ECONOMIC AND SOCIAL EFFICIENCY OF PROPERTY INVESTMENTS

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Investments play a key part within the goods and services industry, consumerism and community as well. The effects generated by any investment project substantiate this statement, regardless the sector of activity in which they are implemented. In the current market economy, economic efficiency indicators are playing an important role in assessing and analyzing an investment project since due to these indicators, the investor can become aware of the most important aspects they need to respond promptly. In this respect, we conducted a market analysis of real estate investments in Romania, highlighting economic and social efficiency of property investments.

Keywords: property investments, economic efficiency, social efficiency

Jel Code: *E22, E63, F21*

1. Introduction

Implementing an investment project will influence directly or have consequences upon employment whereas the increase of employees' number and/or their wages will eventually lead to an increase in demand for goods and services. An increase of people's savings will follow as well as the liquidities of economic agents which, in time will be oriented to the achievement of some other investment projects.

In an economic system, *investment plays a dual role*:

- *First of all,* economic agents that undertake investment operations, which implement various investment projects, expand their range of goods and services by increasing their productive capacity, thus collecting extra income.
- *Then* any investment project will generate new needs and additional requirements in the following sectors: neighbouring sectors, upstream sectors (supplying raw materials, materials, utilities, etc.) or down stream sectors (distributors or consumers of the goods and services that are provided).

Restructuring a real economy can only be achieved by investments, by creating new and more powerful structures in compliance with the strategic options of the society. On a short-term, investments aim at boosting productivity, diversifying activities, improving workplace conditions with a positive impact upon macroeconomic level.

In a social system, investments play the part of regulating/compensating employment, triggering significant changes on the labour market, creating the need for additional labour in the sectors that prepare and perform investment activities (research and design, constructions, car and equipment manufacturing).

Of great interest is the role that investments need to play in solving the issues of the contemporary society, namely *protecting the environ*ment, restoring the ecological balance where it has been neglected.

Investment efficiency is determined by analysing the efforts/effects ratio of investment, taking into account the coordinates of time, economic and social environment.

In the current context, investments represent the decisive factor of economic growth, of promoting the intensive, qualitative factors in efficiency. Undoubtedly, the investment decision is the central decision in a company, as making incorrect decisions in this respect normally leads to significant financial losses and in some cases can lead to bankruptcy.

To conclude, investments represent the material support of economic and social development of a country. Investments ensure the increase of fixed capital, increase of the existing technical and economic yield and also the creation of new jobs.

2. The conceptual framework for property investments

The term *real property* is a legal concept that refers to land and to anything erecting on or affixed to it such as buildings. The real estate market is made up of categories of legal and natural persons, who are owners, sellers, buyers, tenants, contractors and subcontractors in construction, investors, realtors, lenders and borrowers, managers, involved in real estate transactions.

To the extent that private investment property has developed, real estate has become extremely attractive for business. Buying a property requires significant investments. Nowadays real estate has become a constantly expanding industry. In this respect, two boundaries related to the real estate market must be set:

In a broader sense**,** it includes all real estate transactions between legal and natural persons, which are concluded in a particular space, and which match the real estate supply and demand, property prices are set and people negotiate a deed under competitive circumstances.
In a narrower sense: the real estate market can be defined as the market that includes all transactions that involve the transfer of property on land and buildings.

Specialists compiled the factors that influence the real estate market, among them we mention the following:

- cultural, political, social and economic environment;
- legislative framework;
- governmental and administrative environment;
- banking;
- private service sector.

Main characteristics of the real estate market*:*

- ***Durability.*** By definition, a property is sustainable. A building can last for decades and even centuries whereas land is physically indestructible. Therefore real estate markets are modelled as stock/flow markets. About 98% of supply is made up of the stock of existing houses whereas only 2% is made up of the flow of new development.
- ***Heterogeneous.*** Each and every property is unique both in terms of its location, building and financing. Because of this characteristic, pricing becomes difficult, information asymmetry is generated and substitutability is restricted. In order to overcome this problem, economists (beginning with Mut in 1960) defined the supply in terms of service units, i.e. any physical unit that can be divided into real estate services as an unobservable theoretical construct. Housing stock depreciates, thus becoming different in point of quality from a new building. Thus the market equilibrating process operates on various levels of quality.
- ***High Transaction Costs.*** Buying and/or moving into a new house involves higher costs than most types of transactions. These costs include search costs, real estate fees, moving costs, legal fees, transfer fees and fees for deed registration. Usually the transaction costs incurred by the seller represent between 8 to 10% of the purchase price.
- ***Long tine delays.*** The market adjustment process is subject to delays, due to the period of time required both for financing, designing and building the new supply as well as to the low rate of demand change.
- ***A property is both an investment good and a good for consumption.*** A property can be purchased expecting to generate income (an investment good), with the intention of using in (good for consumption), or even with both intentions. These functions of the property can be separated, thus market participants can focus on only one function or can be combined (for instance when people living in a house rent a part of it). The dual nature of the property leads to a particular phenomenon called over – *investment* in real estates, meaning to invest more in an asset that it actually worth on the free market.
- ***Immobility.*** On the real estate market, the consumers are those who come to the good and thus we cannot speak about a physical space for the market. For instance, if people prefer to live in the suburbs then they need to move to suburbs as they cannon physically move their house.

