by the EUR/RON would also significantly impact inflation, so the central bank will be wary to accept a material depreciation of the Romanian currency.

Otherwise, the tax targeting banks alongside previously adopted measures by the NBR to limit the debt-to-service ratio for individual borrowers means less need for an even higher key rate going forward. Even so, money market rates might be kept above the key rate (2.5%), at over 3%, as inflation is set to remain in 2019 close to the upper bound of the target interval - 1.5-3.5% - provided no new shocks (maybe related to new taxes, for instance).
REGIONAL CITIES: ONGOING POSITIVE DEVELOPMENTS

With Bucharest inhabitants having reached standards comparable to even some western European capital cities in terms of purchasing power, Romania’s growth story is set to come from several economic hubs in the country. This more inclusive model will be positive for the country as the development of cities like Cluj-Napoca or Timisoara tends to impact villages and towns around it. Meanwhile, in other parts of Romania, the jobs count is below its pre-crisis levels, highlighting the uneven recovery path, with towns like Bucharest and Cluj-Napoca growing at their expense.

One of the preferred measures to gauge the pace of growth should be the rise in jobs and particularly high-quality jobs. By this metric, the four biggest office submarkets in Romania have had an excellent decade. Out of 10 IT&C jobs created between 2008 and 2017, 5 were in the Cluj, Timis, Iasi and Brasov counties (of course, intuitively, mostly in county capitals – Cluj-Napoca, Timisoara, Iasi and Brasov), around 3 in Bucharest and the rest in other parts of the country. Interestingly, if we also look at figures for the total labour pool, these four towns created more jobs than Bucharest despite the fact that their overall number of people employed is far smaller than the Capital’s.

Though 2018 lacks detailed figures, the big headline figures, like employment in services, suggest that this trend was very much intact last year.

The increased living standards that these regional cities offer, alongside wages not too far below (or at all) to those in Bucharest means that the migration patterns we spoke of in last year’s market report are unfolding as we speak – we refer here to a World Bank study that suggested the number one town in the country Romanians would move to was Cluj-Napoca, even ahead of Bucharest, with other regional cities also seeing large potential inflows. The job creation numbers fully support such trends, though there are other telltale indicators, like the fact that residential prices rose faster in most large towns in Romania than in Bucharest, highlighting a potential lack of supply relative to the increased demand amid a dynamic local economy.

Summing up, while Bucharest remains by far the hardest hitter in the Romanian economy due to both its sheer size and density of qualified workforce (high-tech employment is in the top 5 among EU regions), growth is set to come increasingly more from cities like Cluj-Napoca, Iasi, Timisoara, Brasov in terms of business services, with industry already seeking to find the adequate balance between workforce supply (something which Bucharest lacks) and ease of access to export markets.

Net job gains between 2008-2017

![Graph showing net job gains between 2008-2017](Data Source: INSSE, Colliers International)
RETAIL MARKET

SUPPLY
Around 144,000 sqm in new modern retail spaces came online in 2018, an increase of over 40% compared to 2017’s c.100,000 sqm, taking the total stock to almost 3.8 million sqm nationwide. Around three quarters of the total deliveries came from just two market players: the Prime Kapital/MAS REI partnership and NEPI.

The two single biggest new schemes were NEPI’s Shopping City Satu Mare for around 29,000 sqm and Prime Kapital/MAS REI’s Baia Mare Value Center for over 22,000 sqm. Incidentally, both of these towns are in the 100,000-150,000 inhabitants bracket, which tends to highlight the trend of developers focusing mostly on medium and small towns. Of course, usually small towns see a reduced footprint from developers (i.e. retail parks). Also, the below 100,000 inhabitants category saw nearly 60,000 sqm in new retail spaces delivered in 2018, the highest figure since 2007, with some schemes opened in quite small cities (for instance, with a population of around 50,000).

Bucharest has seen limited deliveries in the last couple of years, though there has been certainly interest (as suggested by the pipeline for 2019), particularly as on a per capita basis, Bucharest is still a bit behind some CEE capitals. Nationwide, there is even more room to grow if we take stock of per capita levels. This also means that domestic shopping centers are more insulated to the surging online retail sales.

DEMAND
Though private consumption slowed a bit in 2018 relative to 2017, which delivered the strongest growth spurt in the post crisis period, it was still enough to keep the engine very much alive. As a matter of fact, Romania has by far the fastest growing retail sales scene in CEE region in recent years, largely thanks to hefty real wage gains as well as a low debt burden compared to other neighbouring countries.

As such, new schemes delivered in 2018 were well digested by the market, having low vacancy, while in the towns with multiple schemes, the competition was not significantly impacted. This was possible given solid interest from existing players on the market, as well as from new brands seeking a presence locally.

We note that a lot of interest came from retail chains offering affordable prices which seem to have prospered greatly in the last couple of years; just in 2018 we saw several new names on the discounter segment (not just fashion, but also FMCG). This might be due to the heterogenous nature of the labour market in Romania, as you have a steady (and rising) number in the posh urban middle class, but also over two million employees paid at the minimum wage level. It also highlights a potentially more cautious approach from consumers, amid painful
Romanian retail scene, lots of room to grow

memories of the past boom-bust cycle. Consequently, entries focused mostly on the medium-low spectrum of the pricing range: Miniso, 50Style, Sizeer, Bestfor, DeFacto, Kik, Replay, Svetofor (with the brand Mere). There were also entries in the upper echelon of the price range: Tumi, Pinko; 2018 also saw the re-entry of Hugo Boss, which set up shop in the luxury high street area of Radisson Blu Hotel in Bucharest.

As another trend, we note that some entries (like Momax – in Timisoara or Kik – in Oradea) were interesting because they did not adhere to the standard practice of “Bucharest first, expand to other cities later”. This might be due to both Bucharest’s more upscale profile, as well as the fact that the Capital is a fairly crowded and competitive market; furthermore, as we said previously, focusing more on the affordable price spectrum makes areas outside Bucharest and the well-developed urban areas a natural choice for some retailers. Polish and Turkish brands continue to be very active, though in a trend started in recent years, Romanian stores are also expanding quite nicely. It is also worth mentioning that retailers are looking to expand their business both via self-investments as well as through franchises.

After years of hefty growth for the fashion industry, recent years have brought a change in the sense that people tend to focus a lot more on experiences; this means that the entertainment segment has increased its share in the leasable surface of a mall towards 25% in new projects versus 5% in some cases before the crisis. Other complementary services (linked to local administration, for instance) are also regarded quite highly.

Amid a robust residential market for the last couple of years, the DIY segment has been expanding nicely and also received some new players in 2018. These are Homelux, Momax and Mathaus. It is also worth noting that the proximity factor weighs a lot and some big box operators are thinking about shrinking to mall-friendly formats. Take for instance Ikea, which opened two collection points in Brasov and Timisoara.

Otherwise, we also note the fact that food anchors see less merit in leasing surfaces as big as in past years; consequently, now they look for 10,000 sqm or less. We believe a few factors may have weighed:

1) the increased competition both from competing schemes as well as the rapid rise in smaller proximity focused supermarkets and discounters; 2) a rise in online retail sales (also promoted by the food anchors themselves).

RENTS AND VACANCY

Despite the uptick in deliveries in 2018, there were no issues with absorbing these new surfaces. On the contrary, one needs a magnifying glass to observe the vacancy at the big/dominant retail schemes (if existent at all).

All in all, given the strong demand and still somewhat limited new supply in comparison with the demand from tenants, 2018 was the first year since 2015 in which rents saw a generalized increase nationwide. This increase was usually in the 10-15% range, though not all shopping centers managed to capture it. For landlords, managing to obtain higher rents from existing players was not always possible, but the new brands trying to carve out a piece of the Romanian market were a bit more generous, especially for prime locations/ground floor. Some upside pressures on rents could still arise at dominant centers, but we do not see this becoming generalized in the future.

Prime rents in shopping centers in Romania

Data Source: Colliers International
FORECAST

With the real estate market more reactive than proactive, the recent consumption-driven GDP growth has caught people by surprise, leading many to observe that many parts of the country still had a subpar coverage of modern retail schemes (and some towns still do). Due to the development cycle delay, it is just now that we are seeing a significant increase in deliveries, with the pipeline for 2019 sharply higher than in previous years: nearly 250,000 sqm, more than double versus a couple of years ago. This would be the highest level since 2011, while outside Bucharest, deliveries should near a post-crisis high.

The quest to bring a retail park to every town with several tens of thousands of inhabitants continues. Meeting developer plans would also lead to a heavy pipeline for 2020, with a figure similar to this year’s just from a handful of large projects.

Comparisons to the pre-crisis situation remain overblown, in our view, due to several reasons: 1) deliveries were much heavier back then (over 1 million sqm came online in 2007-2008); 2) more sustainable consumption patterns (more reliant on wages rather than loans); 3) quite a lot of retail parks (which require a smaller capex).

Following the robust rise in private consumption in recent years, making Romania surpass Hungary in actual individual consumption per capita, as per Eurostat estimates, demand should be solid. That said, with the focus on areas of the country where wages (and even employment ratios) are not on par with the bigger cities suggests that demand will mostly come from brands at the affordable price range or at least medium. We also expect to see new entries on the Romanian market, both regional/European players, but maybe some of the bigger retail brands currently not present locally.

Overall, as long as the economy continues to deliver decent results and wage growth remains comfortably above inflation rates (something which we assume under our baseline scenario), 2019 should remain a good year for the retail segment.
SUPPLY

2018 was a record-setting year for the I&L market in Romania, with more than 0.7 million sqm in new modern storage spaces estimated to have come online during the year just from traditional developers, taking the total stock to 4.2 million sqm nationwide. This is a hefty increase compared to 2017 deliveries of around 0.5 million sqm, with Bucharest accounting for just over half of the total increase in 2018.

