COVID-19

Industry Pulse Report: **Real Estate**

01 May 2020

Building a better working world

COVID-19 Industry Pulse Report: Real estate

- What is the industry sentiment around the impact of COVID-19 on the Real estate sector?
- How is COVID-19 expected to impact the Real estate sector?
- What response measures have been taken to date to address the impact?

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Foreword

"The pandemic has caused global economic turmoil and has disrupted consumption and supply chains across the world.

Cyprus is once again facing an immense challenge that is exacerbated by the global interconnectedness of its economy. The situation calls for ongoing monitoring to ensure proper understanding and sound decision-making.

At EY Cyprus, we have prepared three Industry Pulse reports for the Banking, Real Estate and Hospitality sectors. The reports aim to provide sector-specific perspective with regards to the impact of COVID-19, in conjunction with fiscal and monetary policy response, and include our own assessment of likely scenarios and trends. In this report, we focus on the Real Estate sector.

Our team has spoken with Real Estate sector executives and leaders to obtain a realistic collective sense of their sentiment and expectations of this crisis, their views in relation to the response measures to date and their insights with regards to recovery scenarios and trends.

This publication will be updated periodically and shall incorporate the most updated publicly available information in relation to the impact of the virus on the aforementioned industries, the government and regulators' response actions as well as an updated economic assessment in accordance with our view.

We trust that this publication will become a reference document for discussion among stakeholders such as corporate executives, financial institutions and the government.

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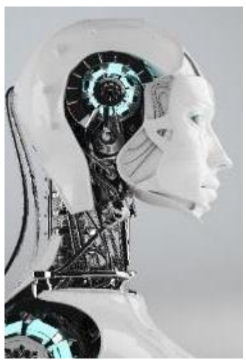
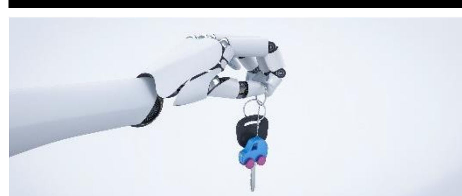




Executive Summary

The unprecedented impact of the COVID-19 crisis is causing major operational disruptions in businesses around the world and financial distress for households and individuals, resulting in a global economic downturn. The Real Estate ("RE") sector has traditionally been a key pillar of the local economy and played a critical role in the country's remarkable economic growth of recent years. Similarly, the sector is expected to be a key driver for the economic recovery from this current crisis. Due to the importance of the sector, we have carried out a survey to capture the market sentiment with regards to its potential impact from the COVID-19 crisis. The results of the survey, together with further analysis and research carried out, are presented in this Pulse Report.

Industry Sentiment – Key Takeaways

As part of the survey we approached key stakeholders of the sector and invited them to provide their views, expectations and sentiment in relation to the COVID-19 impact. The stakeholders considered included RE developers, construction companies, RE agents, lenders, RE appraisers and other advisors.

Overview of EY survey key responses

- A sharp decline in transaction activity (c.70% based on some participants) already observed in the market
- The timely recommencement of construction activity and lifting of country lockdowns to facilitate viewings/sales are considered key for the recovery of transaction activity and mitigation of the adverse financial impact
- Participants are currently adapting their operations mode and using different measures to sustain business and stimulate sales activity (use of technology for remote sales/working from home, offer of discounts on asking prices, utilisation of employee support schemes introduced by the Government, etc)
- The majority of the participants feel that the immediate impact of the pandemic would be relatively short term and they will be in a position to recommence full operations shortly after the relaxation of measures. Recovery of transaction activity however is expected to take longer and be gradual
- Different RE asset types are expected to be impacted in different ways and magnitudes by the pandemic. Retail properties are expected to be the most affected, while residential assets the least

European Real Estate Market sentiment

- The European market in general also faces reduced activity, with recorded sales showing in some cases y-o-y reductions of c.50%
- Transaction volumes are expected to suffer a much larger drop than property prices in the shorter term, with the latter expected by analysts to fall on average by 8% in 2020 in the Eurozone. The COVID-19 uncertainty adversely affects investor confidence and investment activity. Investment in the market from non-European investors (representing around 50% of the total in the past) is further hindered by country lockdowns
- Factors that become important in this crisis include prime location, contracts with solid and long-term tenants, as well as changing buyer/tenant preferences
- Changing trends: the COVID-19 crisis acted as a catalyst for the wider implementation of remote working practises and online shopping; which in effect adversely affect the office and retail RE markets respectively

Additional Sector Support measures

Government measures to support the sector are considered key in stimulating demand/investment and can be provided in different forms. Tax incentives could take the form of elimination of CGT and transfer fees, reduction of VAT rates and tax payment deferrals. Construction activity can be supported through the elimination of bureaucratic procedures (e.g. licensing). While overseas investment in the sector can be boosted through a support and strengthening of the Cyprus Investment Programme.

Executive Summary (cont'd)

Scenarios examining the COVID-19 impact on the sector

Sector performance is largely dependent on external factors such as the governments' health-centric policies on social distancing and travel restrictions. Three relevant scenarios were tested by EY, reflecting different degrees of sophistication/effectiveness of pandemic countermeasures. These are presented below.

Partially effective economic response assumption

- Solid fiscal/monetary policies, robust economy-wide but partial sector-specific measures, moderate timeliness, modest EU solidarity.
- Sector supply/capacity suffers some contraction, mild depression.

Depth of red colour indicates magnitude of COVID-19's negative economic impact

Scenario 1 (2020)

- Severe resurgence episode
- A number of RE sector bankruptcies and unemployment
- Mid-Long-term demand recovery
- Govt debt: Debt/GDP:

Scenario 2 (2020)

- Virus generally contained
- Limited RE sector bankruptcies and unemployment
- Mid- term property demand recovery
- Govt debt: Debt/GDP:

Scenario 3 (2020)

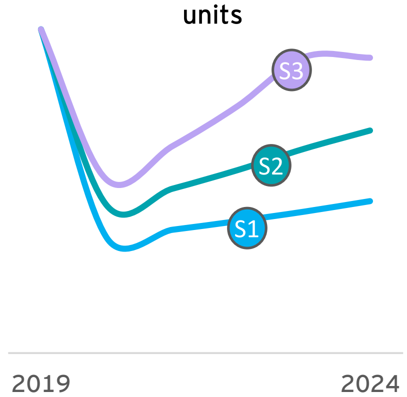
- Virus well under control
- Very limited RE sector bankruptcies and unemployment
- Mid-short term property demand recovery
- Govt debt: Debt/GDP:

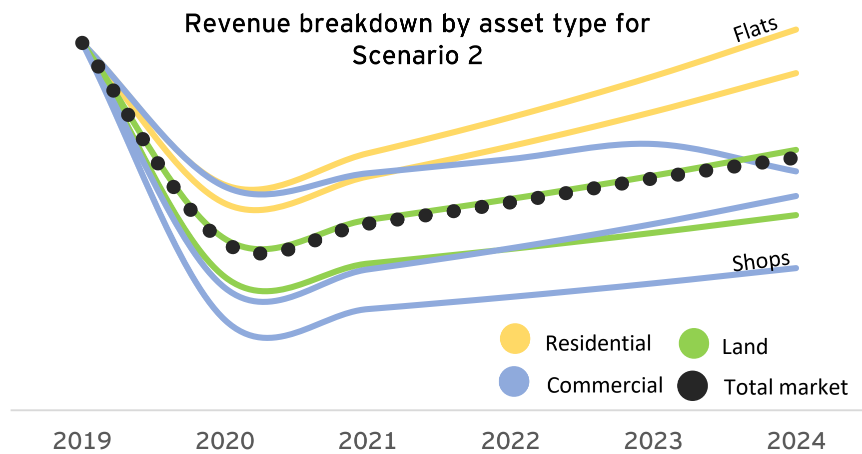
Low	Medium	High

Sophistication/Effectiveness of pandemic countermeasures

The COVID-19 impact was considered under each scenario on the basis of two key metrics; sales revenue and the number of building permits issued. We then tested for each scenario the effect on individual property types, since these are affected differently by the pandemic. The graph on the left below presents a comparison of the effect on total RE sales for the three scenarios. On the right we also present a breakdown of Scenario 2 (chosen for indicative purposes) for each different property type.

Revenue from sales of real estate units





Key takeaways on COVID-19 impact from the scenario analysis

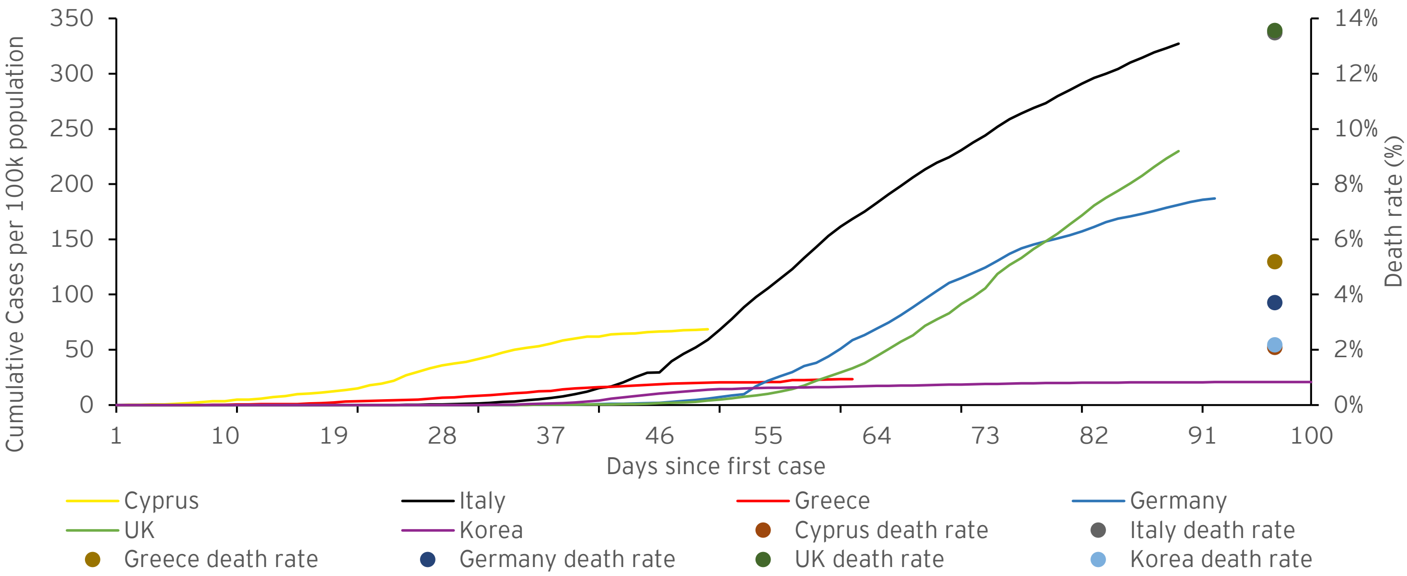
- All three scenarios tested follow an initial large drop in revenue for 2020 resulting from the sharp drop in demand and transaction activity, recovering gradually (albeit at different rates). Scenario 3 is projected to recover quicker and is also the only scenario assumed to reach historic normalised levels post-COVID 19.
- When considering each different asset type in isolation, residential and office units appear to be outperforming the market, as opposed to other property types. It is noted that offices are presenting a decline in sales values towards the end of the period, reflecting the projected market trend towards flexible workspace and associated reduction in space utilisation.
- The asset type that appears to be affected most is retail, which since the commencement of the period presents the largest decline and remains well below the market total.

COVID-19 Key facts & figures

Introduction

The objective of the Industry Pulse report is to:

- Present a snapshot of the latest facts, figures, discussions and the industry sentiment around COVID-19
- Obtain the industry sentiment around the impact of COVID-19 on the Real Estate sector
- Estimate the potential impact of COVID-19 on the given sector
- Discuss effective fiscal and monetary measures for mitigating the adverse potential effects



Governments' reaction

Health

In response to the rapid spread of the virus to date (depicted in the graph above) governments across the globe have adopted health-centric measures based on World Health Organisation's guidance[1], with the aim to control the human-to-human transmission of the virus, and care for those affected. The measures focus on:

- Support the healthcare system through investment in necessary equipment & staff, protecting health workers safety, ensuring critical care of non-virus-related incidents;
- Enforcement of social distancing, closures of schools & public spaces, lockdowns, curfews, quarantines;
- Control points of entry into country, through strict border or travel bans;
- Contact tracing to identify cases, surveillance and monitoring of the spread; and
- Testing ability, extending capacity of national and private laboratories for rapid and reliable tests.

The introduction of these health measures has necessitated the consideration of unprecedented fiscal and monetary interventions to limit the anticipated economic downturn[2]:

Economy

Fiscal

- The European Commission has, for the first time ever, activated the general escape clause of the Stability and Growth Pact to allow governments fiscal flexibility in budgetary rules.
- EU agreement on €540bln package of measures to support governments as they take on unprecedented debt burden: €100bln for joint employment insurance fund, €200bln for liquidity to companies through European Investment Bank instrument and €240bln for credit lines from European Stability Mechanism3. Possibility of an additional temporary fund to help hardest-hit economies and discussion of option for joint sovereign debt issuance (corona bonds).
- Households: Income subsidisation and job guarantees, halt on evictions, tax breaks, VAT reductions, extension of loan obligations and suspension of instalments.
- Businesses: Salary payments to employees, suspension of financial obligations, favourable loan terms, tax breaks, deferral of VAT payments as well as sector-specific measures.

Monetary

- ECB monetary support to governments such as additional asset purchases of €120bln until end-2020, an additional €750bln asset purchase program of private and public sector securities (Pandemic Emergency Purchase Programme), removal of issuer limits from bond-buying programs to allow central banks to push borrowing costs down, relaxation of collateral standards for Eurosystem refinancing operations.
- Banking package adopted to help facilitate lending to households and businesses. Temporary relaxation of Pillar 2 Guidance and liquidity coverage ratio, as well as flexibility in classification requirements and expectations on loss provisioning for non-performing loans that are covered by public guarantees.

1. https://www.who.int/emergencies/diseases/novel-coronavirus-2019/technical-guidance
2. https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19
3. https://www.bloomberg.com/news/articles/2020-04-09/eu-finance-chiefs-agree-on-590-bln-virus-rescue-package

COVID-19 Key facts & figures

Wider implications of COVID-19

The social and economic ramifications in the aftermath of the pandemic are expected to be severe and widespread. These will likely include:

- Decline in consumption
- Drop in investment
- Structural changes as affected sectors shrink
- Spike in unemployment
- Potential banking crisis
- Overleverage as debt to GDP ratio spirals
- Sustained burden on the healthcare system
- Long-term loss in productivity
- Poverty increase
- Increased digitalisation

According to the latest worldwide research and discussions, expected timeframes for key medical solutions are:

- **Vaccination:** 12-18 months
- **Drugs/cure:** 6 months ++ (timing highly uncertain)
- **Antigen (polymerase chain reaction "PCR") tests that are cheap, mass-scalable and reliable :** 1-3 months
- **Antibody (immunity) tests that are cheap, mass-scalable and reliable :** 1-3 months

Overview of the Real Estate sector
Recent past performance (1/3)

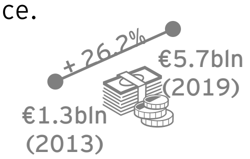
The Real Estate ('RE') sector constitutes one of the main pillars of the Cypriot economy and a key driver in the country's remarkable economic turnaround following the 2013 financial crisis. Revenue generated from real estate sales, increased construction activity linked to these sales and sizeable foreign direct investments in the sector, contributed to this upwards trajectory.