3. Particularities of real estate supply and demand

A. Real estate demand

- **The main determinants are the following:**

1. **Demographic factors.** The main demographic variables are the size of population and the population growth, among these and real estate demand there is a direct, positive connection: *the higher number of people in an economy, the greater real estate market demand.*
2. **Income.** Mention should be made here that most economists take into account in their analysis the permanent income and not the annual income because of the high cost of purchasing a property.
3. **Price of a property.**
4. **Other factors.** Cost and credit availability, consumers' preferences, investors' preferences, price of substitutable and complementary goods etc.

B. Real estate supply

Result from the use of train, labour, other various inputs such as electricity, building materials.

The main real estate supply determinants are the following: ***input costs, the existing housing stock and production technology***

Table no. 1. Classification of real estate markets

In terms of the transaction object		
Office market	**Retail market**	**Industrial market**
Office market of type A category Office market of type B category Office market of type C category Market of business offices located in hotels	Cash&Carry retail market Hypermarket retail market Do-It-Yourself retail market Shopping malls retail market retail market of clothing, cosmetics etc.	Market of production spaces Warehousing market which is classified as follows: ▪ Retail warehousing market ▪ Retail market for warehousing complexes ▪ Retail market for logistics parks
Residential market	**Hotel market**	**Flat (Apartment) market**
Residential assembly market Market of luxury villas Housing market	Market of 1-2 star hotels Market of 3-4 star hotels Market of 5 star hotels	Market of new apartments Market of old apartments Market of housing renovation and modernization

Source: Enache C, 2004: p. 47-55

4. Analysis of real estate market in Romania

In 2003 the real estate market recorded 485.000 transactions, which brought in €*70 m*, in taxes, respectively € 140 per transaction. In 2007 the number of transactions peaked at 513.000 with an average value of € 700 per transaction, five times higher than in 2003. The crisis from 2009 brought about the collapse of transactions, the state receiving € 118 million in taxes, the number of transactions reaching 351.000, with an average value of € 335 per transaction, far below than in 2003.

However it should be mentioned here that the average tax per transaction dropped by 52% between 2007 and 2009, whereas the number of transactions fell only by 31%, which shows that increasingly affordable housing could be traded.

As a result of the 7.1% economic growth, Romania was placed among the countries with the highest economic growth. Nevertheless the national economy witnessed a decline with the same magnitude in 2009. The crisis has had unimaginable adverse economic and financial effects. Global economic instability affects the local market, i.e. supply and demand.

Macroeconomic indicators showed a disastrous trend between 2009 and 2010 as a result of the economic and financial crisis.

Currently, in Romania, real estate projects are being promoted in all market sectors, with an increase of 250 percentage points both for yield for best buildings and for the best shopping centres compared with the capitals of Western Europe countries.

The real estate sector has begun to gain ground, showing 18% increase compared with the same period of 2012. The investment volume is dominated by foreign investors, the share of the most important investors being held by South Africa (37%), Cyprus (20%), France (18%), Central America (16%), Greece (4%) and Spain (2%). Thus the activity of international investors has been of highest importance for maintaining investment activity in commercial property.

Two distinct branches can be identified in the real estate market, namely: *urban real estate market* and *rural real estate market*. The real estate market is made up of these two branches, that show a more intense activity in the urban area where the demand is higher.

In April 2013, 74.937 transactions were recorded on the national level, 6.439 more than in March and 24.071 more than in April 2012.

Real estate market analysis on market segments:

Romanian office market seems to be the least affected by the crisis. Showing a higher percentage of rentals (82% of the total), the demand for offices seems higher than the supply.