The numbers are still in tune with the recent trend of developers focusing on either Bucharest or regional hubs located mostly in Transylvania or in towns with good transport connectivity. The latter aspect still means largely looking past the workforce rich region of Moldova or south-western Romania as these fare much worse in terms of time needed to reach the Western border of the country. Consequently, dealing with increasingly significant labour shortages, developers are becoming more open to various alternatives, with contemplating building some simple cost-effective lodgings for employees relocating temporarily from other parts of the country.

We also take notice of significant self-developed spaces, which we do not include in stock numbers. The notable players here are large retail chains and e-commerce players. eMAG.ro, the largest online retailer in Romania, delivered a huge storage complex of around 120,000 sqm west of Bucharest in 2018, with this alone representing c.6% of the surfaces operated by traditional players in the Capital and surrounding areas. Just the self-developed spaces accounted for by Colliers amount to over 250,000 sqm (or nearly a third of the deliveries by the traditional developers).

In terms of developers, CTP and WDP continue to dominate the market and likely accounted for over half of the reported deliveries in 2018, with Bucharest making up for a major share of their activity. Other players, like Zacaria and VGP, were also quite active (mostly in other parts of the country).

Unfortunately, vital infrastructure (highways or railways) developments that would positively influence the I&L space are yet to become a reality and with limited scope for any progress over the near future (say, the next couple of years), there is little room for optimism on this front. A glimmer of hope comes from the fact that MPs from opposition parties managed in October 2018 to push through the Parliament a bill forcing the government to build a highway linking the north-eastern (Iasi) part of the country to central Targu Mures. A deadline for its completion has yet to be advanced. Otherwise, the transport minister promised initially at least 150 kilometres of new highways to be opened in 2018; just over a third were actually finalized.

Meanwhile, in Bucharest, the areas that have access to the modernized ring road (including the booming region of Stefanesti or Chitila in the northern part of the city, which is growing alongside the developed western parts) are most attractive for industrial and logistics spaces, while southern regions remain less appealing.

DEMAND

For 2018, total reported demand was comparable with 2017’s level of just under 0.5 million sqm of rented modern warehouse spaces. That said, with deliveries some 40% larger than the previous year, according to Colliers estimates, it is likely that a bigger part of the market was made up by direct (and unreported) transactions, seeing as vacancy rates were only a bit higher on an aggregate level.

The retail segment stole the show in 2018, accounting for half of the total, with just two deals concluded by two of the leading retailers in the country (Metro Cash & Carry and Auchan) in the north of Bucharest accounting for a

Impressive growth in both e-commerce and overall retail sales to fuel I&L market

With the market seeing robust growth in recent years (1.2 million sqm or one quarter of the current stock came online in 2017-2018), this has drawn the attention of real estate players not originally focused on storage spaces. Some companies focused on residential, office or retail are looking into moving in new territory. There are also some new names on the market, like Polish MLP Group or Romanian Element Industrial, but we also saw interest from other big names in the CEE/Europe during 2018.
bit over a quarter of the total market in 2018. This shift from the west to the north of Bucharest was anticipated by Colliers amid the plentiful unused land in this area, while also offering good access to various destinations thanks to the ring road.

Looking at demand by city, we notice that Bucharest returned to the forefront of activity, with over 60% of total reported deals, followed at a great distance by hotspots in Transylvania like Timisoara, Deva and Cluj-Napoca. That said, this is not reflecting the underlying trends in the Romanian economy regarding the increased focus on activity outside of Bucharest and so 2018 might prove the exception rather than the norm in the longer run.

PRICES AND VACANCY

With deliveries at a record high of 0.7 million sqm, after the stock expanded at a jaw-dropping pace of 40% in the last two years, it is no wonder that vacancies have climbed a bit in 2018 from ultra-low levels previously. It is still very much a landlord’s market, but not so much as in previous years. Consequently, vacancy has moved towards 5% in the Bucharest area (from under 2% before) and towards 8% in the rest of the country (from 5% before); regarding the latter, it is important to note that some cities, like Cluj-Napoca still have very limited available spaces currently, whereas in Timisoara, vacancy is quite a bit higher than in previous years.

Headline rents have crept up marginally, to 4.15 EUR/sqm for prime storage spaces as a result of the developer market we had until now. The contractual period continues to start from 5 years for new warehouse spaces (build to suit), though for existing spaces, companies accept a period of as low as 3 years. Looking at incentives, we notice that developers are becoming a bit more generous, probably highlighting the increased competition for tenants.

FORECAST

Romania’s long-term potential for industrial developments is very much intact, as the country still displays significant room to grow when compared to regional peers like Hungary, Poland or Czechia; that said, as economic growth normalizes, the industrial and logistics market should also return to a bit slower growth rates. Consequently, we expect to see deliveries of modern warehouse spaces in the 0.4-0.5 million sqm range; market participants might be a bit more optimistic, but we believe that the reality of a cloudier external and internal backdrop as well as the cooldown in GDP growth will catch up sooner or later. This also means that companies will steer clear of speculative developments for the most part and rely rather on build to suit projects, with leases of at least 5 years. As Romania still has a lot of potential especially if we look at stock relative to the population, we expect to see significant entries in 2019, possibly some of the bigger global names.

Besides Bucharest, there are several hotspots that are deserving attention from developers and tenants: Timisoara, Cluj-Napoca, Oradea, Sibiu, Brasov, but also cities outside of Transylvania, like Constanta, Craiova, Ploiesti, Pitesti and Iasi. Some of the destinations we believe in, like Constanta or Iasi, offer quite a lot of potential over the longer run, in our view, despite the fact that they might seem like small markets right now compared to some cities in Transylvania.

Otherwise, structural negatives look set to remain very much in place: the lack of infrastructure does not look like it would see significant improvements over the medium term, as the government has very limited fiscal room for investments. Furthermore, construction costs in Romania have risen quite sharply in recent years, even surpassing Poland’s in some instances, eating at developer margins. Just to put this into perspective, wages in construction were already rising well over 10% per annum in recent years, but last year, the government bowed to pressures from unions and increased minimum wages for this segment alone by a whopping 58%.

Summing up, with demand looking in reasonable shape and sustainable, the industrial and logistics market should have another favourable year as long as the Romanian economy avoids a sharp landing. The consumption-driven growth in Romania, with more purchases taking place outside Bucharest will continue to fuel the need for storage spaces, alongside growth in e-commerce and the rise of Romania’s status of a regional hub for some companies.
Years have passed since Romania became one of the most relevant names for outsourcing in the region. At first, companies were drawn in by the small labour costs, which sometimes bordered on dumping. Afterwards, the favourable argument was the wide range of services they could offer from Romania, as the country had a sufficiently large pool of specialist in various field of expertise (sometimes even niche-segments). It did not take long before recruitment efforts in the services field started moving out of the Capital and companies extended into the bigger cities that could deliver results at least similar to Bucharest’s. The more investments and employment growth were happening, the more these cities were transforming at an astounding pace. So much so that some have become true investment hubs.

Today, years apart from this initial explosion in the services area, the magnetism exerted by business services is still very much alive and kicking. Over 30% of the jobs posted on ejobs.ro are for or linked to services. This includes: call centres, accounting, marketing, audit, consultancy, judicial services and so on. The figure mentioned previously is on a national level, but looking deeper on a city-by-city basis, in many instances, half of the jobs available currently are for positions in the services segment.

It should come as no surprise that Bucharest is the absolute leader in terms of service employers, with more than 4,500 jobs on offer that would fit in this category, out of the total of over 11,000 positions open in the Capital. This number is followed by Cluj-Napoca, where out of 4,000 job openings, around 1,500 are for services. Cluj-Napoca and the entire Cluj county, for that matter, have become a case study about the development of the business, investments, hiring activity, office and residential spaces and about the general market growth.

The third most active city in Romania, from the employment point of view, is Brasov - in terms of both the total number of jobs offered (3,515) and the number of jobs for those working in the services sector (1,291).

As one of the largest university centres in Romania, a fact that, from an employer’s perspective, is invariably seen as “a candidate factory”, Timisoara starts the year with over 3,200 jobs, out of which 1,000 are in the service sector. Except for Iasi, which has gained a considerable amount of popularity in recent years, the eastern part of the country sends candidates to other regions rather than attract them. However, Iasi has caught up with Cluj-Napoca and Timisoara, with a total of 3,230 jobs, out of which 1,300 are in the service sector.

These dynamics of hiring activity are reflected in wage statistics as well. Therefore, employees in Bucharest and Ilfov record the highest average wage at national level, that is RON 2,989, according to Paylab.ro, a real-time salary surveyor. Next are the Western and North-Western regions, with average wages of RON 2,745 and RON 2,729 respectively. Employees in the Central region earn a monthly average wage of RON 2,666, while those in the South (except for Bucharest-Ilfov) and in the East report averages between RON 2,535 and RON 2,618.

However, it is very important to see that all industries that fall under the broad services category are extremely attractive for almost all categories of candidates, regardless of age, level of training or experience. Indeed, most of them are aimed at white collar specialists, but their appeal is substantial for young people too, including students or those who experience their first job.

