Knight Frank

WOLF THEISS

Romania Market Overview

Real Estate Highlights
H1 2020

Foreword

Horatiu Florescu
Chairman & CEO
Knight Frank Romania & Hungary

It is clear that COVID-19 has forced employees from most companies to work remotely from home for a few months, both on the local market as well as in other CEE office markets. Many leasing requirements have been postponed or slowed down given the uncertainty associated with the medical crisis and its impact on the companies' business, as you will see outlined in this research report.

Some of the companies have returned at their offices since the end of the lockdown in the second half of May, with employees coming mainly through rotation (e.g. every other day/ week). Re-occupancy is in focus and will be so throughout the year. The necessary requirement to respect social distancing measures – and a 2m distance between individuals – is forcing the reconfiguration of office layouts. It is estimated that up to ~25% of the employees have returned so far at the office in Bucharest, for example. Their number is expected to increase notably in September/October, once the summer and holidays are over. A full return at the office depends on the evolution of the pandemic during the autumn.

However, the office is central to the creation and maintenance of a corporate culture. It stays as the central space for the innovation and creativity required to stay competitive.

Many surveys have been conducted with regards to the options employees prefer: office vs home and most conclusions incline towards a balance of those two, depending on the industry, number of employees, scope of work etc.

There is life in the office, yet and we are much looking forward to shape the future together.

Bryan W. Jardine
Managing Partner
Wolf Theiss Bucharest Office

The impact of COVID-19 on the business environment promises to be far reaching and profound.

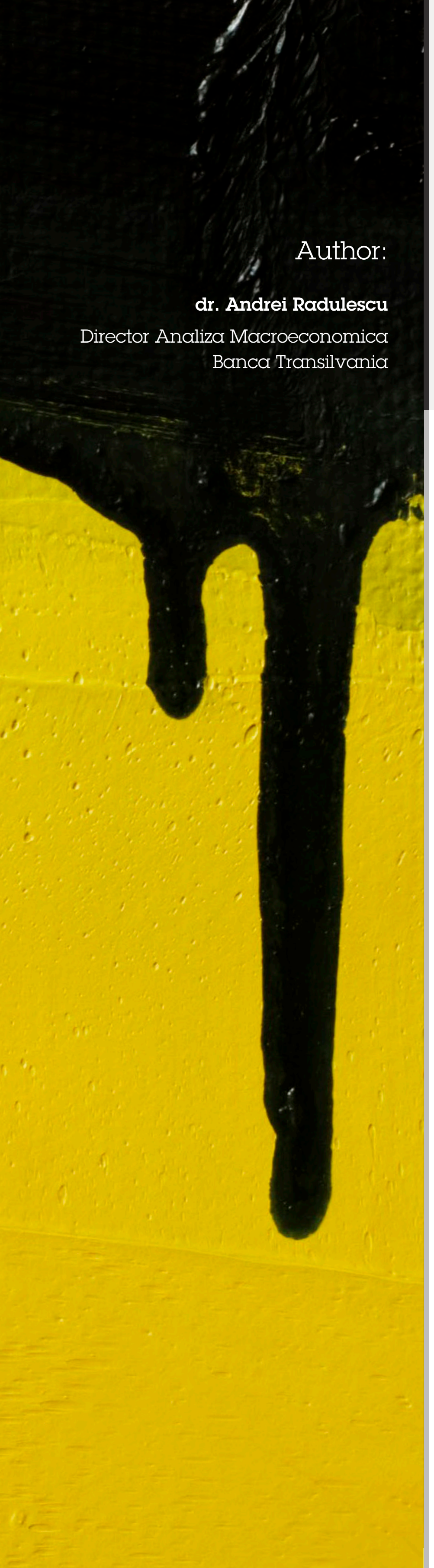
The need for home office, compelled by the lockdown of economies implemented by governments around the world in the spring of 2020, has required companies to implement innovative home office solutions, centered primarily around teleconferencing facilities and communications.

This necessary adaption has now caused certain companies to reassess their fundamental need for "bricks and mortar" office facilities. In particular those service providers which may not require daily face-to-face communications with their clients and customers seem to have fared better through the COVID crisis than industries which necessarily must directly interface with their client base (e.g. hospitality, hotels, restaurants, travel).

This reassessment of office needs and priorities will likely dramatically impact the demand for office space in the medium to long term. Even those companies which determine that they must still have physical office space will reconsider prior trends towards "open space" offices in favor of more traditional yet "socially distanced" ans safer (in a COVID context) private offices.

How this trend towards home office and away from open space offices will develop largely depends on the flexibility of landlords and tenants to work together to find workable solutions in their existing lease agreements. In the following pages, Wolf Theiss senior counsel Flaviu Nanu and I will assess the "lessons learned" over the last months of the crisis and specifically consider how future office leases may be negotiated and adapted by landlords and tenants in the context of a post-COVID Romanian real estate market.

Content



Author:

dr. Andrei Radulescu
Director Analiza Macroeconomica
Banca Transilvania

The worst has passed:
Romanian economy at the beginning of the post-pandemic cycle

The first half of 2020 was dominated by the incidence of the pandemic and the consequences of this unprecedented shock in the post-War history.