The following pages present the performance of the Cypriot Real Estate sector during recent years, focusing on revenue generated from the sales of residential and non-residential units and also the volume of building permits issued to capture the effect on construction activity.

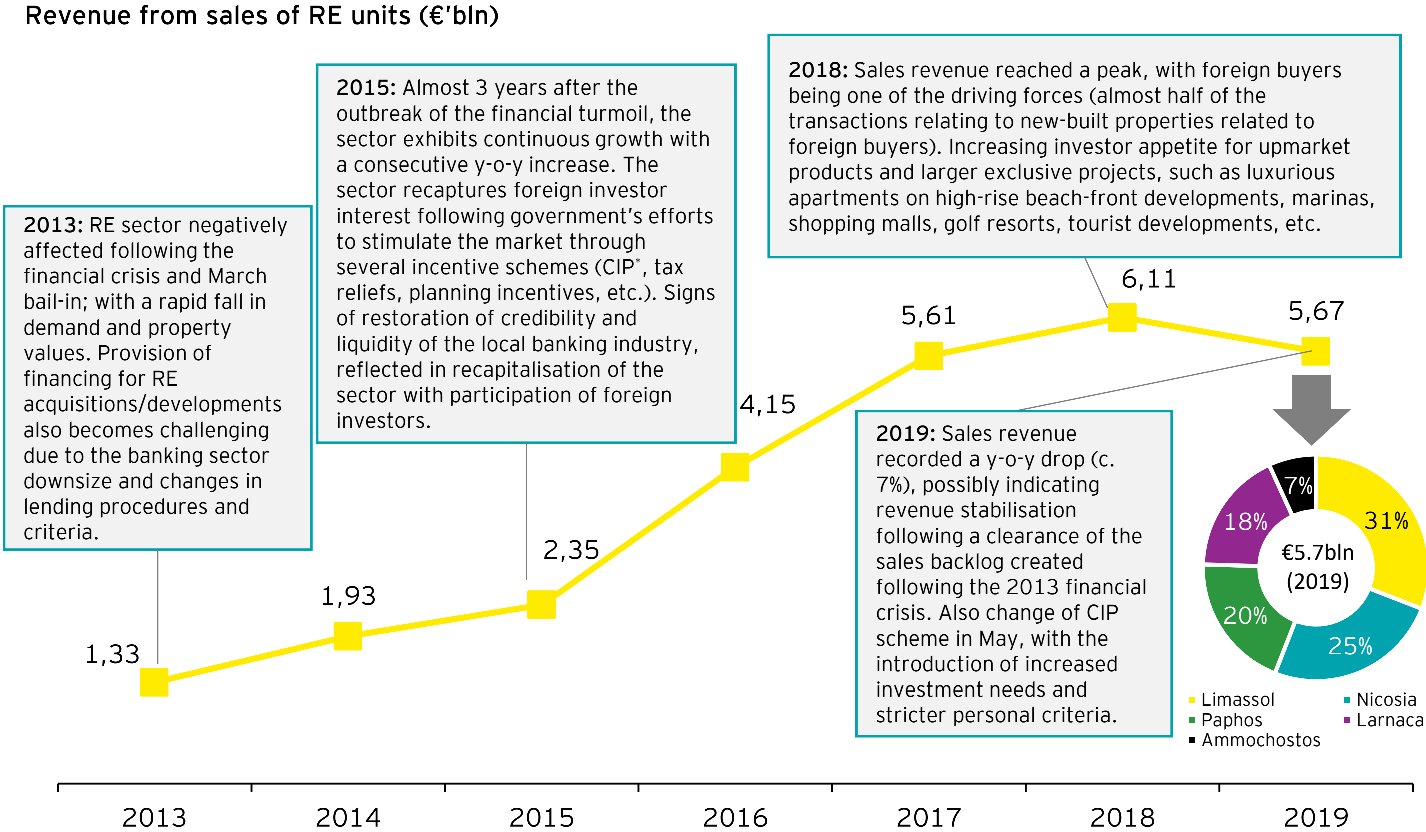
Real Estate sector revenues

The performance of the sector in terms of sales revenue is shown in the graph below. The proceeds from the sale of RE units (both residential and non) have been used as a proxy for the sector's performance.

The revenue generated from the sale of residential and non-residential units for 2019 reached €5.7bln; representing an annual growth rate of c.26% since 2013.



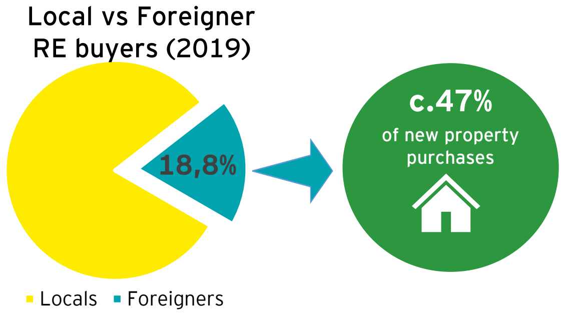
Revenue from sales of RE units (€'bln)



Source: LRO, EY Real Estate Data analytics platform

Notes:
*CIP: Cyprus Investment Programme. Citizenship by investment scheme introduced by Cypriot Government for naturalisation of foreign investors.

Overview of the Real estate sector
Recent past performance (2/3)

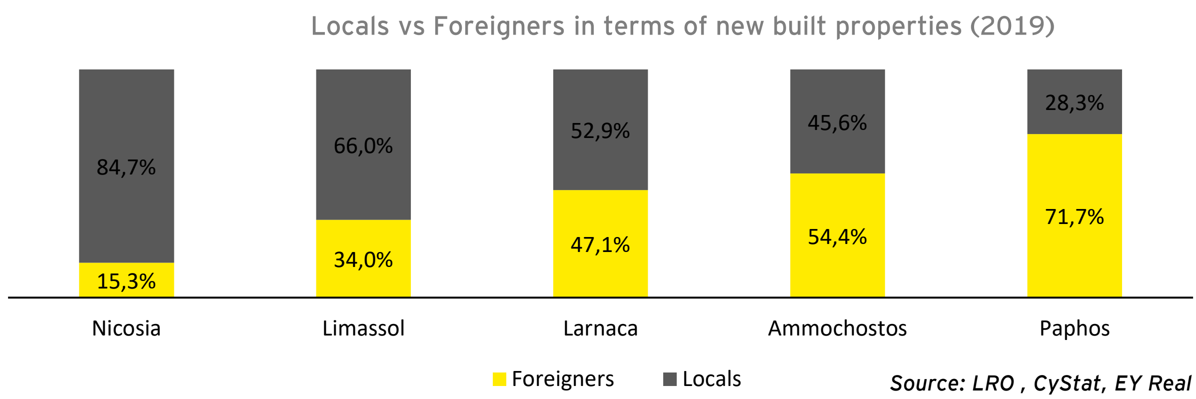


Source: LRO , CyStat, EY Real Estate Data analytics platform

As noted, transactions carried out by foreign buyers have been material and their role has been significant in the recovery of the sector. Key in this respect have been the CIP* revisions introduced by the Government in 2013.

The chart on the left presents the share of these purchases as part of the total number of transactions (c.19%). It is important to note that when it comes to new units the share of foreigners over total is even higher (c.47%). We also note that based on the experience of recent years, transactions by foreigners tend to be of much higher values than those carried out by locals (in their majority laying around the €2m CIP investment threshold). These purchases also concern mostly high end residential developments in the coastal cities, and especially Limassol and Pafos.

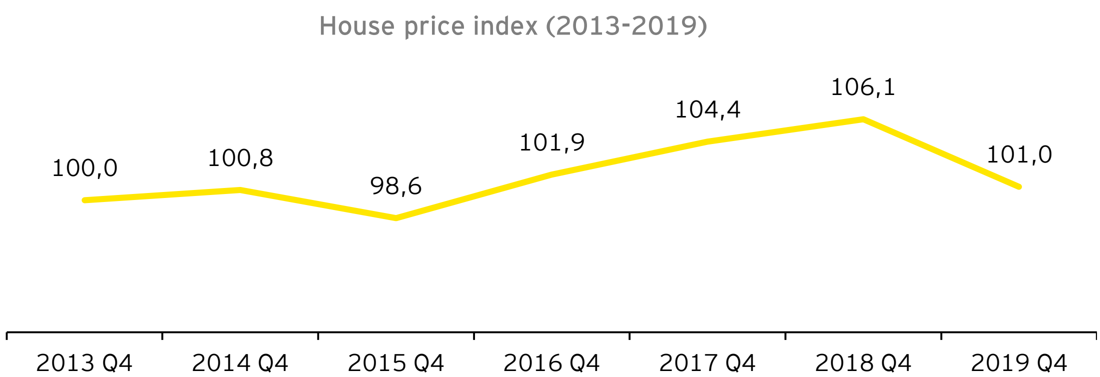
The allocation between local and foreign buyers in terms of number of transactions for new built properties for each district shown below. Despite the important role of foreign buyers, the local market remains the key driver in most districts, especially Nicosia. The continuous growth of the local economy coupled with the recapitalisation of the local banking sector were key in supporting increasing activity from this market.



Source: LRO , CyStat, EY Real Estate Data analytics platform

Real Estate prices

Looking at the house price index issued by CyStat, a fluctuating pattern is observed since 2013; with consecutive increases in the index in more recent years and an apparent return closer to 2013 figures during the last quarters of 2019.



Source: CyStat, EY analysis, 2013=100

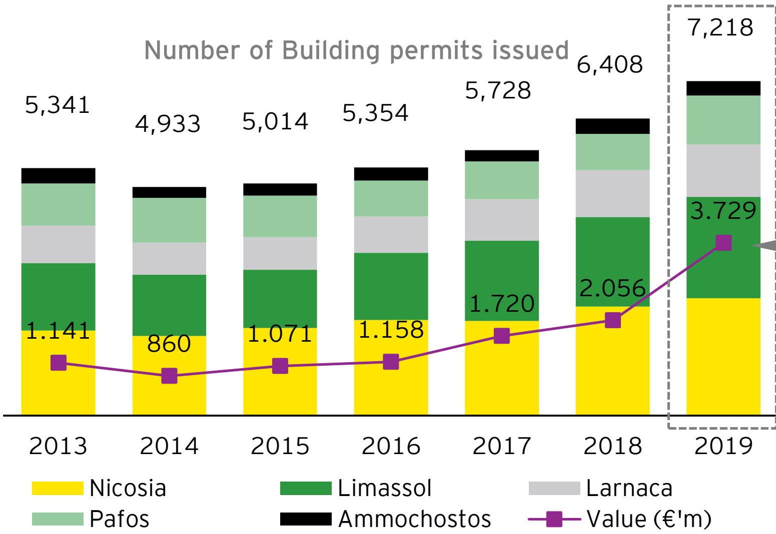
The trend is to a certain extend attributed to the overall CIP performance of the last years, reflecting the CIP revisions in 2013 and the boost of the program in the period leading to 2018. The CIP revisions introduced in 2013 led to a significant number of high-end real estate transactions, with pricing at the upper end of range; thus driving the overall index up. Following the last CIP revision in Q2 2019, with the introduction of increased financial requirements and more strict personal criteria, the number of relevant transactions was reduced. This in turn exerted downwards pressure on the index.

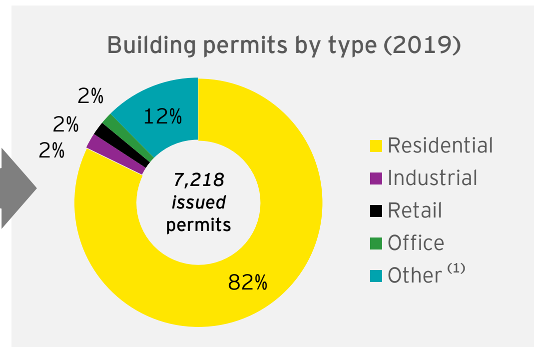
__Notes:__
**CIP: Cyprus Investment Programme. Citizenship by investment scheme introduced by Cypriot Government for naturalisation of foreign investors.*

Overview of the Real estate sector
Recent past performance (3/3)

Building Permits

The growth of the RE sector, and the accompanied higher demand for new-built residential and other units, has also led to an increase in construction activity and the recovery of another sector of the economy badly hurt by the 2013 financial crisis. This is reflected in the issuance of new building permits, which exhibited a steady growth both in terms of numbers and total value in the period. The total number of permits issued during the period 2013-2019 increased by a CAGR of c.5%. In monetary terms, the respective CAGR exceeded 20%. The relevant trend is shown below:





(1) *Other includes the following types: Hotel and similar buildings, Public entertainment buildings, Transport and communication building and Other non-residential buildings.*

Source: IMF, LRO, CyStat, EY Real Estate Data analytics platform

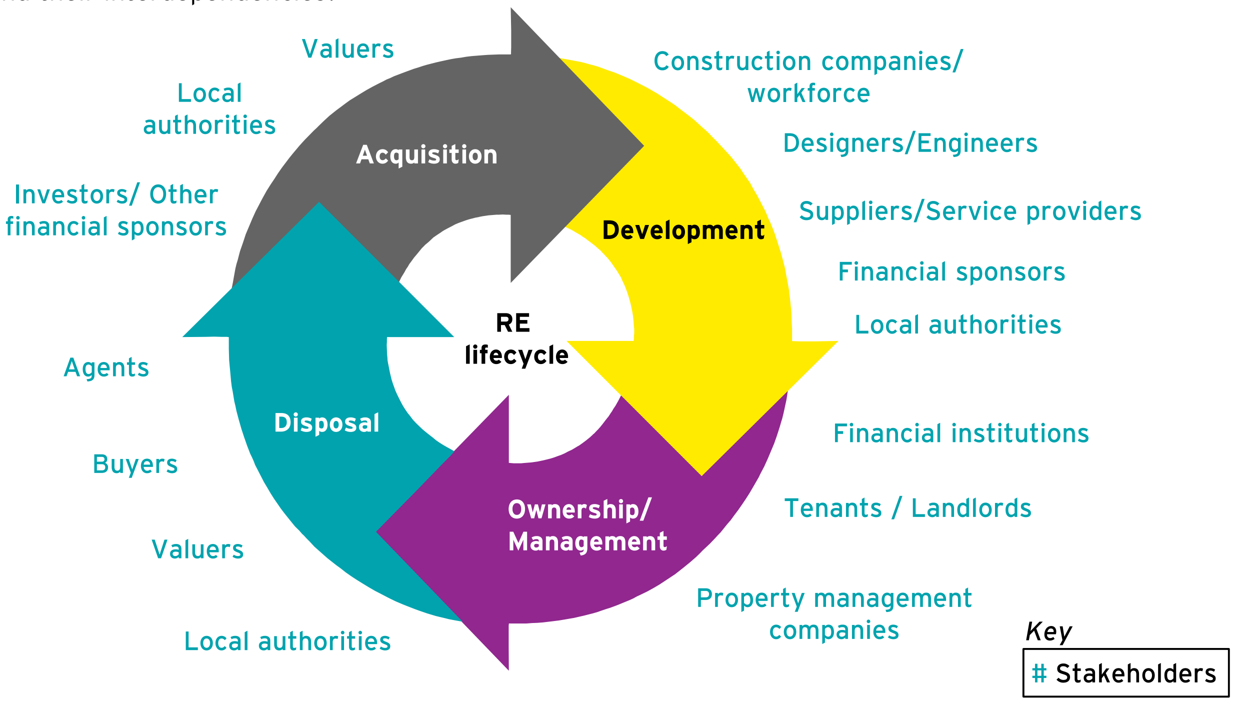
The great majority of the building permits issued concern residential properties, which in 2019 accounted for more than 80% of the total. The estimated total value of the building permits issued in 2019 for residential buildings stood at €2.4bln. This demonstrates the importance of the specific product type for the local economy. The specific type is also the one that has been attracting traditionally the majority of the foreign interest.

