Entering a New Market

– A Model for Evaluating a New Commercial Real Estate Market

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Abstract

Title: Entering a new market – A model for evaluating a new commercial real estate market

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Issue: The development for Skanska Commercial Development (SCD) during the last years has been positive on all markets and Skanska therefore plans on expanding their activity. Central and Eastern Europe has had a considerable economic development, what is assessed to continue during the next following years. Bucharest is one possible alternative in the CEE for a new establishment by SCD. However, the investigation before an entry is a process with many factors that need to be taken into consideration. There are today no models on how and what a developer as SCD should evaluate in terms of opportunities and risks on a possible new market.

Purpose: The main purpose of this thesis is to develop a model for evaluating risks and opportunities of entering a new commercial real estate market. The study aims as well to evaluate the commercial real estate market in Bucharest.

Method: A qualitative methodology has mainly been used in this study, further a framework from Handfield and Melynk (1998) concerning theory generation from empirical findings, has been applied. Moreover, the study has in great extent been done in an iterative process.

Conclusions: The study has concluded an evaluation model for commercial real estate markets, which contributes with a structured way of evaluating new markets. Further the Bucharest commercial real estate market has been evaluated on the basis of the developed model. The main risks found on the Bucharest commercial real estate market are restitution claims, the macroeconomic situation, the market's situation in the real estate cycle, the potential corruption in the planning process of commercial real estate, the supply of land and land prices, and an overstrained construction market. The potential of the market is considered to be significant due to future economic growth potential of Romania and Bucharest and also because of the low supply of modern office space on the Bucharest market.

Acknowledgements

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1 Background

The purpose of this chapter is to give the reader background knowledge of the study and to clarify the aim of this study. A review of the present situation, the problem and the purpose of this thesis are presented. The theoretical framework we have used and basic information about Skanska Commercial Development is introduced. Further Skanska Commercial Development's business model is initiated and finally an outline of the report is provided to give the reader an overview of the chapters.

During the past decades major changes in the political climate mainly in Central and Eastern Europe (CEE) has occurred. Many new markets have evolved after the collapses of former communist regimes in these countries. These markets have in many aspects been rather under-developed in terms of the general economic situation and living standard. The need and the will of changes in order to improve the situation have been and still are considerable for many of these ex-communist countries. Thereby these markets have experienced and still experience strong growth in terms of improved standard of living and in general economic terms, especially during the last decade[1].

The fast rate of change has implied several challenges in terms of adapting the legal systems, the labor- and the financial markets, as well as the institutional structures of these countries, in order to be able to cope with the new prerequisites. The expansion of the European Union (EU) in many of these ex-communist regimes in CEE has put pressure of improving the aspects given above, which has enhanced the situation. Though, it still exist considerable challenges, especially for the countries that recently joined EU.[2]

The business climate in some of these countries can still be categorized by a considerable degree of uncertainty around factors mainly in the macro environment, for example issues referring to corruption and to bureaucracy from different authorities. This since, the governments and the institutional systems as a whole sometimes struggle with corruption and other irregularities in these new markets[3]. The economic situation for some of these countries also can be considered as a potential risk mainly due to for example unpredictable inflation rates, shifting real income, the private credit levels[4] and low state income due to low taxes[5].

In these transition economies many western companies have identified considerable potential for venturing from the changed prerequisite in the CEE-countries. The motives of doing this differs, but commonly these companies establish their business in these countries in order to benefit from low labor costs, but also through a growing domestic demands on these markets. A trend has lately been to establish different

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[1] Prof. Ana Popa (2008-04-07)

[2] Land report, Romania, Swedish trade council (2008-04-23)

[3] Prof. Ana Popa (2008-04-07)

[4] CEE Quarterly 01/2008, Bank Austria p 28

[5] Land report, Romania, Swedish trade council (2008-04-23)

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kind of labor intensive support functions in for example Poland and Romania usually named BPO, *Business Process Outsourcing*[6]. The motives behind these trends are mainly low labor cost and high supply of skilled employees primarily within IT and languages.

International companies, which establish their businesses in CEE-countries usually, have high requirements on the standards of their office space. The demand for new office space therefore increases rapidly on these markets since the existing stock of modern offices is low. Concurrently global investor's starts to interest for new investments in real estate on these new markets and the two aspects together creates business opportunities for a real estate developer of office real estate, in the continuation of this study named developer.

Entering a new market is associated with high financial risk and businesses such as a real estate developer's is connected with considerable risks, since the business idea includes making large investments in land. Further a real estate developer makes profit by developing real estate, which is leased and usually sold to an investor. The process of developing the real estate is in great extent concerned about handling different types of risks and the business in great part deals with risk management[7]. To be able to manage the risk when entering a new real estate market, a comprehensive evaluation is necessary. In the evaluation it is important to be able to judge the risks and take the right decision of entering or not entering the market. Furthermore, if the decision is to enter, the evaluation can be of great importance in order to facilitate the entry and being able to manage the risk.

The Swedish construction company Skanska is expanding their real estate development business, Skanska Commercial Development, to new markets and the countries in CEE are some potential candidates. Skanska Commercial Development (in the continuation of the thesis referred to as SCD) do not have a model that they use when they evaluate a potential market, instead do they trust the tacit knowledge and the experience within the organization[8]. Nor are there any theoretical models developed for what a real estate developer should investigate when evaluating a new market, according to our theoretical research.

Thereby we have seen the need for a study of the situation concerning a market entry for a real estate developer. The aim of the study is to contribute with a theoretical approach concerning the decision-making process of an entry on a real estate market. Furthermore the study also aims to contribute with something of practical use for SCD. The purpose of the study will be more detailed explained below.

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[6] Mats Johansson, President SCD Poland (2008-03-04)

[7] Jan Johnsson, Market Director SCD Finland (2008-03-03)

[8] Per Hansson, Project Manager Skanska Oresund (2008-02-07)

1.1 Issues of the study

An investment decision for a real estate developer is a rather complex decision to make, since the outcome of a real estate development project is hard to tell in advance. This since the process of developing a commercial real estate project is long and involves a great number of interactions with different actors, who can have a considerable influence on the project. The outcome of a project is also hard to predict, since the success of a project are closely connected to a number of external aspects, such as the present and future macro environmental situation in the target country, the future conditions on the specific real estate market and the process of developing the project. Furthermore a real estate project is connected with considerable investments in the acquiring of land and the construction of the real estate. This additionally raises the level of complexity in the decision process of entering a real estate market.

A major field of interest to be evaluated in advance of an investment decision is the potentially present and future risks in the macro environment of the target country, as described above. These issues mainly refer to the political, legal, economic situation of the country.

The political risks concern the general stability of the political system and must be considered so the business climate is feasible in the long term. The legal aspects are also of great importance to evaluate before entering a market, especially when a considerable investment in the country is about to be done. The legal system must thereby be addressed in terms of how the legal system in general works and specific how the real estate laws can be applied. For example the ownership of land is an issue, which calls for a proper evaluation of the legal system since many of these countries have an ongoing restitution process regarding land and real estate.[9] This has in some of these former communist countries created an unclear situation concerning the ownership of land. Thereby the issue of ownership control must be addressed before acquiring land on markets in CEE.

The great part of the CEE-countries have during the last decades experienced a remarkable economic growth, which both have created opportunities and risks seen from a real estate developer's point of view. Opportunities mainly in terms of increased demand of modern real estate but also risks mainly referring to an overheated economy with high price levels on land and high inflation. For a developer it is important to both understand the present economic situation on the market but also to be able to roughly predict the future economic situation on the market. This is mainly important in order to predict the economic potential of a project, which can be hard to estimate due to the length of a development project and also due to the cyclical nature of the real estate market[10].

For an entry on a new market to be interesting, the investment must have a profit potential. One part of assessing the profitability on the new market is to evaluate if

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[9] Prof. Ulf Jensen (2008-01-28)

[10] Renaud (1997) pp 13-44

the specific real estate market is attractive to be on. The starting point of evaluating the potential of the specific real estate market is to find out the demand for the product on the specific market and also examine the competition on the market. Furthermore the supply of land and potential building contractors are of interest to examine. For a developer to understand if the market is interesting to enter and to be successful, knowledge of these actors and an understanding of what drives them must be acquired.

Commercial real estate is in great extent dependent on cyclicality in the economy and it is because of that of interest to gain an understanding of the present and the potential future market situation in terms of economic growth, demand and supply of the product, vacancy levels a yield level among other things. If an analysis of the macro environment and the specific real estate market situation is not done properly, it can be a considerable risk to launch a project. This due to the importance of entering the market at the right time in order to develop a real estate project successfully, since a high potential development project easily can be turned into a great loss for a real estate developer. Furthermore different developers have different strategies on where in the cycle they shall invest mainly depending on their will to take risks, but to be able to make good decisions they all need to analyze the market conditions before entering a new market.

A real estate developer's business consists of projects, which have interactions with a number of actors during the process. These actors, in the continuation named stakeholders, can have a considerable impact on the success of a project. The need of understanding these critical stakeholders and the process of developing a real estate project on the specific market therefore are of great importance to be able to develop projects successfully.

The decision-making process when entering a new real estate market covers a number of aspects that must be examined in order to estimate the risks of an entry. To acquire the essential information for good decision-making and risk-management, a comprehensive evaluation of the new market is consequently of great significance. In order to cope with the complex situation, a model, which contributes with a structured approach of evaluating the critical risks upon a market entry could be desirable, we believe. The purpose of a model is not to reproduce the reality exactly, since that would make the model redundant and too extensive. The purpose rather is to facilitate the reality and provide a realistic enough picture, which makes it easier to interpret the complexity of the real world through a concise and structured evaluation process.

1.2 Developing a model and evaluating Bucharest

The primary aim of this thesis is to develop a model that a real estate developer can use to evaluate a new commercial real estate market. The model should work as a framework that will help the investigator structure and analyze the information in order to identify as well the critical factors as the potential of entering the new market.

Further the model will be applied on the Bucharest market of commercial real estate in order to evaluate the risks and the potential of entering this market for SCD. Moreover the process of evaluating the Bucharest market will be used in order to improve the model further. The Bucharest evaluation will thereby also function as a real case iteration of the model.

The purpose of this study can thereby be concluded in the points given below:
- Developing a model for evaluating risks and opportunities of entering a new commercial real estate market
- Evaluate the Bucharest market of commercial real estate

1.3 Delimitations

1.3.1 Model

The model is developed with a real estate developer such as Skanska Commercial Development in consideration, but other real estate developers should find the model useful as well, we believe.

The model is primarily developed for evaluation of markets in Central and Eastern Europe. Other markets can also be evaluated with the model, but if the market is relatively well known/developed, some parts of the model might be redundant.

The model is a market selection model with the aim of evaluating the risks and the potential of a commercial real estate market. The model does not emphasis how a market will be entered or the potential to succeed with a market entry on the basis of the resources and competencies of the developer's business.

The real estate market consists of several different products with various characteristics. In this thesis we have chosen to focus on the commercial real estate market and more specific the market for prime office-space.

1.3.2 Bucharest

The second part of the thesis is to test the model by evaluating the Bucharest commercial real estate market. The geographical delimitation is the city area of Bucharest. The time perspective is what a plausible project takes, approximately four years.

1.4 Theoretical Discussion

To fulfill the purpose of this thesis and to be able to develop the model, following theories has been used and crossbred:

- International marketing

- Real estate cycle theory

- Stakeholder theory
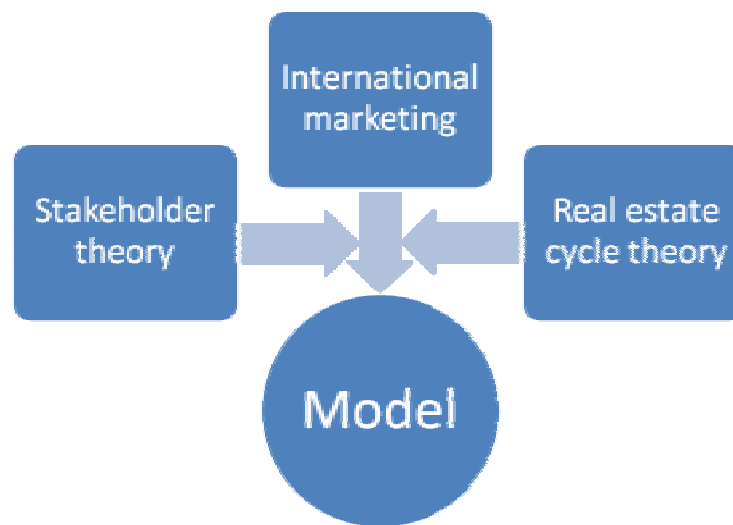
Figure 1 Theory perspectives

The theories will further be presented in chapter 4, *Theoretical framework.* In chapter 3, *Creation of the model,* we discuss why these theories were chosen and how they contribute to the development of the model. Since the purpose was to develop a model for evaluation of a new market, our first mission was to find out if there already existed such a model. From this study we found that this was a rather unexplored theoretical field, which made us search for appropriate theoretical perspectives for the situation. This gave us the theoretical perspectives displayed above.

In the field of *International marketing* we found an appropriate model. The model was however mainly developed for the manufacturing industry. We nevertheless, found the framework of the model in great extent suitable for a real estate developer as well. The next step was to adapt the framework to suit a real estate developer. The *Real estate cycle theory* was then added since it contributed with a useful perspective when analyzing the real estate market, since the commercial real estate market is cyclical in its nature[11]. Real estate cycle theory also brings a dynamic perspective,

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[11] Anders Kupsu, President SCD Nordic (2008-02-08)

since it enables the investigator to better predict the future by analyzing the past on the real estate market.