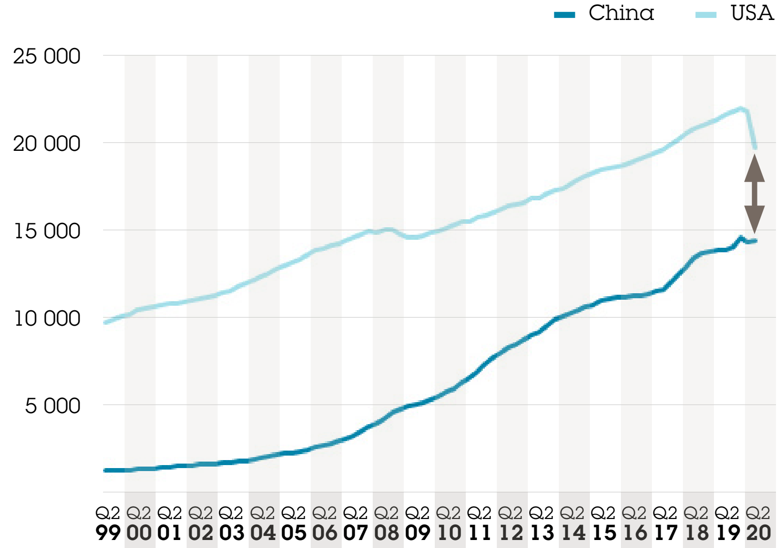
The economies across the world were confronted with the toughest and quickest contraction in decades during 2Q, in the context of the lockdown implemented to counter the spread of the public health crisis.

In 2Q 2020 the gap between the nominal GDP in USA and China (the largest economies of the world) narrowed by USD 2tn to USD 5tn (a record low level, as can be noticed in the following figure), an evolution pointing to a decade ahead dominated by the power shift from the West to the East.

Figure 1.

Nominal GDP

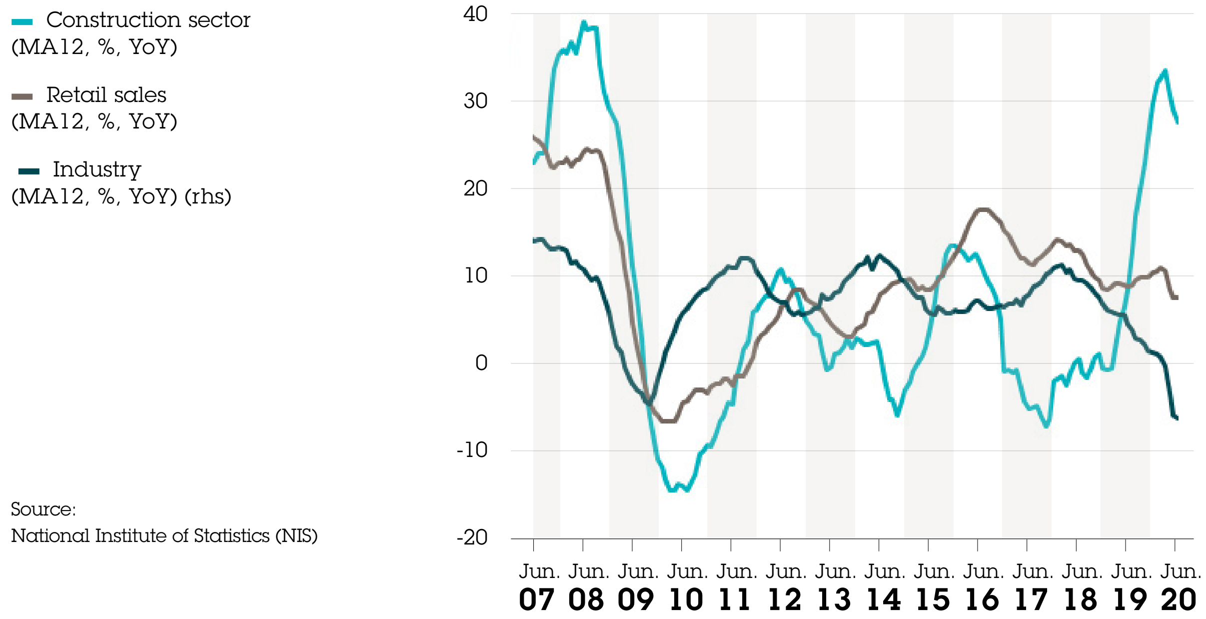
USA vs. China (USD, bn, SAAR)



Source: Bloomberg

Figure 2.

Dynamics of the industry, constructions and retail in Romania



Source:
National Institute of Statistics (NIS)

However, the worst has passed in 2Q, as the countries have gradually exited the lockdown since April, while the policymakers implemented unprecedented expansionary measures, including non-conventional monetary plans, fiscal and income programs with a cumulated volume converging towards USD 20tn at the global level.

The global economy increased for the second month in a row in August, by the highest pace since March 2019, according to the PMI Composite indicator, an evolution determined by the relaunch of the global trade (with positive impact for the manufacturing) and the gradual recovery of the services (the most affected sector by the incidence of the pandemic).

The US economy grew for the third month in a row in August, while the recent macro-financial developments express the entry into the post-pandemic cycle, after an adjustment by 4.4% YoY during 1H2020.

However, there can be noticed the performance of Chinese economy, increasing for the fourth month in a row in August, according to the PMI indicators.

Furthermore, the economy of Eurozone (the main economic partner of Romania) seems to have started the post-pandemic cycle after the severe decline in 2Q (15% YoY), as the investors' confidence hit the highest level in more than five years.

In Romania the GDP contracted by 10.5% YoY in 2Q and by 4.7% YoY in 1H2020, due to the incidence of the pandemic and the consequences of this unprecedent shock.

There can be noticed the increase of the constructions by 18.9% YoY during January-June, an evolution supported by the unprecedented expansionary policy-mix.