In terms of districts, the largest cities of Nicosia and Limassol recorded the highest number of building permits; achieving consistently more than 60% of the total.

Note: Part of the data employed in our analyses was obtained from the LRO portal on 24/01/2020. The data was further analysed by EY. We also note that these transactions exclude any share deals.

How COVID-19 could disrupt the Real Estate lifecycle (1/2)

Real estate is a sector that involves and affects a wide spectrum of stakeholders; both individuals and businesses. The diagram below presents the different stages of the RE lifecycle and some of the key stakeholders involved in each stage. The text that follows expands on the different stages along with possible effects of the COVID-19 outbreak on their duration and completion. The section closes with a separate analysis covering some of the key stakeholders and their interdependencies.



Acquisition

COVID-19 impact:

- Physical viewing of assets by buyers interrupted/hindered due to lockdowns/movement restrictions. Same applies to real estate appraisers engaged to perform asset valuations for transaction purposes
- Relevant submissions to the LRO and other authorities interrupted/delayed (e.g. sales agreements, tax clearances, etc)
- Other due diligence activities also hindered by restrictions
- Face-to-face meetings/negotiations between transaction parties restricted
- General uncertainty surrounding COVID developments reducing investors' appetite/willingness to finalise
- Securing new debt finance for transactions could be more challenging due to the COVID scenario/disruptions

Effect:

- Postponement/delay of acquisitions, resulting in limited transaction activity

Development

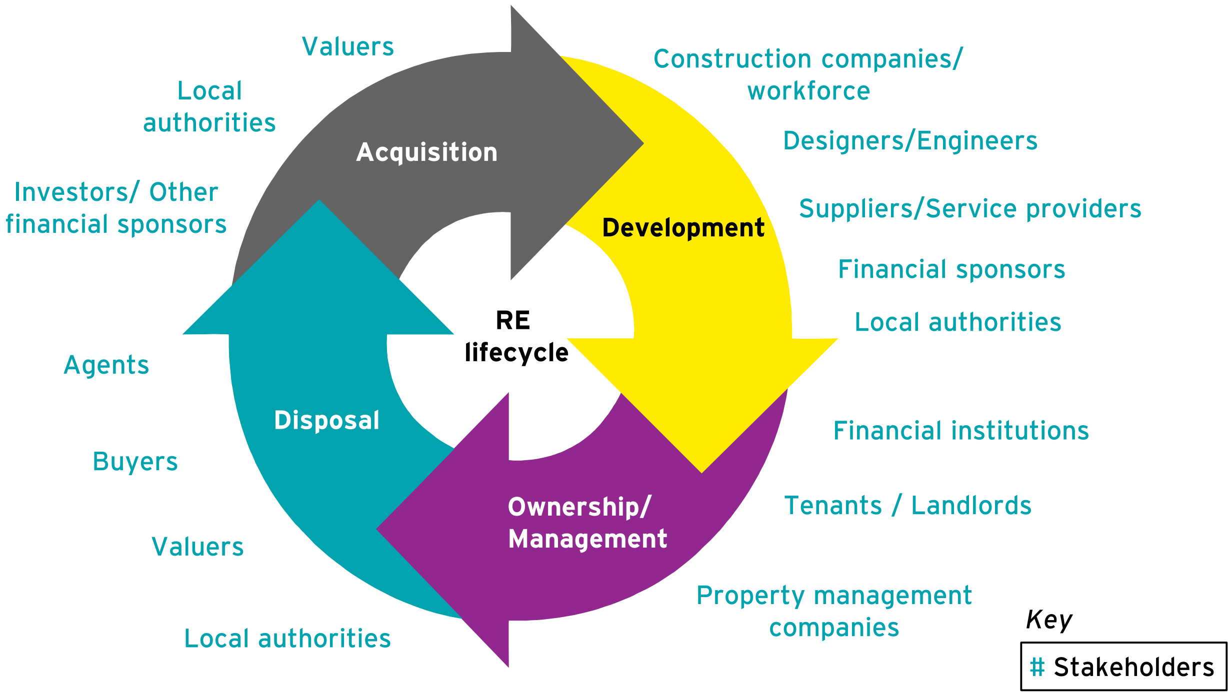
COVID-19 impact:

- Disruption of construction activity due to Government decrees
- Disruption of supply chain relating to construction materials (both logistics and actual production)
- Delays in securing planning/building permits due to limited access to relevant authorities
- Design process partly disrupted due to site visit restrictions
- Obtaining new financing for development purposes more challenging

Effect:

- Delays in the completion of construction/handover of units under construction, with possibility of damages in case force majeure provisions do not apply
- New projects in the pipeline put on hold
- Possibility of higher construction/development costs due to delays/disruption of activities
- Necessity for cost cutting/control activities of relevant stakeholders in order to address reduced revenues/cash liquidity pressure

How COVID-19 could disrupt the Real Estate lifecycle (2/2)



Ownership/ Management

COVID-19 impact:

- Tenants face liquidity pressure, preventing them from meeting payments and other contractual obligations
- Liquidity pressure on owners, preventing them from serving financing obligations or carrying out planned/ agreed capital expenditure (refurbishments, etc)
- Curfews/movement restrictions reduce the possibility of securing tenants for vacant properties. New tenants also discouraged to enter into transactions due to COVID consequences/uncertainty
- Property management activities (maintenance, etc) disrupted/delayed due to movement restrictions

Effect:

- New/existing tenants attempt to renegotiate key contractual terms (rent-free periods, lease durations, lease amounts, etc)
- Cost cutting/control activities of relevant stakeholders to address reduced revenues/ liquidity pressure

Disposal

COVID-19 impact:

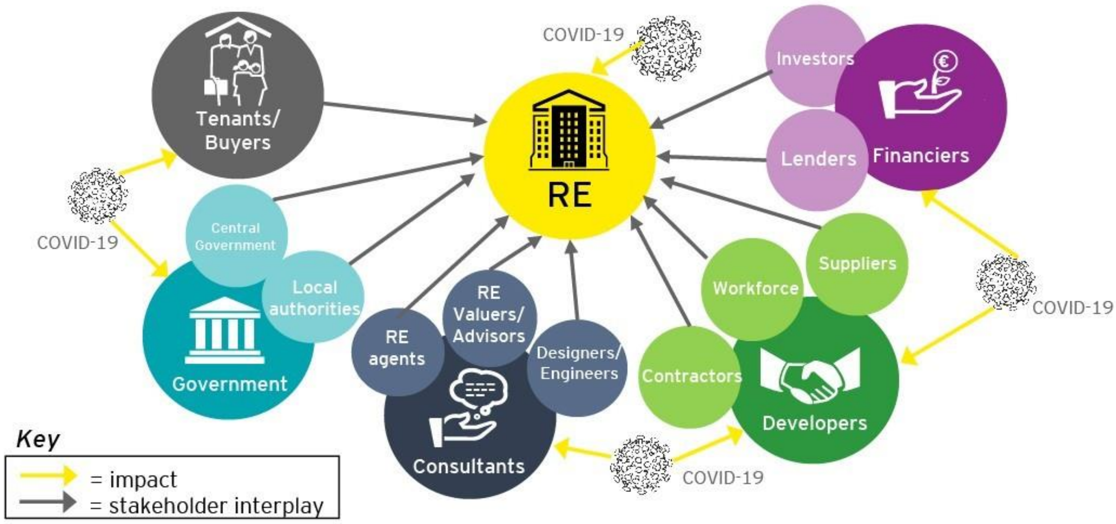
- Disposal efforts hindered by COVID related restrictions, as presented under ‘Acquisition’ box (viewings, due-diligence, valuations, submissions, etc). Especially in case of CIP applicants and other foreign buyers/investors
- Reduced demand due to COVID related uncertainty/lack of funds
- Opportunistic buyers may seek to take advantage of the crisis and transact at reduced prices
- Disposal efforts may be put on hold by some vendors in an effort to protect sales value

Effect:

- Reduced number of transactions due to limited demand and transaction closing issues
- Potential buyers may demand additional discounts to compete transactions. Property valuations distorted by the COVID scenario, exerting further downward pressure on prices
- Vendors not compelled to sell likely to resist such pressures, increasing bid-ask spread and reducing transaction volumes further
- Cost cutting/control activities of relevant stakeholders to address reduced revenues/ liquidity pressure
- Vendors/agents adapting their sales and marketing efforts to accommodate the COVID scenario (new and more innovative promotion methods, etc)

Real estate sector key stakeholder map and COVID-19 impact (1/2)

Below we illustrate how some of the key stakeholders in the RE ecosystem could be affected by the COVID-19 outbreak. We also present potential reactions of these players in their effort to respond and adapt to the new situation imposed by the pandemic. The parties expected to be affected most are presented first.



Developers & Related

Developing Companies

COVID-19 impact:
- Significant reduction in revenues, especially in relation to foreign buyers
- Delays in handover of off-plan sales due to construction disruptions
- Higher costs associated with construction disruptions and other categories (Health & Safety, marketing, etc)
- Cash liquidity pressure as revenues fall

Reaction:
- Reduction of asking prices and hence profit margins to stimulate demand
- Cost saving/control exercises (staff costs, admin costs, marketing and promotion, etc)
- Delay in the launch of new projects

Workforce

COVID-19 impact:
- Impacted by potential salary reductions, redundancies and halt on recruitments
- Liquidity pressure
- Increased health and safety concerns of workforce, especially in case of customer facing staff
- Job insecurity
- Difficulties in carrying out normal duties in case of dependant at home

Reaction:
- Consideration of alternative income sources
- Utilisation of Government support schemes
- Reduced spending

Contractors

COVID-19 impact:
- Suspension/Disruption of operations due to Government decrees
- Reduction in revenues from new contracts as projects are put on halt by developers and other clients
- Increased Health & Safety requirements and costs
- Supply chain disruptions with regards to building materials
- Delays in the handover of projects, resulting in increased costs
- Potential loss of skilled labour
- Cash liquidity pressure

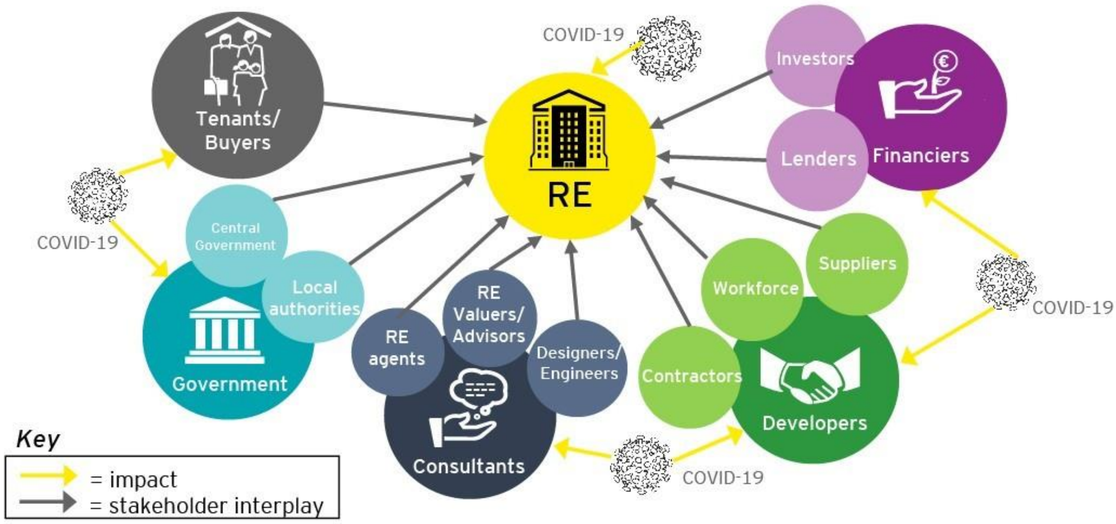
Reaction:
- Cost saving/control exercises (staff costs, etc)
- Bidding for projects at low margins to cover fixed costs
- Focus on working capital management

Suppliers

COVID-19 impact:
- Reduced revenues due to suspension of large-scale construction activity and delay of new projects
- Supply chain disruptions due to lockdowns and other restrictions (transportation/production issues, etc.)
- Liquidity pressure

Reaction:
- Cost savings, including payroll reductions
- Adjustment of working capital management

Real estate sector key stakeholder map and COVID-19 impact (2/2)



Government

COVID-19 impact:

- Suspension/decrease in RE activity leads to reduced Government inflows in the form of taxation and other fees and charges (e.g. direct/ indirect tax, CIP related charges, etc)
- Pressure on Government to support the economy and social welfare
- Liquidity pressured as a result of the reduced inflows and huge spending on support mechanisms

Reaction:

- Measures to support the local economy; including employment support schemes, deferral of tax receipts and reduction of tax rates such as VAT, etc.
- Increased borrowing in order to meet the cost

Tenants/Buyers

COVID-19 impact:

- Potential loss of income as a result of COVID crisis impacting the ability to meet lease obligations/purchase the RE products
- Insecurity with regards to new transactions due to the COVID related uncertainty
- Restrictions on viewing RE products of interest or carrying out relevant due diligences
- Difficulty in raising new funding through banking institutions or other means

Reaction:

- Delay/postponement of new transactions
- Renegotiation of transaction terms (lease amount/purchase price as applicable, lease duration, etc)

Consultants

COVID-19 impact:

- Job hindered by lockdowns/movement restrictions, affecting site visits/inspections/ viewings
- Reduction in real estate activity and postponement of design/development of new projects leads to reduced revenues
- Uncertainty over valuation and other inputs, leads to potential adjustments in their outputs/advise

Reaction:

- Need of adjusting their mode of operation; for example valuers adopting drive-by inspections, RE agent using electronic means like 'virtual viewings', etc
- Cost reduction exercises in order to account for reduced revenues (outsourcing part of work, part-time employees, etc)

Financiers

Lenders

COVID-19 impact:

- Reduced repayment ability of market players (developers, buyers, etc) impacts the lenders' recovery/provisions and profitability
- Reduction in new business (both corporate and housing loans), as transactions decrease and projects put on hold

Reaction:

- Loan restructurings and flexibility offered to borrowers in terms of grace periods and deferral of instalments

Investors

COVID-19 impact:

- Lockdown and restrictions relating to COVID measures hinder site visits and due diligence exercises
- Market uncertainty increases the risks and reduces investment activity

Reaction:

- Prospective investments put on hold
- Requirement for higher returns for the higher risks
- Scanning the market for opportunities that might arise following the outbreak (e.g. distressed assets)

Industry Sentiment
EY Survey results

In an effort to capture the potential impact of the COVID-19 outbreak on the Real Estate market, we carried out a survey between the 8th and the 17th of April 2020. We reached out to a broad range of RE stakeholders, spanning from developers, contractors, RE advisors and agents to financial institutions and NPL servicers.

The purpose of the survey was to capture the participants' expectations and views in respect of the potential impact of the COVID-19 crisis on various aspects of the real estate sector. Responses reflect the views of the participants at the specific point in time.

Q What is the most important impact that you have observed so far in the real estate market as an consequence of the pandemic?

- All participants stated that the highest and most important impact of COVID-19 in the real estate market is a recorded sharp reduction in transaction activity. Some respondents indicated an activity drop in absolute numbers in excess of 70%.
- The sharpest fall in transaction activity was observed in the case of commercial properties.
- In the case of residential assets, transactions are still observed albeit at significantly reduced numbers.

Q How was your company affected by the spread of the pandemic and the introduction of social distancing and lockdown measures?

