

PRS Market in CEE Romania



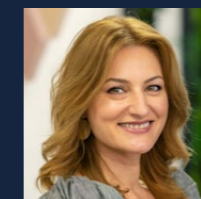
The PRS market in Romania is still in its early stages, mainly focused in Bucharest, with around 800 apartments across two large and 20 small projects.

It is expected to grow rapidly in the coming years. AFI Europe is planning the largest project to date with 450 apartments. Investors face challenges such as the local mentality of wanting to own a home, a small market with a declining population, and changes in taxation and lack of government incentives. However, the COVID-19 pandemic has increased demand for flexible models, such as built-to-rent investments.

Corporate vehicles available for PRS investments in Romania are limited liability companies (LLC) and joint stock companies. The forward funding model is not commonly used due to the complexity of obtaining necessary endorsements and authorizations.

The small investment type of PRS, such as a single building, is most likely to be found on the market in Romania.

Overall, the PRS market in Romania was seen as a promising investment opportunity due to the strong demand for rental housing, the country's relatively low levels of competition, and the government's efforts to support the development of the sector. However, there were some challenges that needed to be addressed, such as the need to streamline the permitting process for new developments, the lack of a legal framework for long-term rentals, and the need for greater transparency and standardization in the rental market.



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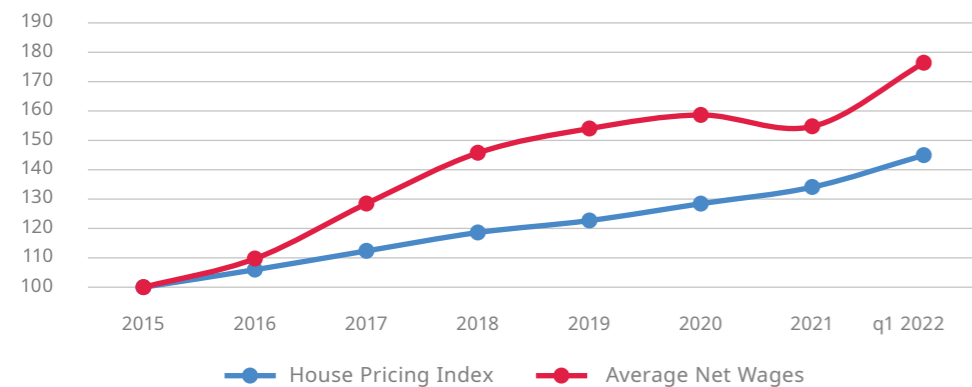
PRS market – can citizens overcome high attachment to ownership?

Residential sector overview

Among a total population of 19 million inhabitants, there are 9.5 million households in Romania. The overwhelming majority of the residential stock is built before 1990, with new dwellings (built mainly after the year 2000) making up for about 13% of the total housing stock. The new market has been growing steadily in recent years, especially in Bucharest,

where new dwellings have a share of 14% in total stock and large academic cities such as Cluj-Napoca, Timisoara and Iași, where urbanization, a growing middle class, and internal migration (approximately 80,000 Romanians migrate from rural to urban areas annually) have led to a strong demand for modernized housing.

HPI vs. average net wages Bucharest [2015=100]