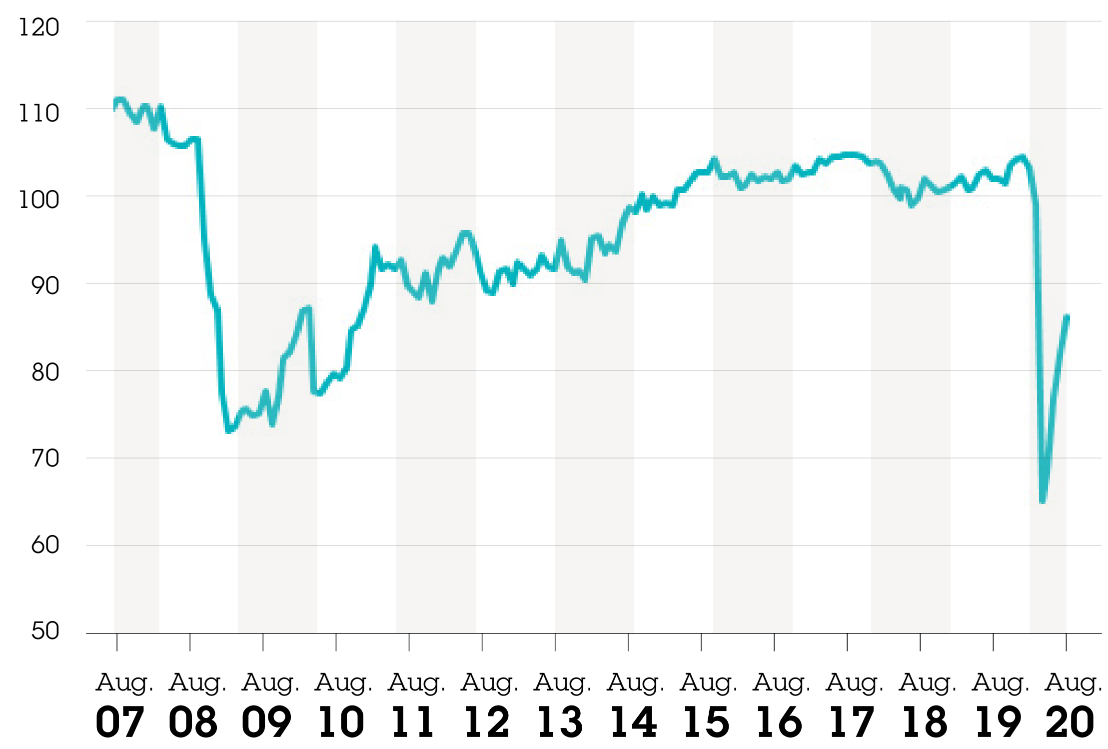
At the same time, the retail sales advanced by 0.5% YoY during 6M2020, an evolution supported by the improvement of the real disposable income of the population and strongly influenced by the incidence of the pandemic.

On the other hand, the industry contracted by 16.4% YoY in 1H2020, given the temporary collapse of the international trade determined by the lockdown in the context of the health crisis.

The recent macro-financial developments (global, European and domestic) express that the worst has passed, and the Romanian economy is heading towards the post-pandemic cycle. For instance, the economic confidence improved for the fourth month in a row in August, towards the highest level since March, according to the indicator computed by the European Commission.

Figure 3.

Economic confidence in Romania



Source: European Commission

In this context, we underline that the incidence of the pandemic (an exogeneous shock) surprised the Romanian economy in a better stance, at least compared with the previous shocks. This perspective is supported by several aspects, including the improvement of the contribution of the production factors to the YoY dynamics of the potential GDP in the second half of the past decade.

These aspects express a high probability for a quick transition of Romanian economy from the post-crisis cycle to the post-pandemic cycle.

According to our core macroeconomic scenario the Romanian economy would increase by an average annual pace above 2.5% during 2020-2022, as the adjustment induced by the pandemic in 2020 would be counterbalanced by the rebound in 2021 and 2022.

In our scenario the fixed investments would increase by an average annual pace of over 3% during 2020-2022, given the persistence of the real financing costs at a low level and the implementation of the EU Next Generation and multiannual financial framework.

At the same time, the private consumption (the main component of the GDP) may increase by an average annual pace of 2.8% during 2020-2022, due to the expansionary policy-mix and the prospects of continuity of economic convergence towards the EU levels.

As regards the labour market we forecast an average annual rate of unemployment of 5.4% during 2020-2022.

For the dynamics of the consumer prices (HICP) our scenario points to an average annual level of 2.9% for the period 2020-2022, as the expected deceleration in 2020 (given the negative output gap) would be followed by an acceleration in 2021.

The prospects for the dynamics of the real economy and inflation corroborated with the monetary policy outlook in US, Euroland and CEE point to the continuity of the accommodative approach in terms of monetary policy in Romania in the coming quarters.

In our view, the central bank would be very active on money, bonds and FX markets in the short-run, in order to counter the risks in terms of macro-financial stability.

As regards the yield on 10 YR Bonds (the barometer for the financing costs of the economy) we forecast a gradual decline of the annual average in the mid-run, an evolution supported by the global developments and the prospects for the acceleration of the European economic convergence of Romania during this decade.

Last, but not least, we forecast the continuity of the gradual upward trend for the EUR/RON in the mid-run.

We point out the opportunities of the Romanian economy during this decade, including the convergence towards the development levels in Visegrad Group and Eurozone and the possibility to join the OECD.

On the other hand, we underline the main challenge for the post-pandemic cycle in Romania: the implementation of a permanent balanced policy-mix, a fundamental aspect for the investors' confidence and for a robust and sustainable contribution of the production factors to the dynamics of the potential GDP.