- Participants referred again to the limited new interest for property sales since the outbreak and a halt in negotiations that were in progress at the time of the outbreak.
- The impact was higher in the case of foreign investors and properties at the upper end of the market. Also, despite efforts to market products remotely to this market through electronic tools and virtual viewings, these proved to be relatively ineffective.
- Another adverse effect noted was the closure of construction sites and anticipated delays in the handover of units under construction. The great majority of the RE developers participating referred to a pro-active update of their clients and felt confident that relevant penalties would be avoided.
- Recommencement of construction activity in considered key by all stakeholders and the first step to recovery. Participants also consider the opening of the airports to be a key milestone for the turnaround of transaction activity.
- Respondents on the advisory side commented that the high current market uncertainty makes their job difficult and does not allow for safe financial forecasts.
- All stakeholders mentioned that they remained operational, albeit at different capacity levels, not throughout the crisis.

Q

What actions is you company taking as a response to the COVID-19 impact?

- All participants referred to a change in their operating mode and working from home for back of the house functions (administration, finance, etc).
- Respondents involved in the sale of properties stated that they had received pressure and offered some level of discount in an effort to keep sales momentum.
- Participants involved in property sales also referred to the introduction of new tools to facilitate viewing of properties remotely and use of different electronic means to facilitate transaction closing.
- A number of survey participants mentioned that they chose to register some of their employees for the government scheme that contributes towards the employees' salaries for a level up to 60%.
- Valuation firms are adapting with just drive-by inspections and adhere to relevant guidance notes referring to the existence of "material uncertainty" in the valuation practice.

Q

How flexible do you believe is the real estate market in terms of returning to normality following the relaxation of the measures, including opening of the airports?

- The majority of participants feel that the impact of the pandemic on the RE market will be rather short-term. Following the relaxation of measures, they expect that the market will be able to recover to pre-COVID 19 levels within a period of 9 months.
- Respondents noted that the above expectations assume that banks will still have appetite for household lending.

Q

In terms of pricing, do you expect any immediate effect to be observed as a direct effect of the COVID-19 outbreak?

- As already noted, sellers of RE properties stated that they plan on providing discounts to encourage sales. Some companies already started providing such discounts.
- Participants involved in the valuation and/or consulting services of real estate expect that inevitably some drop in values should be expected, varying between type of assets and locations.

Q What do you think the reaction of prospective investors would be to mitigate risks associated with COVID-19?

- Survey participants expect that investors will be more cautious now with new investments given the uncertainty the sector is currently experiencing.
- Furthermore, experts anticipate that there will be increased scrutiny on tenant's credit worthiness for commercial assets. A factor that will climb up the priority list when examining new opportunities.
- Properties in good locations will be the first choice of potential investors, as per the majority of the respondents. As they say "Location, Location, Location" is what matters most in real estate.
- It was noted that some participants were already aware of opportunistic funds actively looking for "distressed" opportunities.

Q How do you expect that different asset types will react to the COVID-19 crisis?

- Participants anticipate that the retail property sector will experience the largest hit out of all asset types, given that a lot of retail businesses are facing severe financial difficulties.
- Other commercial properties are also anticipated to suffer a large impact, albeit to a lesser extent compared to retail assets.
- Respondents almost unanimously agreed that residential properties will be the first to recover post-crisis, and especially the apartments.
- Some respondents argued that offices will be least impacted asset type in the short term, especially those subject to long leases with strong tenants.
- It was further mentioned that industrial units could benefit in the mid to long term, given the expected changes in retail trends; for example consumers switching to online shopping, thus increasing the need for logistics centers. Supply chain disruptions may also result in the utilisation of increased storage facilities.

Q What further support could be offered by the Government as a means of supporting the RE sector?

- Participants highlighted the importance of digitisation of the various government authorities linked with the sector and streamlining their different processes. For example, expediting the process of securing building and planning permits for different projects in order the boost construction activity.
- Participants stated that they would expect the government to introduce tax incentives for the sector such as VAT and Capital Gains Tax. The following examples were provided:
  - VAT rate on property sales reduced from 19% to 10% for 2 years and
  - No capital gains tax on disposal of properties purchased in the following two years.
- Respondents also stressed the importance of a new revision of the criteria for the Cyprus Investment Program and simplification of relevant processes, in an effort to re-generate interest and boost activity at the upper-end of the market.

Overview of the Real estate sector
European Real Estate Market sentiment

Inevitably the pandemic has also affected through its global reach the RE sector in overseas markets. The country lockdowns, suspension in operations and uncertain resulting environment, have created turbulence in the international real estate scene. In this section we focus on the adverse effect and reaction of the European market to COVID-19; a market also characterised by increased volatility and sharp drop on transaction volumes.

Sharp drop in Real Estate Transactions

- Data shows that the value of transactions in Europe in March 2020 was €13 billion, compared to €24 billion in the same month last year (c.46% drop). As per Real Estate Capital Analytics, preliminary data indicates that for the first eight weeks of 2020 European activity was reduced by 18% compared to 2019 figures. The same figure for Asia Pacific activity was 50%, reflecting the delayed onset of COVID-19 in Europe relative to Asia and the expected deterioration of the European figure in the weeks that follow.
- Capital Economics predicts that as transactions bear the shock caused by the pandemic, eurozone property values will fall by at least 8 per cent in 2020 while prime property yields will rise by at least 50 basis points in the short term.
- Transactional activity is foreseen to experience a greater reduction compared to RE prices.

Impact on different asset types

Retail

- It is anticipated that sharpest fall in transactional activity as a result of the crisis will be observed in the case of retail assets and hotels.
- Indicatively, based on a survey performed by Savills, during the last week of March 2020 retail activity was reported to be down in more than 80% of the countries covered by the survey (primarily European).
- Liquidity for prime assets is expected to remain stable in the short term with only a small adjustment in prices in main high-street locations. For secondary locations, much higher decrease in values is expected to reflect demand levels.
- Some investors are anticipated to take the opportunity to (re)enter European retail markets, as decompression of prime yields occurs.

Offices

- BNP Paribas forecasts that it is likely to witness a significant decrease in take-up of office units for 2020, particularly during Q2 and Q3.
- The increase in office vacancy is expected to be significant but under control in most European markets.
- In Central London provisional figures for Q1 2020 show a 22% drop in office demand y-o-y while main German cities see a decrease in take-up ranging from 5-15%.
- Recovery of the office market is projected to begin at the end of 2020 and will depend on how fast market activity can recommence once the virus has come under control.
- Savills' survey referenced above, showed a more moderate fall in office transactions compared to retail, with only 45% of the participating countries experiencing a reduction.
- Knight Frank states that whilst it is still too early to be certain about the longer-term impacts, a demise of the office is an unlikely outcome. Instead, there will be growing recognition that the office is just one of a range of workplace settings.

"We still have too many retailers and too many locations that shouldn't be there and should be repurposed", Head of research at a European Real Estate investment management firm

"Retailers that are able to mobilise strong online supply chains will have a much-needed lifeline to their business model and profitability", Investment management company officer

"We are in the middle of the largest test of homeworking in history and corporates are adopting, refining and testing policies, processes and infrastructure to make it work", Head of research at a commercial RE investment management firm

Overview of the Real estate sector
European Real Estate Market sentiment (cont'd)

Impact on different asset types (cont'd)

Residential

- With regards to the residential market, according to a publication by the Real Asset Day citing various industry experts, the COVID-19 effects are expected to be more limited than commercial. Historically this type of assets is more driven by demographics in the mid to long term rather than short term disruptions of the economy.
- While many of the residential subsectors are expected to be more resilient due to the underlying demand strength and mismatch with supply, there are still risks.

Reduction in Investment activity

- The overall investment activity in the market for 2020 is expected to also fall significantly. BNP Paribas projects significant drops in investment activity for Q2 and Q3, with investors returning to the market in Q4 but not at sufficient volumes to reverse the decline.
- In terms of investment funding, in London most lenders are still "open for business", but are reluctant to make new commitments citing the still unknown impact on commercial values.
- Contributing on this stagnation, are sellers that are holding onto their core assets and buyers cancelling or postponing some deals.
- Most non-European investors, representing approximately half of the commercial real estate investment activity in Europe, are currently postponing their ongoing deals in the market until European borders open again. Some analysts argue that the withdrawal of non-European investors from European markets could benefit domestic investment, which may experience an increase compared to 2019.
- Real estate investors that choose to invest during the crisis in the market currently face the following short-term practical challenges:
  - *Property Inspections*: The biggest challenge for investors are the far-reaching travel restrictions that have seen countries close their borders and grounded airlines, clearly obstructing property inspections.
  - *Income collection*: A number of landlords in the market have come to agreements with tenants to postpone or waive payments during Q1 2020, showing that investors could come against income collection issues in the shorter term.

Other key takeaways

- BNP Paribas suggests that investors in the market should focus more than ever on prime locations. In some markets, the risk premium between core and non-core assets could come under pressure.
- The same source confirms a stronger demand, under the current uncertainty, for long-term leased properties with high-quality, bond-like tenants. Property assets backed by long-dated government or government-sponsored income streams are likely to be most resilient.
- Over the medium term, forced working from home may break down cultural resistance in some markets and reduce floorspace per worker ratios.

Sources: 1. https://therealestateday.com/wp-content/uploads/Coronavirus-impact-on-real-estate.pdf
2. https://content.knightfrank.com/research/1957/documents/en/covid-19-commercial-research-april-2020-7109.pdf
3. https://www.realestate.bnpparibas.fr/sites/france/files/2020-03/Covid-19_Report_BNPPRE_Global_Research_20200331_LV_HD_0.pdf

Real estate market post-COVID
What can change for good?

EY has identified certain market developments that could disrupt traditional trends of the RE sector in the medium to long term. The COVID-19 crisis, even not the key driver behind these trends, serves as a catalyst for their introduction both at local and international level. These three key trends are presented below and have also been considered as part of our overall impact analysis that follows.

Flexible workspace / reduction of space needs

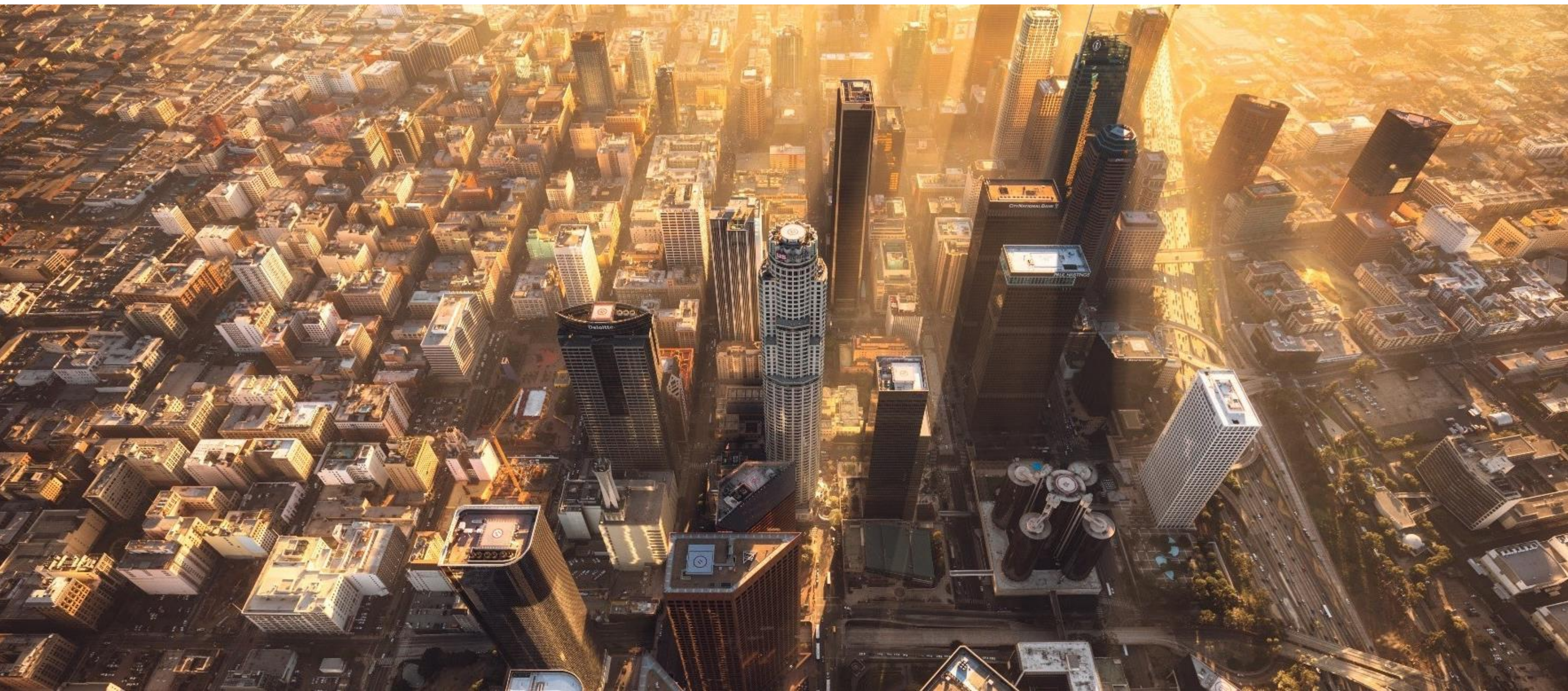
Some employers that have not rushed to promote remote working for their workforce, have now come to realisation that such schemes could be beneficial for both the employer and the employees. If the trend continues post-COVID 19, there will be structural changes to the office market; companies might eventually need less office space to accommodate their employees and eventually switching to more flexible models e.g. intentionally leasing spaces for a portion of their head count.

Retail space demand falls / logistics increase

A large number of consumers could have been reluctant to use online shopping services, especially from local retailers. Inevitably, due to the lockdown, consumers started using such online services and have gotten comfortable with them. Expectations are that this trend will continue and expand following the COVID-19 crisis, with demand for physical retail space eventually falling. The resulting idle retail space on the other hand is expected to be converted into logistics space; with demand for industrial units and especially "last-mile" type of logistics centres to be increased.

Shift from owning to renting

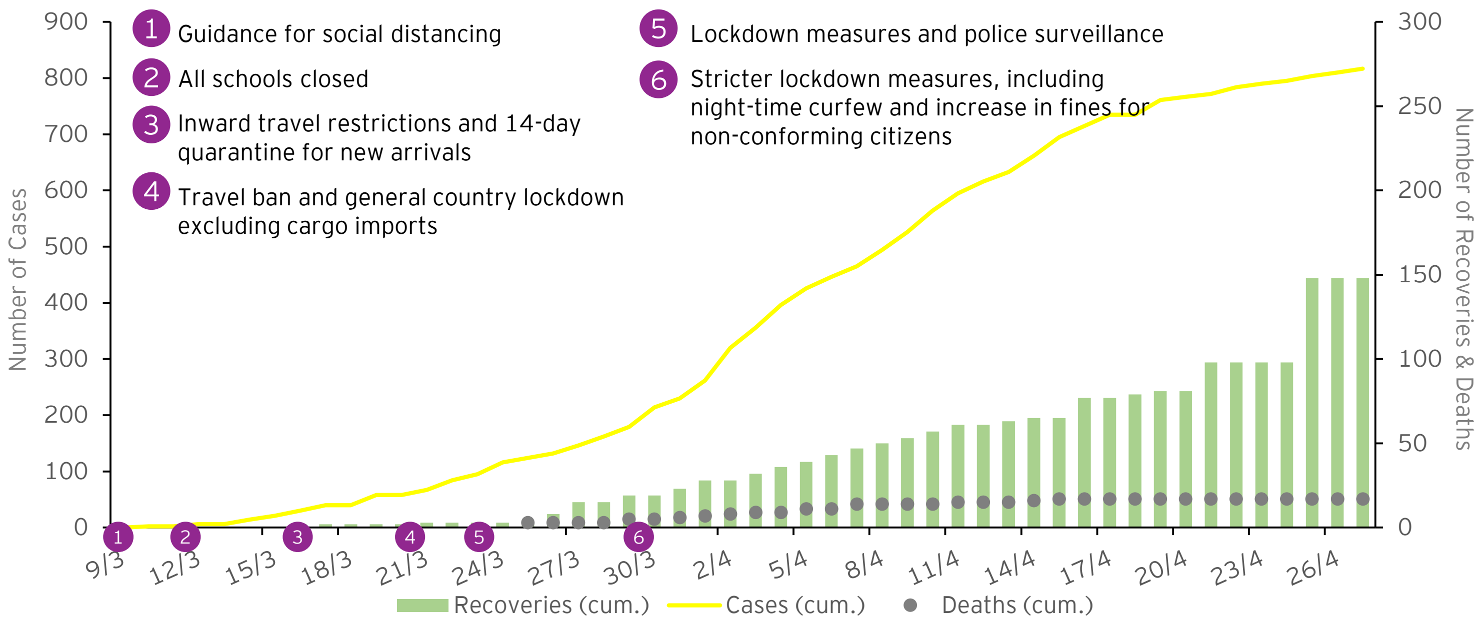
The short to medium term adverse financial impact of COVID-19 on both individuals and corporations, with reduced income and possibly increased unemployment, may discourage investment on owned properties. Prospective home owners and businesses considering occupying office space may no longer wish to engage into significant outlays relating to such ownership and instead opt to rent. This could create disruption in the real estate development industry, but at the same time create opportunities for investors that are looking at investing into relevant property portfolios and renting them out.