It remains to be seen what the future of these exceptionally dynamic employers will bring, while they, as we have noticed, are competing in certain areas of the country with employers in the manufacturing industry (traditionally known as high volume employers), yet, at the moment, candidates continue to consider services as one of the most constant job and career “providers”.
Average net wages per region and job openings in major cities

Most desired job sectors in Romania by number of applications in 2018

<table>
<thead>
<tr>
<th>Sector</th>
<th>Total no. of job openings on eJobs.ro</th>
<th>Total no. of job openings in services on eJobs.ro</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>896,894</td>
<td>4,513</td>
</tr>
<tr>
<td>HoReCa</td>
<td>125,596</td>
<td>120,947</td>
</tr>
<tr>
<td>Logistics</td>
<td>419,534</td>
<td>1,291</td>
</tr>
<tr>
<td>Banking</td>
<td>120,947</td>
<td>102,325</td>
</tr>
<tr>
<td>Accounting</td>
<td>365,853</td>
<td>1,284</td>
</tr>
<tr>
<td>IT</td>
<td>102,325</td>
<td>68,102</td>
</tr>
<tr>
<td>Administrative</td>
<td>287,989</td>
<td>2,666</td>
</tr>
<tr>
<td>Legal</td>
<td>68,102</td>
<td>2,749</td>
</tr>
<tr>
<td>Distribution</td>
<td>264,444</td>
<td>2,989</td>
</tr>
<tr>
<td>Others</td>
<td>46,674</td>
<td>2,729</td>
</tr>
<tr>
<td>HR</td>
<td>178,879</td>
<td>11,243</td>
</tr>
</tbody>
</table>

Data Source: eJobs
ASSIGN THE RECORD STRAIGHT – THE OFFICE SERVICE CHARGE IN 2019

GENERAL CONTEXT

Colliers’ market reports usually focus on the “big figures”, like rents, total demand, deliveries, vacancy rates and so on, but there are other factors at play in the real estate market, some more relevant than it seems at first glance. One such aspect is the service charge, which refers to “works, such as maintenance and repair of the fabric and structure, and true services, such as the provision of heating, lighting, cleaning, security etc.”, as per the RICS (a major real estate professional body) definition. So basically, all that makes a real estate project function like clockwork. As such, we want to underscore that the service charge is one of the most important aspects when considering the longer-term “health” of an office building and it is also directly correlated with the tenant’s satisfaction. This means that paying the right price makes a big difference.

That said, since service charges are very much open for debate and there are no standards or unitary frame applicable to all buildings, at least in Romania, based on Colliers’ vast experience in managing office properties, we are often met with questions about the quoted prices; as usual, people want to pay less and get more, but in such a competitive market, paying less actually leads to not so satisfactory outcomes. For instance, for an average-sized office building (in the 17,000-20,000 sqm leasable area region), an adequate level of the service charge should be around 4.2 EUR/sqm, whereas we notice that some market participants are trying to push for a level as low as 3.5 EUR/sqm.

In the following chapter, we will analyze the various categories of expenditures found in most office buildings and compare what has changed in the last few years, since we last published an analysis on the service charge, some 4 years ago.

SERVICE CHARGES BREAKDOWN

It is important to note beforehand that the service charge can be influenced by the sheer size of a building: a larger property will see certain fixed expenditures (like security or fire brigade) spread over a larger leasable area, leading to a smaller service charge. For this exercise, we looked at a handful of properties (all modern class A buildings, with an average 20,000 sqm between them) and we came upon a weighed average similar to the one we found out 4 years ago: around 3.8 EUR/sqm.

Service charge composition after four years

<table>
<thead>
<tr>
<th>Category</th>
<th>2019</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxes</td>
<td>37%</td>
<td>39%</td>
</tr>
<tr>
<td>Technical Maintenance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Management</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Physical &amp; Fire Security</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cleaning &amp; External Areas Maintenance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Utilities (for common areas)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Data Source: Colliers International
As a first observation, we note the fact that property taxes seem to have decreased a bit, but this might be caused by the change in office buildings we used to calculate the averages, while the percentage drop is not significant enough to note it as such. Furthermore, we want to note that due to the way property taxes are calculated, the weakening trend that the Romania currency has seen in recent years should influence the levy to the upside.

That said, some of the subcomponents of the service charge saw quite big jumps, like security and cleaning costs, which moved higher by some 35-40% in the last four years on a square meter basis. While the fire safety enforcement has likely been strengthened a bit (especially after the tragic Colectiv nightclub fire in 2015, which killed over 60 persons), we doubt that this is the only cause for this category. In fact, a big factor in both instances is the sharp rise in overall labour costs. The minimum wage has been increased by over 70% between 2015 and 2019, with a significant part of the personnel employed by cleaning companies, for instance, earning the minimum pay. It is important to note that such shocks have a ripple effect throughout the economy, having an indirect impact on operating costs for a significant share of the active companies. With this in mind we mentioned previously that a 4.2 EUR/sqm level would be needed, compared to below 4 EUR/sqm levels in some cases. Overall, we believe that there are enough objective reasons behind the sharply higher prices charged by some goods and service providers.

GETTING MUCH MORE FOR A LITTLE EXTRA

In today’s competitive office market, a happy tenant is a guaranteed source of future income; furthermore, it is equally important for tenants to keep their employees satisfied, as in the current tight labour market, wage benefits alone might not be enough to keep the retention rates at high levels. Simply said, amid fierce competition over talent, having a slight edge over one’s rivals may be needed. It is important to note that in a Mercer study on 15 emerging megacities, published in 2018, employees valued much more human factors (satisfaction with life and physical security) than money or job opportunities, which companies believed were much more relevant for employees.

Keeping such factors in mind, this is where a higher service charge might help if it were to include certain expenditures. In Colliers’ view, it is in the best of interest of both landlords and tenants to try to build a community centered around the workplace. Networking and wellness events, concerts, workshops, special events a few times a year (say, around Christmas) can go a long way in adding to the general happiness of employees. Furthermore, keeping a building up to par with modern times could mean additional investments that could either be paid by tenants or shared with the landlords. We are thinking here about prop-tech that can enhance the efficiency and security of the workplace.

Summing up, service charges should be treated less as just a cost by companies, rather as part investment due to the significant impact they can have in the longer run. From making employees happier to improving the long-term health of the building, an adequately priced service charge should be part of any business model striving to achieve sustainability.
Bucharest saw close to 150,000 sqm in new office buildings come online during 2018, an increase of over 20% compared to 2017’s level, taking the total stock for the Capital to over 2.4 million sqm. Though this is quite some way below 2016’s level of 230,000 sqm (also the post-crisis peak), last year saw deliveries comfortably above the average for this economic cycle. The overall figure is a bit lower than what was expected initially as one of the bigger projects, The Mark (25,000 sqm), was bumped to 2019. Overall, developers continued to focus mostly on the Center-West hub, which saw almost 60,000 sqm in new office spaces, the result of two large projects: CA Immo’s Orhideea Towers – 37,000 sqm and the first phase of Skanska’s Campus 6 – over 22,000 sqm. The former was also the biggest delivery in 2018. Another highlight was in the neighbouring West submarket, where AFI delivered the first phase of their Tech Park (22,000 sqm). Otherwise, Piata Unirii (Unirii View - 18,000 sqm and Day Tower – 12,000 sqm) and Dimitrie Pompeiu (second building of Globalworth’s Campus) both received around 30,000 sqm in new rentable surfaces. Overall, a busier year, but one which saw healthy interest for new projects, as demand was robust and buildings’ good quality was favourably received. That said, the construction segment continues to face difficulties, mostly related to low availability of workforce and higher input costs (wages and construction materials). Passing these onto developers leads to a trickier outlook for projects and though 2018 was not a turning point for the market, it is important to note that in recent years, as per Colliers estimates, Bucharest development and land costs have increased faster than in some regional capital cities.

DEMAND
Overall market activity in Bucharest was robust in 2018, with the gross market take-up 327,000 sqm, a bit below 2017’s revised 340,000 sqm print (initially reported at over 320,000 sqm). At first, it looked like last year was heading for a bit of a bigger decline, but Q418 turned out to be one of the best quarters in the post-crisis period, with well over 100,000 sqm in new deals reported (only two other quarters surpassed this level this cycle). The IT&C was the single biggest pull factor in 2018, accounting for close to one third of total market take-up, though this is below 2017’s share of around 42%. Professional services were also quite a big sector, attracting 21% of gross take-up. The third spot belongs to energy / industrial companies, which had a market share of around 14% in total deals. The financial segment, but also pharmaceuticals, medical players and media saw good results. A noteworthy segment on the demand side was co-working (included in the professional services category), which generated close to 8% of the total market activity, dwarfing what was seen in previous years. With a flurry of activity in the Center-West region on the development side, demand has kept up with this and leasing activity for this submarket generated a bit over a quarter (27%) of last year’s total. Floreasca – Barbu Vacarescu, which retains its appeal and a meagre vacancy rate, has been seeing fewer deliveries in recent past and amid a lighter delivery calendar, it accounted for nearly 15% of total activity. The rapid rise of other business hubs compared to the established northern areas comes as Bucharest transport infrastructure is becoming more stretched year after year.

On the other hand, net take-up was notably softer than in the previous couple of years, cooling some 20%, to around 134,000 sqm, though 2017 was an exceptionally strong year and corresponded to the peak for this cycle (initially reported at over 150,000 sqm, revised to nearly 170,000 sqm). Also, looking at the 2012-2018 period (the recovery and expansion phase for the Romanian economy), the yearly average stands at around 120,000 sqm, so this means 2018 was reasonably robust. Some of the details are not as encouraging as they may seem at first sight, however, as co-working operators generated nearly 19% of net take-up last year. We view these as largely neutral to the market as new demand, in our opinion, is either that type of leasing deal that has or will lead to job creation, or is created by relocations from non-competitive stock.

Gross take-up by location in Bucharest (2018, % of total)
Co-working operators, though accounting for a large share of the net take-up, will be rather complementary, as they might be used by big multinationals (seeking to offer employees some flexibility over their workplace location, for instance) and by small businesses/entrepreneurs. This does not exactly equate to new jobs.

RENTS AND VACANCY

Vacancy inched higher to 9.5% by year end after hitting the lowest levels for this cycle, of around 9% in H1 2018. While new demand was not far behind the delivery figure for last year, it is important to note that a significant part was made up of pre-leases for buildings yet on delivered to the market. Furthermore, relocations from competitive stock (i.e. modern office buildings), which actually create vacant spaces when concluded, were at the highest level for this cycle; this type of transactions represented over 31% of the total leasing activity versus 22% in 2017. So far, the mantra “build and they will come” has worked out for new buildings, but the cooldown in labour market means that some tensions are likely to build up.