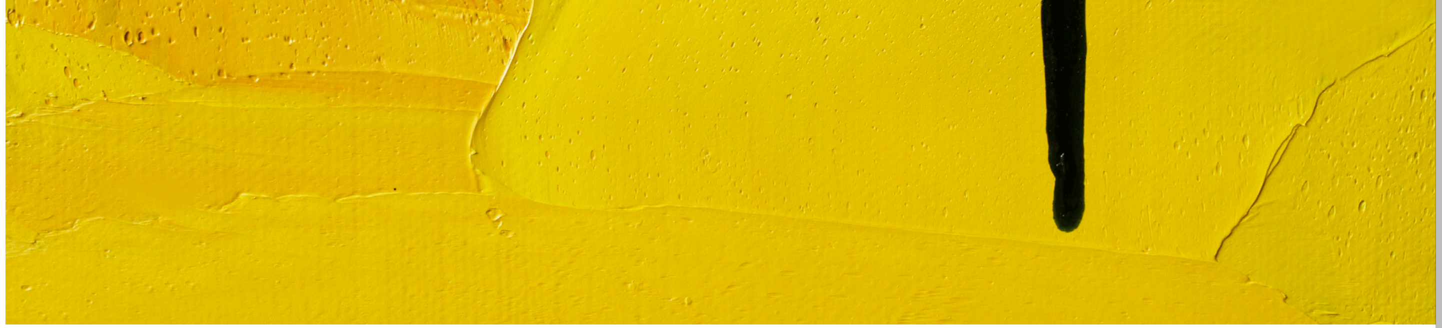
Among the risks for the evolution of the Romanian economy in the short and mid-run we mention: the global and European macro-financial climate; the domestic policy-mix in electoral and pandemic context; the global and regional geo-political tensions.

Authors:

Bryan W. Jardine
Managing Partner
Wolf Theiss

Flaviu Nanu
Counsel
Wolf Theiss

"... choosing the appropriate transaction structures, using necessary powers of attorney/mandates and efficiently using electronic communication systems and platforms have been key tools in keeping real estate projects and business going during the pandemic."



Emerging from the Pandemic:

Lessons for the Romanian Real Estate market from a Legal Perspective

The COVID-19 pandemic took the Romanian real estate market and legal environment by surprise. In the process, it challenged many entrenched professional habits. It has been in many ways a learning process for real estate professionals and legal practitioners, bringing into a new light concepts and methods that had otherwise been typically overlooked. In this manner, the pandemic has helped real estate professionals and lawyers to internalize several important legal lessons.

First, *entering into well-drafted contracts*, covering all legal aspects, is essential. Among others, the concept of *force majeure* has come under renewed scrutiny in the context of COVID-19. As a matter of Romanian law, force majeure is defined as an external unpredictable event, absolutely invincible and inevitable, which, in principle, would excuse the non-performance of a contractual obligation (Articles 1351 and 1634 Civil Code).

However, the scope of force majeure, as well as its effects can be adjusted by the parties in a contract, which can regulate in detail the procedure to be followed and the evidence to be produced in order to prove the occurrence of force majeure. Similarly, the Romanian statutory provisions allow the parties to request a re-balancing of contractual obligations or the termination of the contract, in case the performance of the contractual obligations became exceedingly cumbersome due to a change in circumstances (*hardship* -Article 1271 Civil Code). The parties may nevertheless decide by contract to override these provisions and decide that each party is bound to fulfil its contractual obligations, notwithstanding any change in circumstance. Elaborated force majeure and hardship, which were common in complex construction agreements, often modeled on FIDIC, have become common in other contracts, such as leases. Moreover, the entire system of contractual defaults and remedies has been subject to a thorough analysis, in order to address all potential unclear situations. One of the triggers has been the uneven effects on the market caused by those measures intended to fight the pandemic taken by the authorities and companies. In this respect, while certain types of activities were suspended from operating by order of the public authorities, others were only limited in their business or took a voluntary approach to reduce their activity for safety concerns. This has translated into contractual arguments regarding responsibility, default and risk-bearing.

Second, *the ability to negotiate, execute and close transactions at a distance is a must.* Although the real estate business typically requires to a larger extent direct contact with notaries public (for authentication of real property transfer deeds and other documents) and public authorities (local municipalities for the issuance of building permits, tax authorities, land book offices), transactions could continue due to creative solutions that allowed parties to achieve their objectives without physical presence. Hence, choosing the appropriate transaction structures, using necessary powers of attorney/mandates and efficiently using electronic communication systems and platforms have been key tools in keeping real estate projects and business going during the pandemic. We have also noted an increased willingness of the Romanian public authorities in accepting online submissions and electronically signed documents and issuing corresponding approvals and endorsements in the same form.

Third, *having in place appropriate insurance may provide well-needed protection in difficult times.* Business interruption insurance policies have generally become more common in Romania in the past years. However, it is only now that these policies have been truly put to the test by the effects of the COVID-19 pandemic. Choosing the right policy with the necessary coverage is key to secure the payment of appropriate compensation that could prove essential for the future survival of the business.

Last, but not least, *good faith is paramount.* The COVID-19 pandemic has put a strain on the real estate business at all levels. Tenants have seen their business activity suspended or limited by legal provisions, landlords have had premises closed or disrupted in their normal flow of visitors or activity, financing entities could experience disruptions in their stream of loan repayments from property owners, while developers and contractors are concerned about general market prospects and demand. In certain cases, these strains have led to adverse actions being taken, such as suspension of payments, delays in fulfilment of contractual obligations or even unilateral termination of contracts. While these may be justified in some circumstances, due to their scale and impact, the effects of the pandemic can be usually addressed more appropriately by negotiations in good faith between all parties. The aim should be to reach a mutually acceptable solution for all parties.

As a matter of Romanian law, good faith is an essential principle governing, among others, the performance of contractual obligations, which cannot be reduced or limited by the parties.

Even if the full effects of the COVID-19 pandemic have not yet been realized, the Romanian real estate market has shown an amazing resilience and we are confident that with the mutual efforts and collaboration of all stakeholders, it will emerge stronger in many respects.

