

Cyprus Economy & Real Estate 2014-2015

March 2014

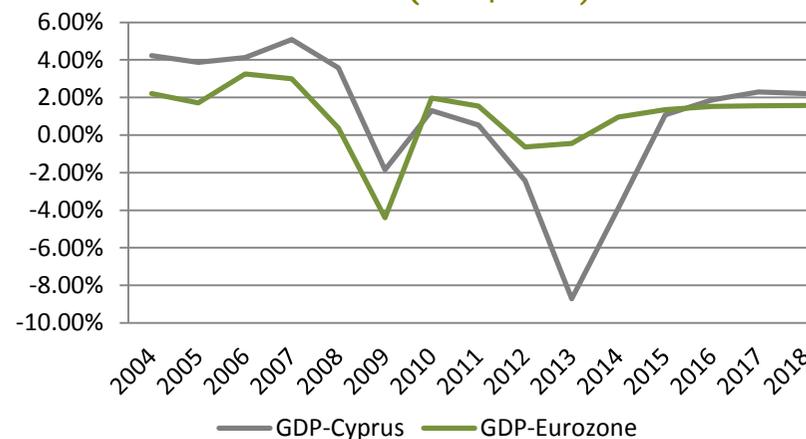
“Forecasting is difficult, especially about the future.”

GDP & Unemployment

- The decrease in Gross Domestic Product (GDP) for 2013 was limited to 5.3%, which can be positively compared to the original forecast for a 8.7% decrease .
- Revised forecasts indicate a minor decrease of GDP during 2014 and an increase of 1.1% in 2015.
- The unemployment rate reached 17.5% in December 2013 and is expected to increase further during 2014 (around 19.2%).
- Expected recovery from 2015 onwards is estimated at GDP growth of 1.0 – 1.5% annually, which is not expected to decrease unemployment below 10% before 2020.
- Public debt is estimated around 120% of GDP and is expected to further increase during 2014 and 2015.

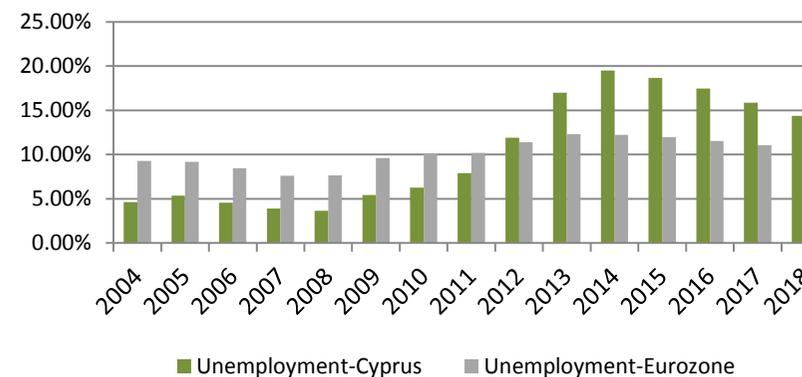
The forecasted economic stabilization and GDP growth is not enough to alter the general situation in the economy and the labour market any time soon.

Gross Domestic Product (2004-2018)



Sources: IMF

Unemployment (2004-2018)

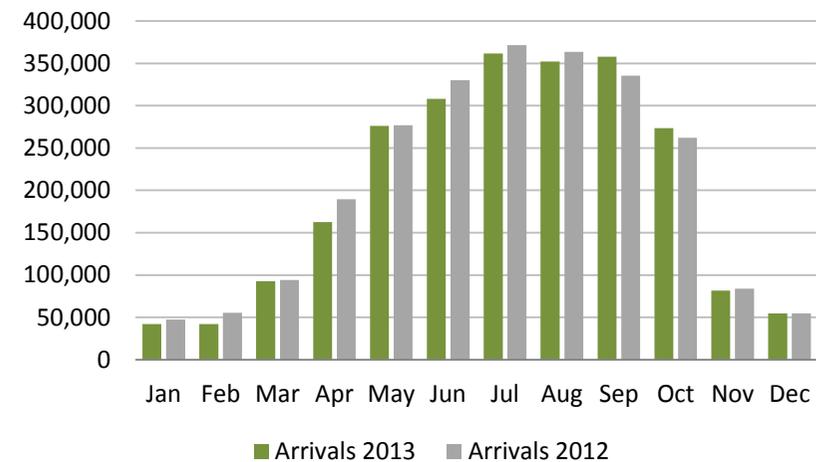


Source: IMF

Tourism

- In 2013:
 - 2.4% Decrease in Tourist Arrivals
 - 8% Increase in Income
 - 27.5% Increase in Arrivals from Russia
- Proportion of tourists from Russia is increasing in relation to those from UK, who nevertheless hold the biggest market share.
- Arrivals are expected to increase during 2014, especially from Russia (increase is estimated to reach circa 11%)
- Open Skies policy is expected to start decreasing the seasonality of tourist arrivals and extend hotel operations by one or two months.
- There is a strong interest from foreign investors for hotels. During 2013, two hotel sales were recorded in Limassol (Le Meridien and Amathus).