Deliveries accelerating greatly even as demand cools to normal levels
For the moment, despite the heavier deliveries in recent years, demand has been largely strong and kept vacancy in the area where it is largely neutral for rents. Some submarkets with very small vacancy rates (most prominently Floreasca-Barbu Vacarescu) have seen upwards pressures on rents and, on a case by case basis, effective rents were quoted a bit higher than in recent years. That said, on average, the prime headline rents were more or less unchanged throughout 2018, at around 18 EUR/sqm, with the average headline for Bucharest around 14 EUR/sqm.

FORECAST

While Romania’s favourable macro backdrop and structural changes leading to a more service-based economy have been a strong catalyst for growth in the office segment, this has led to much more enthusiasm from developers even as the overall economic cycle has peaked. Consequently, potential deliveries for modern office buildings in Bucharest in 2019 are more than double what was seen in 2018, standing at over 360,000 sqm. The bulk remained concentrated in Center-West (nearly 100,000 sqm), with the fast-growing Piata Presei/Expozitiei coming in second (with a pipeline of c.70,000 sqm in 2019). Floreasca – Barbu Vacarescu and West submarkets are each expected to see around 50,000 sqm this year. Overall, it is quite a crowded calendar, particularly as the soft patch in the labour market, which became more visible during 2018, is starting to look entrenched. On a 12-month rolling basis, net job creation in the private services field nearly halved at one point during last year, compared to the start of 2017, but managed to recover part of the pace in the second semester of 2018. Overall, with the unemployment for white collar workers close to all-time lows around 2% and external migration seemingly continuing (at least based on figures until 2017), it is difficult to find any bright spots on the labour market. We would normally expect the c.400,000 sqm potential pipeline for 2020 (based on current developer promises) to be scaled back and adapted to the new realities.

Overall, vacancy is likely to creep up towards 13% in Bucharest by end 2019, based on preliminary estimates, as net take-up will at most be able to print around its average for this cycle (around 120,000 sqm). This will lead to a mismatch between supply and demand that might ultimately result in a smaller average headline rent on an aggregate level, potentially in 2019, though not all buildings and submarkets are born equal and the impact will likely be uneven. We believe the upper echelon of the market, good/premium/new buildings, as well as attractive locations will not suffer as much as the rest of the market; older buildings, that would normally need a refresh, will suffer even more as newer and shinier buildings will woo tenants away, leading to potential pressures on rents.

REGIONAL CITIES IN FOCUS

Regional office markets continue to see mostly favourable results, supported by internal migration and a growing confidence from businesses that they can find the right people here, even for larger operations. Due to the fact that recorded take-up numbers at the Research Forum might be a bit on the low side (amid more direct/unreported deals than in Bucharest); when focusing on other indicators, like job creation, we see strong underlying factors, like the fact that the counties home to biggest office hubs outside Bucharest – Cluj, Timis, Iasi – generated close to 30,000 jobs in services in 2018, according to estimates based on latest figures, some 25% more than Bucharest, despite the fact that their total workforce is two thirds that of the Capital’s.

Overall, in the four largest office markets outside Bucharest (Cluj-Napoca, Timisoara, Iasi and Brasov), the total office stock was expanded by nearly 90,000 sqm in 2018, taking the total to a bit over 700,000 sqm, with Timisoara accounting for nearly two thirds of this expansion and Cluj-Napoca for much of the rest. Amid this backdrop, vacancy climbed in double-digit territory in Timisoara (12%) from very low values in the previous year, but the leasing market remains reasonably strong for the city. Meanwhile, Cluj-Napoca managed to digest its new deliveries quite well, while Iasi has virtually non-existent spaces in current modern office buildings, paving the way for stronger growth.

2019 is busier for these regional submarkets, with around 160,000 sqm in new deliveries (though we might see some pushed back to 2020, as was the case last year). Overall, underlying trends and the low stock relative to Bucharest offer compelling reasons for the longer-term story Romania’s regional cities.

<table>
<thead>
<tr>
<th>Modern office stock (end-2018, sqm)</th>
<th>Office pipeline (2019, sqm)</th>
<th>Vacancy rate (end-2018, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bucharest</td>
<td>2,420,000</td>
<td>360,000</td>
</tr>
<tr>
<td>Cluj-Napoca</td>
<td>229,000</td>
<td>57,000</td>
</tr>
<tr>
<td>Timisoara</td>
<td>182,000</td>
<td>45,000</td>
</tr>
<tr>
<td>Iasi</td>
<td>169,000</td>
<td>38,000</td>
</tr>
<tr>
<td>Brasov</td>
<td>126,000</td>
<td>15,000</td>
</tr>
</tbody>
</table>

Data Source: Colliers International
IS THE REAL ESTATE INDUSTRY READY FOR THE DIGITAL REVOLUTION?

An interesting outcome of EY’s study from late 2017 on the real estate players in US and Europe, revealed that only 55% believe that the digital innovation will have a transformative impact and hence 59% of the companies prefer to wait and then to react (so called fast followers).

Fast forward to 2019, and zooming in at the construction and real estate industry, we see four key elements that disrupt it today:

- The ability to gather feedback on customer experiences and expectations in real time
- Automated and integrated systems driving cost reduction and efficiency opportunities
- Cybersecurity and Data Privacy breach through unexpected and new channels
- Lost market share by simply not reacting quickly enough to the changing environment

To protect against such requirements, the players require to identify and collect data to enable hyperawareness, they require analytics solution to move towards fact based decision making and last but not least, they need to move from concept to operational systems, meaning a fast implementation of systems and processes able to collect and process information.

The study also revealed the top 5 Digital enhanced technologies and products that will add most value to growth:

1. ERP
2. Hand-held technology
3. Cloud solutions
4. BIM
5. Drones
WILL BLOCKCHAIN FULFIL IN 2019 ITS PROMISES?

The hype of Blockchain still reverberates in 2019 and there are interesting potential uses promised for the Real Estate related services. A hot question today is whether Blockchain can improve the way investors acquire real estate.

Looking at the existing Real Estate Purchase & Sale process, it is easy to identify highly complex and time-consuming activities like:

- Inefficient property search process due to fragmented listings data
- Time-consuming, paper-driven due diligence process
- Title and lien recording issues, fraud risk
- Required diligence, cumbersome clearance process causing high costs
- Slow, expensive, opaque financing mechanisms and payments
- High complexity of cross-border transactions

The blockchain promise is to:

- Simplify and strengthen tracking of the provenance of a property
- Reduce channels of corruption in transaction trails through use of digital tokens
- Establish authenticity of the certificates and enabling trust

Some of the earlier adopters of Blockchain have been active in areas like Financial evaluation and Due Dilligence – promised by Chromaway (investigate Smart Contracts and Blockchain for the process of selling a house) or Smart Contracts and Title Register fulfilled by Midasium, creating a global ecosystem for residential and commercial property where transactional and registry functions can be tracked in real-time: Land titles and mortgage registrations, Tenancy and bond arrangements.

WHAT CAN THE REAL ESTATE SERVICE COMPANIES DO TO ATTRACT BETTER, MORE STRATEGIC TENANTS?

A heavily impacted area by technology is the interaction between the building and the tenants – intelligent systems recognizing users’ preferences, learning their patterns and being able to predict and take action to lower the energy consumption, protect the physical user, alert the facility management or security personnel in case of anomalies, help the facility management optimise the activities like replacing soap, emptying trash cans or fix lighting or smell issues)

The Intelligent Building Management Systems have started in the last years to open up to absorb external sets of data, especially user generated, real time data, and have improved, using machine learning algorithms, to predict the next best actions to ensure efficiency and great customer experience.

The proliferation of Internet of Things technologies and sensors have enabled the property development and the real estate offices to offer a much larger palette of services to the tenants, at a greater value without a significant impact on the total cost for the tenants. The tenants in turn have started to be more informed and are demanding better services for their own staff, looking at aspects like employee well-being and keeping them motivated by providing a pleasant workplace.

To summarise, the digital trend has in our opinion already altered significantly the use of real estate, paving the way for better space utilisation, efficiency, flexibility, and qualitative improvements. There is a clear gap of certified personnel in the real estate industry that can assess, certify and design such spaces, which adds further pressure on the real estate providers to come up with innovative yet tangible solutions for their clients.

One thing is clear - technology is here to stay and more importantly, continuously evolve, hence no one can turn a blind eye to upcoming requests like technological outfitting and increased personalised user experience, which are being hailed by the tenants as a significant competitive advantage for their staff.
OVERVIEW

As the Romanian real estate scene is becoming more mature and competitive, so do standards of buildings continue to improve and reach new heights. This leads to both cost savings in the future, as well as improved attractiveness for clients, irrespective of the fact that they might be shoppers in a mall or employees working in an office building. In today’s market, almost every new office building with a decent size seeks a green certification not to differentiate itself (unless it is aiming at top certifications), but because this is the new norm and it would not want to be left out. Furthermore, CSR requirements for domestic foreign-owned companies make choosing a headquarters also dependent on meeting certain requirements for employee health, environment friendliness and resource efficiency. We continue to collaborate with developers/landlords to obtain green certifications, both for BREEAM (Building Research Establishment’s Environmental Assessment Method) and LEED (Leadership in Energy and Environmental Design) standards. 2018 also brought a novelty on the Romanian market: WELL certifications (administered by the same organization behind LEED), which focus more on employee wellbeing, with Colliers helping in obtaining the first such pre-certifications in Romania last year and among the first in this part of Europe.

WELL CERTIFICATIONS

2018 saw the first two pre-certifications for WELL, both for two buildings in Skanska’s Campus 6 office project in Bucharest’s Center-West submarket. This is quite an achievement in itself as, at the start of the year, out of 170 registered projects in Europe, 8 had full certifications and 17 had pre-certifications (including the ones in Romania).