Romania
Capital Markets Overview
H1 2020

by Knight Frank Romania

EUR 380 million

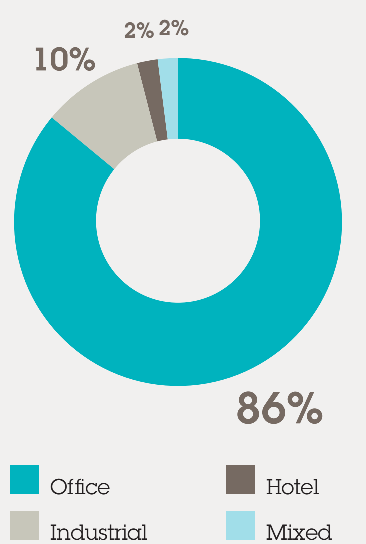
Investment volume

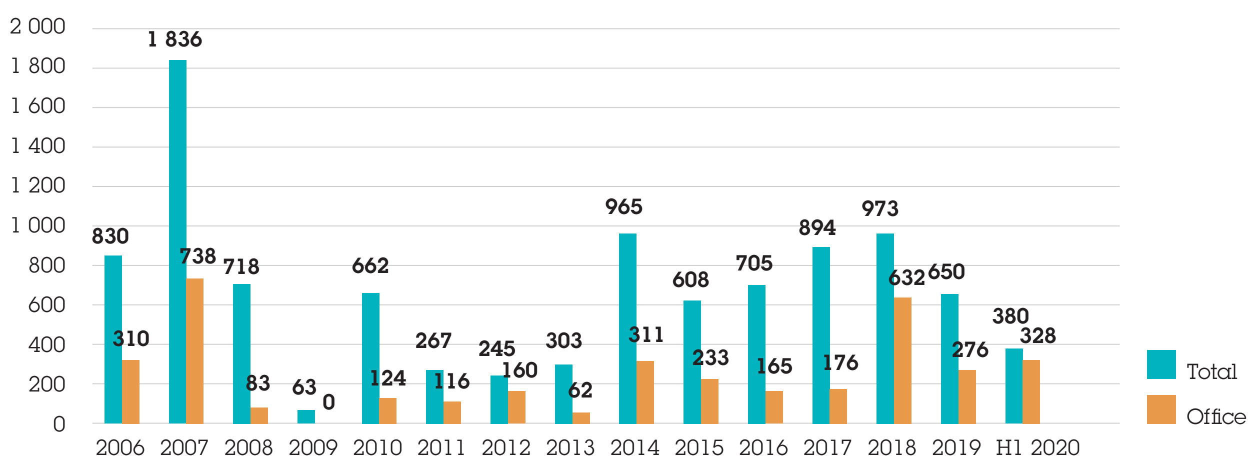
In the first half of 2020 the investment market reached a total volume of EUR 380 million, slightly above the same period of 2019. Despite the slowdown and global uncertainty generated by the pandemic, the strong uprising trend from 2019 managed to confirm the attractiveness of the local market.

As in the previous year, the office segment was the most significant in terms of volume accounting for more than 85% of the total volume with the remaining volume generated mainly by the industrial segment which accounted for 10% of the total volume.

Clearly the overall market is now in a process of reassessment with most sellers trying to mitigate the effects of the current events and maintain a safe and sustainable flow of rents while buyers are being more cautious and trying to price in additional risk premiums. Most likely this situation will continue for another few months until business activity will fully resume and the effects of the pandemic will have been completely assessed.

Transaction distribution by property type

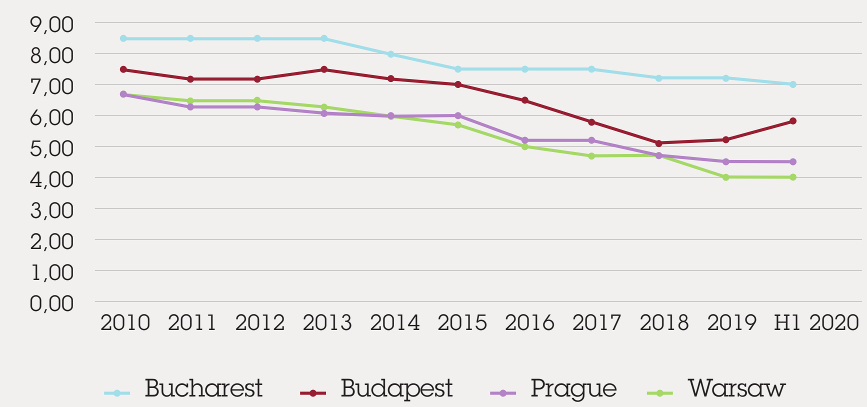




Yields

Stable outlook

Although in 2019 there was a cleat downward pressure on the yields the current events reduced this pressure and we are now witnessing an overall reassessment in terms of yields expectations. Judging by each segment, the downward pressure might still continue for the industrial segment which was not affected by the current events while for the office and retail segments it is expected that yields will remain stable at least until there will be more clarity on the effects of the current events on these segments.



Prime yields
%
H1 2020

EUR 0.8 billion in 2020

Forecast

Judging by the existing pipeline of projects that are currently on sale on the market it is expected that in 2020 we will have a higher volume of transactions compared with 2019 with an upside potential to exceed EUR 800 million.