Another field we believed that the framework lacked to suit a real estate developer, was *Stakeholder theory* since a developer is dependent on its stakeholders in a high degree. A developer works in projects and by using the Stakeholder theory in the real estate development process, the theory can give an understanding of the potential risks of the stakeholders involved in a real estate project and how they might affect the project.

1.5 Skanska

Skanska is one of the world's largest construction companies with expertise in construction, development of commercial and residential projects and public-private partnerships (PPP). Skanska is active in selected home markets in Europe, the US and Latin America. In the US, which is the single largest market, they are a leading company within building and civil engineering projects. In the Nordic region, Czech Republic and Poland, their operations cover the construction and investment businesses. In Latin America, they are mainly active in the oil, gas and energy sector and in PPP. In the UK, they are a leading player in construction as well as within PPP.[12]

During the 1990's Skanska was Sweden's largest private property owner. However owning property and being a long term real estate manager did not fit the company's strategy. To fully exploit the potential of being both a construction- and a real estate company, most of the real estate was sold and the new strategy was to be a construction company and a real estate developer.[13]

1.5.1 Skanska Commercial Development

A developer creates value by planning, building, leasing and selling real estate i.e. developing real estate. Today Skanska's developers operations are managed in two business units, Skanska Commercial Development Nordic and Skanska Commercial Development Europe. In the Nordic business unit they are active on following markets; Stockholm, Gothenburg, Oresund (Malmo and Copenhagen) and Helsinki. In the European business unit it is the following markets; Warsaw, Wroclaw, Prague and Budapest.

The development of SCD has been positive on all markets and they therefore plans on expanding the business. They have operations in Central and Eastern Europe and this region has had a considerable economic development, which is assessed to continue during the next following years[14]. Romania is one of the countries in this region that

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[12] www.skanska.com (2008-02-25)

[13] Richard Hultin, President Skanska Oresund (2008-02-26)

[14] The Swedish Trade Council (2008)

could be interesting, especially since they now are a member state of the EU. If SCD would enter Romania, Bucharest is potential market for a new establishment.[15]

1.6 The real estate development process

The business process of a real estate developer can be seen through six general steps, which spans from the acquiring of land to the disinvestment of the real estate. This process is usually three to five years long and requires a number of different actors, resources and competencies. Each of these steps will below be briefly explained in order to give the reader a common understanding of the business process of a developer.[16] In figure 2 an overview of the process can be seen.

Figure 2 The real estate development process

1. Acquiring land

The real estate development process begins with the developer's acquisition of an attractive site. In the process of acquiring land a due diligence procedure is done, which for example consists of a comprising investigation concerning the ownership of land and what the land has been used to before. Further investigations concerning the environmental- and soil conditions of the land is also considered among other things. Summarized, this step concerns an extensive background check about the land, in order to prevent inconvenient events in the future and an estimation of the possible return on the investment.

2. Planning/Zoning

This step concerns the process of developing a plan for the real estate including the detailed about the property, in order to meet the requirements from the authorities. Many of the requirements that must be met can be found in the zoning- and the city plan. The zoning plan considers what kind of property is allowed to be built on the land. For example; residential, industrial and commercial property which is commonly visualized in different colors in the zoning plan. The city plan normally considers, which buildings, architecture, height of the building and parking space, etc., that must be met in order to receive a building permit. Further the planning and preparing of the construction is also initiated in this step. A developer can in this step add a considerable value by developing the real estate plan for the land.

3. Leasing

On some markets the space is leased before the construction begins, so called pre-lease, this reduces the developer's risk. On other markets pre-lease is not possible and the developer must then build on speculation, this causes increased risk for the

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[15] Andreas Lindelöf, President SCD Hungary (2008-02-28)

[16] Staffan Haglind, Market Director Skanska Oresund (2008-02-26)

developer. Leasing out the office space to the tenants is the part together with the planning/zoning part where most value is created. It is thereby of great importance to sign favorable leasing agreements since this creates the cash flow, which generates a considerable part of the value of the real estate.

4. Construction
The construction of the building is accomplished by a construction company. This since the core business of a developer is to manage the process of developing a real estate project, not the construction. In this step it is important to have proper contacts with the construction companies, so the construction phase is running properly. Additionally it is of great importance to evaluate the construction company's ability to build the real estate to the right cost and quality, and at the right time. In this step the value creation for a developer is quite moderate, since the value of real estate is not the real estate itself. It is rather the real estate combined with the leasing agreement, which generates the value of the real estate.

5. Property management
If the purpose of the project is to sell the property when it is finished, this part of the process is excluded. But if the developer thinks that they can further develop the property, the decision can be to own the property for undetermined time. The process then moves over to property management and property development. In the rest of the thesis we have excluded this step, since we have delimited a developer's strategy to sell the property as soon as it is finished.

6. Disinvestment
The last step of the real estate development process is the disinvestment. When the developer believes that the property is fully developed it is time to find a buyer and to sell the property. The normal buyers of the real estate are investors, who are looking for a fairly safe investment, which generates an acceptable rate of return.

The value creation in the development process
The value of the real estate gradually increases throughout the development process. Though, the steps in where most value is created are the zoning/planning- and the leasing steps. Further the value creation as a whole can be seen in figure 3 below.
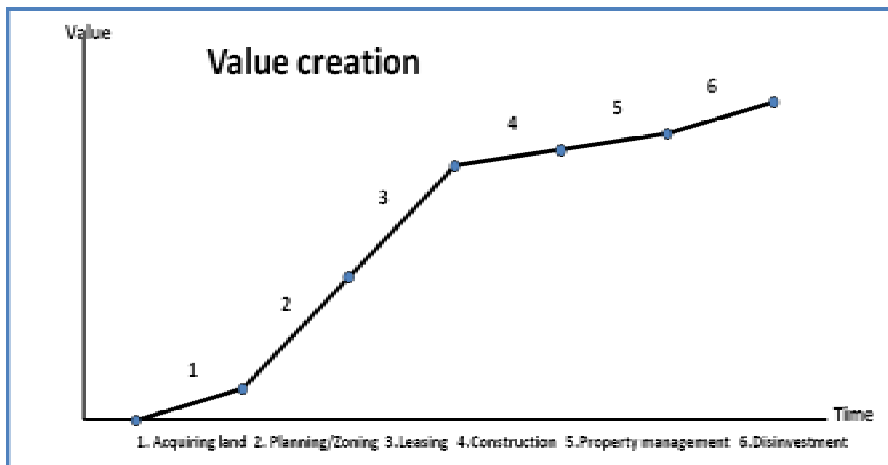
Figure 3 Value creation during the real estate development process, Skanska Annual Report (2007)

1.7 Outline

A brief outline of the study is in this part explained in order to ease the reading of the thesis and to give the reader an understanding of the working process.

Chapter 1, Introduction

The starting point for the study is in chapter carried out

Chapter 2, Methodology

The way of how this study was conducted will in this chapter be explained, discussed and critically reviewed.

Chapter 3, The creation of a commercial real estate evaluation model

The empirical findings from the interview with Skanska are in this chapter explained, analyzed and synthesized with relevant theories to form the evaluation model of commercial real estate.

Chapter 4, Theoretical framework

The theoretical framework that has been applied to develop the model is presented in this chapter.

Chapter 5, The G.U.T-model

The final version of the evaluation model is presented, which has been tested and improved by the Bucharest evaluation in chapter 6.

Chapter 6, Test of the model- Bucharest

The developed model is applied on the office real estate market in Bucharest. The findings from the evaluation is presented and analyzed. Further, a recommendation concerning the Bucharest commercial real estate market is presented.

Chapter 7, Conclusions

The conclusions regarding the study as a whole will in this chapter be presented

2 Methodology

In academic works the need for an appropriate methodology is of great importance for the validity of the study. This since the method sets the agenda of how to gather, process and examine the empirical information in order to solve problems, answer questions or fulfilling a purpose. In this chapter the methodological approach for this study is explained, analyzed and critically reviewed

2.1 The working process

The assignment given from Skanska Commercial Development (SCD) in Oresund and Budapest; "to conduct an evaluation of commercial real estate market in Bucharest", was quite open and free to form ourselves. Thereby we initially had a number of different approaches for our master thesis and we found it difficult to define an appropriate scope of the assignment in order to satisfy all the involved stakeholders. A major part of the problem of defining a proper scope of the assignment was to contribute with theoretical innovativeness and at the same time add something of practical use to SCD´s business through the master thesis. A balance had to be reached between these aspects in order to succeed. After iteration with different stakeholders and several rejected ideas, we finally found an appropriate scope of our master thesis; to develop a model that a real estate developer can use to investigate and evaluate a new commercial real estate market.

2.2 A methodological structure is formed

The next difficulty was then reached; how to develop such a model? What aspects are of relevance when evaluating a commercial real estate market? How to form a working process, which secures high validity of the evaluation model? The need of a structured approach in how to create such a study was needed.

In theory building research a *Grounded theory*[17] approach is considered to be an appropriate methodological approach[18] [19]. The Grounded theory methodology can in short be described as the process of going from empirical findings into something of general nature, a theory[20]. Thereby the theory takes its starting point in observations of a phenomena and events through interviews, protocols, documents and other data sources about a certain topic. Further the data is analyzed, structured and iterated into something general, a theory construct. Handfield and Melnyk's suggested Grounded Theory-process can be compared to the above described and emphasis on an iterative working process of observations and empirical generalization[21]. Douglas also suggests the need for an iterative pattern of data collection, theory generation, comparisons and reflections with other data sources[22]. Further, theory testing occurs

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[17] Bell (2006) pp 27-30

[18] O'Connor et al (2003)

[19] Glaser et al (1967)

[20] McAdam et al (2006) pp 825-837

[21] Handfield et al (1998) pp 321-339

[22] Douglas (2003) 44-52

throughout the whole research process in order to seek alternative explanations of the developed concept.

Consequently there are several types of methodological approaches within the field of Grounded theory applicable, when conducting a research with the aim of generating new theory. The methodological starting point for our master thesis as a whole can be described by Handfield and Melynk´s approach of a framework for theory building[23], see table 1. This framework was chosen since it provides a clear structure of the research by dividing the process into different steps. Further the framework describes the purpose and typical questions of each one of the steps, which additionally gives structure to the research process. Moreover the framework emphasis an iterative research process, which we believe is an appropriate way of approaching this type of study in order to create satisfying validity of the model.

Phase	Purpose	Research question
1a Discovery	• Uncover areas for research and theory development	• What is going on here? • Is there something interesting enough to justify research?
1b Description	• Explore territory	• What is there? • What are key issues? • What is happening?
2 Mapping	• Identify/describe key variables • Draw maps of the territory	• What are the key variables? • What are the salient/ critical themes, patterns, categories?
3 Relationship building	• Improve by maps by identifying the linkages between variables • Identify the "why" underlying these relationships	• What are the patterns or linkages between variables? • Can an order in the relationships be identified? • Why should these relationships exist?
4 Theory validation	• Test the theories developed in the previous stages • Predict future outcomes	• Are the theories we have generated able to survive the test of empirical data? • Did we get the behavior that predicted by the theory or did we observe another unancipated behavior?
5 Theory extension/ Refinements	• To expand the map of the theory • To better structure the theories in light of the observed results	• How widely applicable are the theories that we have developed? • Where do these theories apply? • Where don't these theories apply?

Table 1 Handfield and Melnyk´s framework for theory development (1998)

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[23] Handfield et al (1998) pp 321-339

2.2.1 The process of the study – *applying Handfield and Melnyk's framework*

1a. *The discovery* phase was addressed by conducting a pre-study, to gain an overall understanding of the situation of a real estate developer and the real estate industry in general. An overall picture of relevant areas for our master thesis was found and these areas were then examined from theoretical literature and empirical information concerning these areas. This stage resulted in a clearly defined purpose as earlier mentioned; to develop a model that a real estate developer can use to evaluate the potential and the risks of a new commercial real estate market.

1b. The next phase in the working process, *the description* phase, further examines the areas of importance, when developing the model. In this phase the key issues of the evaluation model was found and described by exploring a number of different information sources such as theoretical literature, implicit- and explicit empirical information. The empirical information gathered in this step was mainly sources of relevance within Skanska's organization, but also through a number of external sources of relevance such as different types of consultancy reports concerning the real estate industry.

2. By *mapping* the outcome of the previous phases, the key issues was further analyzed and broken down into key variables to be considered when developing a real estate entry model. A systematic perspective was then added in this step in order to categorize, find general patterns and critical themes, primary in the empirical findings.

3. From the empirical and theoretical research done in the previous steps a number of common themes and patterns had been discovered during the working process. This *relationships building* phase aimed to synthesize the previous empirical- and the theoretical findings in the research to form the model. Handfield and Melnyk states that this phase concerns; "The process of taking an empirical generalization and developing it into a theory produces concepts and propositions that specify relationships. Theories emerge when the terms and relationships in empirical generalization are made more abstract by introducing terms that refer to non-observable constructs."[24]. In this study this was done by defining general patterns from the empirical research and find out, which relationships that could be seen and if they are of interest to include in the model. Further this approach can be seen as an analogue to Bjerke´s view on the systematic approach; "Reality must be looked at with the assumption that its parts are mutually interacting and can therefore not be added in a simple way. This means that as the relations between the parts come into focus they may give positive or negative effects."[25].