At this point, it is important to note that, besides being a novelty for the market (meaning that developers are not used to its demands), it also comes with fairly tough standards. This means that obtaining such a certification will add that much more value to a project and serve as a strong differentiating factor; in a very competitive labour and office market, this can give an building the slight edge to clinch the deal. Moreover, it can also compensate some shortcomings like the lack of a good location or visibility.

It is important to note that the appeal of WELL is exactly its focus on employees, as it looks at both the visible aspects a project (with various topics related to water, light, air) as well as those that would be encompassed by the idiom “food for thought” (various themes focusing on mind, innovation, with even some requirements targeting HR practices). While it has some overlapping aspects to the “traditional” green certifications, we view it as rather complementary for the latter. Furthermore, WELL also offers the alternative for a certification for the work area/employers that could be attractive for some of the biggest tenants in the office market. Overall, this standard is likely to become in time a major trump card for companies seeking to attract the best talent or for buildings looking for some of the most premium tenants on the market.

GREEN CERTIFICATIONS

After 2017 turned out to be a bumper crop year in terms of certifications (nearly 40 obtained by Romanian real estate projects), 2018 was much quieter, with just 11 new certifications, though with some pre-certifications as well. Overall, this is not necessary disconcerting as we are nearing the end of a cycle (with the 2016-2017 results the highlight of many years of work), while the pipeline is also quite impressive, with around 50 real estate projects that could potentially obtain a green certification in the future. Furthermore, every new average-sized office project, for instance, is seeking a green certification.

**Annual number of green certifications**

<table>
<thead>
<tr>
<th>Year</th>
<th>BREEAM</th>
<th>LEED</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>2012</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2013</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>2014</td>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>2015</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>2016</td>
<td>4</td>
<td>25</td>
</tr>
<tr>
<td>2017</td>
<td>10</td>
<td>29</td>
</tr>
<tr>
<td>2018</td>
<td>6</td>
<td>5</td>
</tr>
</tbody>
</table>

*Data Source: Colliers International*
We also note that we had quite a few novelties last year. 5 projects scored a top LEED Platinum certification versus 3 in total in Romania before 2018; these 5 were, on the office side, the first two buildings in Vastint’s Timpuri Noi Square, Forte Partner’s first phase of The Bridge project and CA Immo’s Orhideea Towers, with the surprise addition of a recreational project to the list – Therme. On the BREEAM scale, there were 5 projects which received an Excellent certification and one Good. So, no new BREEAM Outstanding certifications, but still on the higher end of the ratings scale.

**BREEAM / LEED - quality of certifications**

<table>
<thead>
<tr>
<th>BREEAM Certification</th>
<th>LEED Certification</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outstanding</td>
<td>Platinum</td>
</tr>
<tr>
<td>Excellent</td>
<td>Gold</td>
</tr>
<tr>
<td>Very Good</td>
<td>Silver</td>
</tr>
<tr>
<td>Good</td>
<td>Certified</td>
</tr>
<tr>
<td>Pass</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Data Source: Colliers International

The very good “grades” could be explained by the fact that developers had grown accustomed to what was required of them and market practices had become aligned with the demands; still, from this point forward, with the new (and tougher) LEED standard, it will take some time to reach such a level in the next couple of years. The market is moving in a direction where yesterday’s platinum is today’s gold if a company would employ the same effort and equipment. In the next few years, a “wow factor” will be that much more difficult to reach. Overall, while this might lead to higher development costs (and upward pressures on rents), the quality will ultimately improve as well to the benefit of the clients.

**Green certifications in 2018 by sector**

Just to complete the statistics, most of the certifications were for office buildings (9 in total), with one for a recreational project and one for a residential project in Cluj-Napoca; aside from the latter, there was just one other project outside Bucharest (or in the vicinity) – an office project in Timisoara.

**TAX INCENTIVES**

Besides some advantages that cannot be quantified clearly (like, for instance, an improved appeal to attract and retain tenants for office buildings), there are also more tangible aspects. We mostly refer here to lower taxes (up to 50% lower), offered by local authorities in some instances to green buildings. Cluj-Napoca is continuing its scheme, while Iasi has recently entered the scene and in a first for Romania, it included WELL certifications besides green certifications. At this point, it is uncertain if Timisoara will continue. Another novelty for Romania was the fact that the local authorities from a village just north of Bucharest also offered a reduced tax rate for a green certified residential complex.
INVESTMENT MARKET

Prime yields (2018, %)

<table>
<thead>
<tr>
<th></th>
<th>Bucharest</th>
<th>Warsaw</th>
<th>Budapest</th>
<th>Prague</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office</td>
<td>7.25</td>
<td>4.60</td>
<td>5.75</td>
<td>4.75</td>
</tr>
<tr>
<td>Retail</td>
<td>7.00</td>
<td>4.00</td>
<td>6.00</td>
<td>4.75</td>
</tr>
<tr>
<td>Industrial</td>
<td>8.25</td>
<td>6.50</td>
<td>7.50</td>
<td>5.50</td>
</tr>
</tbody>
</table>

Data Source: Colliers International

Last year was another exceptional one for the investment scene in the CEE-6 countries (Visegrad countries plus Romania and Bulgaria), with volumes climbing some 5% to hit a new record of EUR13.8bn. This means that turnover has almost doubled since 2014 as investors took notice of the dynamic economies in eastern Europe. Poland was the star of the show, accounting for around half of total volumes.

In the CEE markets, offices took center stage with 40.6% of overall volumes, followed by retail (33.3%) and industrial (20.3%). Yields continued to move south in all major countries (including Romania), though dips were more significant in the other CEE countries. Prague and Warsaw continue to be seen as the safer bets, with Bucharest as the riskier, but potentially more rewarding alternative in the long run.

ROMANIA INVESTMENT MARKET

OVERVIEW

Romania’s economic growth continued to deliver solid results and despite rising domestic risks, there is still lots of room to grow. Romanian assets retain an attractive yield spread compared to neighbouring peers and well-developed markets despite the fact that the country has been the outlier in the CEE in recent years in terms of economic activity dynamics.

The total transactional value neared EUR950mn, a meagre dip compared to 2017 and not too far below our call for a EUR1bn. The year had the potential to be something even greater and possibly set a new post-crisis high, as several large deals remained stuck in negotiation phase a bit longer. That said, we did record some of the largest deals ever (two would make it into all-time top 10), while at the same time, domestic capital increased more than fivefold versus 2017, accounting for one fifth of total volumes, not too far behind South African capital. The latter aspect is especially positive as the reduced presence of Romanian money on the real estate market was sometimes criticized by foreign investors in the past; at the same time, this highlights a growing maturity in the Romanian economy overall.

The most notable entries on the real estate scene were those of the investment arm of Romanian-owned DIY chain Dedeman and South African backed Lion’s Head Investments, while other players that have been active in recent years continued to snatch up properties (Prime Kapital/MAS REI, Cerberus Capital Management). Also, the second biggest player on the industrial scene (WDP) made an entry on the investment market by concluding several deals in 2018. Amid favourable outlook and yield differential compared to CEE peers, we saw continuous interest from foreign investors looking at Romanian assets.

TRANSACTIONS AND INVESTORS

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the deals were reported in the region of EUR200mn and EUR175mn respectively. The actual paid amount – what we took into account – was smaller, but still well above EUR100mn in both instances, as figures previously mentioned included in both cases a third building not included in the initial deal (depending on technical indicators like pre-leases ratios, it would be concluded at a later date). A different reference deal for the office market was the purchase of Skanska’s Campus 6 (first phase) by CA Immo. Another noteworthy deal was the sale of Romanian-owned Maestro Business Center in Cluj-Napoca to First Property Group; this marks one of the few examples of an institutional (and listed) investor moving outside Bucharest for office assets. Overall, it was a bumper crop year for the office deals in 2018, which generated close to 55% of total turnover in 2018 despite the fact that several large deals saw their negotiation phases extended into 2019.

The retail segment was a distant second, but still accounted for a significant 34% of total investment volumes. The biggest ticket, estimated at well over EUR100mn, was generated late in the year, when Sonae Sierra bought-out their partner (50%) at the ParkLake Shopping Center in Bucharest. Another large deal saw the Prime Kapital/MAS REI buy the Militari Shopping Center in the Capital for EUR95mn.

Hotels and industrial saw some smaller deals than in previous years, but some large assets were on the market in 2018. For industrial, while very big-ticket items lacked (the two biggest deals were in the EUR20mn area each), it is important to note that the sizeable deals that we took note of were closed by WDP, the second biggest player in the warehouse market.

Bucharest returned to the forefront of demand, as assets in the Capital accounted for almost 82% of volumes compared to 37% in 2017. This is largely due to the prevalence of office transactions during last year and given the way the pipeline looks for 2019, it is likely that Bucharest will continue to weigh the most.

### PRICING

For prime office projects, yields settled around 7.25% (which is still some 25bp lower compared to the first half of 2017), a level confirmed by the benchmark trades in Bucharest. Consequently, domestic yields remain well above pre-crisis lows, whereas in other major CEE economies, the levels moved even farther below said-levels in 2018. For industrial assets, despite the lack of prime assets exchanging hands, we believe that yields continued moving south and a potential trade would see a level around 8.25% currently. For prime retail assets, we see the yield roughly flat around 7%.

Very slow march south for prime office yields in Romania

![Diagram showing office yields in Romania from 2007 to 2018](Diagram)

Source: Colliers International

Funding options for real estate deals remain fairly varied, with central bank’s survey’s showing a favourable risk perception of the real estate segment from domestic banks. That said, such surveys came before the government decided late 2018 to slap a significant tax on banks’ assets (with its level tied to money market rates); based on reactions from lenders and the central bank, this will likely lead to both tighter standards at higher costs, as well as less appetite for handing out loans in general.