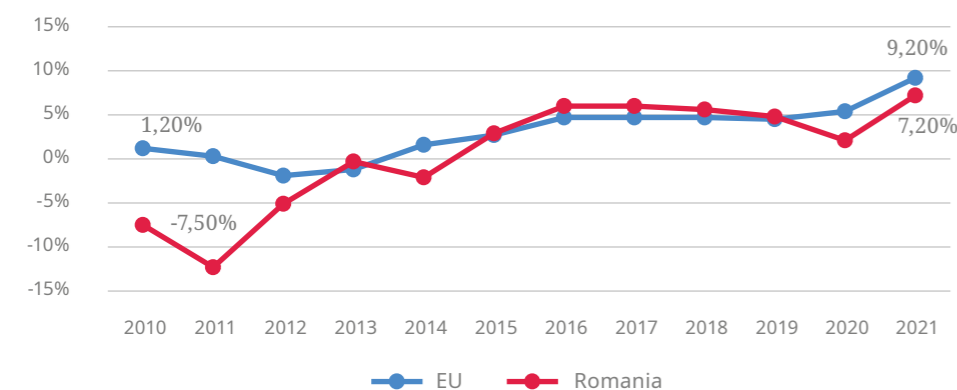


Source: Eurostat

The large breach in housing price evolution between Romania and the rest of the EU has been significantly narrowed in the past ten years when the yearly growth rate in

house prices in Romania has aligned with the European trend. The market has evolved from a speculative one before the 2008 crisis, to a more stable one.

Evolution of apartment prices: Romania vs. EU average (2010–2021)

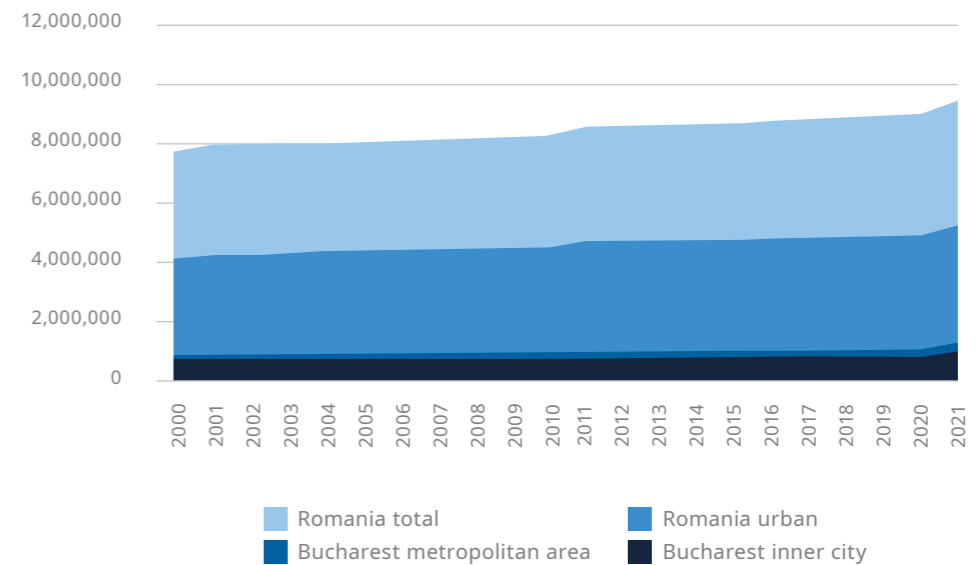


Source: Eurostat

Although 95.3% of Romanians are homeowners (the largest rate in the EU, where the average is 69.9%), 45.1% of dwellings in Romania are overcrowded, while

the European average is 17.5%. Thus, the need for new developments in the residential market is extremely high.

Residential stock evolution (2000–2021)