Arrivals Per Month (2012-2013)



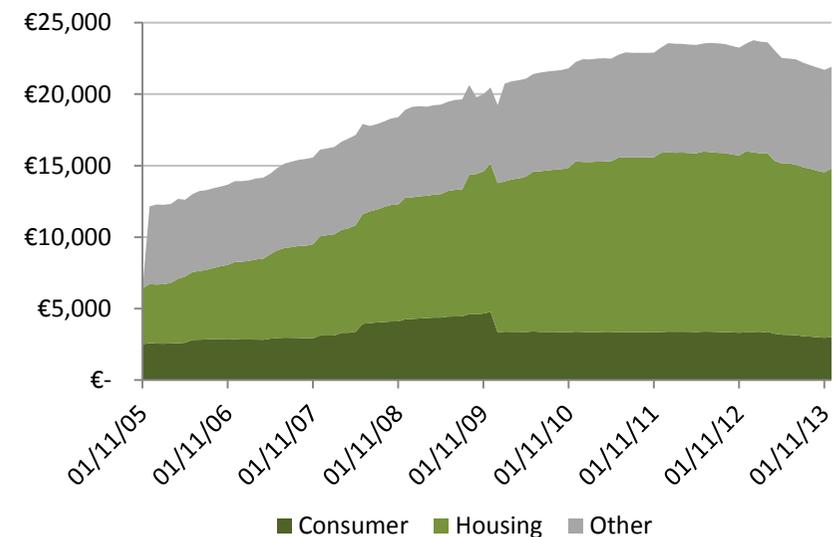
Sources: CYSTAT

Despite the increase in arrivals, hotel owners are in a difficult position due to their levels of indebtedness. Furthermore, they have not invested in their hotels for a long period of time, which has resulted in their product offering being somewhat inferior when compared to other markets.

Household Debt and Non Performing Loans

- There is annual decrease of 7.1% in the total loans of households in 2013, in comparison to 2012.
- Most household loans are housing loans (€11.8 bs), the total of which equals to 53% of total loans outstanding.
- Total of non performing loans (NPLs) amounts to €24.1 bs, which equals to 147% of the 2013 GDP .
- Majority of NPLs are recorded in the construction sector, amounting to €4.62 bs.
- As at year end, NPLs equalled 53% for Bank of Cyprus and 47% for Hellenic Bank.
- For the COOPs, NPLs equalled 47% of their portfolio as at 2013 Q3.

Household Debt ('000)



Source: Central Bank

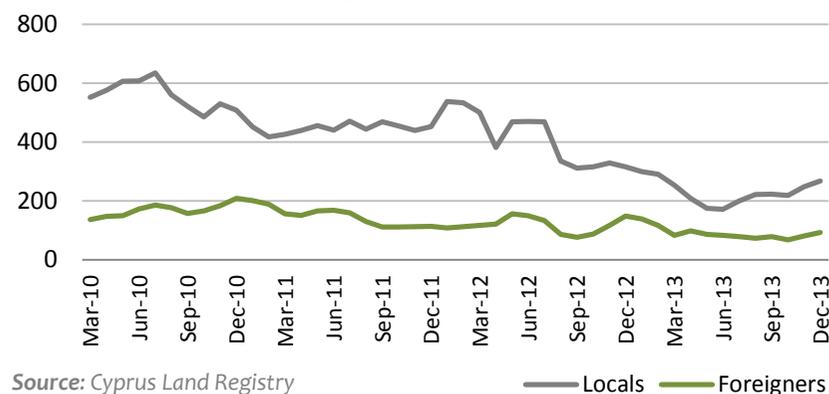
The percentage of Non Performing Loans appears to be stabilising, but at these levels collateral disposal is essential and the need for further recapitalization of the banks is very likely to be necessary.

Transaction Volume and Prices

- In 2013, the highest movement in total volume (31% or 1.164 sale and purchase agreements) and purchases by foreigners (38% or 445 sale and purchase agreements) were recorded in Paphos district .
- 27% of sale and purchase agreements in Cyprus (1.017 sale and purchase agreements) involved foreign buyers.
- The smallest number of sale and purchase agreements (583) was recorded in Famagusta district (6% of total), whilst lowest percentage of transactions to foreigners was recorded in Nicosia (13% of total transactions, 92 properties).
- Prices decreased across all cities and for all types of real estate. The largest decrease was recorded for shops (42% decrease in relation to 2009Q4) and the lowest in houses (26% decrease).
- The largest decrease was recorded in Nicosia, where prices are decreasing at a fast pace since the capital was the last city to be affected by the crisis and its economy is largely reliant on the public and on the banking sectors.

