



# REAL ESTATE INVESTMENT ANALYSIS

## BULGARIA

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Petar Kolev (06052553)

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## 1.0 Bulgaria: Country facts and Introduction

- **Full name:** Republic of Bulgaria
- **Population:** 7.5 million (UN, 2009)
- **Capital:** Sofia
- **Area:** 110,994 sq km (42,855 sq miles)
- **Major language:** Bulgarian
- **Major religion:** Christianity
- **Life expectancy:** 70 years (men), 77 years (women) (UN)
- **Monetary unit:** 1 lev = 100 stotinki
- **Main exports:** Chemicals and plastics, food and drink, tobacco, machine-building equipment
- **GNI per capita:** US \$5,490 (World Bank, 2008)
- **Internet domain:** .bg
- **International dialling code:** +359
- **Membership of International groupings/organizations:** EU, WTO, NATO

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(Source: BBC News, 2009 - [http://news.bbc.co.uk/1/hi/world/europe/country\\_profiles/1059735.stm](http://news.bbc.co.uk/1/hi/world/europe/country_profiles/1059735.stm))

The following report briefly assesses the Bulgarian Real Estate Investment environment and its characteristics. All sources of reference used vary in 6 major segments: Real Estate services (Colliers), Professional services (Deloitte), Investment banks (Goldman Sachs and Raiffeisen bank), Property agencies (Forton), international organizations (IMF) and Business and professional media (WSJ and BBC). Data from all segments has been gathered, analyzed and filtered for identifying key information relevant to this subject.

The first part will evaluate the current macro-situation by discussing political and economic factors and their influence on the Real Estate investment perspectives in Bulgaria. The second part will deepen in the different property sub-segments by providing summary on the industrial and logistics, office, retail and residential markets. In the end of this work a brief conclusion will be drawn and relevant recommendations will be brought to the readers' attention.

## 2.0 Political and Legal Review

Bulgaria's transition from communism to market economy has not been a trouble-free task. Political uncertainty, instability and strikes blotted the first half of the 1990s and former communists remained a significant influence during the transition period (BBC News, 2006). The country became a NATO member in 2004 and EU member in 2007. As a present member of the Single European Market, Bulgaria experienced a rapid economic growth, business progress, and living standards improvement in the last two years. In July 2009, the centre-right GERB party led by Boiko Borisov made a clear winning in general parliamentary election. Mr. Borisov's promises were mainly focused on eradicating corruption and pulling the country economy out of the worst recession for the last decade (BBC News, 2009). A recent substantial achievement as a consequence of the GERB's policies is related with the country budget. For 2009 Bulgaria had the lowest budget deficit among the 27 EU member states (Parkinson, J. 2010) and also it is the only European state meeting the Maastricht treaty criteria. Such positive results achieved by the new government, are an evidence of competence and capability for establishing sound and stable political environment which will be favourable for supporting local businesses and attracting foreign investors.

## 1.1 Taxation and Duties

- Corporate Income Tax – 10% (Source: Deloitte, 2009)
- Personal Income Tax – 10% (Source: Deloitte, 2009)
- Value Added Tax (VAT) – 20% (Source: Deloitte, 2009)
- Duties: Imposed on Alcohol and alcoholic beverages, Tobacco products, Energy products and electric energy, Coffee and its extras, Cars. (Source: European Commission, 2008)

Bulgaria is the only EU state that has introduced a 'flat' tax of 10% (Deloitte, 2009). The implementation of this policy has contributed to improvement in the local business performance and to attracting foreign companies looking for tax friendly business environment which as an effect will contribute to higher level of employment, improvement of living standards, and increasing government tax income

## 1.2 Buying guide

Foreigners can only purchase a structure on a plot of land such as apartments or condo units however, they cannot acquire freehold on a land directly. Yet in 2006 the Bulgarian government decided that non-residents will be allowed to purchase freehold land directly in 2014. Before that date, foreign investors have an alternative option to buy land by registering a legal entity with the purchaser as a sole owner or director of the newly established firm (Global Property Guide, 2007). Another incentive introduced by the government in 2009, was the reduction of the cost for establishing a private limited company from 5000 BGN to 2 BGN (approximately 1 EUR) (Bulgarian Properties, 2009)

In 2014, when non-residents will have the right to purchase land, the attractiveness of the Bulgarian Real Estate market will be enhanced by the eliminated legal requirement of establishing a legal entity. Furthermore, the reduction of the foundation capital will promote entrepreneurship, thus will support the local economic environment. Foreign investors could be also enticed from the low start-up costs which consequently could attract overseas SMEs looking for low budget foreign opportunities.