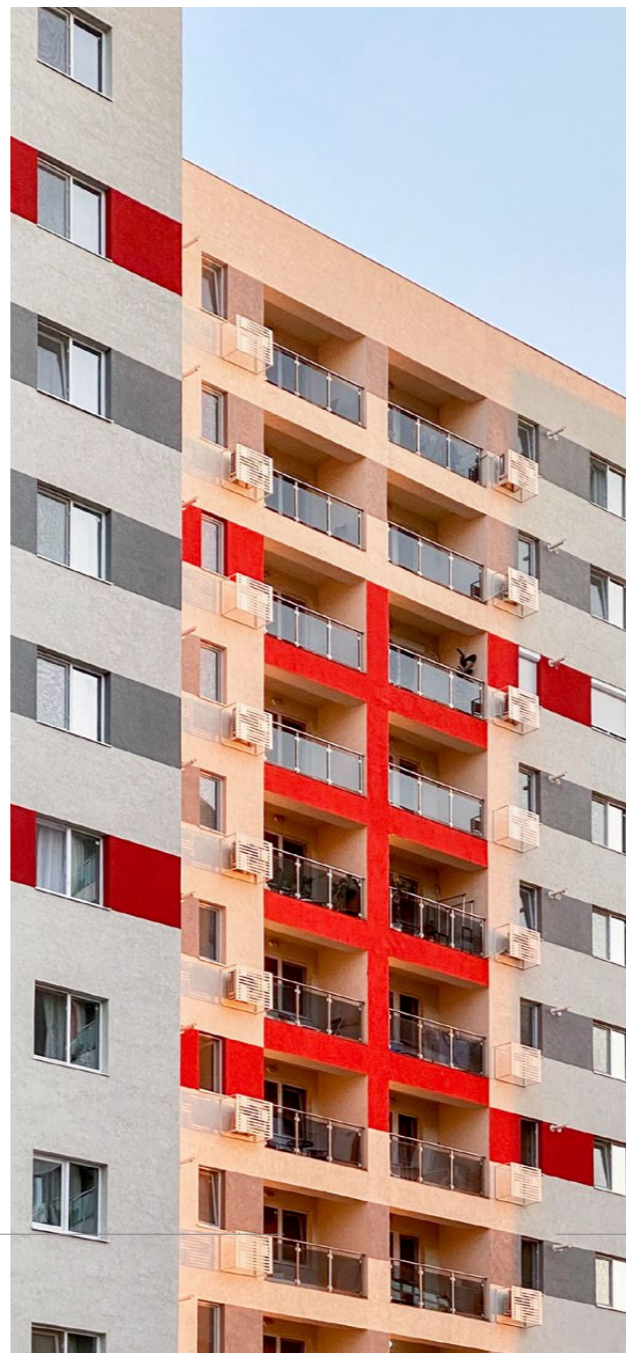
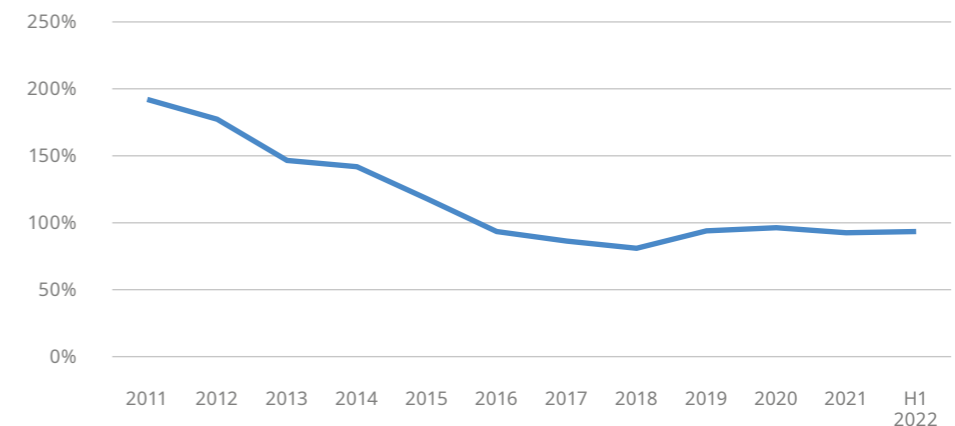
* 2011 and 2021 spikes in stock represent census-related corrections. 2021 data is preliminary.

Source: INS

The preference of Romanians for owning a home instead of renting can be attributed to both mindset and economic considerations: the declining interest rates in the last 10 years have made mortgages more appealing than rents. In 2021, in Bucharest, monthly mortgages were, on average, over 10% cheaper than

the average monthly rent. The inflation surge in 2022 has led to a rise in interest rates, making mortgages less affordable. Currently, the balance seems to tilt in favour of rents: the income-to-mortgage ratio per capita for a one-bedroom apartment in Bucharest is 2.3, versus a 2.7 income-to-renting cost ratio.