Year		Type	City	Buyer	Seller	Building/Description	Area (sq m)	Price (Euro)
2020	Q1	Industrial	Bucharest	CTP	East Balkan Properties	Equest Logistic Center Dragomiresti	56,800	30,000,000
2020	Q1	Office	Bucharest	Globalworth		Renault Business Connected 50%		40,000,000
2020	Q2	Office	Bucharest	Arion Green Group	Global Finance	Global City	51,000	55,000,000
2020	Q2	Office	Bucharest	Dedeman	Forte	The Bridge III	21,200	53,000,000
2020	Q2	Office	Bucharest	Optimum Ventures	GTC	60%		126,000,000

Bucharest Office Market Overview

H1 2020

by Knight Frank Romania

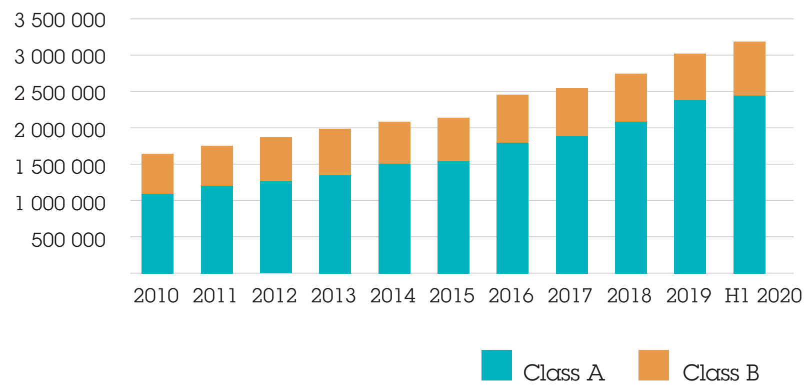
105,000 sqm

Supply

H1 2020 saw class A and B supply reach approximately 105,000 sq m, representing around 50% decrease compared to same period last year; the stock reached 3.131 million sqm.

Modern office stock

Annual evolution

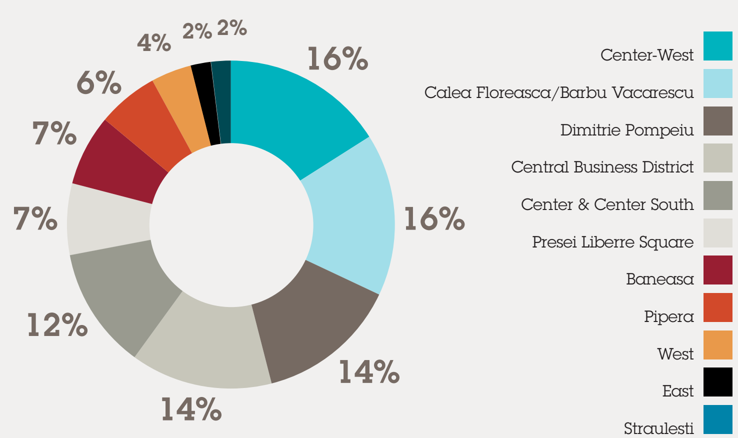


3.131 mill sqm

Stock

The submarket with the highest modern office stock is Center West area (516,000 sqm) followed by Calea Floreasca / Barbu Vacarescu (490,000 sq m) and Dimitrie Pompeiu (443,000 sq m).

Stock by submarket

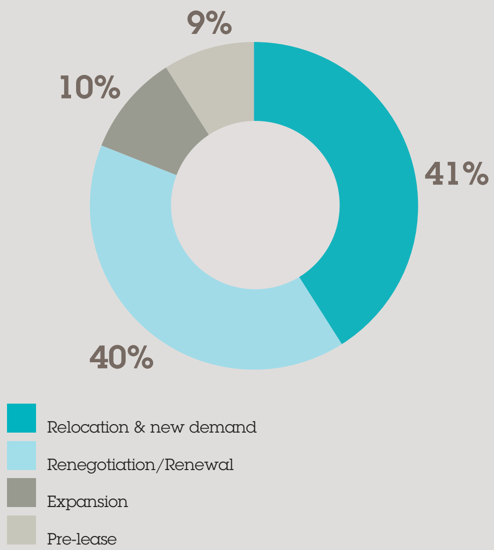


100,000 sqm

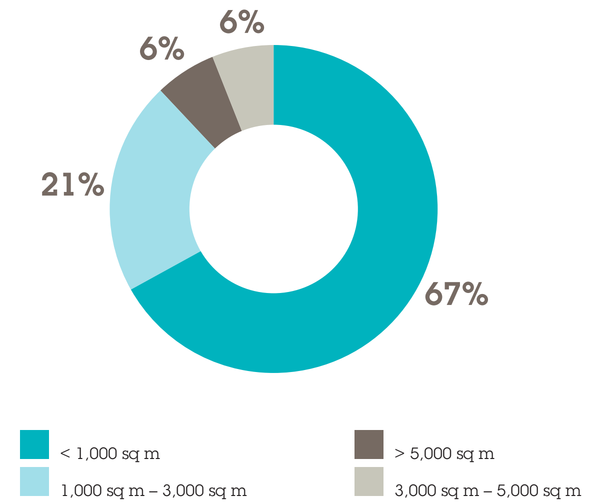
Demand

Demand in Q2 2020 reached 45,000 sqm, only 50% of the level registered in Q2 2019. Out of 45,000 sqm, 57% were renewals, 20% relocations and 17% new demand. There were 30 transactions in total, whereas 10 were above 1,000 sqm, the largest one being the 15,500 sqm renewal of UniCredit Bank. Demand in the second quarter followed the same rhythm of the first quarter, respectively 50% of the level registered in the previous year. Thus, demand in H1 2020 totaled 100,000 sqm in 66 transactions, compared to 196,000 sqm in 110 transactions in H1 2019. The average size of the transactions decreased from 1,800 sqm in H1 2019 to 1,500 sqm in H1 2020.