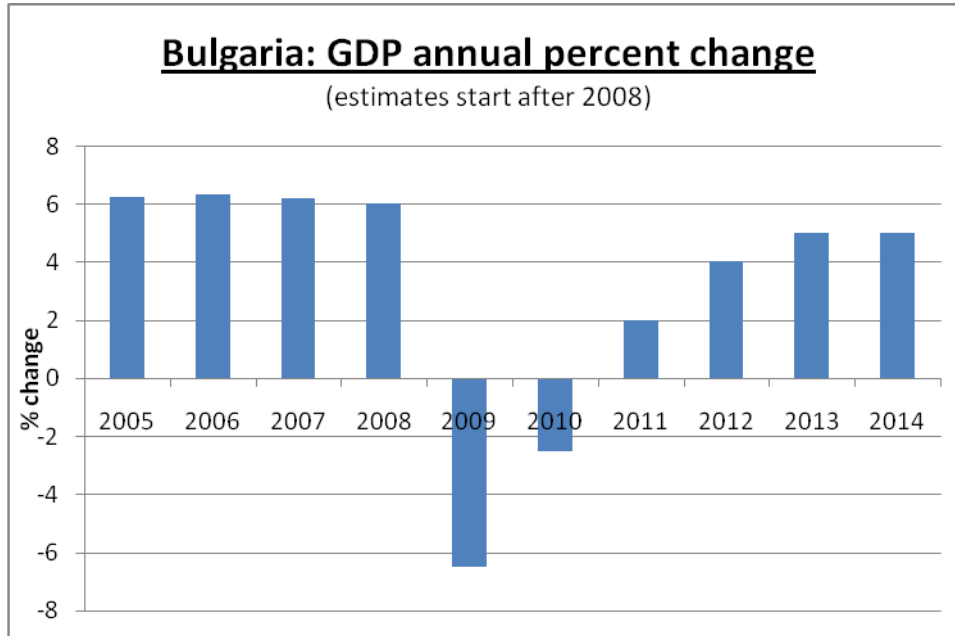
## 3.0 Macroeconomic Review

Macroeconomics represents the fundamentals of all markets. Investments, no matter of the asset class, are highly dependent on their behavior. Some of main factors that Real Estate investors should assess before entering new markets are the GDP, inflation, FDI, exchange rate, ratings unemployment, labour costs and the country specific advantages and characteristics.

### 3.1 GDP

The Bulgarian GDP performance was one of the strongest in Europe for the period from 2005 to 2008. As you can see below, it was mainly driven by FDI inflows which is a strong proof of the market's investment attractiveness. FDI volumes increased from €3.5 billion in 2005 to their peak of more than €8 billion in 2007. The Real Estate sector accumulated the highest investments volumes of more than €2.5 billion in 2007 (Forton, 2009). However, the country's wealth is still highly dependent on Western Europe's economies. Yet, the latest publications show growth of 0.4% for the Eurozone for the Q3 of 2009 (BBC, 2009). This trend consequently will have a positive impact on the Bulgarian market, returning it to growth after 2 years of recession.

**Table 2.1** Bulgaria: GDP annual percent change



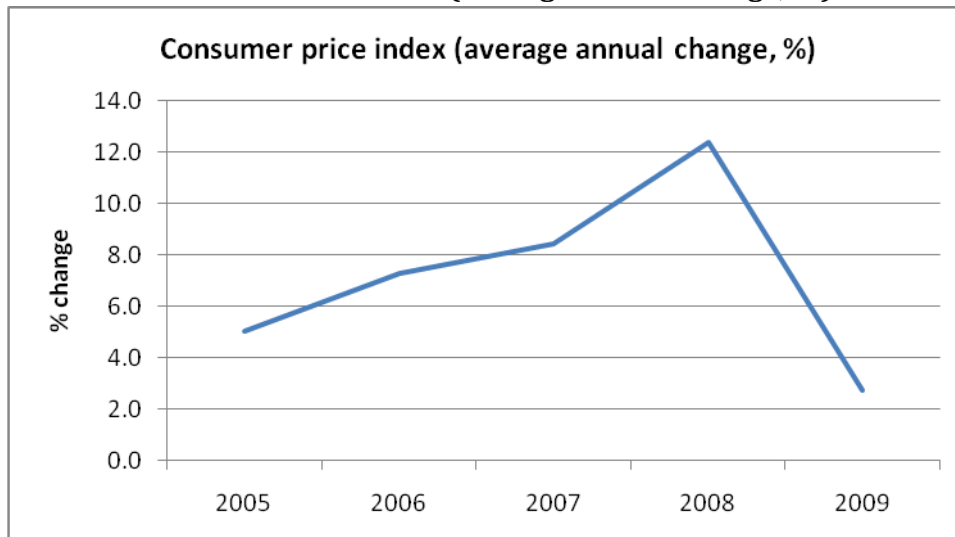
(IMF, 2009) <http://www.imf.org/external/pubs/ft/weo/2009/02/weodata/weoselgr.aspx>

On the 22<sup>nd</sup> January 2010 The European Bank for Reconstruction and Development (EBRD) forecasted even enhanced projection about the Bulgarian GDP percentage change. Positive growth of 0.7% and 3.5% are expected for 2010 and 2011 respectively (see appendix A) (EBRD, 2010). Such tendency of improving economic projections is mainly contributed by the framework of anti crisis policies that the new government is implementing.