4 & 5. In this phase the model is tested by applying it on the Bucharest commercial real estate market, in order to find out if the model can be used as an appropriate

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[24] Handfield et al (1998) pp 321-339
[25] Bjerke (1981)

market evaluation-tool. The findings of this test were then used as starting point for improving the validity of the model and to make the model more appropriate for its purpose. Moreover the investigation of applying the model on the Bucharest market also aimed to evaluate opportunities and risks of entering the market, since this also was a part of the purpose.

The description-, mapping- and relationships building phase should be seen as iterative in great extent, i.e. that the matching between empirical findings and appropriate theories has developed through an iterative process.

2.3 The working process – *an iterative process*

The working process of developing the model can be described as an iterative process, where empirical- and literature studies alternately followed each other in order to secure the capturing of relevant information and to find patterns of explanatory nature. Thereby the work of our master thesis neither can be characterized as an inductive- or a deductive methodological approach. The working process could more appropriate be described as being an iterative mix of the two methodological approaches, see figure 4.
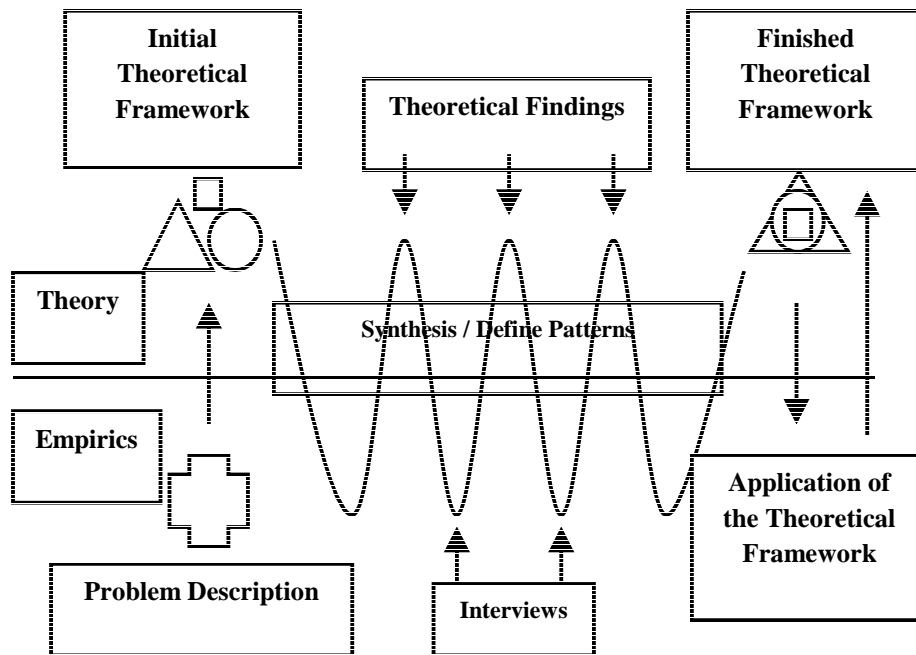
Figure 4 The iterative working process

We believe this approach is an appropriate way to address a research of our kind since the degree of complexity of a decision making model of this kind is considerable. To be able to develop an appropriate model we thereby believe that this process might be a useful methodology to create high validity of our model. This methodological approach is also considered to be useful by among others

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Eisenhardt[26], Wallace[27] and Handfield & Melnyk[28]. The research process as a whole and aspects such as interviews and other empirical information will further be examined below.

2.4 Data collection

The data collection in this study can be divided into two parts; the model creation part and the evaluation of the Bucharest commercial real estate market part. These parts partly call for different types of approaches concerning the data collection. Below the data collection of the parts are examined separately by addressing the following points:

- The need of information
- Where this information can be found
- How the information is captured
- Weaknesses of the chosen approach of collecting the data

2.5 The model creation

The characteristics of a problem call for different types of methodological approaches. In this case it was hard to overview the outcome of the research since the process of developing an evaluation model for real estate market entries is rather complex. The previous research within the field of entry models for real estate investments is limited and thereby the need of understanding the overall picture as well as the details was needed. The method for collecting these data must thereby capture both details of a phenomenon and the context of it, this to gain a proper picture of nuances as well as the holistic view of the situation. This primary calls for a qualitative methodological approach, which is appropriate when the research question is hard to overview and the research in the subject is limited.[29] Thereby the model development part of the study in great majority is based upon qualitative data through interviews, but also through quantitative information.

2.5.1 Selection of relevant sources of information

The selection of respondents for developing the model was chosen on a strategic[30] basis, i.e. in short they were mainly chosen due to their industry experience and knowledge about commercial real estate development, and the commercial real estate markets. The respondents all represent Skanska but have different experiences and positions within the firm. Two groups can be categorized among the respondents and that is; people that have experience of being project managers of commercial real estate development projects in different countries and people who are decision-makers concerning investments in commercial real estate within Skanska. By including the two groups in the study the aim is to capture both the operationalized

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[26] Eisenhardt (1989) pp 532-550

[27] Wallace (1971)

[28] Handfield et al (1998) pp 321-339

[29] Jacobsson (2002)

[30] Lundahl & Skärvad (1999)

perspective seen from the project manager's view and the perspective from the decision-makers in these projects. This will likely give a richer, more nuanced picture of the aspects, which needs to be included in the model. Several respondents have experience from commercial real estate development from several countries world-wide. Respondents with experience from the new markets in Central Eastern Europe such as Poland and Hungary have been especially interesting for the model development since the model primary aims to be applied on emerging markets.

A considerable part of the study has been done by examine literature of interest for our topic, such as theoretical frameworks, information concerning real estate in general and specific, and information given by institutes. This information has been collected from the university libraries, common libraries, bookshops and on search engines on internet.

The theoretical frameworks have been collected from textbooks, academic studies and published articles in well-acknowledged academic journals. The starting point for our choices of theoretical foundation has been based on the criteria; (a) the theories must be of practical use and (b) the theory must add a dimension or perspective to the phenomenon or context, which had been hard to reach with solely common sense. Thereby the theories chosen have been critical reviewed in order to fulfill these criteria. Textbooks have also been applied but mostly by giving extra support in the theoretical framework when needed, according to our point of view.

Reports and other information concerning aspects related to the real estate market have also been important sources. This information has been critical reviewed since it in many cases is given from a certain perspective of the market, for example a consultancy report gives a different view on the market then a report from a legal firm. In order to find an adequate picture different sources have been used when looking at a certain phenomena.

2.5.2 Capturing the information from interviews

Before the interviews were conducted a presentation of ourselves and an introduction of the theme of the interview was sent in advance to the respondents. This was made in order to get the respondents to prepare and reflect around the topic.

The structure of the interviews concerning the development of the model was in the first round carried out without any structured questionnaires and agendas. With this methodology we aimed to capture as much background information as possible concerning aspects of importance in the commercial real estate market. We also used this interview structure since we did not want to limit ourselves to a certain perspective, which potentially could reduce the validity of the model. Further interviews were carried out a second round in order to get detailed information of a specific part of the model. These interviews were done in a semi-structured way in order to find out more about a specific phenomena/part of the model.

When conducting these interviews it was important to critically question the answers to sort out the personal opinions, since the answers most likely are influenced of the

respondent's personal opinions, for example given by background, profession and experience[31]. The interviews in the first part of the thesis, the model creation phase, were both done face-to-face and by telephone. The ideal from our point of view would have been to conduct all interviews face-to-face, but it was not possible since the major part of the interviewed people at Skanska work in different parts of the world. All the interviews have been done by the two of us in order to give a dual perspective on the interview and thereby improve the validity of the interview. In connection with the interview the findings have been discussed and summarized to capture the relevant findings, nuances and details of the interview.

2.5.3 Points of improvements

The study has mainly been carried out by using primary sources within Skanska's commercial development business unit. This has most likely influenced the result of the model development. A greater selection of respondents would thereby be desirable, which would give a more general selection of respondents. However, the study has been complemented with external sources such as theories within the fields of interest and consultancy reports of the real estate market, which probably have influenced the study in a positive way by adding general perspectives to the model. As earlier mentioned the interviews were carried out both face-to-face and by telephone. Preferable all the interviews should have been done face-to-face or at least in a consistent way, but it was unfortunately not feasible in this study. The choice made; to include as many relevant respondents as possible in the study was however an appropriate choice even though this has resulted in an inconsistent methodology of conducting the interviews, we believe.

Additionally the model most likely could be improved by going through a greater number of iteration with the respondents. However the model has been iterated several times, mainly with our supervisors at Skanska and by some of the respondents, which most likely has improved the model.

2.6 Applying the model on the Bucharest market

When evaluating the Bucharest commercial real estate market the model will be applied. The model calls for both quantitative- and qualitative information in order to make an evaluation of the market. Therefore both quantitative and qualitative data collection have been conducted. Though the Bucharest evaluation in great extent has been done by interviews since the validity of the quantitative information especially from statistical institute in Romania in some cases can be questioned[32] [33] [34]. It is also hard to find up-to-date statistics about Romania, which is a problem since the economy is developing rapidly.

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[31] Jacobsson (2002)

[32] Mikael Olsson, Partner KPGM Romania (2008-04-08)

[33] Prof. Ana Popa (2008-04-07)

[34] Filip Ripa, Consult Swedish Trade Council Romania (2008-04-09)

2.6.1 The selection of relevant sources of information
The selection of respondents for the Bucharest evaluation has been done in order to (a) cover all the areas of interest when applying the model on the Bucharest commercial real estate market and (b) to give an appropriate picture of the situation of the Bucharest market. The selection can thereby be described as *strategic*[35], i.e. a selection chosen on the basis of covering the areas of interest. Further the selected parts for the Bucharest study have been consultancy agencies within commercial real estate in Bucharest, legal consultants considering the legal aspects of entering the market, tax- and advisory consultants. Further people with specific real estate developer experience in Bucharest, academics specialized in Romanian real estate market and potential customers for a commercial real estate developer have been interviewed.

The Bucharest study has also been based on published sources such as market specific information concerning the economy in general, the legal environment and the commercial real estate market specific through different types of consultancy reports and statistics from institutes.

2.6.2 Capturing the information from interviews and published sources
The interviews were conducted in two parts; one part with an open structure without pre-made agendas and a latter part, which in great extension followed the structure of the developed model and thereby can be seen as a semi-structured interview. The purpose of having this "two-part" outline of the interviews were in the first part of the interview to examine the validity of the model and in the second part to examine the risks and opportunities of the Bucharest commercial real estate market.

The idea of applying an open structure to the first part of the interview was to get the respondents picture of the aspects, which needs to be addressed when making an appropriate evaluation of entering a commercial real estate market. The open structure was used in order prevent the respondent of being influenced of our model. The findings were then compared with our model in order to examine the validity of the model and to find out how the model can be improved. The semi-structured part of the interview aimed to examine the potential of the Bucharest commercial real estate market by applying the model.

The published information sources such as statistics and consultancy reports have been looked upon critically and thereby several sources usually have been used in order to make an appropriate estimation of a specific aspect.

2.6.3 Points of improvements
The data selection of the study could have been broader and covers a greater part of the real estate market, for example no respondents from the construction and developer side were included in the evaluation. Information concerning these parts thereby is based on secondary sources, though we consider these sources to be

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[35] Lundahl & Skärvad (1999)

reliable. Further the number of sources could have been greater, which probably had improved the validity of the evaluation additionally. Concerning the interviews the respondents also could have been interviewed over telephone in advance in order to capture more information of relevance. The information collection process in Bucharest as a whole we consider to be well planned and structured, which generated rich and relevant information for evaluating the Bucharest commercial real estate market.

2.7 Reliability

In this study a major part has been based on interviews and it is hard to control the reliability of theses interviews since many aspect come in to play when conducting a face-to-face interview, for example how questions are asked or external aspects affecting the opinion of the respondent[36]. However, the model has been discussed with several persons at different occasions, with similar results, which indicates that the model itself most likely can be considered to have an acceptable reliability. We are aware of the fact that we are only two persons with limited experience within this field, which most likely affects the reliability of the study. However we believe that our openness towards new facts and findings, our dual perspective and method of using different types of information to describe a phenomenon can be considered to improve the reliability of the study.

2.8 Validity

A considerable part of the study has been focused on how to approach the process of developing a model. Thereby the process has followed a well-defined structure and the interviews and the collection of other data have been carried in order to support the process of developing the model. This has affected the validity of the study in positive way, though there are points of improvements of the study as a whole. For example that the study in great part has been carried out by interviews, which might affect the validity since interviews in considerable extent are dependent on the respondents personal opinion, background, experience, profession, etc.[37]. However, we have interviewed several respondents in order to avoid this situation.

As earlier explained the respondents selected for creating the model could have been selected on a broader basis and not solely within SCD. This would most likely have increased the validity of the model. However, we consider the model to have satisfying validity due to the test of the model in Bucharest. Another aspect also addressed above, concerns the selection of respondents on the Bucharest market, since the selection could have been broader and consisted of a greater number of respondents. We also believe that we could have applied the described methodological approach, mainly Handfield & Melnyk's framework[38], even stricter to further improve the validity of the creation of the model.