### FORECAST

Under normal conditions, Romania’s dynamic economy in recent years coupled with the juicy yield differential compared to products in neighbouring CEE countries (which, incidentally, saw slower GDP growth rates than Romania) would support a rosy outlook for the real estate investment scene. And we retain a moderately optimistic outlook as we believe that the positives still weigh more than the negatives, particularly if we take stock of the long-term perspective.

The current pipeline for real estate transactions looks good, with investors continuing to show healthy interest for products currently on the market. We also expect to see appetite from investors not currently present or active on the domestic market (including some of the biggest names globally). All this leads us to expect total volumes of at least EUR1bn in 2019, with offices set to remain the star with a pipeline of at least EUR0.5bn – there is potential for much more than this if all stars align. However, there are some threats on the horizon. Besides the worsening macroeconomic picture and fresh uncertainties (both domestic and external), the biggest potential threat we see for the investment scene comes from the bank tax, in our opinion. This has the potential to reduce bank appetite for real estate products, though at the start of the year, at least, our experience with banks suggest business as usual for now. We expect prime assets to fare best in this environment, seeing good demand from lenders.

The positives would normally support yields trending a bit lower in 2019, particularly as Romania still boasts some of the best growth perspectives in Europe and prices remain attractive compared to pre-crisis levels. That said, some of the other aspects (particularly the levy on bank assets) make us feel products might trade in 2019 at similar yields to 2018.
DEMAND

To start off, 2018 was the best year for the land market in the post-crisis period and this is largely the result of the residential segment, which has also seen its best results in a decade. Overall, we estimate the total market volumes of land for real estate projects (excluding industrial) at over EUR400mn, an increase of around 17% compared to 2017 and nearly 50% versus 2016. This jump was caused both by an increase in actual large-scale deals as well as prices moving higher for good land plots. Further underscoring the fact that 2018 was the best year this economic cycle, besides the deals closed last year, land plots secured last year add up to over EUR200mn (these could be closed in 2019).

It is noteworthy that Bucharest generated around 70% of turnover in 2018 similar to the previous year. In Bucharest, residential made up of around half of turnover, office – 35-40% and retail – 15%; these percentages are estimates, as it is difficult to assess the shares in large mixed-use projects. Nationwide, residential and retail were the stars, both with equal shares of around 40-45% and the rest for office developments. It is worth noting the increase of the residential segment outside Bucharest, mostly in the very active regional economies, which previously saw positive developments on the office segment.

For the first time ever, residential deals took center stage nationwide. As real estate developers tend to be quite reactive rather than proactive (i.e. follow trends rather than lead them), this is justified by the surge in both purchasing power and housing sales in recent years. The trend of residential following office developers was intact, as significant deals were closed in the active business areas of Bucharest: Floreasca-Barbu Vacarescu and Center-West. In other parts of the country, residential developers generated quite a lot of interest in cities where the office segment is bustling with activity (like Cluj-Napoca, Timisoara or Iasi).

Retail saw a slight slowdown in interest from both retailers and developers as they reached an adequate coverage of regional towns in Romania as well as secured a solid land bank; the pipeline for modern retail projects is more than double for 2019-2020 compared to 2017-2018 period.

For office, demand has been off the chart in recent years and 2018 was no exception, with both traditional and newer names present on this scene (like Speedwell or One United for the latter). Due to the higher prices amid elevated interest for the good plots, negotiation between owners and developers have been extended in many instances and these deals could close this year or even in 2020.

SUPPLY

The market benefited from adequate supply throughout 2018; portfolios like Telekom’s or Immofinanz’s (Adama) were well digested by the market. Furthermore, though large non-performing loan portfolios are no longer the norm, local banks remained an important player on the sell-side in 2018 as they continued to clean up their balance sheets. Other investors that held onto their plots for a longer time, either small owners or those with portfolios, are seeing this as a good moment for an exit. Furthermore, there are some instances where landowners had considered developing, but after receiving aggressive offers and considering the risk-reward balance of a new development cycle, they decided to sell. Former factories in urban setting remain an attractive option both in Bucharest and regional towns, especially now that the real estate

Land market sales in 2018

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market has matured enough to absorb big retail schemes or mixed-use projects (especially residential + office). Amid an increasing shortage of available land in certain areas suitable for office and retail projects, we are also seeing more transactions without zoning documents in place; at the same time, price discounts compared to similar plots with all permits are not as deep as they were in the past, except for residential destination, where the situation is largely unchanged.

**PRICES AND TRANSACTIONS**

The minor uptrend in prices that began in 2015 continued in the subsequent years and 2018 followed in the same vein. We estimate that prices increased, on average, some 10-15% last year amid a battle for very good locations for retail and office projects. That said, these increases were not at all generalized, as there were areas where prices remained more or less flat, whereas in certain battleground submarkets, prices saw increases of 20-30%.

Overall, the underlying market perception is that last year was similar to 2017, though based on Colliers estimates, overall market turnover for real estate projects (retail, office, residential, excluding industrial) expanded some 17% over 2017’s EUR350mn, setting a new post-crisis record. With very limited exceptions, the big deals remained in Bucharest. The 5 biggest land sales in the Capital topped EUR100mn.

**FORECAST**

After 2-3 very active years for land sales which helped developers acquire a significant land bank, we expect new demand to cool down a bit on all segments. It is noteworthy to underscore that we are talking about new demand, as several big deals are currently in various stages of negotiations and could close in 2019; this means that this year may very well turn out to be another excellent year in terms of overall market volume. Over the medium term, our baseline scenario is for a gradual decline in market volumes compared to 2017-2018’s post-crisis highs, not a boom-bust type scenario, as prices remain at least 2 times smaller than in the 2007-2008 period in a lot of instances.

Furthermore, while taking into account the normalization of GDP activity (with risks clearly skewed to the downside) and growing talk of woes in the global economy, there seems to be limited room for further increases in land price. All in all, we are heading for a stable market, though a lot depends on the outcome of several variables.

A major unknown is related to the residential segment, where several factors have piled up and look set to lead to unchanged apartment prices in 2019, in an optimistic scenario; a decline that could erase 2018’s gains looks possible. These factors include: tighter monetary policy over the last year and a half, a new indebtedness limit relative to earnings (below market averages) for individuals seeking bank loans, a new levy imposed by the government on bank assets likely to lead to higher bank margins, a decline in consumer confidence. On the supply side, we note the hefty deliveries in the last years. Still, for investors with a longer term view, there is still value in the residential market, particularly near office hubs, while the extended reduced VAT rate of 5% for residential purchases should offer developers and buyers some support. Furthermore, as the market might close effectively for some potential buyers amid changes pursued by the central bank, the rental market might slowly start to look like a viable investment alternative.

We also expect to see regional cities weigh more in terms of overall market volumes, so that this 70-30 percent split in favour of Bucharest will become more balanced; of course, there are some major deals that might close in the Capital and these may very well keep this balance skewed in 2019.

<table>
<thead>
<tr>
<th>Land prices intervals for the major cities in Romania (EUR/sqm)</th>
<th>Central</th>
<th>Semi-central</th>
<th>Periphery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bucharest</td>
<td>1,000-3,000</td>
<td>250-1,000</td>
<td>100-400</td>
</tr>
<tr>
<td>Cluj-Napoca, Timisoara, Iasi, Brasov</td>
<td>500-1,000</td>
<td>250-500</td>
<td>100-300</td>
</tr>
<tr>
<td>200-300k</td>
<td>300-800</td>
<td>150-300</td>
<td>50-200</td>
</tr>
<tr>
<td>100-200k</td>
<td>200-500</td>
<td>100-200</td>
<td>50-150</td>
</tr>
<tr>
<td>50-100k</td>
<td>150-300</td>
<td>100-200</td>
<td>30-100</td>
</tr>
</tbody>
</table>

Price intervals are indicative and are based on Colliers’ transactions and/or market expertise. They highlight the most targeted type of land plots. As usual, the prices are influenced by size, destination, building parameters, status of the permitting process.

Source: Colliers International
MARKET OVERVIEW

The hotel markets in Romania and Bucharest especially continue to improve amid favourable macro trends. We still see most of the market generated by business travellers, though the leisure component has been rising quite fast in recent years; meanwhile, guests for meetings, incentives, conferences and events (or MICE) are still fairly few in numbers, though this category is on the rise as well. In 2018, the growth rate of the total number of foreign tourists slowed down to around 2% after c.10% in the previous year. Last year, the number of foreign tourists was around 2.8 million (estimated), with neighbouring Hungary and Poland attracting over 2 times more foreign visitors and Czechia, nearly four times more. That said, with Bucharest ranked as one of the fastest-growing metropolitan regions in Europe in terms of number of nights spent in the post-crisis period and the country frequently popping up on lists of touristic destinations flying under the radar, it is only a matter of time until the tourism industry takes off, as Romania definitely has a lot to offer. For the moment, with an average duration of stay of around 2 nights per foreign tourist, Bucharest looks very much dominated by business trips.

The average occupancy for hotels in Romania increased to the best level in the post-crisis period (over 39% for 2018 compared to 37% in previous years and well higher than the 31-32% lows during the recession phase of the economy). Though this is several percentage points below the 2007-2008 high, it is worth mentioning that the hospitality industry has developed greatly both quantitatively and qualitatively in the last decade. Otherwise, while the tourism industry growth rate levelled off on many components in 2018, this is coming after a few years of explosive growth. The best measure of this is the fact that airport traffic, a proxy for business/leisure tourism and economic activity in general, has increased on an unprecedented scale, putting some of Romania’s airports among the fastest growing in the EU in their respective size categories. Yes, airport traffic is climbing from low levels compared to CEE peers, but the gap has been reduced significantly in the last decade.