### 3.2 Inflation

Another important factor for Real Estate investing is inflation. A high inflation rate in 2008 has triggered property prices up which have favoured 'flippers' looking for a quick turnover. Now, when spending is weak, inflation has bottomed to almost below 3% of 2010 (BNB, 2010). That will suppress the flipping practices, and will limit speculations on property prices and will prevent future property bubbles.

**Table 3.2: Consumer Price Index (Average Annual Change, %)**



(Source: BNB, 2010) [http://www.bnb.bg/bnbweb/groups/public/documents/bnb\\_download/s\\_macro\\_indicators\\_a1\\_pdf\\_en.pdf](http://www.bnb.bg/bnbweb/groups/public/documents/bnb_download/s_macro_indicators_a1_pdf_en.pdf)

### 3.3 FDI

As already stated the FDI inflow was a main engine for economic growth from 2005 to 2008, mainly directed to the Real Estate sector (see appendix B). However, inward investment figures remain weak for 2009. Expectations for rebound in FDI are anticipated for 2010 and 2012 as considering the current political and macroeconomic trends. More detailed assessment on them will be provided in the conclusion and recommendations.

### 3.4 Foreign Exchange Rate

Another important factor for foreign investors is that the Bulgarian currency is fixed to the Euro (1.9558 BGN per 1 EUR) (ECB, 2009). Moreover, the government has build sound fiscal reserves from €4 billion to €14 billion for the period from 2003 to 2008 which will further cushion the effect of the current economic slowdown (See appendix C) (Raiffeisen, 2008) . This means that there is no risk of currency exposure such as transaction or economic exposures that would affect value or yields of properties owned by Euro zone investors.

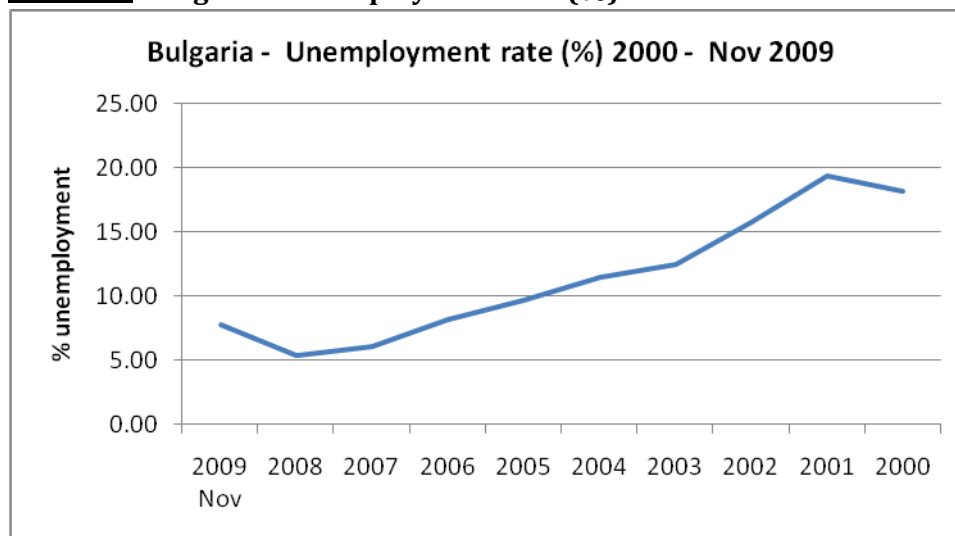
This month, January 2010, The Bulgarian PM Boiko Borisov made an announcement that the government will officially apply in the Euro zone in the end of January with the objective of adoption in 2013 (Parkinson, J. 2010) by outpacing even Poland on its way to the Euro, the only state that hasn't suffered a recession from the Central and Eastern European countries (see appendix A).

Another short-term opportunity for investors outside the Euro zone is the lowest exchange rate of the European currency against the Sterling and the US Dollar for the last 6 months (CNBC, 2010) By its weakening the Euro zone markets and others with pegged currencies such as Bulgaria will become more attractive for US and UK based investors by taking the advantage of purchasing properties at lower costs.