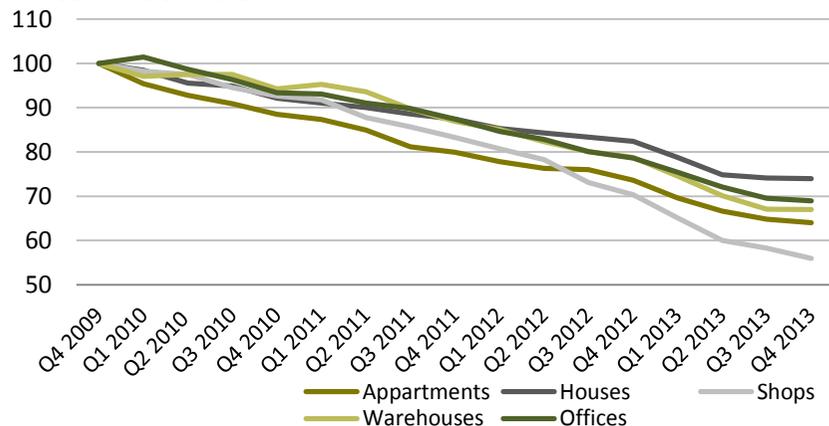
The decrease in transaction volume and property prices does not present an accurate picture of the property market. There is a dearth of demand for land purchases (especially fields) and for constructions in secondary locations. In multiple cases, especially for 'mass production' real estate, even though prices are below construction costs, there is no interest.

Sale and Purchase Agreements



Source: Cyprus Land Registry

RICS Price Index



Source: RICS Cyprus

2014 Prospects...

- Privatization of semi-public organisations according to MoU terms, starting with CYTA, EAC and Cyprus Ports Authority.
- Changes in public sector operation, including early retirement schemes and abolishment of mobility restrictions to permit personnel to move across departments .
- Immovable Property Tax revision by adjusting 1980 prices to 2013 values (readjustment of tax rate is expected).
- Amendment in legislation for speeding up the process of real estate foreclosure, ensuring that properties are disposed of within 2,5 years of initiating legal proceedings for someone's primary residence and 1,5 years for all other properties
- Launch of casino licensing process, with government submitting relevant bill.
- Formulation of a strategic plan for the exploitation and utilization of state property (including real estate).
- Completion of town planning and regulations which will determine the development potential within the British Bases.
- Establishment of NLP and property management units in all banks and COOPs
- Reassessment of property taxation method and calculation so as to increase state income, and transfer the tax burden on owning the property rather than on the transaction

Rationalising procedures and liberalizing information exchange between government departments and financial institutions will increase the pressure on borrowers and will allow for the financial system to function more effectively in relation to the management of its multiple problems relating to NPLs.

Thoughts and Forecast

- The smaller than expected decrease in GDP disguises the uneven allocation of the effects of the economic crisis. The gap between rich and poor, as well as the tension between locals and foreigners in the labour market, have increased .
- Unemployment is likely to begin decreasing or at least be contained. This will not be a result of the stabilisation of the economy, but of the government’s plans/ incentive schemes for companies to employ staff and the increase in the levels of part time employment.
- Increase in real estate supply, especially secondary residential units and commercial space for rent. This, in conjunction with decreased demand due to a decrease in local’s purchasing power, will subdue any forthcoming recovery.
- Despite the expected stabilisation and minor recovery of the economy, it is estimated that in the near term real estate prices, especially that of land, will decrease further as no substantial uplift in the price of the end product is expected, the rate of sale is likely to remain slow, and no debt-finance will be available.
- The gap between asking price, valuation and transacted price will grow further, due to increased uncertainty in the marketplace caused by a lack of market signals (transactions).

Capital Values - 2014 & 2015 Forecast

Housing Plots	(-) 17%
Commercial Plots Εμπορικά	(-) 32%
Offices	Cat A (-) 16% Cat B (-) 23%
Apartments	Centre (-) 13% Secondary locations (-) 16% Touristic locations (-) 12%
Shops	Centre(-) 17% Secondary locations (-) 19% Touristic locations (-) 9%
Fields	(-) 28%

Source: Leaf Research

Note: Forecast in comparison to 2013

In the short term, the biggest challenge will come from the prospect of developing within the British Bases, since this will significantly increase the supply of available land in Larnaca and Limassol. In the medium term, the economy will face the ongoing challenge of the banks’ deleveraging and foreclosure of real estate assets, while in the long term there will be multiple policy issues relating to the reckless incentives provided to boost construction by granting additional building density for various developments which has created ‘pent up’ oversupply.

Company Profile

Leaf Research is an advisory firm providing real estate market research, strategic advisory services, and valuations.

It undertakes feasibility and viability studies, competition analysis, and business model creation for residential and commercial properties. The company specialises in alternative types of real estate, such as hotels & leisure, health, education and mixed-use developments.

Leaf Research provides advice which sets the foundations for financial decisions being made by banks, real estate firms, private investors and investments managers.



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