SUPPLY

When looking at Bucharest, the most developed market in Romania, last year saw some deliveries, like Ibis Styles Erbas or Hilton’s Garden Inn (with the latter just at the turn of year); the short-term pipeline looks even more interesting – more on this subsequently. Overall, there are a bit over 10,000 hotel rooms in Romania’s Capital spread among over 130 units, with additional lodging resources in the vicinity of the city or other schemes like aparthotels. Such a stock is, on a per capita basis, well behind other big CEE cities.

We analysed the biggest international chains present in Bucharest, which make up more than 40% of the Bucharest market. The biggest, by far are AccorHotels, with 5 brands present in Bucharest (1,165 rooms in total), and Wyndham Hotels in second place (1 brand spread among 4 properties, 921 rooms). Radisson Hotel Group (764 rooms) and Marriott International (672 rooms) both have two brands present here and display somewhat similar capacities. Hilton Hotels (3 brands, 561 rooms) and InterContinental Hotels (1 brand, 257 rooms) round up the list. We would also mention here Phoenicia, a Romanian-owned chain which has a fairly large market share (over 500 rooms) and has been fairly active in the recent period as well.

Overall, despite growing steadily in recent years, Romania and even its most developed submarket (Bucharest) still display a lot of room to grow over the medium to longer term. On a relative basis (per capita), Bucharest’s 10,000 hotel rooms are nearly half compared to Budapest and several times below Prague.

DEMAND AND PRICES

Bucharest’s hospitality industry has been booming in recent years and recorded some of the most robust growth rates in Europe in the recovery phases of the crisis. 2018 saw a bit of a cooldown after such excellent results, with the full year occupancy rate moving a bit south for a blended average of 4- and 5-star establishments, from 74% to almost 73%.

Meanwhile, the ADR moved a bit higher last year, though this time, the increase was in single-digit territory (under 5% versus well over 10% in 2017). Romania’s ADR for a true 4-star establishment stood at around 78 EUR/night last year, marginally more than Warsaw’s 75 EUR/night, but well below the more established tourist destinations in the CEE region: Vienna – 97 EUR/night, Prague – 88 EUR/night and Budapest – 84 EUR/night.
FORECAST

It is important to note that growth rate for new establishments (quite a lot being constructed from the ground up, not just renovated buildings) in 2019-2020 will be at an unprecedented scale. The international hotel chains we mentioned previously will add around 1,500 new rooms, an increase of the overall stock in Bucharest of well over 10%. Most of the new additions will focus on central areas, but also in the vicinity of office hubs (including the fast-growing Center-West and Floreasca-Barbu Vacarescu); two new projects near the airport from AccorHotels and Hilton are also worth mentioning.

Marriott International will be the most active, adding around 590 rooms through 3 different new brands for the local market (Courtyard, Moxy and Autograph Collection). AccorHotels will add around 440 rooms in the next two years with several hotels, while Hilton add with nearly 220 new rooms with one single project. This year will also bring a new brand from InterContinental – Indigo, a boutique hotel with around 100 rooms. A new entry (on the luxury segment) will be the one of Corinthia Hotels International, which will add Grand Hotel du Boulevard (50 rooms) to its portfolio. The Romanian owned Phoenicia hotel chains, which already owned over 500 rooms in Bucharest in 2018, added Lido to the market early 2019, with another 115 rooms. Furthermore, the month of September will also be quite busy for hotels, as one of the country’s major cultural events - the George Enescu International Festival - will take place. Still, going forward, it might take some time for the new supply to be digested and this might, under normal circumstances, exert some downward pressures on ADR rates. Still, there are some objective reasons that would cause ADR rates to increase by at least 5-10%; 1) the rapid rise of minimum wages in the last years (with lots of personnel in the HoReCa industry paid at or around this level); 2) the rise in utility costs; 3) general pressures on wages due to labour shortages and increased reliance on “imported” workforce; 4) significant rise in construction costs (impacting hotels in construction).

Overall, we continue to expect further growth on all segments, mostly business and leisure, both in Bucharest and in major economic hubs in other parts of the country (like Cluj-Napoca, Timisoara or Iasi). Timisoara, for instance, will also be the Cultural Capital of Europe in 2021, which will lead to the city receiving a huge inflow of foreign tourists. Otherwise, we note that regional cites are becoming more interesting and though markets are well smaller than Bucharest, each year, more and more hotels are becoming affiliated with international chains.

Passenger traffic on Romania’s major international airports (million)

The hotel market continues to mostly consist of individual investors (both local or foreign), but we are seeing some interest from institutional investors. The 2017 purchase of Radisson Blu Hotel in Bucharest by the Cerberus / Revetas partnership is emblematic, but there are also investors like the Lithuanian fund Apex, which owns several properties and continues to expand. This rise in institutional investors does highlight that the market is entering in a new, more mature, phase.

Demand should be good for now, especially as Romania is host to the rotating presidency of the Council of the European Union in the first semester of 2019 (set to add an estimated 50,000 nights spent in Bucharest hotels). Furthermore, the month of September will also be quite busy for hotels, as one of the country’s major cultural events - the George Enescu International Festival - will take place. Still, going forward, it might take some time for the new supply to be digested and this might, under normal circumstances, exert some downward pressures on ADR rates. Still, there are some objective reasons that would cause ADR rates to increase by at least 5-10%; 1) the rapid rise of minimum wages in the last years (with lots of personnel in the HoReCa industry paid at or around this level); 2) the rise in utility costs; 3) general pressures on wages due to labour shortages and increased reliance on “imported” workforce; 4) significant rise in construction costs (impacting hotels in construction).

Overall, this means a foggy (and more challenging) outlook for the hotel industry, particularly after 2020 and if the global economy stalls.
Office leases have become more or less standardised in Romania (to the delight of both tenants and landlords): “Western-style” lease agreements are widely used and, coupled with Romania’s Civil Code, grant sufficient certainty to the parties to a lease agreement as to what should happen in the event of any dispute. In the past, however, such lease agreements have typically ended up in the proverbial desk drawer, and no one would look at them until trouble arose.

As lawyers involved in numerous property transactions and financings, we see an increase in the review of such leases and in the pressure on landlords to change some aspects of their practice to accommodate the concerns of both banks and property buyers. Below are some of the trends that we are seeing in the context of negotiating office leases that tenants should be aware of.

**PARTY ALLOCATION OF PERMIT COMPLIANCE: INCREASED LANDLORD MONITORING**

In the past, the allocation of permit compliance in lease agreements was straightforward: a clause would be added that both the landlord and tenant would be responsible for each of its permits, and that would be the end of the story for the duration of the lease.

In our experience, this is no longer the case: landlords now require in detail what permits must be obtained by the tenant and will insist on evidence of compliance. With the increased vigilance surrounding fire permit compliance, for example, agreements now are clear that the landlord would commonly be responsible for obtaining the fire safety permit for the building (open-space), while the tenant would be responsible for resuming the fire safety authorisation process following the implementation of its fit-out. Other specific permits related to the operation of the tenant, e.g., food safety authorisation for restaurants, etc., may also be mentioned in the lease agreement.

A landlord will then require evidence of such compliance and will likely insert a specific termination right for failure to comply, and even a right of recourse against the tenant in case it suffers any damages as a result of tenant non-compliance, e.g., with fire safety obligations. Landlords will seek to place the blame on banks and even on potential purchasers of office buildings: both require evidence of compliance as part of borrower covenant and due diligence procedures, respectively. Thus, tenants should no longer expect a “laissez-faire” approach by landlords in this respect.

The allocation of fire permit compliance obligations has gone beyond actual fire permits and, in a more comprehensive approach, now covers a wide variety of fire safety-related obligations, such as the setting up of private service providers to handle emergency situations, etc.
EXCLUSIVITY CLAUSES: LEGAL RESTRICTIONS

Exclusivity clauses are also getting more attention nowadays, as major tenants tend to request that landlords not rent premises in the same building to their direct competitors. Such clauses have a double limitation: from a legal perspective, the prohibition must be limited to five years; from a negotiation perspective, landlords usually request that direct competitors be expressly listed in the lease so as to avoid a potentially unreasonable market restriction in terms of whom they can lease to.

Such exclusivity clauses frequently raise concerns from a competition law point of view, as non-compliance might lead to the exclusivity clause being annulled and considerable administrative fines of up to 10% of the party’s annual turnover (at least in theory).

REGISTRATION OF LEASES WITH THE TAX AUTHORITIES

Although the registration of leases with the tax authorities is not mandatory and landlords would often not do it, as part of a due diligence exercise and bank financing, it is often required that all lease agreements be registered with the tax authorities. This is because of the expedited enforcement procedure that would apply for the recovery of any unpaid rent and for the retaking of the premises upon expiry of the lease term performed through a bailiff and with minimum court involvement.

Tenants should be aware of the fast-track enforcement of a lease and avoid leaving non-performances to pile up and not responding to landlord requests for a specific performance, as such non-compliances might eventually lead to enforcement procedures being taken against them, including having their accounts frozen.

HANDOVER CONDITION

Whether a tenant contemplates to relocate its business or to extend an existing lease, the main matter of concern for the tenant is to have premises suitable to the particularities of its activities. That is why what happens in the unlikely event that the premises do not meet tenant’s expectations is essential and the lease should contain language to address any such outcome, such as the right to refuse the takeover of the premises in case of major defects and non-compliance with the tenant’s required technical specifications, or even the right to step-out of the lease if the premises are not brought to an adequate state in a specific period of time.

Tenants should also pay attention to the base specifications of the premises and the manner in which the fit-out budget allocated by the landlord as an incentive for the conclusion of the lease can be spent, as any misunderstanding may lead to unanticipated costs in tenant fit-out. The fit-out budget is commonly granted for expenditures related to fixed items that increase the overall value of the building and remain at the premises and may not extend to furniture or other such movable assets.