### 3.5 Unemployment and Labour costs

As you can see on the table below, the unemployment rate has decreased by approximately 15% for the last decade, a trend mainly driven by the sustainable economic growth for this period (ECB, 2009). However, again because of the global recession, the Bulgarian economy has shrunk by causing an increase in unemployment for 2009. Yet, that provides employers with higher choice of skilled labour available on the market

**Table 2.3: Bulgaria - Unemployment rate (%) 2000 - Nov 2009**



(ECB, 2009) [http://sdw.ecb.europa.eu/quickview.do?SERIES\\_KEY=132.STS.M.BG.S.UNEH.RTT000.4.000&](http://sdw.ecb.europa.eu/quickview.do?SERIES_KEY=132.STS.M.BG.S.UNEH.RTT000.4.000&)

In addition, Bulgaria also had the lowest average labour cost within EU for 2008 which as a consequence facilitates companies' production efficiency by outsourcing low cost manpower (Eurostat, 2008). This automatically leads to economies of scale, a strategic advantage for companies competing with foreign EU incumbents.

### 3.6 Ratings

An important event for the rating of Bulgaria from international rating organizations is that Moody raised the outlook on government rating to positive from stable on the 21<sup>st</sup> January 2010, citing the country's resilient government finances. This is also supported by Bulgaria's capability to reestablish growth and weather the impact of external shocks, and the expected exit from recession in the mid of 2010 (WSJ, 2010). Rating companies are a strong indicator for countries performance and a reliable guide for investors, thus the Bulgarian Real Estate sector attractiveness could be further underpinned by Moody's outlook.

### 3.7 Country Specific Advantages: Location

The strategic location of Bulgaria is another essential factor for Real Estate entrepreneurs. Macedonia and Turkey are EU candidates (EC, date unknown). Moreover, Macedonia, Serbia and Montenegro were offered EU visa-free travel from the beginning of 2010 (Vucheva, E., 2009). These events will make Bulgaria a centre of trade in the Balkan region which will develop the logistics industry and will pick property prices up, thus higher levels of yields.

**Image 3.7: Candidates for EU membership:**



(Source: BBC, 2010) <http://news.bbc.co.uk/1/hi/world/europe/7529707.stm>

## 4.0 Property Overview (recent trends)

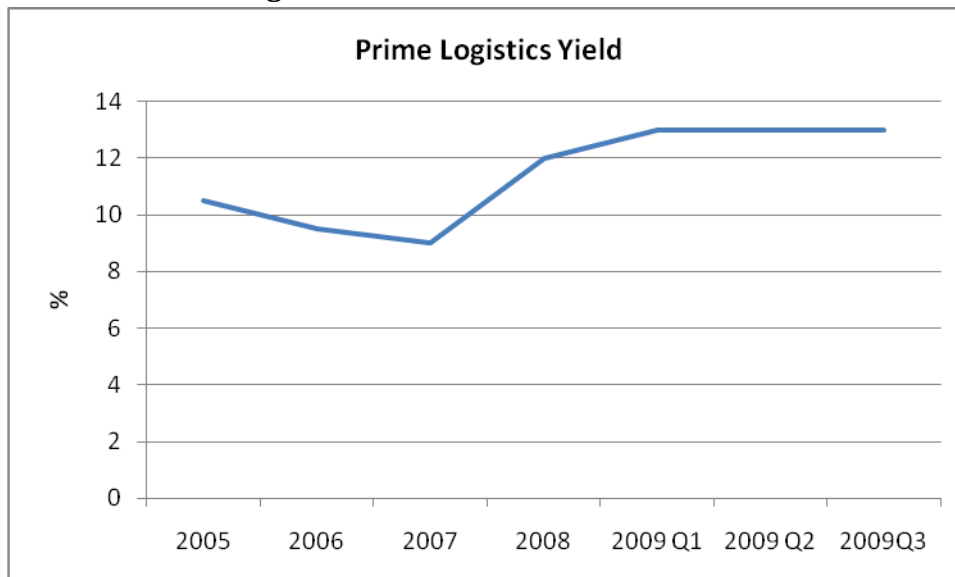
### 4.1 Industrial and logistics markets

The supply of logistics and industrial have been relatively unaffected by the recession. These segments have started their development later compared with the commercial real estate segment, thus remains undersupplied with relatively stable prices. Many projects have been delayed in the first part of 2009, mainly because of the weakened financial back up but it is strongly expected to be retouched in short-term (Colliers, 2009).

The demand in the beginning of the year was very weak but it has started picking up after the second part of 2009. This increase in demand was underpinned by super- and hypermarkets, establishing sound logistics networks, which have flourished in the current recession. Some of them are Lidl, Billa, Kaufland, and Carrefour (Colliers, 2009).

New report released in 2010 for the first half of the year confirms the trends assessed in the previous publication for the second half of 2009. However, another major concern discussed in it is the weakening of the industrial sector mainly affected by decline in exports and local consumption. This exercises pressure on industrial property prices, however creates BMV (Below Market Value) opportunities that potential Real Estate investors can exploit bearing in mind the presently expected recovery which will lead to future increase in property value (Colliers, 2010).