Impact of COVID-19 on the Real estate sector
Key considerations and scenarios

Health measures and virus control

In alignment with WHO guidelines, the Cypriot government has imposed social distancing measures escalating to citizen lockdown and travel ban. The graph below illustrates the chronological escalation of these measures[4].



These actions are estimated to reduce contact by 75%, which allows the virus to still spread albeit at a slower rate, alleviating the burden on the healthcare system and buying time until the threat passes[5]. Measures resemble those implemented in most other countries, especially in Europe and the US, but may vary in the future as each country decides to deal with the threat differently.

At current knowledge status, scientists speak of the following potential remedies:

- Development of vaccine in 12-18 months.
- Development of effective therapy protocol, based on existing (or new) drugs, to deal with acute symptoms and diminish mortality rate. Timing remains uncertain.
- Herd immunity through infection assuming immunity can last and no mutation.

In view of the uncertainty surrounding potential remedies, health-centric measures are developed with the understanding that the pandemic may last 12-18 months, that is the time needed for a vaccine to be developed and commercialized. Under this assumption, the government has the following toolkit at its disposal:

A. **Varying degrees of lockdown and border control** applied in accordance to the capacity of the health system to accommodate and treat the infected. Notably, relaxation of social distancing measures and travel ban but return to strict lockdown once the number of new cases exceeds a certain threshold. This swinging between the two strategies makes little difference for economic revival and comes at a great political cost.

B. **Upgrading and scale up of antigen (PCR) testing capacity**. This would enable proactive regular PCR testing for large samples of the population to provide a representative view of the spread of the virus. PCR tests produce very few false positives but there is an issue with false negatives resulting from problems with collecting and processing patient samples. They can be used to confirm the infection but are less reliable in confirming its absence. Mass testing is estimated to be possible in 1-3 months.

C. **Contact tracing**. Testing can be used to identify people who are infected and, with the use of app-enabled (location-based) technology, contact tracing serves to find those people who have come into contact with infected persons so as to monitor/ isolate them. This option can be viable in 1-3 months.

D. **Immunity passports with antibody tests**. Large-scale antibody testing, once approved by authorities, can be used to identify those who have had the virus and are therefore potentially immune and can return to work. Private manufacturers have played an outsized role in the development of antibody tests but products still need to be validated by authorities for their reliability. Roll out is estimated at > 3 months[6].

4. https://www.pio.gov.cy/en/press-releases/
5. https://www.imperial.ac.uk/media/imperial-college/medicine/sph/ide/gida-fellowships/Imperial-College-COVID19-NPI-modelling-16-03-2020.pdf
6. https://institute.global/policy/suppression-exit-strategies-options-lifting-lockdown-measures-uk

Impact of COVID-19 on the Real estate sector
Key considerations and scenarios (cont'd)

Health measures and virus control (cont'd)

Possible exit strategies are derived based on the above options and adjusted as the development of scientific remedies plays out. Such strategies vary in effectiveness in terms of how fast the country can begin exit from lockdown and travel ban (part exit) so that the economy can be resuscitated without risking a virus spread that spirals out of control and overwhelms the healthcare capacity.

We classify the ability of a country to respond to a pandemic into three levels of sophistication for the virus countermeasures. The higher the degree of sophistication, the more tools a country can deploy to respond to highly contagious pandemics and limit disruption to economy activity (more "exit" strategy options). It is evident that in the case of COVID-19, the benefit of utilizing the full suite of countermeasure tools outweighs the cost of deploying them until an effective therapy protocol or vaccine is developed, or until herd immunity is reached.

Strategy components:	Sophistication of pandemic countermeasures		
	Low	Medium	High
▸ Govt applies various degrees of social distancing/border controls while keeping burden on healthcare system manageable.	✓	✓	✓
▸ Government performs mass scale & proactive sample PCR testing.		✓	✓
▸ Government employs app-based contact tracing.			✓
▸ Antibody tests used to allow immune people to exit isolation.			✓

Impact of COVID-19 on the Real estate sector
Key considerations and scenarios (cont'd)

Economic measures and anticipated recovery

The Cypriot government has acted swiftly and with determination in both containing the virus spread and providing a soft cushion for the economy, for both households and businesses:

Fiscal

Fiscal stimulus packages of total size €1.32bln[7] (5.4% of GDP) deployed to (a) aid the health sector in combatting the pandemic; (b) provide income support to households through leave allowance for parents/ vulnerable groups, unemployment benefits and banning of eviction in case of failure to pay rent; and (c) support to affected businesses by paying employee salaries and deferring VAT payments and GHS contributions. Government to guarantee up to €2bln to banks emergency lending, pending approval by Parliament.

Monetary

Monetary measures at EU level include ECB's Pandemic Emergency Purchase Programme to buy government and corporate debt, removal of issuer limits from bond-buying programmes, release of capital and liquidity buffers for banks, government guarantees for new loans and suspension of loan installments for nine months. Eurozone agreement of €540bln package to help battle the economic fallout is a significant milestone, though not yet agreed by leaders.

The degree of effectiveness of government intervention depends on the combination, coordination and concerted implementation of fiscal and Eurozone monetary policy, that is timely, sufficient in magnitude, and targeted.

- **Monetary & fiscal measures.** Sophisticated combination and coordination of monetary and fiscal policies can maximize impact by reinforcing and providing financial backing to each other.
- **Coordination at Eurozone level.** The extent of quantitative easing, liquidity provision and relaxation of thresholds for banks are decided by the ECB, as are decisions affecting government debt and financing mechanisms. And while all Eurozone economies are affected, those countries relying more heavily on tourism and with a weak banking sector (such as Cyprus) are in a more dire situation with respect to the pace of recovery than countries with a hefty reliance on manufacturing. Solidarity between Eurozone states will be key in how effective the economic measures are for supporting Cyprus.
- **Timeliness.** Effective measures will curtail bureaucratic procedures and be delivered swiftly to households and corporations, be based on latest scientific evidence, and adaptable as the situation evolves.
- **Magnitude.** Effective measures will near in size the extent of the expected loss in output. Government to date has announced packages of €1.32bln, 5.4% of 2019 GDP figure (compared to 3% European average), but loss in economic output is set to exceed this number and disproportionately affect different sectors of the economy.
- **Economy-wide vs. sector-specific.** As some sectors are hit harder by the pandemic, or have different pain points, fiscal stimulus packages targeted specifically to those sectors can be more effective in preventing high rise in unemployment and permanent contraction of the sector.

We consider three key scenarios of government intervention in terms of their effectiveness to avoid a deflationary spiral leading into depression, and to lead to a quick economic recovery. The role of each policy component in each of the scenarios is depicted by the green bars. High effectiveness of intervention involves synchronized and sophisticated combination of monetary and fiscal policies, including sector-specific measures, careful planning to ensure that aid is transmitted to the appropriate recipients in a timely manner, monitoring to prevent misappropriation of aid, proactive expansion of fiscal stimulus package as needed. In terms of monetary policy, there is little space for maneuvering but EU-level solidarity matters.

Strategy components:	Effectiveness of intervention: Low	Partial	High
▸ Combination and coordination of monetary and fiscal policies.			
▸ Circumvention of bureaucracy in favor of timely transmission of financial aid.			
▸ Government expands fiscal stimulus package as needed.			
▸ Government successfully introduces sector-specific measures.			
▸ High EU-level solidarity/coordination/agreement and maintenance of ECB Quantitative Easing policy.			

The degree to which each policy component is successfully implemented is depicted by the green bars (mobile signal).

7. https://www.pio.gov.cy/en/press-releases-article.html?id=13197#flat

Impact of COVID-19 on the Real estate sector
Key considerations and scenarios (cont'd)

Scenario summary

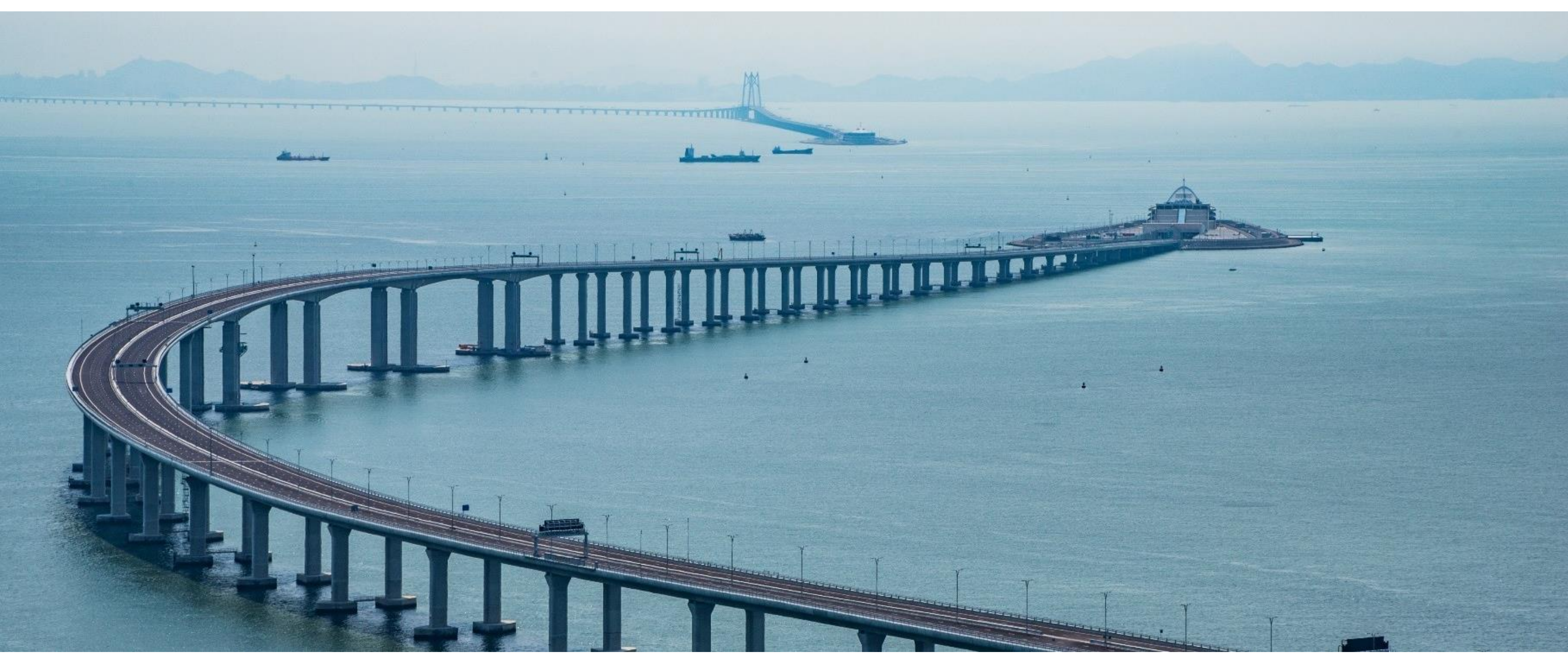
In the matrix below we summarise and combine the virus control strategies with the economic & fiscal strategies outlined previously, so as to derive various scenarios for COVID-19's economic impact (under the assumption that the pandemic will last for 12–18 months). For each scenario we provide a brief description in the respective matrix quadrant, along with an illustration of the magnitude of COVID-19' negative economic impact, and its longevity:

Effectiveness of intervention

	Low	Medium	High
Highly Effective economic response • Strong fiscal/monetary policies, to-the-point sector-specific & economy-wide measures, high timeliness, high EU solidarity • Sector supply/capacity preserved, depression threat averted	Impact / 2020 ▸ Severe resurgence episode ▸ Limited number of RE sector bankruptcies and unemployment ▸ Mid term property demand recovery ▸ Govt debt: Debt/GDP:	Impact / 2020 ▸ Virus generally contained ▸ Very limited number of RE sector bankruptcies and unemployment ▸ Faster property demand recovery ▸ Govt debt: Debt/GDP:	Impact / 2020 ▸ Virus well under control ▸ Almost no RE sector bankruptcies and unemployment ▸ Swift property demand recovery ▸ Govt debt: Debt/GDP:
Partially effective economic response • Solid fiscal/monetary policies, robust economy-wide but partial sector-specific measures, moderate timeliness, modest EU solidarity • Sector supply/capacity suffers some contraction, mild depression	S1 Impact / 2020 ▸ Severe resurgence episode ▸ A number of RE sector bankruptcies and unemployment ▸ Mid-Long term property demand recovery ▸ Govt debt: Debt/GDP:	S2 Impact / 2020 ▸ Virus generally contained ▸ Limited RE sector bankruptcies and unemployment ▸ Mid term property demand recovery ▸ Govt debt: Debt/GDP:	S3 Impact / 2020 ▸ Virus well under control ▸ Very limited RE sector bankruptcies and unemployment ▸ Mid-short term property demand recovery ▸ Govt debt: Debt/GDP:
Low effectiveness economic response • Partial fiscal/monetary policies, few sector-specific measures, weak timeliness, EU disagreement and reversal of ECB QE • Deflationary spiral leading to depression	Impact / 2020 ▸ Severe resurgence episode ▸ Widespread RE sector bankruptcies and unemployment ▸ Very slow property demand recovery ▸ Govt debt: Debt/GDP:	Impact / 2020 ▸ Virus generally contained ▸ Substantial RE sector bankruptcies and unemployment ▸ Sluggish property demand recovery ▸ Govt debt: Debt/GDP:	Impact / 2020 ▸ Virus well under control ▸ A number of RE sector bankruptcies and unemployment ▸ Long term property demand recovery ▸ Govt debt: Debt/GDP:
Depth of red colour indicates magnitude of COVID-19's negative economic impact	**Low** • Use of various degrees of social distancing/border controls	**Medium** • Use of various degrees of social distancing/border controls • Upgrade & scale-up of testing + proactive testing	**High** • Use of various degrees of social distancing/border controls • Upgrade & scale-up of testing + proactive testing • App-based contact tracing • Immunity testing

Sophistication of pandemic countermeasures

The real estate sector horizon and impact is likely to move along the "**Partially effective economic response**" scenarios as presented in the above matrix, which have been used as the basis of our analysis. On the next pages we analyse the impact of the pandemic on the RE market by considering the potential effect of these scenarios on key sector metrics.



Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

In an effort to gauge the potential impact of COVID-19 on the Real Estate sector in the following years, we combined the three scenarios identified on the previous page with the survey results and the rest of the market analysis. The analysis focused on the effect that the virus control strategies will have on two key metrics of the RE sector, specifically the **revenue from RE sales** and the **number of building permits** issued.

For clarity, revenue refers to all sales of real estate units either as a direct transfer or through the submission of a sale agreement to the Land Registry department ('LRO'), as per the raw data received from the LRO.

The number of building permits relates to all real estate projects licensed within the year, excluding infrastructure projects.

Revenue from RE sales for the purposes of the analysis was indicatively broken down into the following key categories:

- Fields - Offices - Plots - Retail - Flats - Other - Houses

Based on the analysis, different asset types are expected to be affected differently by the virus. The differences relate to both the magnitude of the COVID-19 impact as well as the recovery rate.

The basic assumptions in relation to each scenario are presented below:

S1 Scenario 1- Low degree of sophistication of pandemic countermeasures – Long exit horizon

Revenue from RE sales	Large initial drop in revenue
Number of building permits issued	Sharp drop in building permits issued, with numbers not returning to 2019 levels in the projected period
Recovery Period	More than five years for the market to recover closer to 2019 sales revenues

S2 Scenario 2- Medium degree of sophistication of pandemic countermeasures - Medium exit horizon

Revenue from RE sales	Moderate to large initial drop in revenue, depending on type
Number of building permits issued	Moderate drop in building permits issued, with numbers not returning to 2019 levels in the projected period
Recovery Period	Market will partially recover within the projected period, approaching the 2019 sales revenues closer than Scenario 1

S3 Scenario 3- High degree of sophistication of pandemic countermeasures – Short exit horizon

Revenue from RE sales	Moderate drop in revenue, depending on property type
Number of building permits issued	Lower reduction in building permits issued compared to other scenarios and returning to 2019 levels in the projected period
Recovery Period	Market will recover in the mid-term, approaching 2019 sales revenues

Notes:

- *The scenarios presented in the following slides are only indicative, based on historical data gathered from CyStat and the Land Registry office, together with a number of assumptions. The assumptions by nature are uncertain and depend on a series of unknowns at this stage. The situation surrounding the COVID-19 outburst is dynamic and changing rapidly, on a daily basis. As such, the scenarios presented should by no means be considered as certain or accurate predictions for the future. They are only provided for discussion purposes.*
- *An asymmetry in the effectiveness of virus control between different countries could have a negative impact on the effectiveness of the measures implemented locally.*
- *There is considerable uncertainty surrounding the timing of an effective therapy protocol or vaccine, and the latter may not be a final solution.*

Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

As already noted, each asset type is expected to react differently to the COVID-19 disruption and therefore is considered separately in the analysis that follows. Before presenting the different results we explain below each asset type behaviour and its impact .

Land

Fields

Fields tend to be vulnerable to recessions, as they are not considered as an investment priority, especially in the case of fields located in non-development zones. On the other hand, fields located in development zones are mainly bought by developers, who at present are expected to focus on their existing pipeline and disposal of current stock. Transaction in the fields category are thus expected to be significantly reduced during the COVID-19 crisis.

Plots

Residential plots, constituting the majority of plots being sold (the rest being commercial, touristic or industrial), are considered to be among the assets attracting higher investor interest and thus expected to recover quicker than fields. Their relatively low prices combined with the fact that they are also purchased by individuals looking at developing their own homes, increase further their appeal to different sections of the market.

Residential

Flats

Flats are the type of assets that are expected to be least affected by the COVID-19 outbreak. Based on previous disruptions or downturns of the market, demand for flats, either from individuals or investors, appears to have been historically the least volatile. Flats have prices lower than houses and again appeal to a wide section of the market; from young couples to families and overseas buyers at the higher end of the market. They are thus expected to also recover quicker than other asset classes.

Houses

Although the fundamentals that drive the demand for houses are similar to those for flats, the fact that some were built for own use (i.e. not reflecting market needs but merely the owner's preferences) and the fact that they usually carry higher prices, reduce their appeal and rank them lower than flats in speed of recovery.

Commercial

Offices

Offices are expected to be impacted by COVID-19 in different ways, as follows:

- Most offices are likely to be under long lease contracts that may predate and outlive the virus crisis, in which case the initial negative impact would be less material.
- On the other hand, demand in the followings years, and probably supply pipeline, could contract compared to historical trends due to permanent behavior changes in the markets and a shift towards remote working and flexible workspace.

Shops

Retail assets are expected to suffer the biggest blow. A number of tenants are expected to face difficulties in serving their lease obligations and others to suspend or cease operations. Even when lockdown measures are relaxed, tenants' ability to meet lease obligations remains questionable. Taking these into consideration, one can anticipate investors / buyers requesting higher yields thus exerting downwards pressure on prices.

Other

Other type of properties include, inter alia, industrial assets, hotels, as well as all other assets that are transacted through the Land Registry and are not included in any other category. These type of assets, as a category and not individually, are expected to perform better than retail assets and fields, albeit not making it to the investors' priority list in the short to medium term. Consistently with other income producing assets, investors are again likely to require higher yields and exert pressure on prices.

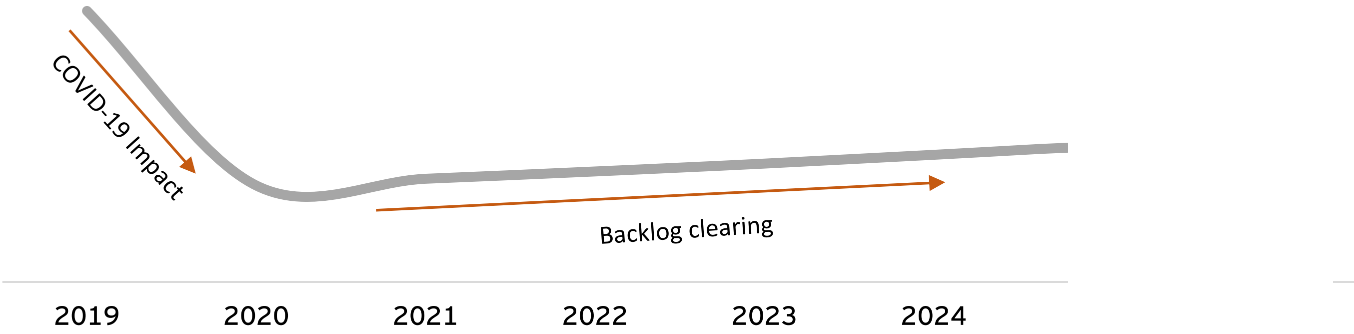
Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

S1 Scenario 1 – Low degree of sophistication of pandemic countermeasures

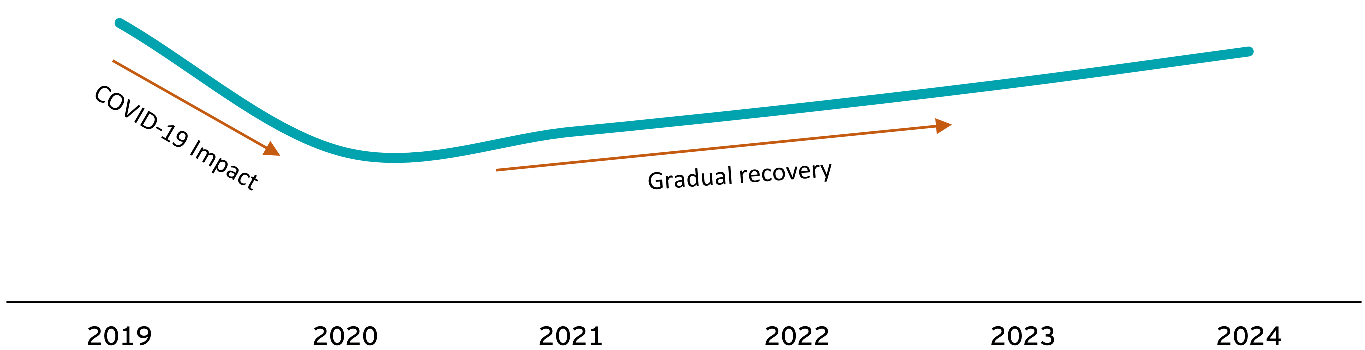
Scenario 1 is the most "pessimistic" among the three scenarios examined. It assumes the following:

- Transactions in residential and non-residential assets are projected to face a severe negative impact, with the implications suffered for more than five years and the market struggling to recover.
- The scenario also assumes the largest drop in RE revenue in 2020 and the slowest recovery rate. The projected horizon of 5 years is not considered sufficient for the market to fully recover to normal levels.
- Issuance for buildings permits is also projected to slow down, in an effort to catch up with the backlog created from the large sales reduction. The number of building permits issued in 2020 is projected to be around 55% of the 2019 levels. This number gradually increases but does not reach 2019 levels within the next five years.

Total Revenue from RE sales



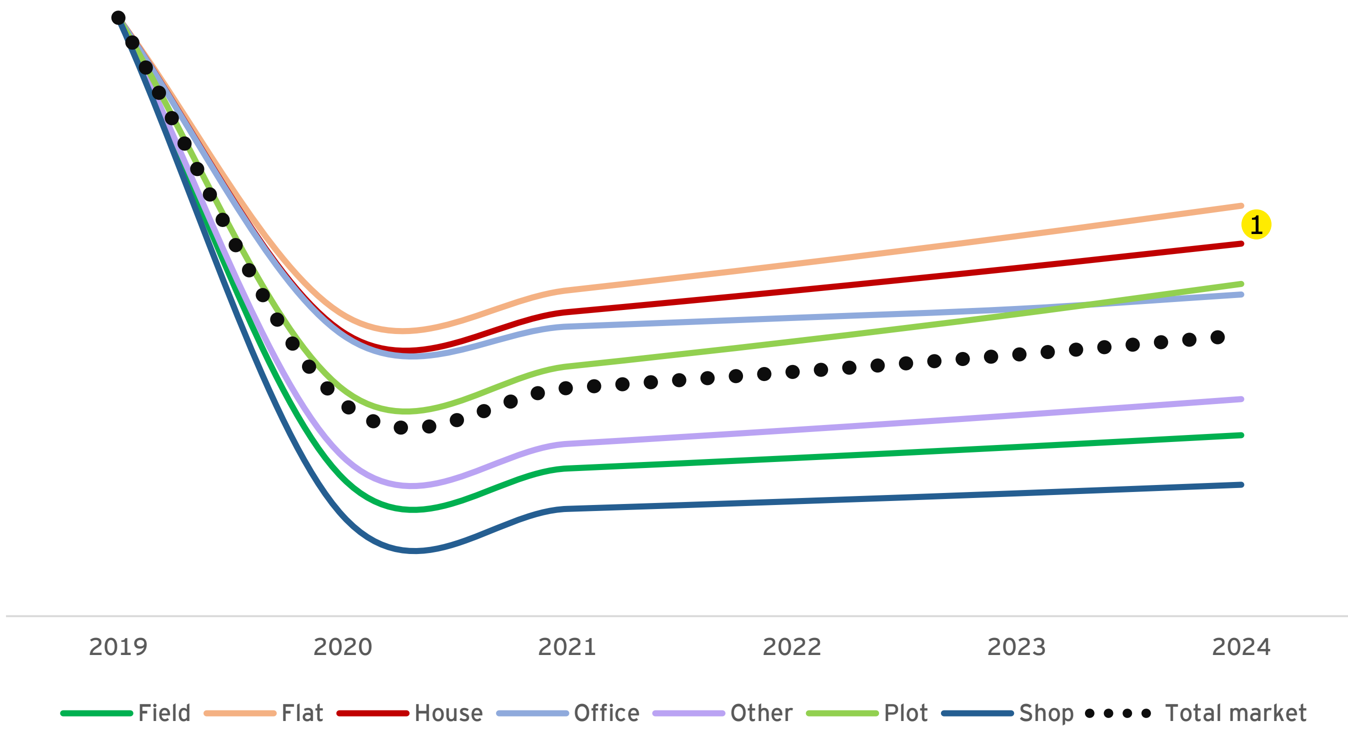
Number of building permits issued



Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

As previously noted, each asset type is expected to react differently to the shock of the pandemic. The analysis that follows covers a breakdown of the projected impact on the different unit types. The different behaviors are plotted on the same graph together with the market total, in order to facilitate comparison.

Scenario 1 – Revenue breakdown by asset type



Key observations

- Residential assets (1) are expected to exceed the overall market performance during the projected period. Flats and houses are forecasted to experience the lightest drop and have the quickest recovery out of all property types.
- Offices are expected to undergo a structural change which is evidenced by the unique trend observed compared to other property types; despite an initial above-market performance in 2023 offices' recovery eventually slows down and a drop in revenue is observed toward the end of the period.
- Under Scenario 1, plots also appear to outperform the overall market performance post 2021.
- Fields, shops as well as the "Other" category, are foreseen to perform worse than the total market during the projected period.
- The "Other" category, which among others includes industrial units, is not expected to be the priority of buyers/investors in the foreseeable future, and has a sub-market performance (but not as negative as retail).
- Shops appear to follow the steepest L-shaped behaviour and are the worst performing asset class, exhibiting the highest initial drop. It is also anticipated that this category will have a very slow recovery rate.

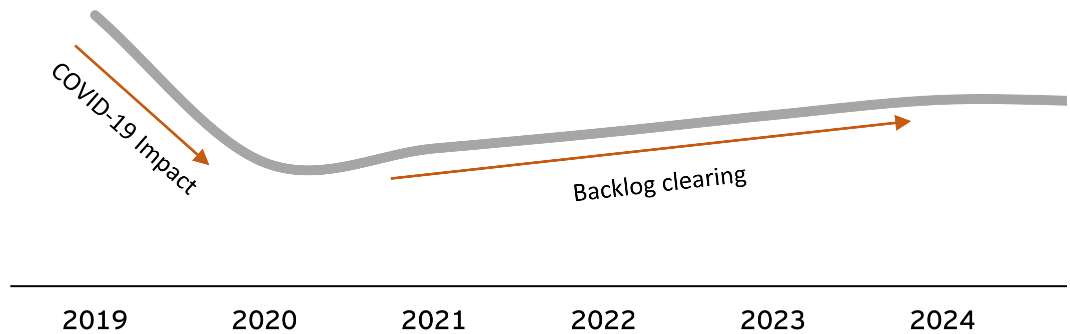
Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

S2 Scenario 2 - Medium degree of sophistication of pandemic countermeasures

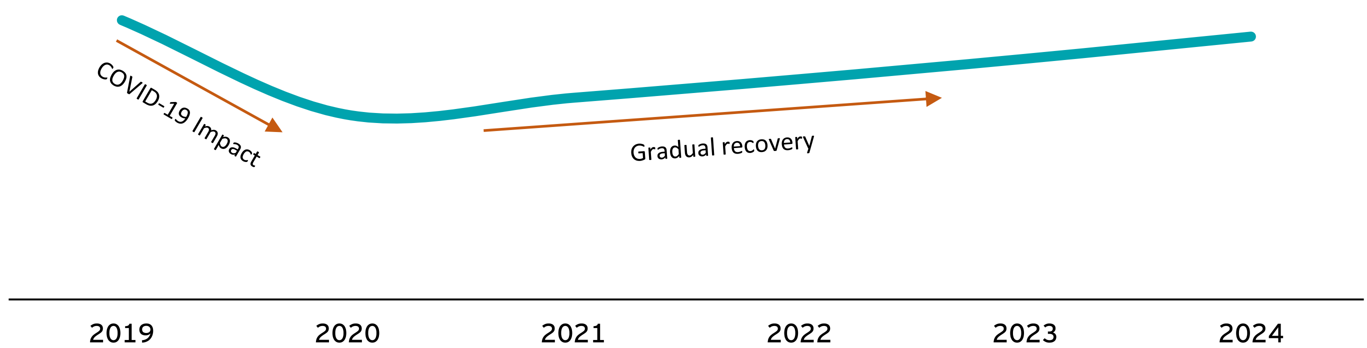
Scenario 2 is a "moderate" scenario, but not necessarily the most likely to happen. It assumes the following:

- Moderate initial drop in RE revenue as well as a moderate recovery rate.
- Revenue from RE sales recovers faster than under Scenario 1 following the shock in 2020. By the end of the five-year period the market is forecasted to recover and return to normalised trading volumes thereafter (closer but still lower than the levels observed in 2019).
- Under this scenario the total number of building permits issued suffers a drop in the region of 35% compared to 2019. Similarly to scenario 1, it is assumed that it takes more than five years to reach the number of permits issued in 2019.