Mortgage as % of income: Bucharest (2011–H1 2022)



Share of owner-occupied and rented apartments

The Romanian residential rental market is fairly unregulated, with the majority of landlords being individuals renting their second homes. According to Eurostat data, on a national level, out of the 3.9% of Romanians living in rented homes, 2.6% live in state-owned social housing units or in state-subsidised homes. In the absence of comprehensive legislation regarding the residential rental market which would allow for a clearer image of the size of the market, it is estimated that rented units make up for about 15–20% of the total stock in the two largest Romanian cities, Bucharest and Cluj-Napoca.



Estimated size of the market-rent sector and subsidised-rent sector or private vs. state-owned rental stock

Official data shows the Romanian state as the largest owner of built-to-rent units, with approximately 29,000 units on a national level and over 6,000 units in Bucharest. All of these units are part of a social program and are available for lease only for young people under 35, with the possibility of subsequently acquiring the apartment at a reduced cost.

The PRS market in Romania is currently in its early stages, with under 1,000 delivered units in Bucharest and about 700 units planned or under construction. However, given the current economic circumstances, an increasing number of developers are taking into consideration the shift toward PRS and are willing to explore this opportunity in the upcoming years.

Historic development of the PRS stock

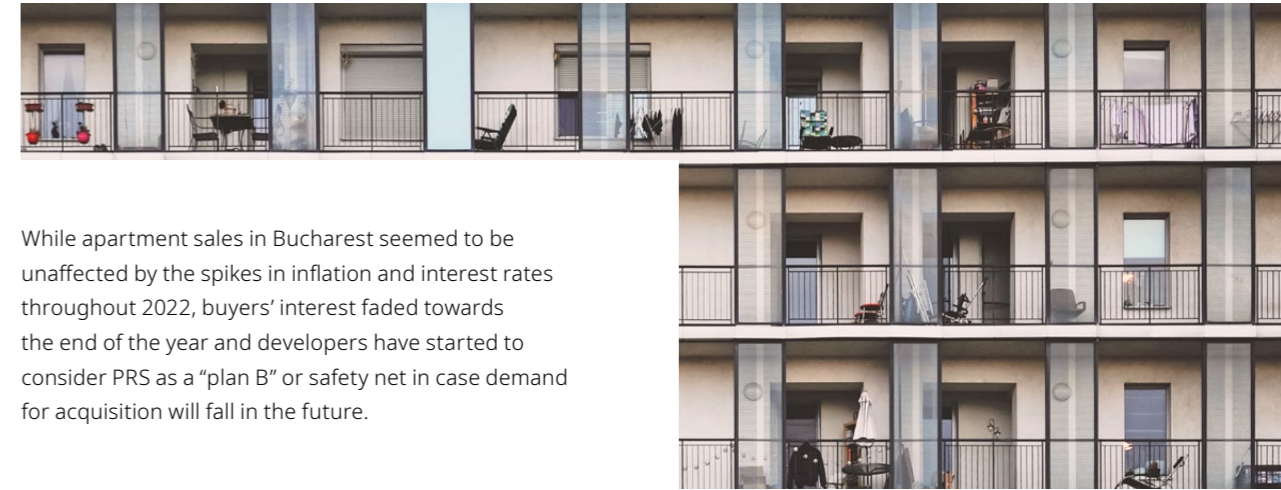
When were the first projects launched and by whom

The first and largest PRS project was launched in Bucharest in 2016 by Bucharest Properties REIT, a company with US-based shareholders. With a third phase delivered last year, the project has a total of 375 units and an occupancy rate close to 100%.

Major events, market or macro shifts that historically influenced the PRS market

Given the nature of the rental market in Romania, individual-owned flats are often located in old buildings and have substandard quality. Moreover, tenants are usually vulnerable to sudden price changes, made to cover repairs and maintenance costs and are exposed to early terminations of lease agreements in the absence of a binding contract. The existing PRS projects have thus been successful so far mainly because they offer a higher standard of living, provide a wide range of facilities and amenities and give tenants a much-needed sense of security.