**Table 3.1: Prime Logistics Yield**



(Source: Forton, 2009) [http://forton.bg/en/wp-content/Q3\\_2009\\_Logistics.pdf](http://forton.bg/en/wp-content/Q3_2009_Logistics.pdf)

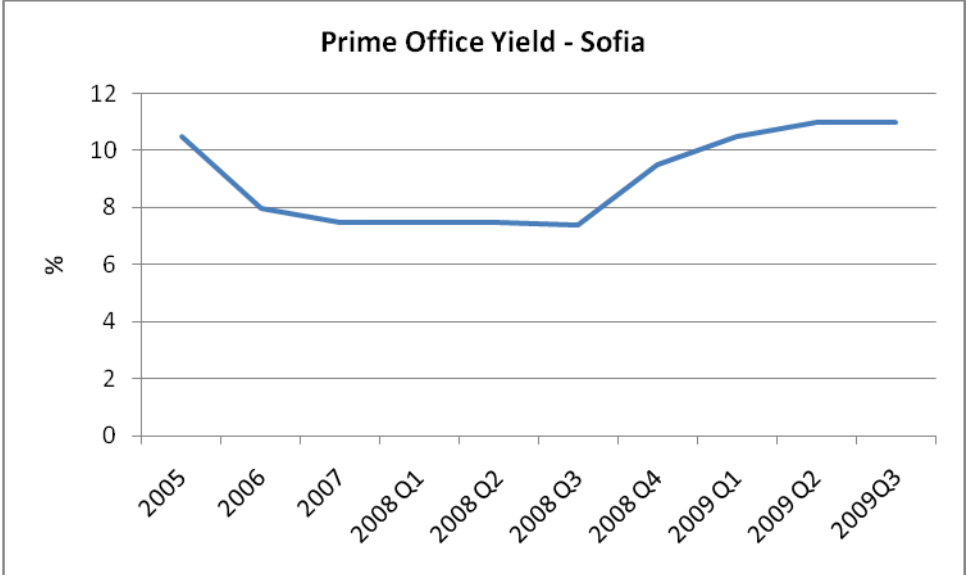
### 4.2 Office market

The office market, particularly in the capital of Bulgaria, Sofia, continues of the most affected commercial market from the economic recession which started in the beginning of 2009. Most companies limited their expansion and some of them even closed down, leaving vacant space. This market remains highly oversupplied because of the weakening demand from tenants which led to fall in renting prices with more than 30% (Forton, 2009)

On the other side, falling office prices and the cheap labour have attracted international outsourcing companies. That makes Bulgaria a leading market for outsourcing on the region of Central and Eastern Europe. According to a research made by Forton, Bulgaria is holding 13<sup>th</sup> place among the world premium outsourcing destination (Forton, 2009)

Furthermore, because the market has been demand-driven for a year now, landlords have adjusted to the new market situation by taking more flexible options; rent- free periods, step rents, fit-out or even relocation costs covered by the landlord are all part of the incentives offered (Colliers 2010).

**Table 3.3: Prime Office Yields – Sofia**



(Source: Forton, 2009) [http://forton.bg/en/wp-content/Q3\\_2009\\_Office.pdf](http://forton.bg/en/wp-content/Q3_2009_Office.pdf)

**4.3 Retail market**

The fast growth in the retail sector that was witnessed last year has slowed down in the beginning of 2009 due to the worsened current economic situation in Bulgaria. Many retail businesses were forced to minimize costs as a result of the decrease in the sales volumes. Because of the weak performance of shopping malls, retail businesses were forced to make requests for renegotiations for lease terms (Colliers, 2009). A factor easing this sector is the financing provided by banks. They tend to provide loans to retail operators perceiving them as a low risk investment and healthy developers for the market (Colliers, 2010)

The demand in the retail sectors has considerably decreased. Many businesses in this sector have reestablished their expansion strategies by taking a wait-and see positions because of uncertainty in future revenues. (Colliers, 2009) The interest for contemporary retail space continues to be underpinned by international retailers which is an evidence for the attractiveness of this sector. A fresh demand is supported mainly by drug stores, children goods and international multi-brand retailers (Colliers, 2010)

#### 4.4 Residential market

During the second part of 2009 the supply grew with a modest rate. Just few projects that have previously secured financing have been launched in that period. The supply of units went down with 41% compared with 2008, however the market is still significantly undersupplied (Colliers, 2010).

Demand started to pick up in the beginning of Q4 2009. This trend has been supported by the increased availability of mortgages, the low interested rates and the lower property prices. Cash payment method is till significant for financing which contributes to higher liquidity for investors. Bearing in mind that this segment is demand driven, the buyers can take the advantage of the current economic situation by negotiating optimal terms and price. Prices are expected to stabilize in the end of H1 2010 as demand increases and full recovery is expected in the next 12 to 18 months (Colliers, 2010).