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[36] Bell (2006)

[37] Jacobsson (2002)

[38] Handfield et al (1998) pp 321-339

2.9 Triangulation

Throughout the study we have applied several different sources of information in order to get an appropriate picture of a specific aspect or a phenomenon. This has been done by interviewing different people and by studying other sources of information about a specific aspect. The results have then been analyzed and compared with each other in order to create high reliability and validity in the work. In some cases contradictious facts has been discussed with other persons with experience and knowledge in the specific area to give their view on the situation. This methodology is usually called *triangulation* and refers to using multiple methods for data collection. The common notion by the advocators of this methodology is that qualitative and quantitative data should be used in order to be able to cross validate the data and thereby improve the validity of the study as a whole. [39]

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[39] Jick (1979)

3 Creation of the model

This part will present the process of generating a general evaluation model for the commercial real estate market based on the findings from the data collection. The foundation of the model has been based on interviews and theories relevant for the situation of a market entry on a commercial real estate market. Additionally other data from institutes and consultancy reports also has been concluded in the process of developing the model.

At an early stage of the study interviews was carried out with Skanska concerning which areas are of interest to evaluate in order to enter the commercial real estate market successfully (see Skanska respondents in the *List of references)*. Throughout all the interviews a number of perspectives were given on which aspects, that should be considered when entering a commercial real estate market. The perspectives given by the respondents were then described, mapped and analyzed in order to find general patterns, themes and common denominators. At a general level three key issues were frequently mentioned to be of great importance to evaluate before entering a commercial real estate market, these are presented below.

3.1 Investment climate

The macro environment has been considered to be the initial key issue to examine before entering a commercial real estate market, according to the respondents. The importance of understanding the present situation and the possible outcome of it in the future is argued to be crucial, when doing this kind of considerable investment in a country. The respondents have in great extent seen a proper working macro environment as a prerequisite for doing business in the country. The macro evaluation aims to get an indication of where in the economic cycle the economy as a whole is positioned and also to find out the future potential of the economy in the country. Moreover the legal- and the political systems as whole in the country are considered to be critical to examine, since it can have a great impact of the success of running this kind of business. Further the quotes below reflect some of the general aspects to be considered when evaluating the investment climate, seen throughout the interviews with the respondents.

> "*The evaluation process of entering a commercial real estate market can be seen as a funnel, which starts with examine the macro environment in terms of growth in the economy, inflation, political- and legal aspects among others, which indicates the present situation and where about the country is situated in the economic cycle.*" Anders Kupsu, President SCD Nordic (2008-02-08)

> "*Initial aspects such as GDP, unemployment rate and inflation must be considered to estimate where the economy can be found in the economic cycle, since timing of entering the market is of great importance in this business.*" Jan Johnsson, Market Director SCD Finland (2008-03-03)

> *"The ownership control risk is critical to examine, since many countries in central/eastern Europe still have restitution processes running. This can be a great risk for these kinds of investments."* Anders Kupsu, President SCD Nordic (2008-02-08)

The macro environment can consequently be broken down into a number of aspects. The aspects of relevance for the evaluation of the investment climate is considered to be; economical-, legal-, cultural- and political aspects, which constitutes the fundamental of a country. These aspects will further be address later in this chapter.

3.2 Real estate market

Another key issue to be investigated prior to a market entry is to evaluate the situation of the specific real estate market. This needs to be addressed in order to estimate the potential and the risk of the specific commercial real estate market. Several aspects must thereby be further evaluated such as the demand- and the supply of the product, yield-, vacancy- and rent levels on the commercial real estate market. Below quotes, which states these key variables are presented.

> *"It is important to evaluate the demand of the product and to do this, the growth of the customers are looked upon, in our case mainly the growth in the service sector. It is also of importance to go beyond the growth and to look at aspects, which drives this growth by looking at labor costs, education level, language skills, infrastructure and geographic situation among other things in order to understand whether it is an attractive market for our customers."* Mats Johansson, President SCD Poland (2008-03-04)

The customers of a commercial real estate developer both are the investors, who might buy the property, and the tenants, who lease the offices. The demand from these customers thereby can be seen as a presumption of investing on the market.

> *"Since our strategy is to develop, lease and sell the property it is important to primary find out if there are investors interested in investing in property in this market as well as tenants who want to lease."* Per Hansson, Project Manager Skanska Oresund (2008-02-07)

The specific situation of the commercial real estate market must be addressed in terms of the trends considering the yield-, take-up (demand)-, supply-, vacancy- and rent levels. The specific location in the city is also of interest to find out, since some areas in a city usually are more attractive due to for example clusters and infrastructure on the location. This information is useful in order to understand the present situation on the market, as well as to get an indication of the future development on the market.

> *"The real estate market must be proper evaluated by considering the supply-, take-up-, yield-, rent- and vacancy levels in order to find out the potential of the market. Further it is important to get an indication of where the market is in the real estate cycle, since timing is important for these investments."* Lars Vardheim, President SCD Europe (2008-03-03)

> *"Since timing is critical to our business it is important to have an idea of where the economy in general and the specific real estate economy are situated"* Anders Kupsu, President SCD Nordic (2008-02-08)

> *"We usually look for locations, which are attractive or have the potential to be attractive in the future due to the urbanization process of the city, the forming of clusters and planned infrastructure projects."* Anders Kupsu, President SCD Nordic (2008-02-08)

An important part in the developer's business process is the construction of the building. This is done by a construction company, a contractor, hired by the developer. Usually this is done by Skanska Construction but sometimes with an external contractor, which is likely to be used on new markets where Skanska Construction has no market presence. If an external contractor is used it is important to find out, which capability the construction companies have in terms of capability to build to right quality, at right time and to the right costs. The quote below gives expression for this.

> *"It is important to think through how the construction will be done, either by Skanska Construction or by an external construction company, a contractor. If an external contractor is needed it is important to secure that the contractor can build with right quality, on time and to a feasible price."* Per Hansson, Project Manager Skanska Oresund (2008-02-07)

The existing competition on the commercial real estate market also needs to be addressed, by find out the number of existing competitors and ongoing commercial real estate projects and when they are about to be completed.

> *"The competitors on the market and their projects must be considered especially how these projects might affect the supply/demand situation, when they reach the market."* Lars Vardheim, President SCD Europe (2008-03-03)

3.3 The process of a real estate development project

The last key issue concerns the business process of running a commercial real estate project on the specific market. This process, as described in the part about the real estate development process, should be considered before an entry decision, since the enforceability of the process in great extent can have a large impact whether a commercial real estate project can be developed successfully in terms of time and cost of the project. Thereby the business process must be evaluated if there might be any critical legal aspects, critical actors and/or authorities to be considered before running the development process. Critical events during the process can for example

be feasibility to enforce for example permits related to the building, such as different types of construction permits from authorities and other actors critical in the business process.

> *"In central- and eastern Europe the legal system as a whole is important to consider, especially when running the planning process. The planning process must be feasible according to Skanska's code of conduct and in order to develop project on time to the right costs."* Anders Kupsu, President SCD Nordic (2008-02-08)

3.4 Risk management

In addition to the given aspects above a perspective frequently mentioned to be of great importance to be considered in the evaluation process is risk management This since a developer's business is in great extent dependent on several aspects and a number of actors in the environment of the firm. For example the process of running a development project includes interactions with a large number of authorities, other firms and persons, which can have considerable influence on the project's success. Moreover the success of a project is dependent of the economic development on the specific real estate market and the macro economic situation at a national and global level. Consequently a developer's business in great extent is concerned with handling different kind of risks.

> *"Our business can in great extent be seen as management of different risks referring to the development of real estate projects"* Jan Johansson, Market director SCD Finland (2008-03-03)

> *"Risk management is of fundamental importance for Skanska's success as builder and project developer."* Skanska Annual Report (2007) p 13

The holistic perspective of a developer's business can thereby be seen as risk management of different risks referring to the investment and the development process of the real estate. A superior perspective of the evaluation process will therefore be risk management.

3.5 The forming of a market entry model for commercial real estate

The previous three key issues will be addressed in combination with theoretical perspectives in order to form an appropriate market entry model for commercial real estate. The findings from interviews partly displayed above will here be synthesized with relevant theory of the specific aspects to form the model. Further referring to the methodological approach of this model's creation phase, the three key issues will be analyzed and broken down to key variables, which together with relevant theories constitute the model.

3.6 Theoretical perspectives

From the starting point of the empirical findings three theoretical perspectives have been identified as relevant to include in the forming of the model. The process of how these theoretical perspectives were selected will in the following sections be explained. The three chosen perspectives seen are:
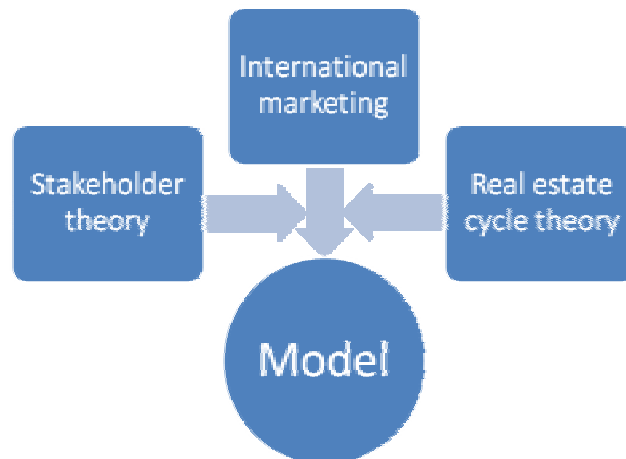
Figure 5 Theoretical perspectives

3.7 International marketing – *the starting point for the model*

A number of theories have been studied within the theoretical perspective of international marketing for example Kumar[40], Johanson & Vahlne[41], Johansson[42] and Root[43]. The theories mainly concern entry strategies for producing firms, who have a physical product to enter the new market with. The mode of entry is therefore in great extent emphasized in the theories through different ways of entering a market; export, licensing, joint-venture and through investment. For a real estate developer the entry mode is through investment and thereby selected parts of these theories have been of interest for this study. An appropriate model concerning entering new markets through investments is Root, which has been chosen as the theoretical framework within international marketing[44]. Root's framework covers a great part of the relevant aspects, which has to be considered when entering a commercial real estate market, based on the empirical findings. Further, this theoretical framework provides an appropriate structure for pursuing this kind of evaluation process, we believe. Though, some parts of Root's framework have been adapted in order to be better suited the situation of the evaluation process of a commercial real estate market. The

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[40] Kumar et al (1994) pp 29-53

[41] Johanson et al (1977) pp 23-32

[42] Johansson (1997)

[43] Root (1994)

[44] Root (1994) pp 123- 126

original framework from Root can be seen in the theory chapter. Below the process of forming the evaluation model for commercial real estate will be displayed.

3.7.1 Set the frames of the investments

In the first step of Root's framework the prerequisite for the investment are addressed. This step aims to at a high level define the frames and main objectives of the investment. In the theory it is considered to be important to have these frames and objectives in mind throughout the whole evaluation process, since they will work as a guide during the process. Further these frames and objectives will be the starting point of for an investment project, which the strategy concerning the investment will evolve around. Frames and objectives can for example be; return on investment, project time, internal policies, etc.

3.7.2 Investment climate

The second step in Root's framework, concerns the present investment climate of a country on a macro environmental level. Moreover the third step in Root's model concerns the future of investment climate. These steps have been concluded in one in the evaluated model, since both of the steps considers the investment climate. Root's framework for evaluating the investment climate, we consider to be appropriate due to empirical findings from the interviews, stated above[45] [46]. The framework has many similarities with the PEST framework[47], explained in chapter 4, *Theoretical framework*, but differs in the perspective on the future. Root's framework is more extensive and covers several types of risks, which have to be considered when evaluating the future of the investment climate. For this kind of evaluation model, Root's approach on the future investment climate is too extensive, we believe, and thereby we have chosen to use the PEST model's view on the future of the investment climate by evaluating the *key factors of change[48]*.

Additional this step have been modified in order to make it appropriate for investigate the investment climate of real estate. This has been done by adding aspects of relevance for the real estate market such as legal aspects referring to restitution of real estate. Legal aspects concerning the planning process have also been added to this step. These aspects have been added, since empirical findings have stated the need of evaluating legal considerations concerning ownership and the real estate planning process[49] [50].

In short this part of the evaluation model consists of aspects displayed below. The detailed model can be seen in chapter 5, *The G.U.T. Model.*

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[45] Jan Johnsson, Market Director SCD Finland (2008-03-03)

[46] Anders Kupsu, President SCD Nordic (2008-02-08)

[47] Grant (2005) pp 68-69

[48] Johnson et al (2005) pp 64-69

[49] Anders Kupsu, President SCD Nordic (2008-02-08)

[50] Anders Kupsu, President SCD Nordic (2008-02-08)

Macro environmental factors
> *Political environment*
> *Legal environment*
> *Economic environment*
> *Social and cultural environment*

Key factors of change
> *Critical macro environmental factors future outcome*

3.7.3 The specific real estate market

The fourth step in Root's model aims to investigate the economic potential of an investment on the target market. In this case the framework from Root has been modified in order to be suitable for real estate investments. The interviews have indicated that in order to investigate the economic potential on a specific real estate market, the customers, suppliers and the competitors must be evaluated[51]. The specific conditions on the real estate market such as yield, rent, and vacancy rate also must be evaluated to find out the economical potential on the commercial real estate market[52]. Moreover the cyclical patterns on the specific real estate market are of importance to map, since timing is important for these investments[53].