Expats and multinational corporations are a significant portion of the demand for the PRS market due to their desire for a seamless relocation experience and high living standards.



While apartment sales in Bucharest seemed to be unaffected by the spikes in inflation and interest rates throughout 2022, buyers' interest faded towards the end of the year and developers have started to consider PRS as a "plan B" or safety net in case demand for acquisition will fall in the future.

Current and expected situation in the PRS market

Number of existing projects and rental units

Currently, there are two large projects (over 100 units) and approximately 20 small-sized and boutique PRS buildings in Bucharest, totaling some 800 apartments.

Number of projects under construction (incl. number of units)

AFI Europe is planning its first PRS project in northern Bucharest. The new development will include three residential buildings with 450 apartments, making it the largest PRS project in Romania to date.

An established residential developer, with 3,000 delivered units in 8 projects located in central-western Bucharest, is assessing the shift to PRS for the first phase of one of their upcoming projects, which will include approximately 200 units.

Key challenges facing investors

- **Local mentality** – Romanians want to own a home
- **Small-sized market**, with a declining population
- **Changes in taxation**, lack of governmental incentives

Institutional rent in practice

Cost allocation

A. Tenant: utilities

B. Landlord:

- property tax: 0.1%–0.3% of property value/year
- rental tax: 10% of gross annual rental income
- insurance: mandatory insurance (20€/year) + optional insurance
- maintenance and repair costs

Average gross-to-net ratio

The net rental revenue is, on average, 80%–85% of the gross revenue. Apart from the taxes detailed above, extra costs will include a yearly repairs and maintenance budget. Apartments in Romania are usually leased fully furnished and equipped. Extra costs will thus require an initial furnishing investment of about 10% of the value of the apartment.

Rent indexation – is it commonly applied?

Usually not inflation-indexed as utilities are paid for by the tenant but up for re-negotiation every 12 months.

Most common lease periods

At present, the common lease period for a residential unit is 12 months.

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

As a general rule, Romanian legislation does not provide rules that differentiate between PRS investments and other types of real estate investments. Therefore, the corporate vehicles available for investments are those generally used for all types of real estate investments, namely: (i) limited liability companies (LLC), and (ii) joint stock companies. The more common structure is the first one, as it offers more flexibility to investors and is also quicker and cheaper to incorporate, due to the LLCs having no minimum share capital requirement. In respect of joint stock companies, there are specific requirements for corporate approvals for the sale and purchase of real estate, depending on the value of the transaction.

Limited liability companies (LLC) offer more flexibility to investors.

Type of deals: Forward Purchase model or Forward Funding model

A. Forward purchase

Transactions are mostly structured to consist of two phases: (i) the signing of a preliminary sale agreement concerning the property or the shares in the company while the investment is still being permitted or developed, followed by a due diligence, and (ii) the transfer of the ownership under a transfer agreement subject to the fulfillment of various predetermined conditions precedent, such as obtaining the building permit or the works completion reception protocol.

B. Forward funding

This model, when the investor and the developer agree to sign an agreement concerning the sale

of the property or the shares in the company without the condition precedent of the work being completed followed by the funding by the investor of the development process, is not commonly applied in the Romanian real estate market, as the process of obtaining the necessary endorsements and authorizations, especially the building permit, is a complex one and usually takes a long time, with investors preferring for these stages to be completed prior to funding being granted.

Tax issues connected with share deals/asset deals

A transfer of shares as opposed to real estate assets allows payment of registration and authentication taxes (which amount to approximately 1% of the purchase price) to be avoided. One of the major benefits of the acquisition of real estate by way of a share deal is that this type of transaction is not subject to VAT. Another advantage of the acquisition of real estate by way of a share deal is the fact that there are no thresholds imposed at the level of the transaction value and any person, irrespective of their nationality, can freely acquire shares.