#### 5.0 Conclusion and recommendations

To sum up, the Bulgarian Real Estate market has an attractive framework of incentives for foreign investors. The political situation is stabilizing by making Bulgaria the only EU member state meeting the Maastricht treaty criteria at the moment. In terms of macroeconomics the country is performing poorly, mainly because of the global recession and its negative impact on the emerging markets. However, this trend will be temporary until developed nations return to growth, as the Euro zone has already achieved that, and re-establish foreign investment practices, returning the Bulgarian market to growth again. The country's rating upgrade is another positive sign for the economy. Short-term projections for growth have been already confirmed by a report published by EBRD in January 2010. When it comes to the Real Estate environment, many entrepreneurs have suffered losses mainly because of the outflow of foreign investors' financing. This consequently led to property bubble burst which led to decline in prices. In addition, the higher unemployment rate contributed to weak consumption which had a negative impact on the retail, office and residential property sectors.

The economic recession and the downturn of the property market in Bulgaria however, provides lucrative opportunities. Property prices have reached their bottom. Investors now have the bargaining power to purchase properties below their market value. The different property sub segments have been hit but they are also offering profitable perspectives as already explained above. Long term forecasts for the Bulgarian economy are as well positive with average 4% growth compared with 2% for Western Europe for the next 5 years (see Appendix E) (Goldman Sachs, 2008). That will reduce unemployment and will return investors' confidence thus fresh financial resources will be poured in the market. Such a trend will push property prices up again however, margins could shrink. Therefore, at the moment investors have the chance to purchase Real Estate on their lowest rate, below the market value, and to reap the benefits of future pickups in property prices and consumer spending. An example of a country taking advantage on Real Estate opportunities in Bulgaria is Russia. According to the Russian based Real Estate agency Duki, Bulgaria is number one destination for investing in properties by Russian investors for 2009 which is 25% of their overall foreign property investments (Sofia News Agency, 2010).

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## Appendices:

### Appendix A: Growth in Real GDP:

#### Bulgaria

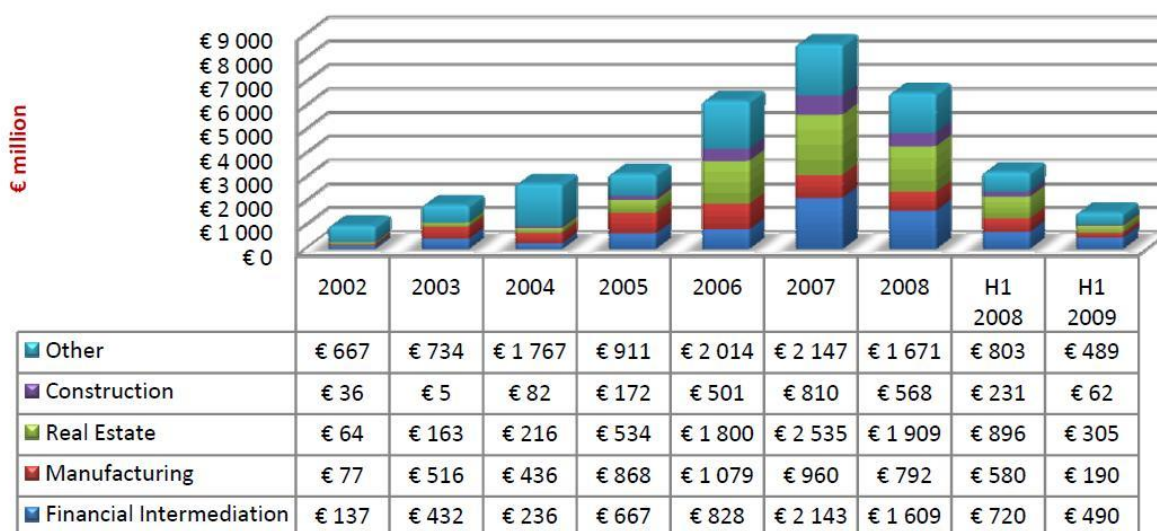
##### Growth in real GDP

	GDP Growth (year over year per cent change)								Memorandum item GDP Growth within year (Q4 over Q4 per cent change)			
	Current forecast				EBRD Forecast in October 2009				Current Forecast			
	2008	2009	2010	2011	2009	Change Oct <sup>3</sup>	2010	Change Jan	2008	2009	2010	2011
<b>Central Europe and the Baltic states</b>												
Croatia	2.4	-5.9	0.6	2.0	-5.4	-0.5	1.5	-0.9	0.2	-4.9	0.8	2.7
Estonia	-3.6	-14.7	-1.8	2.7	-13.2	-1.5	0.1	-1.9	-9.2	-12.7	2.4	2.6
Hungary	0.6	-6.7	-0.6	2.0	-6.5	-0.2	-0.9	0.3	-2.5	-5.3	0.4	2.5
Latvia	-4.6	-17.9	-2.0	2.5	-16.0	-1.9	-1.2	-0.8	-10.3	-15.7	1.2	3.2
Lithuania	2.8	-15.2	-0.5	2.3	-18.4	3.2	-3.0	2.5	-2.2	-13.7	-0.7	3.2
Poland	5.0	1.4	2.3	3.0	1.3	0.2	1.8	0.4	2.6	1.9	2.1	3.6
Slovak Republic	6.2	-5.3	2.8	3.7	-8.0	0.7	3.5	-0.7	1.6	-5.3	2.2	4.0
Slovenia	3.5	-7.5	1.9	2.7	-7.8	0.2	2.6	-0.8	-0.8	-4.2	1.7	3.0
<b>Average<sup>1,2</sup></b>	<b>3.5</b>	<b>-3.3</b>	<b>1.4</b>	<b>2.8</b>	<b>-3.4</b>	<b>0.2</b>	<b>1.3</b>	<b>0.1</b>	<b>0.3</b>	<b>-2.3</b>	<b>1.6</b>	<b>3.3</b>
<b>South-eastern Europe</b>												
Albania	7.0	4.3	2.0	3.9	3.0	1.4	1.6	0.3	6.9	2.1	3.2	4.1
Bosnia and Herzegovina	5.4	-4.4	0.6	1.9	-3.1	-1.3	0.8	-0.2	...	...	...	...
<b>Bulgaria</b>	<b>6.0</b>	<b>-4.8</b>	<b>0.0</b>	<b>2.7</b>	<b>-6.0</b>	<b>1.3</b>	<b>-1.5</b>	<b>1.5</b>	<b>3.5</b>	<b>-4.9</b>	<b>0.7</b>	<b>3.5</b>
FYR Macedonia	4.8	-1.2	2.0	3.8	-1.6	0.4	2.0	0.0	1.0	-0.6	3.2	4.0
Montenegro	7.0	-4.3	0.4	2.0	-4.1	-0.1	0.1	0.2	...	...	...	...
Romania	7.1	-7.0	1.3	2.3	-8.0	1.0	1.0	0.3	2.9	-6.1	2.2	2.8
Serbia	5.4	-3.1	2.4	3.2	-4.0	0.8	1.0	1.4	2.8	-1.7	1.9	3.7
<b>Average<sup>1</sup></b>	<b>6.5</b>	<b>-5.4</b>	<b>1.2</b>	<b>2.6</b>	<b>-6.2</b>	<b>0.9</b>	<b>0.6</b>	<b>0.6</b>	<b>2.9</b>	<b>-4.4</b>	<b>1.8</b>	<b>2.9</b>
<b>Eastern Europe and the Caucasus</b>												
Armenia	6.8	-16.3	2.0	3.5	-14.3	-2.0	1.3	0.8	-1.2	-12.2	1.4	4.6
Azerbaijan	10.9	9.3	9.0	8.0	5.0	4.3	7.1	1.9	7.9	13.7	4.5	9.5
Belarus	10.0	0.2	3.0	3.9	-3.0	3.1	0.9	2.1	7.5	1.3	2.3	4.4
Georgia	2.1	-4.5	2.0	4.0	-5.5	1.0	2.0	0.0	-2.5	-0.7	0.4	5.0
Moldova	7.2	-6.7	4.0	4.0	-8.5	1.8	1.5	2.5	6.2	-4.7	3.1	4.4
Ukraine	2.2	-14.5	3.0	3.0	-14.0	-0.5	3.0	0.1	-8.0	-5.3	0.0	4.7
<b>Average<sup>1</sup></b>	<b>5.0</b>	<b>-7.8</b>	<b>4.0</b>	<b>4.2</b>	<b>-8.7</b>	<b>0.9</b>	<b>3.1</b>	<b>0.9</b>	<b>-2.3</b>	<b>-1.4</b>	<b>1.4</b>	<b>5.5</b>
<b>Turkey</b>	<b>0.9</b>	<b>-5.6</b>	<b>4.7</b>	<b>4.0</b>	<b>-6.0</b>	<b>0.4</b>	<b>3.0</b>	<b>1.7</b>	<b>-6.5</b>	<b>3.1</b>	<b>1.0</b>	<b>6.0</b>
<b>Russia</b>	<b>5.6</b>	<b>-8.7</b>	<b>3.9</b>	<b>4.2</b>	<b>-8.5</b>	<b>-0.2</b>	<b>3.1</b>	<b>0.8</b>	<b>1.2</b>	<b>-5.6</b>	<b>3.5</b>	<b>4.5</b>