Total Revenue from RE sales



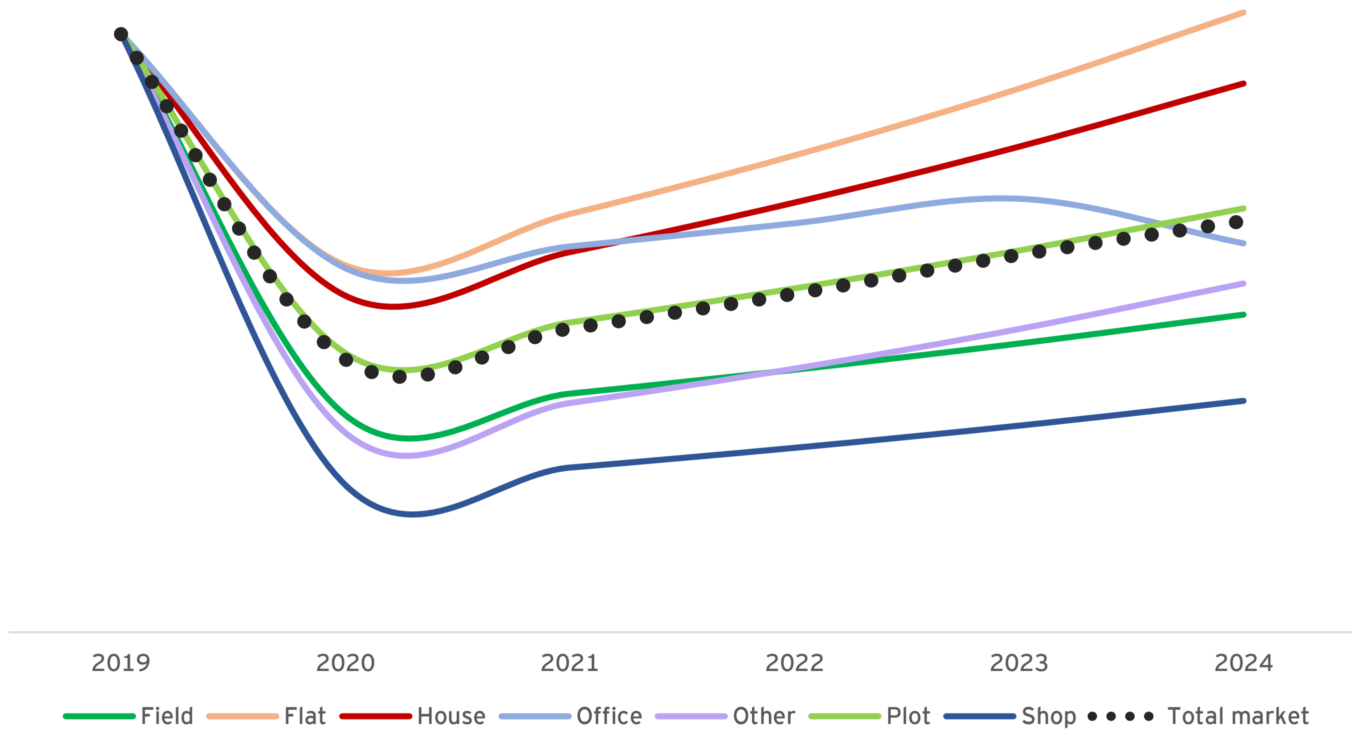
Number of building permits issued



What do the scenarios mean for the real estate market?

The revenue breakdown per asset type under Scenario 2 together is presented below together with the market total.

Scenario 2 – Revenue breakdown by asset type



Key observations

- Consistent with Scenario 1, flats are the best performing property type in the projected period but with a much faster recovery rate that reaches 2019 revenue levels by 2024 (only category reaching 2019 performance). Houses follow with a similar trend.
- Under this scenario, offices appear to experience a lighter initial drop compared to houses. However, due to their slower growth levels, they eventually get surpassed by houses. Offices are forecasted to have a relatively stable performance between 2020-2023 but experience a drop in revenue for 2024, due to shifts in sector trends (e.g. work from home schemes, more flexible office spaces etc.).
- Compared to Scenario 1, in this scenario plots are projected to move in line with the overall market during the projected period, however starting from a higher point.
- Once more, shops are expected to face the steepest initial drop and remaining well below the 2019 transaction levels.
- As it is also observed on the graph, the initial drop in revenue of fields is lower than the "other" category. However, it is expected that assets included in the "other" category (e.g. industrial, hotels etc.) are expected to perform better in the long run.

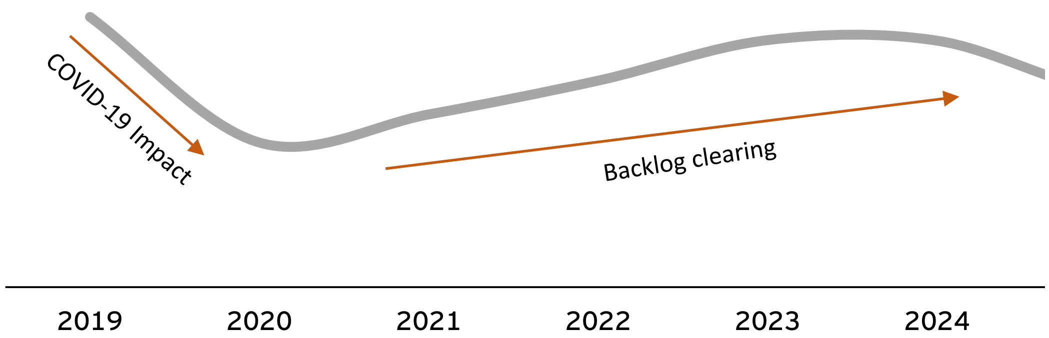
Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

S3 Scenario 3 -High degree of sophistication of pandemic countermeasures

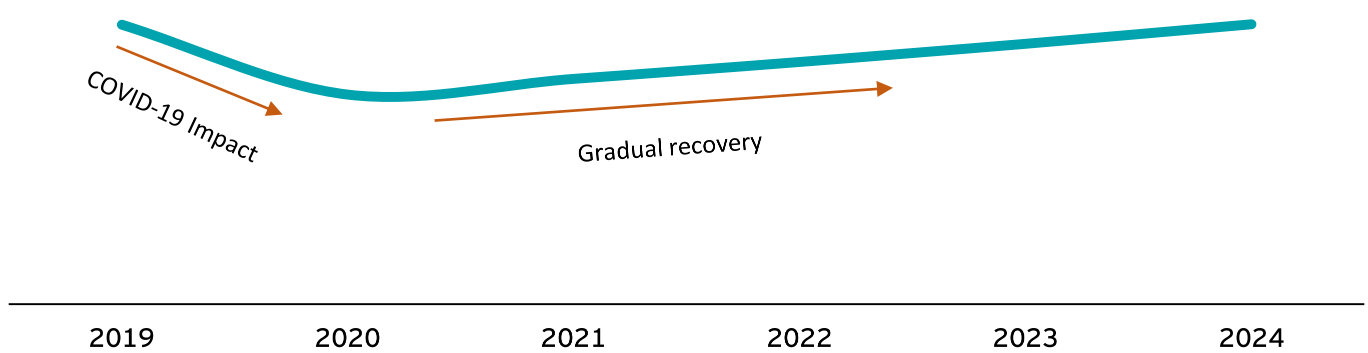
Scenario 3 represents a "best-case" scenario in relation to the pandemic's impact. The key assumptions are as follows:

- Most of the negative impact on RE sales would be limited to the lockdown period. Following the relaxation of the lockdown measures (including opening of the airports), the market is projected to promptly embark on a steadfast recovery. This impact from the lockdown is expected to lead to smaller drop of revenues compared to 2019 figures than the other two scenarios. Overall sales are expected to normalise the end of 2023.
- Under this scenario, as opposed to scenarios 1 & 2, the number of building permits issued in the period reaches 2019 levels.

Total Revenue from RE sales



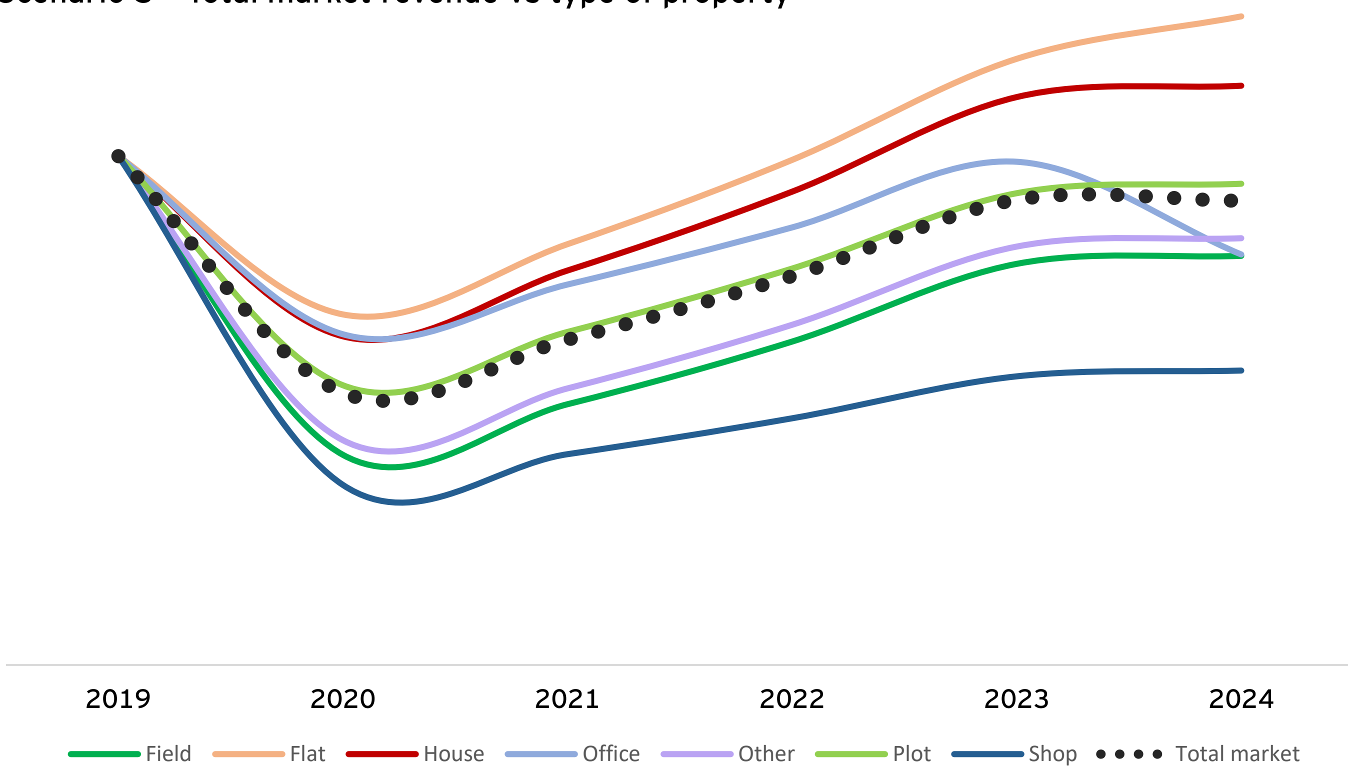
Number of building permits issued



Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

The revenue breakdown per asset type is presented below, in an effort to demonstrate the different expected behaviour of each type of property under Scenario 3.

Scenario 3 – Total market revenue vs type of property



Key observations

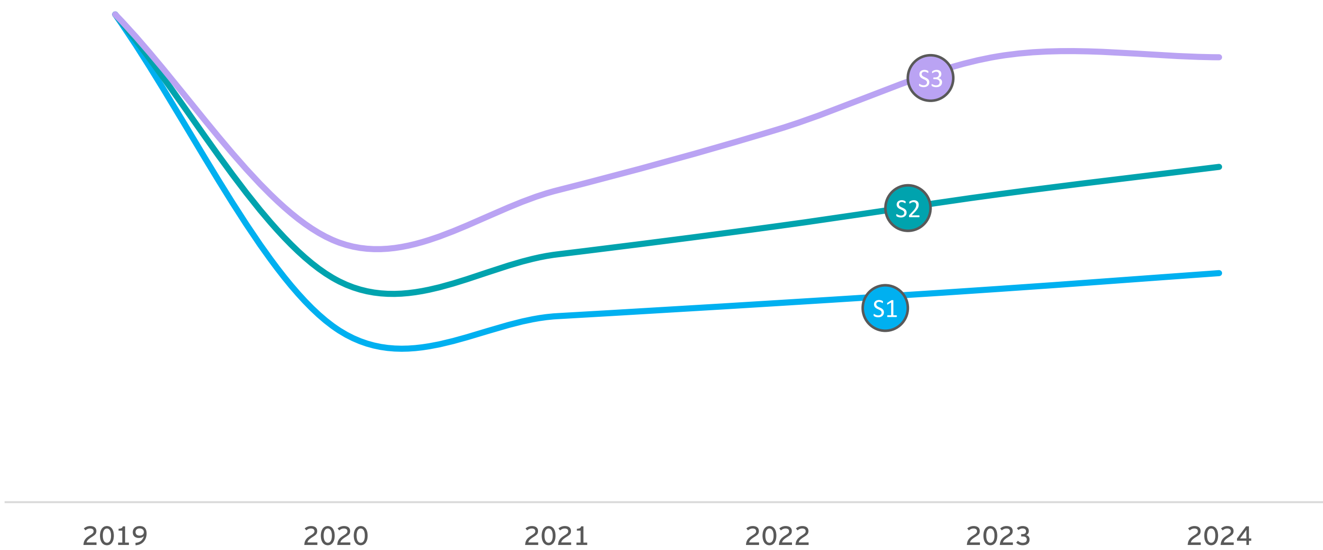
- This scenario also assumed that flats are outperforming the other asset types, but with a more aggressive rate. By 2022 revenues from flats are expected to reach 2019 levels.
- House transactions are also anticipated to experience a rapid recovery, reaching 2019 levels by 2023.
- Offices, as in the previous scenarios, are expected to perform better than the overall market during the first years. Eventually, changes in sector trends are again projected to lead to a sales decline towards the end of the projected period.
- Under this scenario, "Other" category is expected to perform better than fields during the entire projected period (as in Scenario 1).
- Consistent to scenario 2, plots are expected to mirror total market's behaviour.
- Fields, like in the case of the other two scenarios, are not foreseen to be able to follow the total market's level of transactions since they are not considered to be high on the buyers/investors list.
- Shops, consistently with the other two scenarios, are the worst performers. Their performance remains well below both the rest of the market but also the 2019 levels.

Impact of COVID-19 on the Real estate sector
What do the scenarios mean for the real estate market?