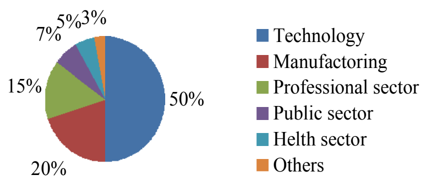
2008 was an active year for office market concerning the supply and demand, recording the highest figures from the beginning of the real estate market in Bucharest. 2009 brought a massive supply of new buildings, thus the end of the year revealed 1.250.000 m^2 total stock of office space. Due to the difficult economic conditions, the number of transactions decreased with a higher rental vacancy rate.

In the first nine months the *contracted prime rents* remained unchanged, being quoted at 18.5 €/m^2 /month. A decreasing trend is estimated for the prime rents for 2013, as a result of a higher supply of office space available in the business centre of Bucharest. The overall vacancy rate is estimated at 15.88%.

The office market is one of the most dynamic real estate segment, arousing the interest and being requested by potential tenants. In the office sector, the most active tenants are from IT and Telecommunications, with 50% of the sector rents. The lowest share is held by the medical sector with only 5%.

The figure below shows the share of all sectors that perform their activity in the office segment.

Figure no. 1. Share of sectors on office segments

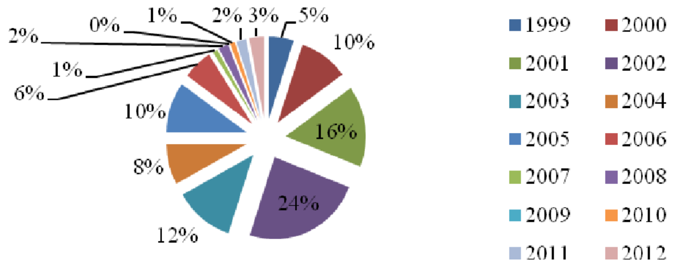


Source: data taken and analysed by the author based on the information provided by www.cushmanwakefield.com

The retail market is in a different position, facing the risk of oversupply. 2008 was the most active year up to now for the retail in Romania. Even before the onset of the crisis, the market became difficult especially for projects built in towns; in most cases not being able to open all rented spaces. The crisis led to a market welcome decline by imposing a natural selection of projects, thus preventing oversupply. The difficulties witnessed by the financial market and low chances of economic growth determined a fall in demand for commercial spaces.

Prime rents (shopping centres and *street units)* are estimated to vary between 55and 65 €/m^2 /month. Both types of rents showed a slight decrease compared to the values carried forward in 2012. By the end of 2013 no major changes are expected in prime rents (shopping centres and street units). The figure below shows the evolution of the commercial segment in Romania between 1999 and 2012. We can notice a dramatic fall between 2008 and 2009 when the economic and financial crisis hit Romania thus affecting the commercial segment as well.

Figure no. 2. Share of commercial segment in the main towns

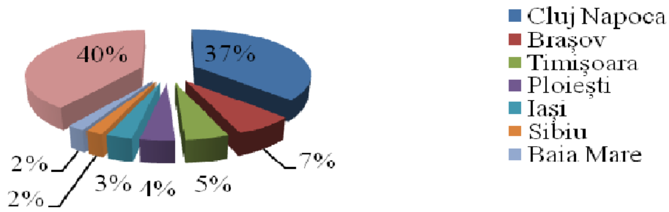


Source: data analysed by the author based on the information provided by www.cushmanwakefield.com

Industrial spaces market recorded changes in industrial space lease. The prime rents for industrial spaces range between 3.8 and 4.0 €/m^2/month. The rental of light industrial units are estimated to range between 3.5 and 4.25 €/m^2/month. For larger spaces, exceeding 20.000m^2, rents are lower, ranging between 3.5 and 3.75 €/m^2/month.

The figure below shows the cities in Romania with the highest share of industrial segment.

Figure no. 3. Share of industrial segment in the main cities of Romania.



Source: data analysed by the author based on the information available on www.cushmanwakefield.com

Conclusions

To conclude, Romania still remains an area with a huge real estate potential but which has a lot to recoup. Numerous projects are frozen because of the economic crisis. However they did not leave the country due to their confidence in the Romanian market. 2014 and 2015 are estimated to be good years for the real estate market because of the announced projects. The market will still remain focussed on retail and office that are constantly expanding and that have provided or they are about to provide the best projects in Romania. A sustained program of stimulating the economy is highly needed, so that the real estate market to be able to expand again. Obtaining financing is an incentive in real estate market; its accessibility might lead to an increase in the number of real estate projects developed by investors.

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