BUSINESS INTERRUPTION

One of any prospective tenant’s main objectives when negotiating a lease is to ensure the unhindered and continuous use of the premises, as any inability to use the premises may trigger a substantial disruption of the tenant’s business leading to a significant loss of revenue. Such disruption of a tenant’s business may be caused by the need to carry-out major repairs to the premises, an interruption in the supply of essential utilities, or otherwise, determined by reasons either under or outside the control of the landlord. It is important for the lease to provide a mechanism for such situations in order to avoid getting stuck in a lease for premises that are ultimately unusable by the tenant.

The tenant’s best scenario is that the lease expressly provides for the tenant’s rights and remedies in such situations and the conditions under which they apply. For example, an exemption from payment of rent after a specific period of time (grace period) and the landlord’s obligation to ensure the tenant’s relocation to the building and / or the right to terminate the lease in case the interruption lasts for a longer period of time and affects a substantial portion (percentage) of the leased premises. In our experience, landlords generally take all steps necessary to reduce to the minimum any business interruption in order to ensure the continuity of the lease.

TERMINATION

Termination clauses are perhaps the most sensitive and heavily negotiated provisions of a commercial lease. Landlords aim at limiting as much as possible and even excluding tenant termination rights in order to ensure an unbreakable lease that is easily bankable. In turn, tenants seek to ensure that they have a way out in case certain expectations are not met and to limit their liability towards the landlord in case of an earlier termination of the lease. Break options (the right to unilaterally terminate the lease without cause) are widely unacceptable to landlords, especially in case of shorter lease agreements (3 to 5 years). Even if accepted, a break option would usually impact the level of incentives granted by a landlord for the conclusion of a lease agreement.

A particularly important aspect to pay attention to is what happens in case of termination of the lease by reason of tenant default. The most difficult aspect of this has proven to be agreeing on the penalty to be paid by the tenant in case of the early termination of the lease agreement by the landlord due to tenant default. While landlords seek to obtain rent for the entire term of the lease, tenants prefer to limit the penalty to a specific amount or to the rent payable until another suitable tenant is found. Less attention is given to the penalty that would be owed by a landlord in case of an early termination of the lease due to landlord default, as such are not usually regulated in an express manner in lease agreements.

The above are just a handful of the various clauses that require negotiation before signing office lease agreements in Romania, and the entire lease agreement should be scrutinised and adapted to the particularities of each tenant.
CORPORATE INCOME TAX ASPECTS

DEDUCTIBILITY OF FINANCING COSTS

A corporate income taxpayer’s exceeding borrowing costs (i.e. the amount by which deductible borrowing costs exceed taxable interest revenues) in relation to various types of financing (including e.g. bank loans) may be deducted for corporate income tax purposes up to 30% of the company’s EBITDA, adjusted for tax purposes.

This EBITDA limitation will be applied to those exceeding borrowing costs which are above an annual threshold of EUR 1,000,000 (i.e. the first EUR 1,000,000 would not be subject to the limitation).

The investors should consider that unlike under the interest deductibility restrictions until 31 December 2017, the interest related to bank loans is now included and subject to the same rules mentioned above.

N.B: For computing the corporate income tax for 2018, the thresholds to be considered are 10% and EUR 200,000.

MICRO-ENTERPRISE TAX REGIME

Any company with a turnover below EUR 1,000,000 / year has the obligation to declare and pay micro-enterprise tax instead of corporate income tax. The tax is 1% or 3% depending on whether the respective company has employees, applied to the turnover.

During the period in which this mandatory regime is applied, the tax loss is not taken into account nor can be used to offset future profits. In other words, newly set-up companies during the investment phase (when usually the turnover is below EUR 1,000,000) or operating companies with a small turnover, will not benefit from the tax loss generated by the expenses incurred.

Nevertheless, a company with a turnover below EUR 1,000,000 may still opt to apply for corporate income tax regime, only once, as long as it has at least RON 45,000 as subscribed share capital and at least 2 employees.

RENTAL INCOME

Rental income is included in the taxable profits of the companies and subject to a flat 16% corporate income tax.

DIVIDEND INCOME

Distribution of net profits is taxed with a 5% dividend tax. This rate could be reduced based on tax treaties or EU Parent-Subsidiary Directive. The quarterly distribution of dividends is also possible, under certain conditions.

CAPITAL GAINS

Capital gains obtained by Romanian companies from disposal of Romanian real estate properties are subject to a 16% profits tax rate. As an alternative, the shareholders of a Romanian company can opt to sell the shares of the company. In this case, they are liable to the 16% income tax applied to the capital gain obtained through the company sale. In certain situations (i.e. participation exemption regime or tax treaties), sale of shares held in Romanian companies may be exempt from tax in Romania.

INDIVIDUAL TAX ASPECTS

RENTAL INCOME

The tax rate stays at 10%.

The effective tax rate could be lower as the taxable income is determined either by (i) deducting 40% from gross income or (ii) single-entry bookkeeping or (iii) income quota.

Health fund charges of 10% are due only if taxpayers estimate to obtain in 2019 rental income (or other types of income, except for salary) above 12 national minimum wages. In 2019, health fund charges, if due, are capped at RON 2,496 annually.

Estimated income should be reported by 15 March 2019 for both income tax and health fund purposes. Annual reconciliation is due by 15 March 2020, when tax and health fund liabilities should also be settled.

REAL ESTATE TRANSACTIONS

Real estate tax, due by taxpayers on transfer of property right or its divisions over buildings and land, or land without constructions, stays as the same rate as in 2018:

- tax exemption for a sale amount up to RON 450,000
- 3% income tax applicable to what exceeds RON 450,000
No health fund charges are due in this situation. Normally, tax reporting and payments are made by Public Notary Offices.

Individuals who undertake real estate transactions for commercial purposes should register with Romanian Trade Registry, either as freelancers or legal entities. If the activity is performed via a freelancer structure, individual’s obligations are: 10% flat tax rate plus 10% health fund charges (levied similar to rental income).

DIVIDEND INCOME

The tax rate on dividend distributed to individual shareholders is 5%. The rate could be reduced under a double tax treaty. Health fund charges are due similar to rental income. Estimated 2019 income should be reported by 15 March 2019 for health fund purposes. A final annual tax return for 2019 is due by 15 March 2020, when tax and health fund liabilities should also be settled.

CAPITAL GAINS FROM DISPOSAL OF SHARES

10% flat tax rate is payable on the net capital gain from sale of shares. Health fund charges are due similar to rental income.

Estimated 2019 income should be reported by 15 March 2019 for health fund purposes. A final annual tax return for 2019 is due by 15 March 2020, when tax and health fund liabilities should also be settled.

VAT ASPECTS

Rental of real estate property is, as a rule, VAT exempt without deduction right. Taxable persons have the option to charge 19% VAT on rental of real estate (enjoying deduction right).

The sale of old buildings/parts of buildings, the underlyng land, and non-building land is VAT exempt without deduction right, with an option to charge VAT. This VAT exemption is not applicable for the sale of a new building or building land. Special rules are applicable for buildings and land registered under one single cadastral number.

A reduced 5% VAT rate is applicable for the sale of social houses (including related land) under certain conditions (i.e., maximum surface of 120 square meters and price up to RON 450,000 – net of VAT). Individuals trading in real estate as a business could be liable to VAT register, if the volume of their transactions exceeds RON 300,000.

The VAT split payment mechanism was introduced in 2018 and involves special bank accounts for transfer of VAT. A tax rebate of 5% of the profit tax / income of micro-enterprises is available to taxpayers who choose to apply the VAT split payment mechanism. The VAT split payment mechanism was not approved by the EU Commission, but so far, no changes were announced by the Romanian tax authorities.

OTHER VAT RELATED ASPECTS:

• The taxable supplies of real estate (land and building) between two VAT registered taxable persons are subject to reverse charge.
• The VAT adjustments can be performed for yearly, instead of one-off (exceptions apply).
• Mergers and spin offs are by default out of scope of VAT.
• VAT Group rules are available.

LOCAL TAXES AND STAMP DUTY ASPECTS

The local tax for non-residential buildings due by companies ranges between 0.2% and 1.3% applicable to the taxable value (for building tax purposes) of the building as at 31 December 2018. The local council may increase this tax with up to 50% of the normal rate. Moreover, a higher building tax rate of 5% is applicable for buildings which are not revalued for more than 3 years.

The land tax is established by taking into account the number of square meters of land, the rank of the locality where the respective land is situated, as well as the area and/or the category of use of the respective land, as established by the local council.

In case of a sale of a building or land, normally, the related building or land tax for the year the transfer is taking place would be due by the owner, while the beneficiary would only be liable starting with 1 January of the next year.

Additionally, there are certain cases when judicial stamp duties apply (e.g., in court, etc.). In the case of real estate transactions, notary and Real Estate Register fees apply (in total approximately 1%, depending on transaction value).

IFRS 16

As a consequence of IFRS 16, effective as of 1 January 2019, real estate entities that prepare financial statements in accordance with IFRS will need to change certain lease accounting practices when implementing this new IFRS standard. IFRS 16 provides for the real estate tenants to recognize most leases (i.e. rental contracts) on their balance sheets as lease liabilities with corresponding right-of-use-assets. The profit and loss recognition pattern will change as only interest and depreciation expense will be recognized (similar to IAS 17 finance lease accounting) as opposed to the rules in force until 31 December 2018 when the value of the rental expense was recorded in the profit and loss statement.

As an exception, tenants can make an accounting policy election, by class of underlying asset to which the right of use relates, to apply accounting similar to IAS 17’s operating lease accounting for the ‘short-term’ leases (i.e. rental agreement with a period no longer than 12 months). For tenants, recognizing lease-related assets and liabilities could have significant financial reporting and business implications (e.g., decisions about whether to lease or buy property might change). Tenants may seek more flexible lease terms to manage the impact on their balance sheets and their financial statement ratios.

Landlord accounting is substantially unchanged from current accounting. As with IAS 17 Leases, IFRS 16 requires landlords to classify their rental contracts into two types, finance and operating leases.
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