The following fees are due in an asset deal involving real estate:

- the notary public fees for the authentication of the sale agreements, which vary depending on the value of the transaction. For example, for an immovable asset with a value higher than RON 600,001 (approx. EUR 122,205), a notarial fee of RON 5,080 (approx. EUR 1,035) plus 0.44% of the real estate value exceeding RON 600,001 is due; and
- fees for registration with the Land Book equal to 0.5% of the purchase price for legal entities, and 0.15% for individuals.

It is market practice for the buyer to pay all fees and taxes relating to the transaction. However, the parties can agree to divide the costs.

Preparation phase

Location: zoning

Overall, the legal procedure through which the necessary endorsements and authorizations are obtained in order to fulfill the mandatory requirements for construction is the same for all types of investments. However, the urbanism regulations provide rules and conditions under which constructions may be built depending on the area of the future projects/buildings.

The relevant legislation provides several general and local urbanism regulations and plans such as the general urban plan, the zoning urban plan, and the detailed urban plan. The importance of these technical documents resides in the fact that they determine, among other aspects, the construction and zoning parameters for real estate. Nonetheless, the existing urbanism regulations may be amended by the investors through a formal procedure of adopting new urbanism documentation (usually a zoning urban plan), but there are some limitations in this respect due to the specifics of the land.

Type of investment: single building or PRS as a part of a bigger investment or separate apartments

In Romania, the real estate market regarding these kinds of projects is still under development and, due to this fact, the small investment type of PRS, such as a single building, is most likely to be found on the market.

The preference in the real estate sector used to be for investments under the built-to-sale model given that for most Romanians buying a home is the most common type of real estate investment.

Since the COVID-19 pandemic, the number of remote/hybrid workers and nomad workers increased and as a result, investors, including institutional investors, are looking for more flexible models in order to satisfy these kinds of needs, such as built-to-rent investments – while steadily growing, the market segment is still emergent.

Due diligence (performed by the investor, lender, and developer)

Besides the usual risks that can be identified in a real estate due diligence analysis, such as ownership title issues, applicable special regulations (e.g., historical monuments, green areas, etc.), improper Land Book and tax registration, etc., an additional focus should be placed on the specific permitting requirements related to the residential sector. Also, in case the business model is qualified as a hotel (rather than a standard residential lease), the supplementary permits which must be obtained in order to be compliant with the specific legislation regarding the hotel sector should be verified.



Financing: obtaining external financing

A. Financing model

The funding of PRS projects is not subject to special regulations or limitations, and the financing may cover the construction phase and/or the operation phase. The primary source of funding is bank financing.

B. Collateral

The most common forms of security created or entered into by an investor who is borrowing to acquire or develop real estate are mortgage over the real estate and mortgage over movable assets such as shares, receivables, contracts, insurances, bank accounts, and any other tangible or intangible assets assigned to the activity of the enterprise.

Acquisition

The acquisition of a real estate property is the same, regardless of the project to be developed in the end, so no specific conditions must be met in case of acquiring a property for the purpose of developing a PRS project.

The subject of the transaction may be the ownership right over the real estate property, namely the land and building, or the right of superficies over the land, meaning the right to build the construction which turns into an ownership right over the building, once the building is completed. The beneficiary of a superficies right has a complex right consisting of (i) the right to own or to construct a building on another person's land and (ii) the right of use over the relevant land. A superficies right can only be transferred through a deed authenticated by a notary public and together with the ownership of the building (as opposed to the ownership of the land, which can be transferred independently).