Real estate market conditions

The situation on the commercial real estate market must also be addressed in order to evaluate the economic potential of the specific market. By mapping the factors of importance on the commercial real estate market an understanding of the historical and present situation on the market can be achieved. From these data, potential trends concerning the future development on the market can be spotted.

Market conditions
> *Land price*
> *Rent level*
> *Vacancy level*
> *Supply*
> *Demand/Take-up*
> *Yield*

Industry analysis

An industry analysis has been added in order to explore the actors on the market and estimate the attractiveness of the market. The customers are in this case both tenants and investors. Further the competition within the commercial real estate market must be considered to estimate the potential of market[54]. The suppliers, in this case the construction companies must also be evaluated to find out if a development can be

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[51] Lars Vardheim, President SCD Europe (2008-03-03)

[52] Micko Pettersson, Business Developer SCD (2008-02-25)

[53] Anders Kupsu, President SCD Nordic (2008-02-08)

[54] Lars Vardheim, President SCD Europe (2008-03-03)

pursued to the right quality, cost and time[55]. Therefore the theoretical perspective *Industry analysis[56]* is considered to be a useful framework to evaluate the industry environment and the potential in the industry. The industry environment consists of following actors:

Customers
        Leasers
        Investors
Suppliers
        Land owners
        Construction companies
Competitors
        The main competitors

Real estate cycle
To further analyze the information collected in the previous step, *the real estate market conditions,* a theory concerning cyclicality on the real estate market has been added. The need for this step has emerged due to the emphasis of timing when investing in real estate, stated in the interviews[57] [58]. This step aims to apply the theory of the real estate cycle to get an indication where about the specific real estate market is situated in the cycle.

The theoretical starting point for this analysis has been taken from Mueller's cycle theory[59] [60], concerning the financial- and real estate cycle, which are described in detail in chapter 4, *Theoretical framework*. Other theoretical perspectives concerning real estate cycles have been studied such as, Renuad[61], Brown[62] referring to real estate cycles and Wheaton's research[63] considering the cyclical behavior of the American national office market during the eighties. We have found these perspectives interesting for our study, but due to the extensive need of empirical data over a longer period of time and also due to the lack of focus on the cyclicality of the commercial real estate market, we have chosen to reject these theories.

Mueller's theory concerning cyclicality in the commercial real estate market has been chosen, since it contributes with a clear systematic approach of analyzing the real estate cycle from a physical real estate cycle perspective and a financial cycle perspective. This approach we find appropriate for analyzing the cyclicality in the

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[55] Jan Johnsson, Market Director SCD Finland (2008-03-03)

[56] Grant (2005) pp 68-69

[57] Lars Vardheim, President SCD Europe (2008-03-03)

[58] Anders Kupsu, President SCD Nordic (2008-02-08)

[59] Mueller (1999) pp 131-150

[60] Mueller (1995) pp 47-53

[61] Renaud (1997) pp 13-44

[62] Brown (1984) pp 539-549

[63] Wheaton (1987) pp 281-299

commercial real estate market, because of the empirical findings throughout the whole study. For this type of evaluation model of commercial real estate this kind of cycle theory is a sufficient approach of investigating the cyclicality of the real estate market, we believe. Further, the theory is in its whole presented in chapter 4, *Theoretical framework*.

3.7.4 Project risk management

A developer's business is pursued in projects, which in great extent are dependent on several actors in the environment of the firm. It is thereby of importance to create an awareness concerning potentially risks in advance of launching a new project.

The theoretical perspective, Stakeholder theory has been included in order to provide with a relevant perspective for the situation, described above. The general theoretical foundation has in great extent been founded upon Freeman[64] and Frooman[65]. Further, Newcombe's theory concerning stakeholders in a project has been the main theoretical framework of this step[66]. The projects has then been evaluated in terms of; (a) what degree the stakeholders have the power to influence the project (b) the predictability of the stakeholders actions towards the project. The detailed theory can be seen in the theory chapter. This step aims to contribute with a risk management perspective on running a potential development project on the target market.

3.8 The development of the model throughout the study

From the synthesis above the model has been created and this model has then been applied on the Bucharest commercial real estate market, which is presented in chapter 6, *Test of the model – Bucharest*. In the evaluation of the Bucharest market the model has been tested in order to find points of improvements in the model. Further, a final version of the model has then been generated on the basis of the iteration, which is presented in the chapter 5, *The G.U.T. Model*.

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[64] Freeman et al (1983)

[65] Frooman (1999) pp 191-205

[66] Newcombe (2003) pp 841-848

4 Theoretical Framework

4.1 International Marketing

There are several reasons why companies enter international markets, some follow their customers, others because their home market are stagnant or foreign markets are growing faster[67]. Before the entry the organization need to evaluate the market. This evaluation consists of a comprehensive investigation since it should expose the potential and the risks on the market.[68]

4.1.1 Market entry modes

Companies can enter international markets in several ways depending on factors concerning the target country's market, environment or internal factors concerning the company. Different ways of entering is for example through export, licensing, joint ventures or foreign direct investment.[69] The usual strategy is to begin with indirect export and then switch over to active exporting or licensing and, to invest in foreign manufacturing and to in the last step have full-scale production and marketing in the country.[70] There are advantages and disadvantages with all the different entry modes, foreign direct investment is however due to the investment in and commitment to the host country the mode that causes the highest financial exposure for the company[71]. The traditional way to enter an international market is therefore by exporting the products before invest in the country, the company does not then have to invest and commit resources until it has knowledge of the market and how well their products are being sold[72].

4.1.2 Entering international markets through investment

A real estate developer cannot enter a market by exporting products since it is an investment based business where value is created through investment, the only entry mode possible is therefore through investment. Entering a new market through investment infers a higher exposure to risks due to the high resource commitment compared to other entry modes. Moreover, investment entry is subject to a wider range of political risks than other entry modes. The high financial exposure and risks makes strategic planning exceptional important. To estimate the risks and to be able to plan strategically, good information is crucial. To put the matter in another way, the probability of insufficient investment decisions is magnified by the lack or misinterpretation of information, more so than with other investment modes.[73] Consequently, the investigation before the entry is of great importance and because of the great number of factors that can influence the success of the entry, a well-structured investigation process is required. In Root's book; *Entry Strategies for*

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[67] Johnson et al (2005) pp 291-293

[68] Root (1994) pp 1-4

[69] Johnson et al (2005) pp 291-293

[70] Root (1994) pp 124-127

[71] Johnson et al (2005) pp 291-294

[72] Root (1994) pp 123- 126

[73] Root (1994) pp 123- 126

*International Market*s the author presents a framework for evaluation and decision making when entering an international market through investment (Figure 6).[74] This model has been used in this thesis as a foundation for the development of our model.
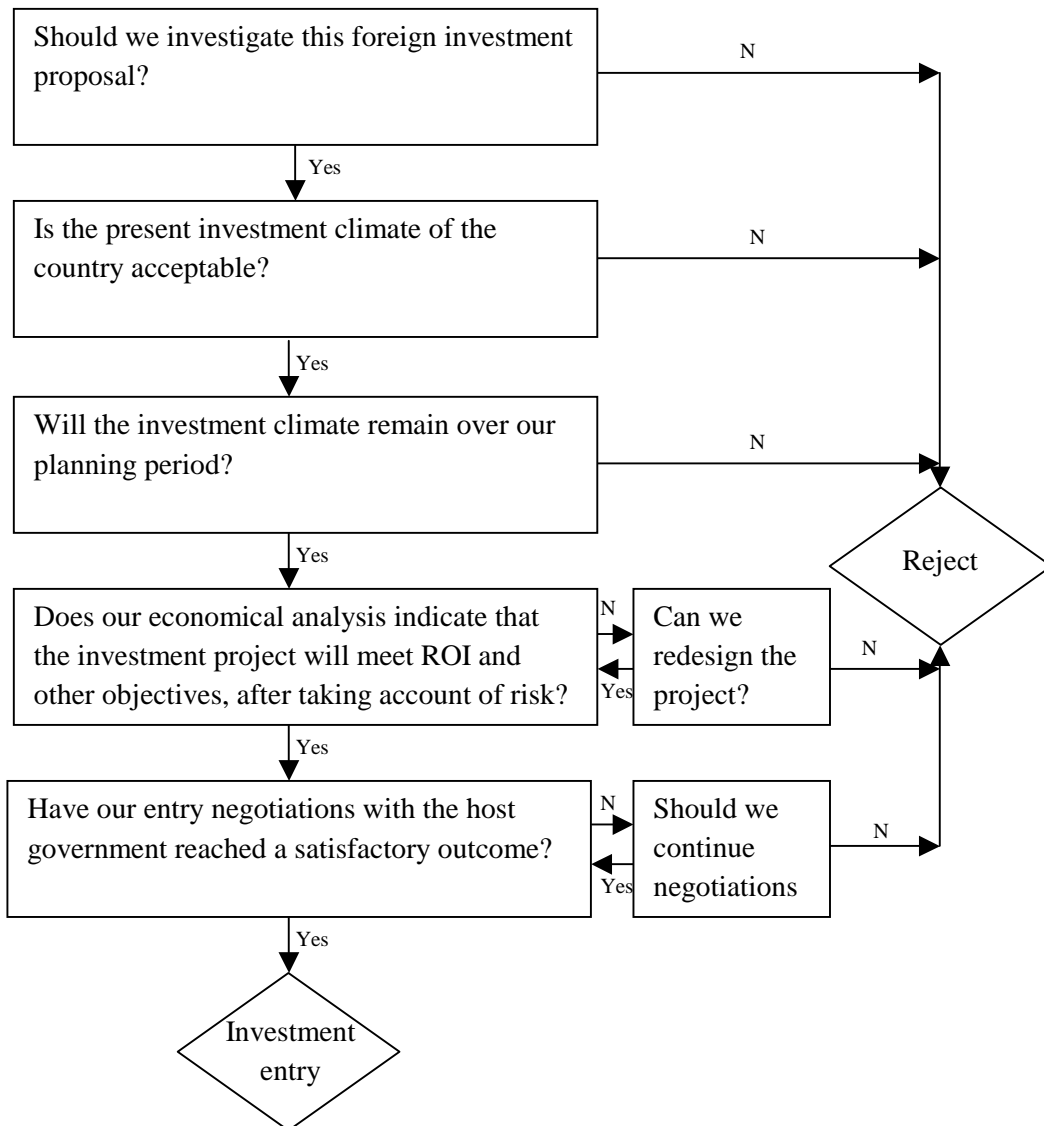
Figure 6 Checkpoints in the Foreign Investment Entry Decision Process, Root (1994)

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[74] Root (1994) pp 123- 127

4.1.3 Root's foreign investment entry decision process

Should we investigate this foreign investment proposal?
The decision to investigate a foreign investment proposal is important since an investigation requires considerable management time and money. An investigation decision should therefore only be made after an evaluation of alternative entry modes and forms of investment. If the managers believe that the best entry mode is through investment, the next step is to appraise which form of investment entry is suitable; acquisition versus greenfield, and sole venture versus joint venture. Companies often set up an investigation team that has the focus on the investment, by making them motivate why they should investigate the proposal, you can prevent the team from getting tunnel vision.[75]

Is the present investment climate of the country acceptable?
The next step is to make a comprehensive assessment of the present investment climate of the country. The investment climate consists of the country's political, legal, economic, social and cultural environments[76]. In other literature the investment climate can be referred to as the country's macro-environment[77]. In Grant's book; *Contemporary Strategy Analysis,* the author suggests a PEST analysis (Political, Economic, Social and Technological factors) when analyzing the macro-environment[78]. The authors of the book *Exploring Corporate Strategy* expands the PEST analysis to what they call The PESTEL framework. In this framework environmental and legal factors are also included as influences of the macro environment which the company operates in.[79] Understanding how PESTEL factors might impact on and drive change in general is however only a starting point. Managers need to identify and comprehend the *key drivers of change*, i.e. forces likely to affect the structure of an industry, sector or market. The three following questions are recommended to use in order to identify the *key drivers of change*:[80]
- What environmental factors are affecting the organization?
- Which of these are the most important at the present time?
- Which of these are the most important in the next few years?

Root has a similar approach as the PESTEL framework for analysis of the investment climate and since foreign markets often is more uncertain and dynamic than the home market. It is of great importance that the company understands what environmental factors might affect the organization and the entry. Managers should therefore rise following three questions about the country's investment climate:[81]

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[75] Root (1994) pp 123- 126

[76] Root (1994) pp 125- 128

[77] Johnson et al (2005) pp 291-293

[78] Grant (2005) pp 68-69

[79] Johnson et al (2005) pp 64-69

[80] Johnson et al (2005) pp 64-69

[81] Root (1994) pp 126- 130

- Which variables in the investment climate are critical to the success of the entry?
- What is the present behavior (value) of these critical variables?
- How are these critical variables likely to change in the future?

Does our economical analysis indicate that the investment project will meet ROI and other objectives, after taking account of risk?