(Source: EBRD, 2010) <http://www.ebrd.com/new/pressrel/2010/100122.pdf>

## Appendix B: Bulgaria – FDI by Sector

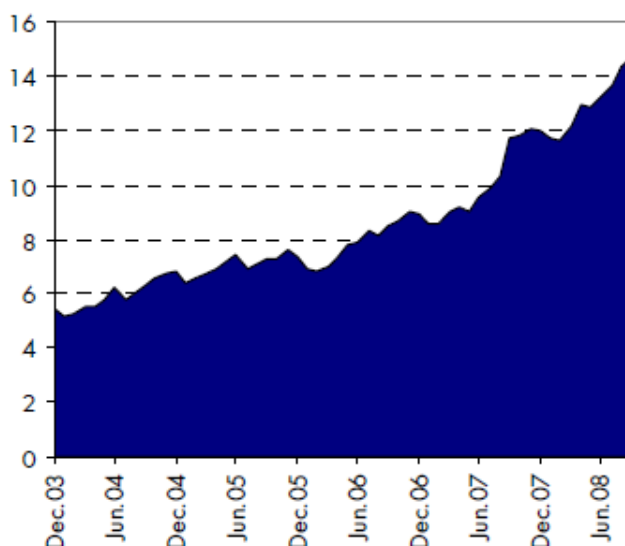
### FDI by Sectors



(Source: Forton) [http://forton.bg/en/wp-content/Q3\\_2009\\_Economic.pdf](http://forton.bg/en/wp-content/Q3_2009_Economic.pdf)

## Appendix C: Bulgaria: FX reserves

### FX reserves (EUR bn)



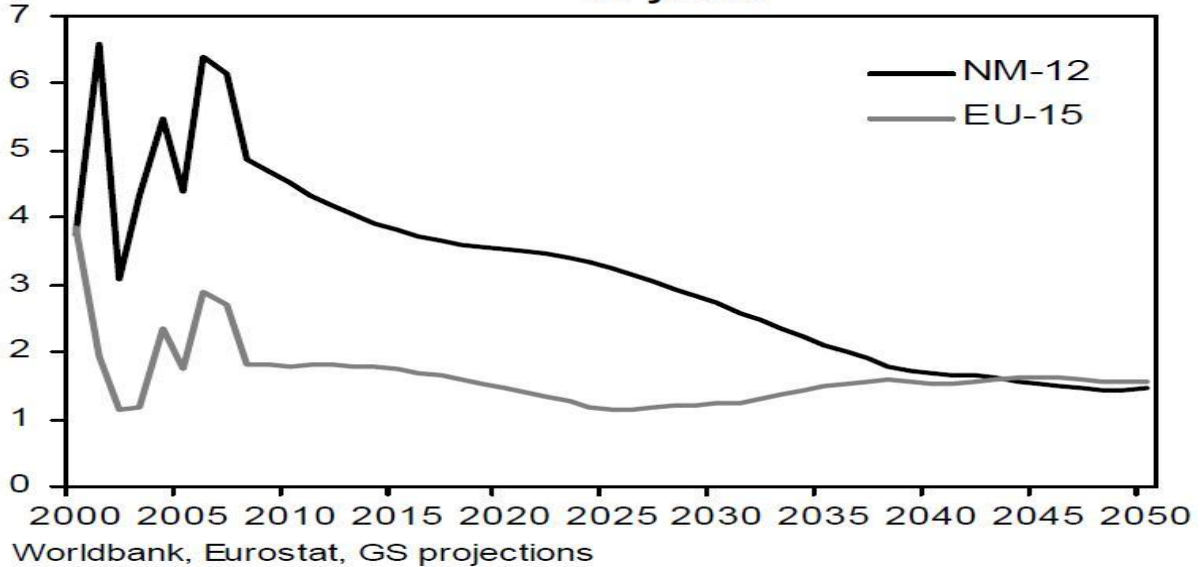
(Source: Raiffeisen, 2008) [http://www.raiffeisen.at/eBusiness/services/resources/media/1026359884948-1026359885014\\_1026067974202\\_1027874455325\\_1027874650133-168343813675254969-1-NA-EN.pdf](http://www.raiffeisen.at/eBusiness/services/resources/media/1026359884948-1026359885014_1026067974202_1027874455325_1027874650133-168343813675254969-1-NA-EN.pdf)

**Appendix D: Companies in Bulgaria**



**Appendix E: New EU Member States—A Fifth BRIC?**

Real GDP growth, % **NMS can grow faster than EU-15 for the next 30 years**



(Source, Goldman Sachs, 2008) <http://www2.goldmansachs.com/ideas/global-economic-outlook/new-eu-member-states-pdf.pdf>