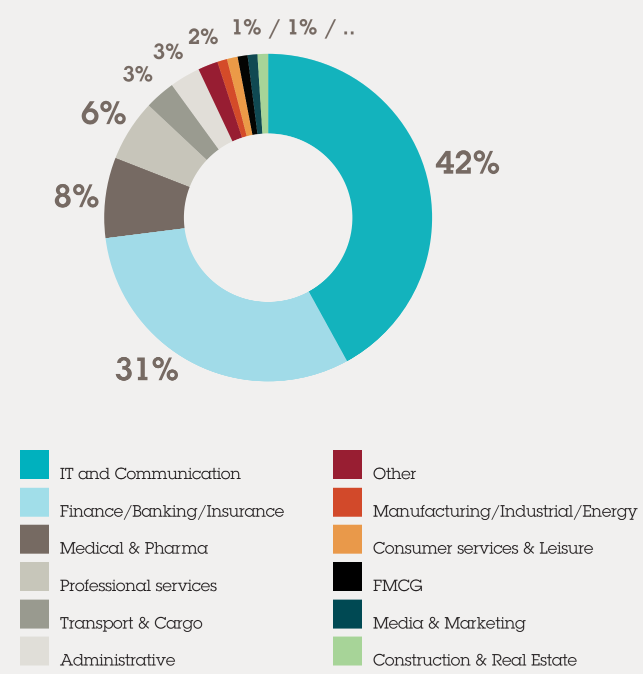
Demand by type of transaction



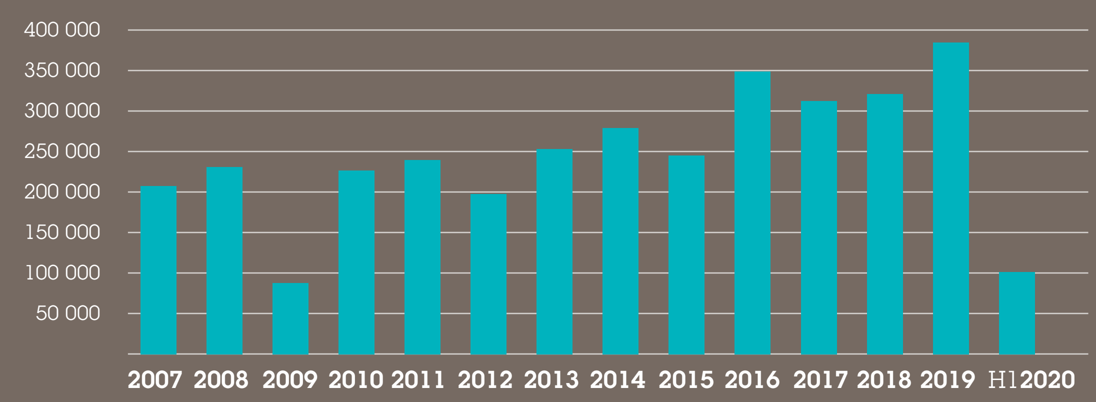
Demand by number of transactions



Demand by tenant activity



Total take-up evolution



18.5 EUR
sqm/month

Rents

Rents have remained stable for the time being but we are carefully looking at the impact COVID-19 and the lockdown period will have.

11.5%

Vacancy

The vacancy rate for Class A and B offices witnessed a slight increase to 11.5% from 10.5% at the end of 2019, as both the take up and the supply registered low levels compared to the same period of last year.

100,000 sqm
in the next half of 2020

Forecast

The pipeline for 2020 has reduced by ~10% compared to the estimations made at the end of 2019 and is expected to reach ~205,000 sqm based on the latest data. A shift in pipeline has been noticed as some projects moved their delivery date from 2021 in 2022. Thus, the pipeline for 2021 is expected now to reach ~250,000 sqm, significantly below the previous expectations – rather half. A similar shift may be rolled down again, from 2022 to 2023.

Bucharest Residental Market Overview

H1 2020

by Knight Frank Romania

Supply

This year would have been reached new records in terms of supply as per 2019's forecast, but it's early to conclude if the foreseen stock of new dwellings will be reached or we should expect a shortage.

The slowdown generated by the lockdown between Q1 – Q2 2020 will affect the deadline of several residential projects, thus a stock similar to 2019 is expected to be delivered by the end of the year.

Bucharest transaction dynamics

	H1 2019		H1 2020
January	1619 units	▲	1920 units
February	2457 units	▲	3097 units
March	3030 units	▼	2729 units
April	2680 units	▼	1696 units
May	2849 units	▼	1517 units
June	2548 units	▼	2361 units
July	2964 units	▲	3118 units

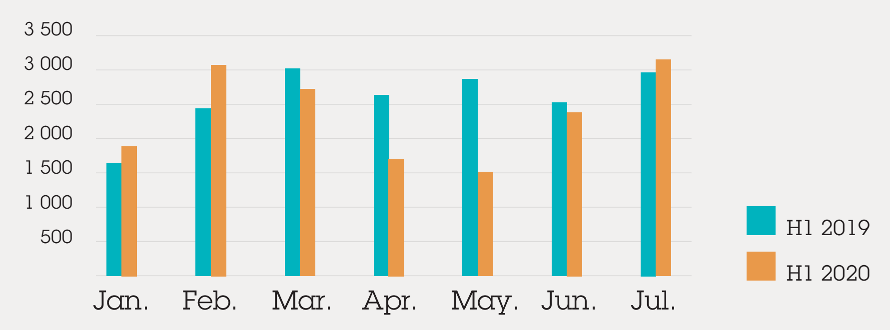
* The above represents apartments transactions in Bucharest

Demand

In H1 2020, 16.438 residential properties were traded, compared to the same period in 2019 when 18.147 transactions were registered, as per ANCPI. Accountable for the decreased number of transactions is the global pandemic which resulted into a 3 months' lockdown for Romania. More precisely, between March and April 2020, the number of real estate transactions decreased by 40%.

Analyzing the apartments segment in Bucharest, the below charts indicates the ascendant trend on the residential market and more importantly the optimistic improvement in the following months after the lock down.

Bucharest transaction dynamics



Prices

The Romanian residential market coped with the shock generated by restrictions and social distancing. The number of transactions returned in June and July at pre-pandemic values and prices remained stable, fundaments such as income vs. price or supply vs. demand being more solid than in 2008 period.