Summary of the three scenarios examined

The graphs below present a comparison of the three different scenarios examined for each of the two key metrics. The trend of all scenarios follows a common sharp drop in RE sales in 2020 followed by a gradual recovery.

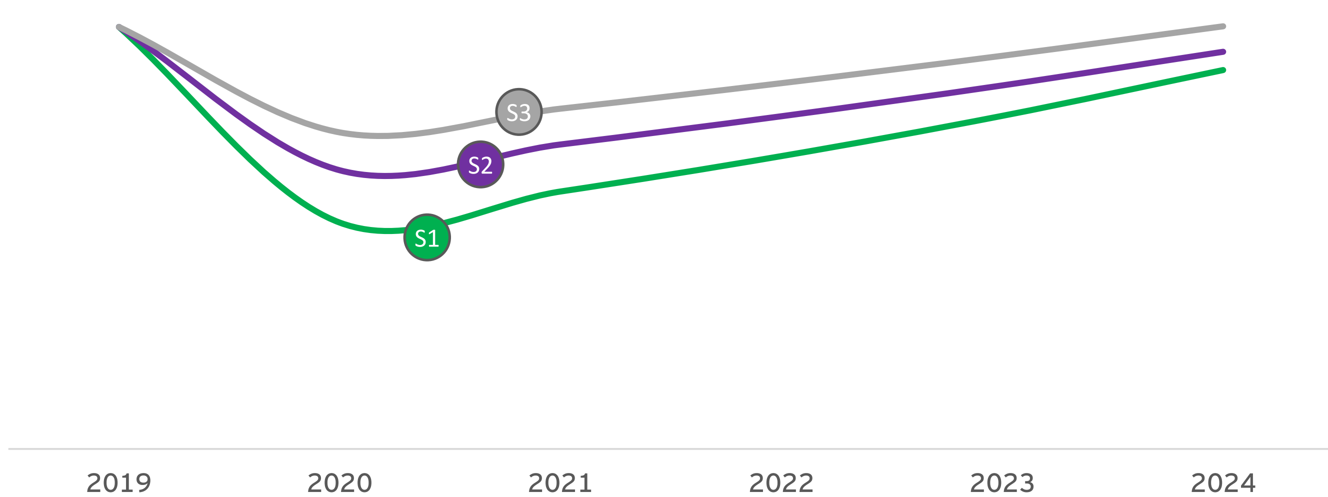
Total market RE sales revenue



The largest initial drop takes place under Scenario 1, which assumes low sophistication in COVID-19 countermeasures, which in turn translate into a greater shock to the market. Scenario 3, which is the most optimistic, assumes the smallest drop in the short term due to more a more sophisticated COVID-19 response and a thus a lower impact on the sector.

In terms of recovery rates, Scenario 1 assumes that there will be a very slow recovery towards pre-COVID levels, especially after the first year of the projected period. On the other hand, Scenario 3 which assumes that the virus is under more control (due to the more sophisticated measures) assumes a faster recovery in the short to mid term and a stabilisation by the end of the projected period.

Number of building permits issued



The number of building permits issued follows a similar trend with the sales performance captured in the first graph. A gradual recovery is expected during the five-year period examined. Again, the key factor that differentiates the three scenarios is the initial drop in the number of permits issued. By the end of the projected period, all scenarios are assumed to return closer to 2019 levels.

Economic impact of COVID-19 on real estate
Sector-specific government measures

Governments across the globe have acted swiftly to implement fiscal, financial and legal measures in an effort to shield the different RE stakeholders from the consequences of COVID-19. The most popular of these measures so far are summarised below:

- **Tax relief measures for the real estate sector**
  Deferral of payments for tax liabilities/ arrangements to pay in instalments/ suspension of debt collection proceedings/waiving of penalties and interest accruing on unpaid liabilities. Such tax liabilities include:
    - VAT payments
    - Health and social insurance taxes
    - Corporate income tax
    - Capital gains tax ('CGT')
    - Municipal taxes such as property tax

- **Deferral of rent payments and protection from eviction for commercial tenants**
  Moratorium on the forfeiture of commercial leases by landlords for non-payment of rent
- **Measures for the protection of residential tenants,** including deferral of rent payments and moratorium on evictions in certain cases.
- **Deferral of loan payments (mortgage holiday)** offered by banks upon the encouragement of the central banking systems across the world.
- **State aid/ solidarity funds** to cover (capped) corporate losses incurred in March 2020.
- **Government guarantees on new loans** for healthy borrowers, to ensure liquidity and payment of suppliers.
- **Circumvention of bureaucracy** to expedite processes (construction permits, etc).
- **Force majeure and non-fulfilment of contracts**
  Commercial courts interpreting as force majeure the non-fulfilment of relevant contracts due to the pandemic, including developer contract, construction and supply contracts.

What can be done in Cyprus?

To date, the Cypriot government has enacted a number of fiscal and financial economy-wide measures that also cover the RE sector. These include the partial coverage of salaries to employees, postponement of VAT payments, deferral of health and social insurance contributions and 10% decrease in electricity bills. Specific to the real estate market, the government has suspended the eviction of tenants until May 31st.

Below we list additional measures tested successfully both locally and abroad during previous market disruptions.

Elimination of bureaucracy

- Prioritise and expedite the digital transformation of the Land Registry, Planning Authorities, and other relevant to the sector departments.
- Simplify the process and reduce the time needed for the construction licensing process (building and planning).

Further tax incentives

- Eliminate transfer fees for all RE transactions, e.g. 2 years.
- Reduce the VAT rate on property sales, e.g. from 19% to 10% for 2 years.
- Eliminate or reduce Capital Gains Tax (CGT) on all new properties purchased, e.g. in the following two years.

Strengthening of CIP scheme

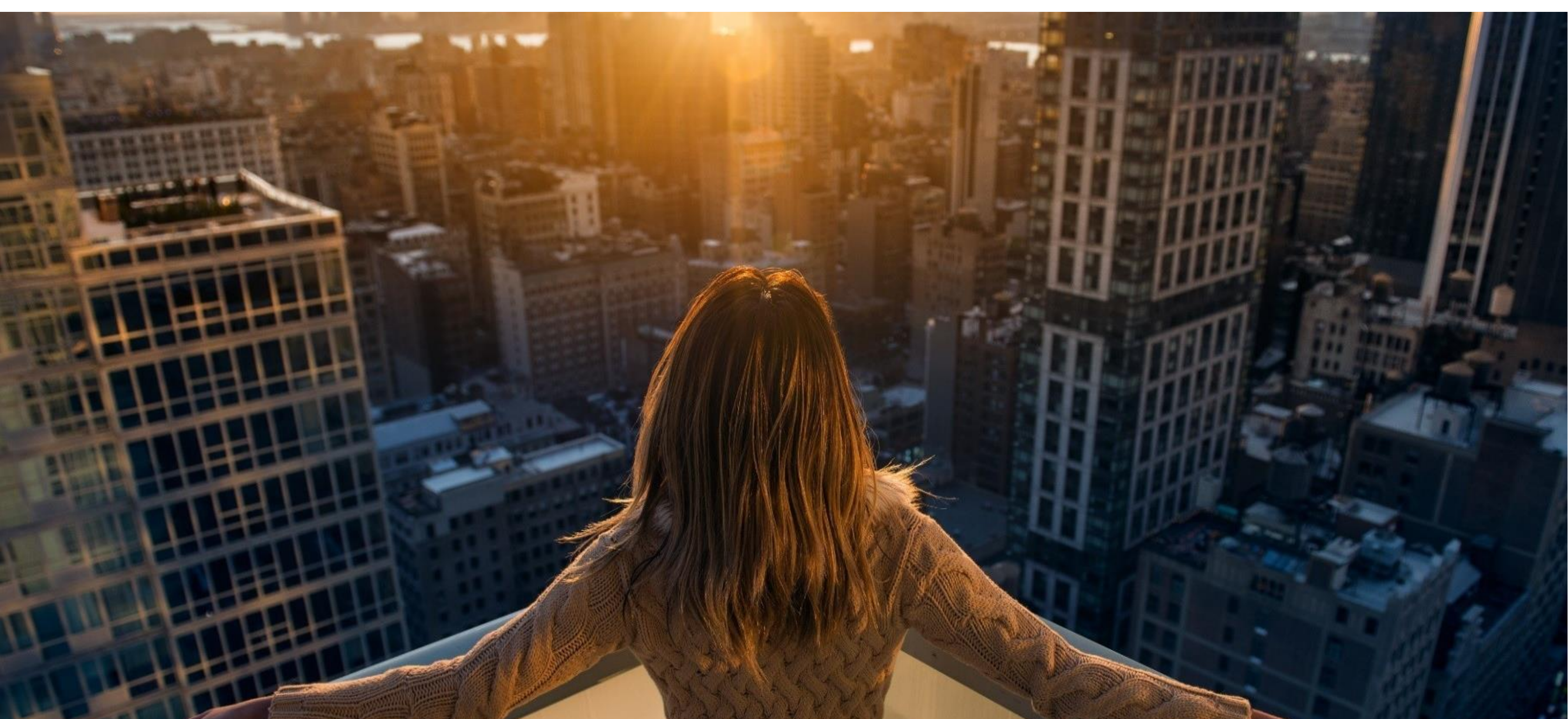
- Prioritise the clearance of the backlog of existing CIP applications.
- Simplify application process for new applications. Also take account of the travelling restrictions currently faced by applicants.
- Reconsider and revise criteria to both protect the scheme but at the same time encourage serious interest

- Creation of efficiencies in the market with simplified procedures
- Reduction in transactions related costs
- Sustaining and increasing demand by foreign investors

Sources: 1. https://www.squirepattonboggs.com/-/media/files/insights/publications/2020/04/covid19-government-measures-in-real-estate-europe/covid19-government-measures-in-real-estate-europe.pdf

Key Takeaways

- The Real Estate sector constitutes one of the key pillars of the Cypriot economy, and a key driver in the country's economic turnaround following the 2013 financial crisis. Revenue generated from the RE sales for 2019 reached €5.7bln, achieving a CAGR of c.26% since 2013. A growth that benefited a large number of players, including RE developers, construction companies, professional service providers, designers and suppliers. The sector's performance is closely linked with construction activity, evidenced by a CAGR of 20% on the value of building permits issued since 2013.
- In addition to growing local demand, the sector has been attracting material foreign direct investment, with c.47% of the new built sales in 2019 relating to overseas buyers.
- The COVID-19 outbreak introduced a number of significant challenges and disruption in the sector; including the suspension of construction activity and sales activities, rapid reduction in revenues (exceeding 70% based on market participants), reduced profitability for relevant stakeholders and liquidity pressures.
- The timely recommencement of construction activity and lifting of country lockdowns are considered key by the sector's stakeholders for the recovery of transaction activity and mitigation of the financial impact.
- Market participants are also currently adopting a number of measures in order to maintain operations and stimulate sales activity, including among others the use of technology for remote property sales, offer of discounts on asking process, working from home for back of the house staff, cost control activities, etc.
- The European RE market also faces reduced transaction activity, with recorded sales indicating in some cases y-o-y reductions approaching 50%.
- Factors that become more important under the current market conditions include prime locations, existence of solid and long term tenants, and changing buyer/tenant preferences. COVID-19 encouragement of flexible workspace/remote working expected to impact the office market while online shopping is expected to favour logistics space against retail outlets.
- Different RE products are expected to be impacted differently by the pandemic. The largest impact is expected on the retail sector. Residential products are expected to be least impacted and quickest to recover. These forecasts are also supported by our own analysis covering the impact of COVID-19 under three different COVID countermeasure scenarios. In terms of market recovery to normalised historic levels, the best case scenarios forecasts a turnaround by 2023 while the worst case predicts a recovery after 2024.
- Government measures to support the sector are also considered key and can be provided in different forms. Tax incentives could take the form of elimination of CGT and transfer fees, reduction of VAT rates and tax payment deferral. Construction activity could also be supported by the elimination of bureaucratic procedures (e.g. licensing). Finally, overseas investment in the sector can be boosted through a stimulation and strengthening of the Cyprus Investment Programme.



How EY can help

Services that bolster your resolve and reshape your future

Short-term cash & liquidity management

- Analysis of cash gaps
- Identification of quick wins
- Dynamic forecasting of cash needs under crisis scenarios and identification of mid-term solutions

Financing options

- Analysis of financing structure
- Identification of alternative options
- Securing non-bank / quick financing

Negotiations with banks

- Advice with bank negotiations
- Lenders deck and banking presentation preparation
- Preparation of financial projections
- Capital structuring

Independent business review

- Independent Business Review preparation for your lenders, creditors, etc.
- Stress testing based on market situation

Working capital advisory

- Lean organisation and processes optimisation
- Supply and demand planning
- Assessment of key Working Capital drivers and cash release opportunities

M&A support

- Divestment advisory
- Real-estate sales
- Quick direct sale process
- Identification of opportunities

Economic Advisory

- Economic Impact Assessments
- Cost-Benefit Analysis
- Incentives analysis & planning
- Regulatory economics
- Competition economics

Corporate Finance Strategy

- Corporate strategy
- Value optimisation
- Investment strategy
- Feasibility & business planning
- Portfolio strategy

Real Estate specific sector expertise

- Financial, technical and commercial due diligences
- Feasibility studies
- Business plan preparation and independent assessment
- Advisory valuations and reviews
- M&A Advisory services
- Real estate data and analytics
- Strategy

Services relevant to: Government/Regulators Banks Businesses

How EY can help (cont'd)

People

Stelios Demetriou
Partner /
Transaction Advisory Services Leader
Real estate and Hospitality Leader

Stelios has over 20 years of experience in advising leading real estate, hospitality and other clients in transaction services in Cyprus. He has helped leading groups in the sector to raise capital, led due diligences, handled merger and acquisition transactions, and advised on financial restructurings. He as also provided strategic advice to different stakeholders, including some of the largest hotel chains locally and the government

Alexandros Pericleous
Director / Transaction Advisory Services

Alexandros focuses on strategy and corporate finance. He has helped clients reshape their results through regaining control of their cash and working capital, business planning and review, restructuring, renegotiating debt, and investing / divesting. He is a member of the Royal Institution of Chartered Surveyors (RICS) in the pathway of business and intangible valuations.

Andreas Anastasiou
Director / Transaction Advisory Services

Andreas was involved in financial advisory engagements for various clients in the real estate and hospitality sector. He managed teams involved in capital raising and debt restructurings, led due diligence exercises, prepared business plan and feasibility studies, and advised on transaction structuring and negotiations.

Michalis Loizou
Manager / Transaction Advisory Services

Michalis has over 10 years of experience in advising clients, in the whole spectrum of the real estate cycle, including valuations, feasibility studies and portfolio underwriting. He is a member of the Royal Institution of Chartered Surveyors (RICS) in the pathway of valuations as well as a real estate valuation practitioner with the Technical Chamber of Cyprus.

Renos Solomides
Manager / Transaction Advisory Services

Melina Moleskis
Assistant Manager / Transaction Advisory Services

Natasa Apostolou
Analyst / Transaction Advisory Services

Transaction Advisory Services are all about helping our clients get more for their capital. We provide comprehensive guidance on all aspects of transactions – understood as major corporate undertakings outside the ordinary course of operations – from inception to execution. In this way, we manage to support the flow of capital across borders, help bring new products and innovation to market, and enable organisations to reshape themselves for a better future, in a rapidly changing, increasingly digital and disrupted business environment.

Why EY Transaction Advisory Services?

EY ensures the best outcome by combining:

- A highly experienced and entrepreneurial team
- Comprehensive solutions
- International network
- Sector expertise
- Digital expertise

EY | Assurance | Tax | Transactions | Advisory

About EY

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