In this step Root suggest that an economical analysis in which the foreign investments profitability is assessed. In order to assess the profitability, managers need to identify and measure all the factors that will affect and determine the project's operating revenues and costs. Aspects to take into consideration are:[82]

- Market factors
- Production/supply factors
- Labor factors
- Capital-Sourcing factors
- Tax factors

The results from the market investigation should be brought together in a financial analysis and the method Root recommends is a discounted cash flow analysis since it takes into account the time value of money.[83]

In the book *Contemporary Strategy Analysis,* Grant means that for a company to be successful it must create value for its customers. Hence, it must understand its customers. Second, in creating value, the company acquires goods and services from suppliers. Hence, it must understand its suppliers and how to create business relationships with them. Third, the ability to generate profitability depends on the competition among the firms that fights for the same value-creating opportunities. Hence, the company must understand the competitors. Consequently, the firm must understand *the industry environment* which consists of the relations between the firm and its; customers, suppliers, and competitors. Further is the profitability of an industry dependent on three factors:[84]

- The value of the product to customers
- The intensity of competition
- The bargaining power of the producers relative to their suppliers

The success of an entry in a foreign market is dependent of the industry environment[85] and when investigating the new country, before the decision to enter, the industry environment must be taken into consideration[86].

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[82] Root (1994) pp 136-141

[83] Root (1994) pp 136-141

[84] Grant (2005) pp 68-72

[85] Grant (2005) pp 414-417

[86] Johnson et al (2005) pp 291-293

Have our entry negotiations with the host government reached a satisfactory outcome?

This is the last step in Root's model for entry through investment. Every country has their own regulations and especially developing countries are adopting comprehensive laws and regulations on foreign investment. Investors should therefore investigate the investment regulations of the target country in order to know the screening criteria used by the officials to evaluate foreign investment proposals. The process is often a negotiation with the host government and the investor's bargain power is greatest before the entry, since after entering the country the investment is hostage to host government policies. It is therefore important that the investor negotiates satisfactory terms before the entry.[87]

4.2 Real estate cycles theory

It is argued that the commercial real estate market always has been a cyclical activity[88] and a driving force behind commercial real estate business is changes in the economy in general[89] [90]. Changes create possibilities as well as economic failures, which address the importance of understanding why these changes occur[91]. The starting point to at least gain some kind of understanding of the direction of the change can be found by examining the cyclical nature of the economy in general and specific in the real estate economy[92]. It may not be possible to predict these cycles in the long run, but through monitoring the movements for different types of factors on the real estate market, better predictions can be achieved concerning where the real estate market is heading[93].

In the work *Understanding real estate´s physical and financial market cycles* by Mueller, a theoretical perspective is given on cyclicality in the commercial real estate market. The theory takes its starting point from the assumption that a real estate market cycle can be characterized by four different phases; recovery-, expansion-, hypersupply-, and recession phase. Further the commercial real estate market cycle can be divided into two separately cycles; the physical real estate cycle and the financial cycle. The purpose of dividing these cycles, is to separate the key distinctions of the physical real estate cycle and the financial cycle. These key factors must be separately examined in order to gain an understanding of the direction of the real estate market in the future. These cycles are however closely linked to each other and consequently affect each other in great extent.[94]

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[87] Root (1994) pp 153-154

[88] Renaud (1997) pp 13-44

[89] Lars Vardheim, President SCD Europe (2008-03-03)

[90] Richard Hultin, President Skanska Oresund (2008-02- 11)

[91] Mueller (1995) pp 47-53

[92] Dokko et al (1999) pp 69-96

[93] Mueller (1995) pp 47-53

[94] Mueller (1995) pp 47-53

4.2.1 The physical real estate cycle

The physical real estate cycle is primary based on supply and demand characteristics of the physical product on the commercial real estate market. The property/office space is a necessary component in the economic process of running most businesses and the demand arise from the development in the economic environment in general. The production, which generates supply of the product, is driven from the demand of the product in the market place. Production time in real estate projects is usually long, which makes it difficult to meet the demand on time. Developers therefore must speculate in the expected demand in the future before the start of the development project. This creates risk since drastically changes in the market prerequisites can occur during the development of the project.[95]

At any given time the demand and the supply movements are trying to reach the equilibrium level. The market equilibrium is defined as the point in the cycle where supply and demand are in balance, which can be seen through the "normal" vacancy level on the specific real estate market or on a similar real estate market. It is impossible to accurately estimate the "normal" vacancy level but an attempt to do so is to generate a long-term vacancy level by looking at the vacancy level over at least a business cycle, preferably longer.[96]

The phases of the physical real estate cycle
The theory makes the following distinctions between the cycle phases in terms of the prevailing conditions of the rent- and the vacancy levels on the physical real estate market (see figure 7 and table 2 below).[97]
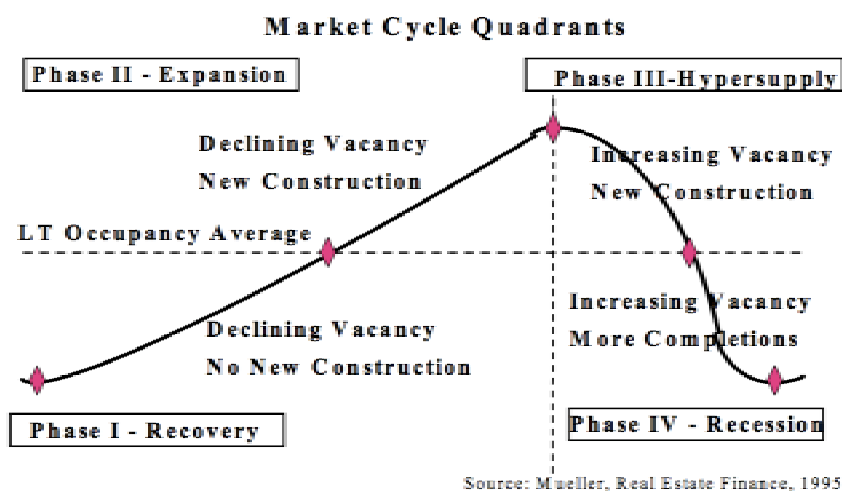

Figure 7 The Physical Market Cycle Characteristics, Mueller (1995)

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[95] Mueller (1995) pp 47-53
[96] Mueller (1995) pp 47-53
[97] Mueller (1995) pp 47-53

Recovery phase	Expansion phase	ypersupply	Recession phase
Part one • Vacancy level is substantially higher than the equilibrium level • Negative growth rent level but slowly increasing **Part two** • Vacancy level higher than the equilibrium level • Rent growth below inflation level but increasing	**Part one** Before cost feasible to new construction rent levels • Vacancy level is lower than the equilibrium level and reduces rapidly • Rents increases rapidly towards feasible to construction levels **Part two** After cost feasible to new construction rent levels • Vacancy level additionally lower than the equilibrium level and reaches its lowest point • Rents increases rapidly above cost feasible to new construction levels • New supply starts to be generated through production	• Rents still above cost feasible to new construction levels, but declines fast • Vacancy level is low but increases rapidly	• Rent growth is below inflation and the growth is negative • Vacancy level is at its highest level in the end of this phase

Table 2 Characteristics of the physical Real Estate Market Cycle, Mueller (1995)

4.2.2 The financial real estate cycle

The physical real estate market cycle does not take place without the presence of investment capital. Thereby the physical real estate market is influenced by the capital market and the flow of capital in the economy.[98]

Characteristics of the financial real estate cycle

The transactions in the real estate market are historically privately held and the market can thereby not be characterized as a perfect market, with all information available. The characteristics of the capital flows on the real estate market can be described as either too easy or nonexistent, mainly because many investors and lenders follow each other and create a pattern, which can be described as a "herd"-mentality[99] [100]. This affects the risk level in the real estate market, which both can create arbitrage opportunities and liquidity risks. Other factors influencing the financial real estate market are among other things; cost of capital, interest rate

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[98] Mueller (1995) pp 47-53

[99] Mueller (1995) pp 47-53

[100] Jan Johnsson, Market Director SCD Finland (2008-03-03)

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movements, alternative investment opportunities, foreign exchange rates, which plays a complex and rather unpredictable role in the real estate's financial cycle.[101]

The financial cycle
Referring to the physical real estate market cycle, the financial real estate cycle also can be divided into the same four phases as described above; recovery, expansion, hypersupply- and recession phase.[102]

The recovery phase
When the real estate market is in this phase, the lowest rents and cash flows are seen. Consequently little capital is available for investments in existing real estate or for new construction. The only investors that might be operating in these conditions are the most high-risk tolerant investors such as venture capitalists.[103]

The expansion phase
As the physical real estate market moves through the recovery phase, the expectations starts to increase as rents begins to rise. Traditional equity capital investors appear on the market to buy below "replacement cost" prices. The capital flow continues and the expansion phase is reached. Further the equilibrium point is passed and the capital flow gains momentum as rents reach "cost feasible" to construct levels. The physical real estate market is now in the second half of the expansion phase and the capital flow increases substantially through purchase of existing buildings and investments in new construction.[104]

Hypersupply- and recession phase
As the peak on the physical real estate market is reached, investors continue to invest in existing properties and in new construction, since vacancy level still is below the equilibrium level. The liquidity on the market is still high but when investors realize that the market is on its way down, they lower their expectations. Consequently the bid prices from the investors drops, which creates illiquidity on the market since the asking prices from the owners do not decline as fast as the bid prices. The investors usually at this moment perceive a great downside risk, which in many historically cases has led to a major drop in demand of properties on the real estate market. At the same time the supply of the product are at its highest level in the cycle, which further impacts the recession.[105]

Linking the real estate- and financial market
The links between the physical cycle and the financial cycle may vary dramatically. These differences can primary be explained by the investor's view of returns on

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[101] Mueller (1995) pp 47-53
[102] Mueller (1995) pp 47-53
[103] Mueller (1995) pp 47-53
[104] Mueller (1995) pp 47-53
[105] Mueller (1995) pp 47-53

alternative investments compared to real estate investments. This usually reveals the attractivity to enter the real estate market for investors and can primary affect the real estate market in two ways; either a excess of capital or very little access to capital. These situations can appear regardless the phase of the physical cycle and historically this phenomenon has created contradictive results. Thereby the links between the cycles may vary from time to time, mainly due to the situation of the investors in terms of the rate of returns of other assets than real estate at the time.[106]

The expansion phase without funding
For example, recessions on the real estate market have been experienced, though the physical real estate market has been at an expansion phase, primary because of the lack of capital for real estate investments. This affected the prices negatively and the real estate market did not experience the same peak as usually is seen. Consequently this happened at a time when the alternative investments had a higher return then real estate investments.[107]

Excess of capital – price boost and major downturn
Another scenario has been experienced with major downturn in the real estate market as a result. The situation was an extensive excess of investment capital on the real estate market, although the physical real estate market already had experienced the peak and was moving into the recession phase. The excess of capital on the real estate market boosted the prices and new construction. This gradually created an oversupply of real estate. This situation occurred in great extent since investors had experienced low returns on alternative investments of real estate and thereby many investors entered the real estate market.[108]

4.3 Stakeholder theory
A firm is usually connected to a great number of different actors in its external environments, which interacts in different ways such as through exchange of products, information and other resources. These links can all have different character in terms of impact and power of the firm. It is therefore of interest for a firm to understand the nature of the links in order to benefit and/or protect themselves from the actors in the external environment.[109]

A developer is in great extent dependent on actors in the external environment to be able to succeed with its development projects. These actors have great influence of the strategic decision making of a developer and therefore the understanding of the power and impact of these relations are of great importance[110]. For a developer and the majority group of firms, it is thereby of interest to monitor and analyze these relations to the actors in the firm's external environment. Consequently the

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[106] Mueller (1995) pp 47-53

[107] Mueller (1995) pp 47-53

[108] Mueller (1995) pp 47-53

[109] Frooman (1999) pp 191-205

[110] Jan Johnsson, Market Director SCD Finland (2008-03-03)

Stakeholder theory is a useful perspective in understanding the external environment surrounding the firm[111]. Further we consider that the Stakeholder theory can be applied for a real estate developer in order to:

- Understand the stakeholders involved in the business process
- Evaluate the risk of entering the market
- Create strategies for managing the stakeholders

4.3.1 Stakeholder theory – an overview

In Freeman's *Strategic Management*[112], the Stakeholder theory was brought into the mainstream management literature and the theory still has a considerable influence on the strategic management literature of today[113]. The purpose of the stakeholder theory is to enable managers to understand and manage stakeholders through their strategic decision-making, as Freeman states;

> "*The stakeholder approach is about groups and individuals who can affect the organization, and is about managerial behavior taken in response to those groups and individuals"* Further Freeman defines a stakeholder as; *"any group or individual who can affect or is affected by the achievement of the firm's objectives"*[114].

Thereby three general questions need to be addressed about stakeholders in order to develop responsive strategies:[115]

1. Who are they? (This question concerns their attributes.)
2. What do they want? (This question concerns their ends.)
3. How are they going to try to get it? (This question concerns their means.)

In the literature regarding the Stakeholder theory, a common distinguishes is to divide the stakeholders into *primary-* and *secondary stakeholders*. The primary stakeholders have a greater impact on the firm and are of importance for the existence of the firm. These stakeholders are legislates, government, shareholders and customers among others. The secondary stakeholders do not have the same importance to the firm, but still they could be important to understand since the impact of these stakeholders can change rapidly. A change can for example take place through media's view on the firm or by shifting attitudes towards the firm by stakeholder groups in the society.[116] Additional another distinction concerning the perspective on the stakeholders are made by dividing stakeholders into *moral-* and *strategic stakeholders*. The moral stakeholder perspective discusses stakeholders who are affected by the firms' actions

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[111] Hatch et al (2006)

[112] Freeman (1984) pp 48

[113] Frooman (1999) pp 191-205

[114] Freeman (1984) pp 48

[115] Frooman (1999) pp 191-205

[116] Clarkson (1995) pp 92-117

and the strategic stakeholder perspective focuses on how stakeholders' actions can affect the firm.[117] The emphasis on managing how different stakeholders' actions might affect the firm is crucial when a real estate developer is entering a new market and further, the primary- and strategic stakeholders will be the most forth coming in this study.