The H1 2020 prices value on the residential segment is 23% lower compared to the same period in 2007, the "boom era" on the local market; an important indicator of for the actual context.

In Bucharest, after a decrease of 3.4% in second half of March, the available apartments stock registered in April a 2% increase, from an average of 1.395 euros / usable sqm to 1.423 euros / usable sqm.

Corporate Lettings

Online courses, working from home or activity suspension for a determined period, made a lot of tenants from large cities to move back into their hometowns. Their options were either to terminate the contracts or to postpone rent payments for 3 – 4 months, especially for those in technical unemployment.

H1 2020 marked a period of contracts renegotiation, demand being determined most frequently by cost optimization.

Trends

New limits have been approved for housing loans, boosting the affordable and middle sector: "Prima Casa" becomes "The New House" program with the following thresholds:

1. Affording housing

70.000 euro loan with advance payment of 5%

2. Middle sector

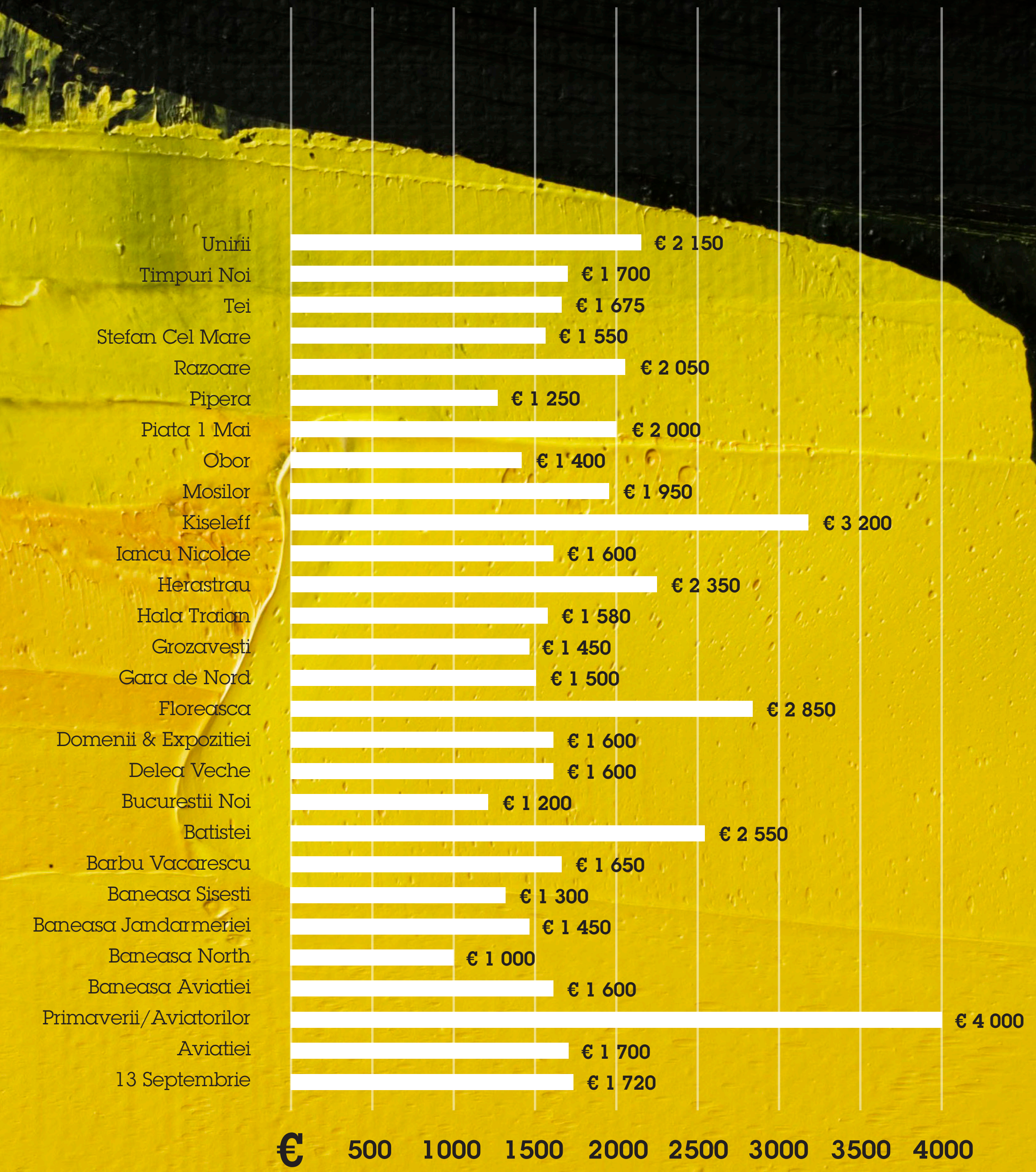
140.000 euro loan with advance payment of 15%

Being isolated in a small apartment made Romanians change their preferences in terms of property. Thus, in H1 2020 the demand for houses increased by 40%.

More and more clients are turning to houses with gardens and apartments with large outdoors space.

Medium price/built sq m

New buildings, Bucharest, Center-North



Romania Market Overview

Real Estate Highlights H1 2020

KNIGHT FRANK ROMANIA

Horatiu Florescu, Chairman & CEO
+40 21 380 85 85
horatiu.florescu@ro.knightfrank.com

239 Calea Dorobantilor, 3rd floor
Bucharest 1
010567
Romania
T. +40 21 380 85 85
office@ro.knightfrank.com

WOLF THEISS

Bryan W. Jardine
T. +40 21 308 81 00
bryan.jardine@wolftheiss.com

4 Vasile Alecsandri Street
010639 Bucharest
Romania
T. +40 21 308 81 00
bucuresti@wolftheiss.com