Under Romanian law, the transfer of the ownership title over a real estate property requires the conclusion of the transaction in the form of a notarial deed. Ownership in real estate must be registered with the Land Book only for publicity purposes at the moment, and therefore, it is not a condition for the validity of the ownership transfer.

authorities place such leases in the hotel sector rather than the residential one due to the short term of the lease. Also, due to the specifics or purpose of the agreement, the authorities may consider that the agreement is not supposed to be categorized as a residential lease and therefore, they will requalify it as an agreement subject to the hotel regime. In order for an investment to be subject to the hotel regime legislation, a classification certificate (in Romanian: certificat de clasificare) must be obtained, according to Government Decision no. 1267/2010 regarding the issuance of classification certificates, licenses and tourism patents, and other prior specific requirements must be fulfilled, such as setting up a limited liability company with NACE code 55 (hotels and other accommodation facilities) and establishing work points for each of the leased properties under hotel regime.

Tax issues

Legal entities operating in Romania have to pay profit tax for the income resulting from rental activities. Rental income is taxed at 16%, assuming that the company is subject to a corporate income tax regime (other tax regimes may be applied, subject to fulfillment of certain conditions) and the taxable

Operational phase

Residential use (lease agreement) vs. commercial use (hotel regime)

A. Lease agreement

The Romanian Civil Code provides both the general framework for leases in Romania and the particular framework for residential leases. The special provisions in respect of residential leases, that amend and supplement the general regulations regarding lease agreements, refer to (i) the tenant's right to unilaterally terminate the lease agreement, the notice period depending on the indefinite or fixed period of time of such lease agreement, (ii) the right of first refusal of the tenant at the conclusion of a new lease agreement of the housing unit, (iii) invalid clauses regarding the insurance, the joint or indivisible liability of the tenants for damaging the common areas, the payment in advance for housing repair or the landlord's right to diminish or suppress the benefits undertaken by the agreement and (iv) the eviction of the tenant.

B. Hotel regime

The commercial use of the PRS projects may include the hotel regime, in the case when the relevant public

period is the fiscal year, which may correspond to the calendar year. The tax rate of 16% applies to the financial result of the company, determined by adding all the income obtained in a fiscal year, minus the value of the deductible expenses. Additional fiscal adjustments may arise – to be analysed on a case-by-case basis.

A lease of real estate properties is generally a transaction that is not subject to VAT. However, the landlord can choose to apply the regular VAT regime, which will entitle the landlord to deduct the input VAT on its expenses.

Operating real estate within the accommodation sector (e.g., hotel or similar functions, including the

rental of land for camping) is a transaction subject to 9% VAT (under current provisions of the legislation, rates may change).

Currency of the rent: RON or EUR?

As a general rule the Romanian legislation provides that payments, transfers, and any other similar operations between residents, which are the subject of trade in goods and services, are carried out only in the national currency, namely RON, save for some exceptions which do not include payment of the rent. Of course, current and capital foreign exchange operations are carried out freely between residents and non-residents, in foreign currency and the national currency (RON). Also, although paid in RON, the rent or hotel tariffs are usually listed in EUR.

Exit plan

Sale of individual units

A common exit from a PRS project is to sell individual units to third parties. The transfer of the benefits and the liabilities of the lease from the former owner to the new owner as their legal successor depends on the fulfillment of the publicity requirements, namely the registration of the lease agreement in the Land Book. The parties can establish, by mutual consent, the termination of the lease agreement if the leased property is sold.

Sale of the whole building

This type of sale is similar to the common sale of commercial buildings on the real estate market. The sale of the whole building is the least common exit plan from such investments on the Romanian market. Please note that a due diligence analysis is recommended before concluding such a sale.

Sale of a business

The sale of this kind of investment is treated like any other type of business sale, no special provisions are applicable. Please note that an even more extensive due diligence analysis that should include all business components is recommended before concluding such a sale.



Authors – Romania

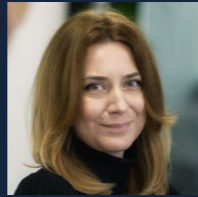
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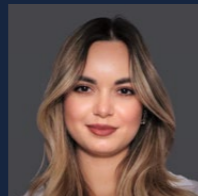


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