4.3.2 The stakeholders' power and impact

The power of the stakeholder is a fundamental aspect to examine in order to reveal their impact towards an organization or a project. This is important since a great understanding of the different stakeholder's power on the firm makes the strategic decision-making in the firm more likely to be successful.[118]

As already mentioned an organization is not self-sufficient and the external environment must be relied upon to provide support. Consequently, there are relationships between the firm and its external environment. These relationships can be characterized as different sets of balances in terms of power between the firm and its stakeholders, which most likely reveals how they might and should act in order to succeed with their respectively strategy[119].

In the literature the indicators of power in the Stakeholder theory are seen through a number of perspectives. For example, Freeman and Reed's perspective on power through dividing power into formal-, economical- and political power. Another perspective addressed by Frooman is the resource dependencies theory's influence on the stakeholder power, i.e. who is dependent on whom. This theory is based on how dependent a firm or a stakeholder are of a certain resource, which the firm or the stakeholder posses. This situation determines the power balance between the firm and the stakeholder.[120]

The resource dependence can be revealed when one part is supplying another with a resource that can be characterized with: [121]

1. Concentration
2. Controllability
3. Nonmobility
4. Nonsubstitutability
5. Essentially

The resource dependency view on power will thereby be applied in our model in order to reveal the relative power balance between actors involved in a real estate

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[117] Hill et al (1992) pp 131-154

[118] Freeman et al (1983)

[119] Frooman (1999) pp 191-205

[120] Frooman (1999) pp 191-205

[121] Frooman (1999) pp 191-205

development project[122]. However, the nonmobility will be excluded since the recourses of a developers' stakeholders is not mobile, we believe.

4.3.3 Stakeholder theory as a tool in project management

Most literature concerning the stakeholder theory emphasizes how organizations can evaluate and manage different actors in their external environment, based on the perspective seen from the organizations point of view. Though there is literature, which expands the scope and thereby uses the stakeholder theory in the analysis of stakeholders involved in a specific project[123] [124] [125]. This extension of applying the stakeholder theory in the management process of a project is considered as a useful tool in for example construction projects[126].

In an article by Newcombe, the stakeholder theory is addressed as a strategic perspective in the managing of construction projects. Further, the article suggests conducting a stakeholder analysis of the involved stakeholders in a construction project by examining following questions:

- Who are the project stakeholders?
- What do these stakeholders expect from the project?
- How likely each stakeholder group is to enforce its expectations on the project?
- Whether these groups have the means to do so. This is concerned with the power of stakeholder groups?
- The likely impact of the stakeholder expectations on future project strategies?

To address the last question the stakeholders involved in the project are mapped in a matrix, in terms of power and predictability of acting in a certain way in the project, see figure 8 below.

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[122] Pfeffer et al (1978)

[123] Olander (2007) pp 277-287

[124] Newcombe (2003) pp 841-848

[125] Landin et al (2005) pp 321-328

[126] Olander (2007) pp 277-287

Predictability

	High	Low
Low	**A** Few problems	**B** Unpredictable but manageable
High	**C** Powerful but predictable	**D** Greatest danger or opportunities

Power

Figure 8 Stakeholder mapping: power/predictability matrix, Newcomb (2003)

In *box A,* stakeholders who are highly predictable and posses low power towards the projects are situated. These stakeholders present few problems towards the project. In *box B* the stakeholders can be categorized as having low power and as being unpredictable in their actions. Although, because of the low power present they few problems for the project. But still these stakeholders should be closely monitored, since their impact might change over time. Stakeholders in *box C* usually are described as having a conservative and constraining influence on the project and may not be a problem during continuity and stability in the project. But changes might occur if for example these stakeholders are put under pressure from the environment in case of a fundamental event. The stakeholders situated in *box D* can be characterized as powerful and unpredictable and are consequently the most dangerous stakeholders for the project. It is therefore important to monitor these stakeholders closely and to bring their possible impact on the project in the management process of the project.[127]

The stakeholder analysis presented in the model aims to use the common literature regarding stakeholder theory together with Newcomb's perspective on stakeholders in projects. Further Frooman's perspective on power, i.e. resource based theory as a theoretical starting point for power, will be applied in the model.

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[127] Newcombe (2003) pp 841-848

5 The G.U.T. MODEL[128]

After having developed the model in the previous chapters, the final model is presented in this chapter. The model has been applied in Bucharest, which is presented in the next chapter, and thereby tested and improved. The model should be seen as a manual on how to use the model when evaluating a new market. When working with the model, a help could be to use the next chapter; Test of the model – Bucharest and the previous chapter; Theoretical Framework in order to understand how the model should be applied.
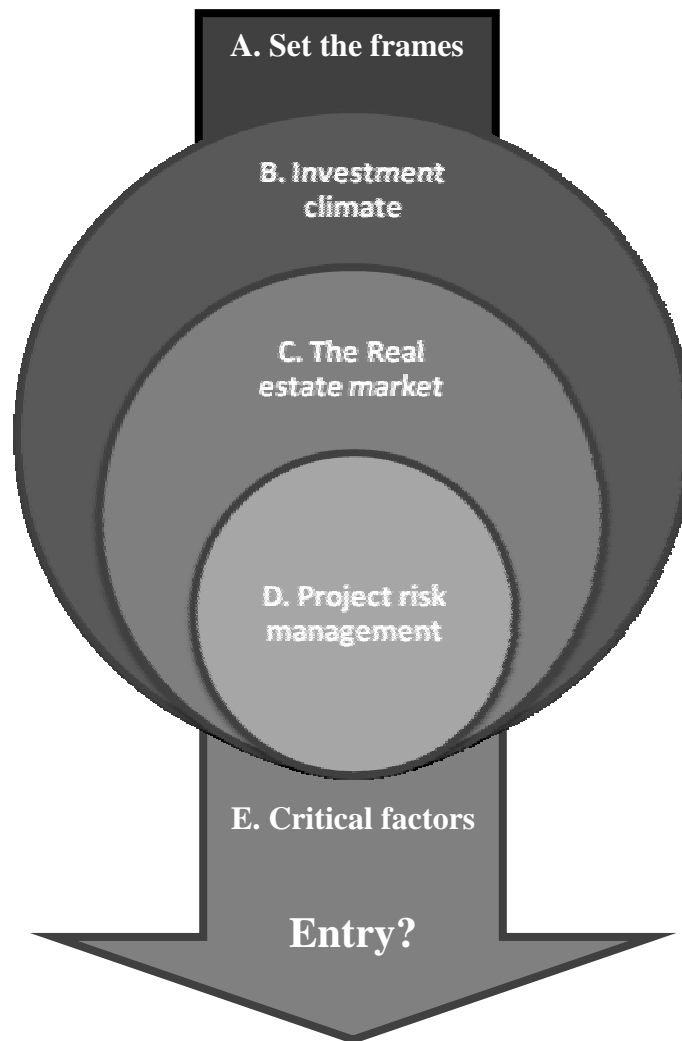

A. Set the frames

B. Investment climate

C. The Real estate market

D. Project risk management

E. Critical factors

Entry?

Figure 9 The G.U.T-Model

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[128] The G.U.T. expression originates from "gut feeling", since several respondents argued that it is in the end gut feeling that determine whether you enter the market or not. However, we believe that this model is better to follow when deciding and can compensate the gut feeling. Therefore, we named it the G.U.T. model

5.1 A. Set the frames

The first decision the company has to take is whether the new foreign market is interesting enough to spend resources on or not. The next step is to define the frames and the main objectives with the entry.
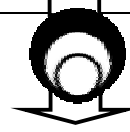
1. Why should the market be evaluated?

Motivate why the new market have potential enough to spend the company's management resources to evaluate it.

2. Main objectives and frames

What are the main objectives with the entry and within which frames must the venture stay?

5.2 B. Investment climate

In this step the target country's investment climate is analyzed (political environment, legal environment, economic environment, social and cultural environment). The purpose of the investigation is to create an overall understanding of the macro environment. The investment climate analysis is divided into two steps:

1. Identify the critical factors
2. Key factors of change

5.2.1 Identify the critical factors

Identify the factors in the investment climate that are critical to the success of the entry and the variables present status. In the following checklist suggestions of variables that can affect the entry are presented. Every developer should however identify the critical factors on the specific market and use the checklist as a guide.

Political environment
> Government/political system stability
> Restrictions on foreign ownership/investment
> Incentives for foreign investment

Legal environment
> Enforceability of contracts
> Taxation
> Ownership of real estate
> Restitution
> Transfer of the ownership
> Tenant law
> The planning process of developing real estate

Economic environment
> Membership in customs unions or free trade areas
> GNP trends
> Rate of inflation
> Disposable income
> Unemployment
> Interest rates
> Economic growth
> Infrastructure and communication
> Exchange risk

Social and cultural environment
> Demographics
> Income distribution
> Level of education

5.2.2. Key factors of change

Analyze how the critical variables are likely to change in the future in order to recognize how they will affect the organization and the entry on the new market.
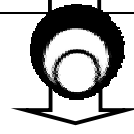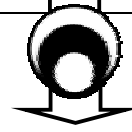
Political
Critical variable X

Legal
Critical variable X

Economic
Critical variable X

Social and cultural
Critical variable X

5.3 C. The real estate market

This step aims to examine the target country's real estate market and evaluate if it is profitable for a developer to enter the market. This step of the model consists of following three steps:

1. Real estate market conditions

2. Investigate the industry environment
3. An analysis of the real estate cycle

5.3.1 Real estate market conditions

Investigate the following factors in order to gain an understanding of the situation on the real estate market:

Supply of real estate
Demand/take-up of real estate
Vacancy rate
Yield
Land supply and land price

5.3.2 The industry environment

Evaluate the industry environment in order to understand the actors on the market and determine if the market is attractive to be on. The industry environment consists of:

Customers
Tenants
Evaluate the demand of the product
Evaluate the drivers behind the demand

Investors
Evaluate the demand of the product
Evaluate the drivers behind the demand

Suppliers
Land suppliers
Evaluate the possibility to acquire proper land at the right price
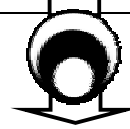*Evaluate the bargaining power of the land suppliers*

Construction suppliers
Evaluate the supplier's ability to fulfill the requirements of cost, time and quality
Evaluate the bargaining power of the suppliers

Competitors
Evaluate the intensity of competition

5.3.3 The real estate cycle

Commercial real estate markets are cyclical and before entering a new market it is important to understand the present market situation and where in the cycle the market is situated. The real estate market is affected by two cycles, both the physical and the financial real estate cycles. This step consists of following parts:

1. The physical real estate cycle

2. The real estate financial market cycle

The physical real estate cycle
Compare the trends on the real estate market with the theory, in order to find out where in the physical cycle the real estate market in Bucharest is situated.

Market trends
Analyze the trends of the following four factors; supply, demand/take-up, rent level and vacancy level to be able to apply Mueller's theoretical framework concerning cyclicality in the real estate market.

Theory
Use Mueller's theoretical framework in order to estimate in which quadrant in the physical cycle the market is situated [129].

Position in the physical real estate cycle
Estimate the position of the real estate market in the physical cycle and conclude the most likely future position.
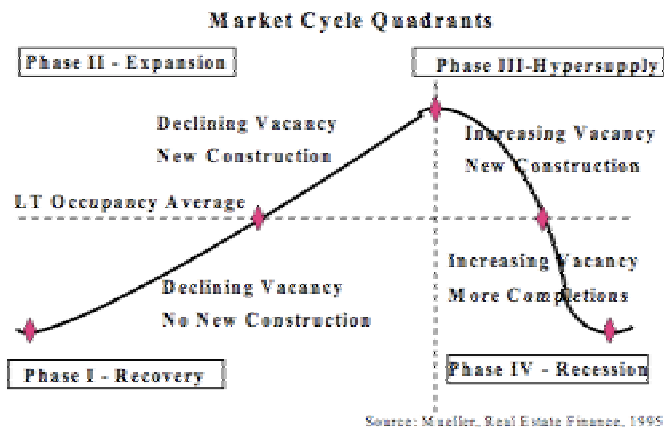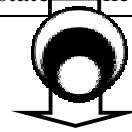
Figure 10 Real estate market cycle, Mueller (1995)

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[129] Mueller (1995) pp 47-53

The financial real estate cycle
The financial real estate cycle is dependent on; which types of investors, the supply of investment capital and in which direction the yield level is moving. In this step the trends on the real estate market are connected with the theory, in order to find out where in the financial cycle the real estate market is situated.

Market trends
Analyze following factors; which types of investors are active on the market, the supply of investment capital and in which direction the yield level is moving to be able to apply Mueller's theoretical framework[130] concerning cyclicality in the real estate market.

Theory
Use Mueller's theoretical framework in order to estimate in which quadrant in the financial cycle the market is situated [131].

Position in the financial real estate cycle
Evaluate the position of the real estate market in the financial cycle and compare the position with the position on the physical cycle above. Conclude which the most likely future position is.
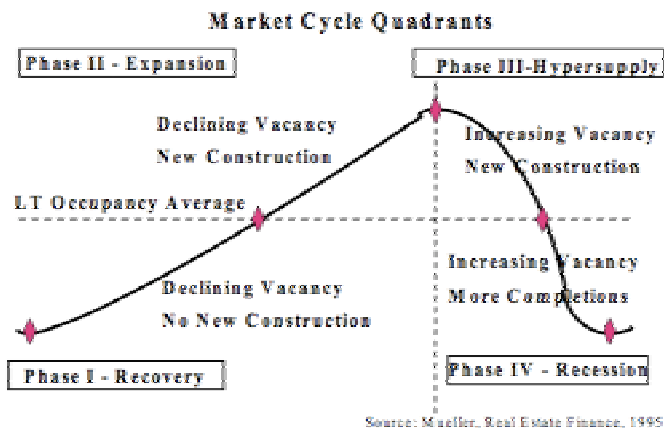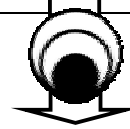

Figure 11 Real estate market cycle, Mueller (1995)

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[130] Mueller (1995) pp 47-53
[131] Mueller (1995) pp 47-53

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5.4 D. Project risk management

In this step a stakeholder analysis is conducted to provide a risk assessment of the most important stakeholders. The stakeholder analysis is done in context of the business process of a real estate development project, i.e. acquiring land-, planning/zoning-, leasing-, construction-, and disinvestment. The analysis consists of following three steps:

1. Mapping the stakeholders
2. Assessment of the power and predictability
3. Risk assessment of the most important stakeholders

5.4.1 Mapping the stakeholders

The external strategic stakeholders (se the chapter about stakeholder theory for explanation) are mapped in the different parts of the business process. Consequently it is likely that the same stakeholder occur in a number of steps in the business process.

1.Acquiring land	2.Planning/ Zoning	3. Leasing	4. Construction	5.Dis- investment
Stakeholder 1	Stakeholder 1			
Stakeholder 2	…			
Stakeholder n	…			

Table 3 Mapping the stakeholders

5.4.2 Assessment of the power and predictability

In this step the stakeholders' power and predictability are assessed, the stakeholders are then placed in a matrix for each part of the business process. The position in the matrix is dependent on the assessment of the power and the predictability of their actions.

Power

The power is a result from a qualitative assessment from one to five (1=low, 5=high) of the following four categories, thereby an average power index is given. If the power is high it means that the stakeholder have power to affect the project:[132]

1. Concentration
2. Controllability
3. Nonsubstitutability
4. Essentially

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[132] Frooman (1999) pp 191-205
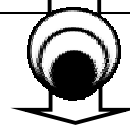
Predictability
The predictability is an estimation, qualitatively assessed, of how predictable we believe that the stakeholders are (1=low, 5=high). If the predictability is high it means that the stakeholder and the actions it might take are predictable.

Result
Fill in the factors for the stakeholders in all the parts of the business process. Below is a list for the first step, acquiring land.

1.Acquiring land	Concentration	Controllability	Non-substitutability	Essentially	Power	Predictability
Stakeholder 1	X1	X2	X3	X4	(X1+X2+X3+X4)/4	Y
Stakeholder 2						
Stakeholder n						

Table 4 Assessment of the power and predictability

Take the predictability and power from the previous list and place the stakeholders in a matrix for every part of the business process.
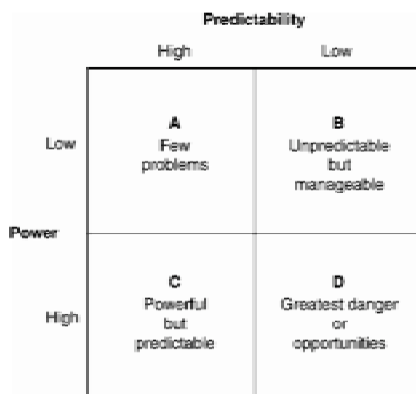
Figure 12 Stakeholder mapping, power/predictability matrix, Newcomb (2003)

5.4.3 Risk assessment of the most important stakeholders
The stakeholders that were placed in the matrix's D box is considered as the greatest risk since they both have power and are unpredictable. Consequently analyze them further in this step.

1. Acquiring land
Stakeholder X^1-X^n

2. Planning/zoning
Stakeholder X^1-X^n
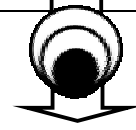
3. Leasing
Stakeholder X^1-X^n

4. Construction
Stakeholder X^1-X^n

5. Disinvestment
Stakeholder X^1-X^n

5.5 E. Evaluation of the critical factors
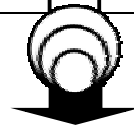
In this step of the model, the most important factors from the previous steps are selected in order to present the critical factors for a developer to consider when making the decision to reject or to enter the market. This step and consequently the model are concluded with a recommendation of what the developer should do about the entry on the target market.

5.5.1 Critical factors
- Critical factor X
- Critical factor X

- Critical factor X

- Critical factor X

5.5.2 Recommendation

Present the conclusions of the evaluation; the most critical factors, and a recommendation of what the developer should do concerning the entry on the market.

6 Test of the model – Bucharest

In this chapter the model is applied and tested on the office real estate market in Bucharest. There are three purposes with the test and this chapter; the first is to test the model we have developed in order to find out if the model is useful and if it is necessary, to improve it. The second is to evaluate the office real estate market in Bucharest for Skanska Commercial Development. The third purpose is to apply and fill in the model in order to present a demonstration of how we intend the model to be used.
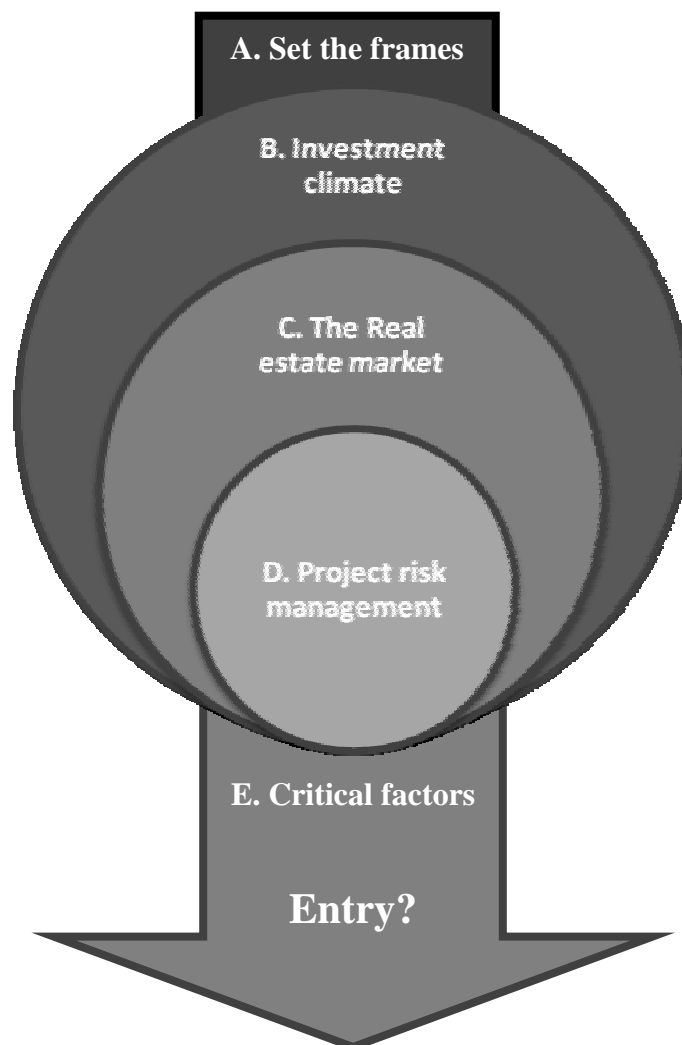

Figure 13 The G.U.T-Model

6.1 A. Set the frames

The first decision the company has to take is whether the new foreign market is interesting enough to spend resources on or not. The next step is to define the frames and the main objectives with the entry.

6.1.2 Why should the market be evaluated?

Motivate why the new market have potential enough to spend the company's management resources to evaluate it.

- It is the second largest market in Central and Eastern Europe, with a population of 21.7 million people[133]
- Geographically, it is located in a strategic position, establishing a link between Central and Eastern Europe, targeting over 200 million consumers in a 1000 km area, and providing access to developing markets[134]
- The labor force is highly skilled and able to communicate in foreign languages (mainly English and French)[135]
- The EU membership in January 2007 brought access to the European Single Market, creating significant advantages for investors.[136]
- There is a lack of high quality office space and therefore a considerable demand for Skanska Commercial Development' products.[137]

6.1.3 Main objectives and frames

What are the main objectives with the entry and within which frames must the venture stay?

Create a leading position as a real estate developer in Bucharest

In order to achieve the operative and financial targets, Skanska's goal is to have a leading position on the markets where they have presence.[138]

Skanska's code of conduct must never be compromised

Skanska's code of conduct consists of following four areas; general principles, employee relations, business ethics, and environment. The code of conduct is a set of regulations on how Skanska and the employees should act.[139]

Required return on capital

The required return on capital employed is 15 percent (including unrealized development gains and change in market value)[140]

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[133] The World Factbook Romania, CIA (2008-04-25)

[134] The World Factbook Romania, CIA (2008-04-25)

[135] Filip Ripa, Consult Swedish Trade Council Romania (2008-04-09)

[136] Land report, Romania, Swedish trade council (2008-04-25)

[137] Tim Wilkinson, DTZ (2008-04-08)

[138] Skanska Annual Report (2007) p 7

[139] Andreas, Lindelöf President SCD Hungary (2008-02-28)

[140] Skanska Annual Report (2007) p 10

The venture shall follow the qualitative targets expressed in Skanska's five zeros vision

(The five zeros vision is copied from Skanska's annual report 2007)
- Zero loss-making projects. Loss makers destroy profitability and customer relationships
- Zero accidents, whereby the safety of our personnel as well as subcontractors, suppliers and general public is ensured at and around our projects
- Zero environmental incidents, by which our projects should be executed in a manner that minimizes environmental impact
- Zero ethical breaches, meaning that we take a zero tolerance approach to any form of bribery or corruption
- Zero defects, with the double aim of improving the bottom line and increasing customer satisfaction

6.2 B. Investment climate

In this step Romania's investment climate is analyzed in terms of the; political-, legal-, economic-, social- and cultural environment. The purpose of the investigation is to create an overall understanding of the macro environment. The investment climate analysis is divided into two steps:

1. Identify the critical factors
2. Key factors of change

6.2.1 Identify the critical factors

Identification of the factors in the investment climate that is critical to the success of the entry and the variables present status.

Political environment
Government/political system stability
Romania is since the election 2004 controlled by a liberal coalition government consisting of four parties.[141] There are some questions regarding the political climate and there has been some tension in the coalition government the last years.[142] Furthermore, the constitution allows the president to resolve the parliament, and the parliament to resolve the government. In 2007 the parliament did suspend the President, but the President resumed his duties after a month since a referendum confirmed that his impeachment should not stand.[143]

Prior to the EU-membership the government worked hard against the corruption in order to adapt Romania to EU. The corruption which has been a major problem has therefore decreased the last years, although there are some issues left to solve.[144]

Restrictions on foreign ownership/investment
Individuals and entities may freely set up companies to develop business activities[145]. A foreign company has several options when establishing in Romania. Joint stock companies and limited liability companies are however the most common entities[146].

Incentives for foreign investment
After the fall of the communist regime 1989, the economy has grown stronger, even if the change from a centralized economy to a free market economy has taken some time. This has caused a number of legislative issues. However, the possibility of attracting foreign capital gave way to a new legislation, where several tax incentives aimed at fostering foreign investment were made.[147] The EU-membership has brought

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[141] The World Factbook Romania, CIA (2008-04-25)

[142] Filip Ripa, Consult Swedish Trade Council Romania (2008-04-09)

[143] The World Factbook Romania, CIA (2008-04-25)

[144] Land report, Romania, Swedish trade council (2008-04-25)

[145] Investment in Romania, KPMG 2008 p 5

[146] Romania Legal and Regulatory Report, Linklaters (2008) p 9

[147] Romania Legal and Regulatory Report, Linklaters (2008) p 8

several advantages, but also some new constraints for investors. For example have several fiscal incentives been phased out after the EU-entry.
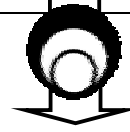
Legal environment
Enforceability of contracts
The legal framework is a fair process but considered to be slow and it is often easier to solve the problem through negotiation.[148] Ownership right, lease and mortgage should be registered in the Land Book. The transfer, lease or agreement is valid without a registration, but the enforceability of rights against third parties is not possible without a registration. For example if two buyers acquire the same property from the registered owner, the first to register the right in the Land Book in good faith is the new legal owner.[149]

Taxation
In 2005 a flat tax, at a rate of 16% for both profits and personal income was introduced[150]. Building and land tax exist and vary depending on the local council.[151] There are no special issues or risks concerning the tax and fiscal systems, we consider.

Ownership of real estate
At present, EU or EEA (European Economic Area) based companies which are resident in Romania are allowed to own and purchase land in Romania in the same premise as Romanian companies. A local holding company is the recommendable option for real estate investment. In addition, a local company will facilitate the exit with a sale of the shares in the holding company instead of the real estate itself.[152]

Restitution
In 1991 most of the real estate owned by the government was transferred to private persons. At present, about 90 % of the land is in private hands and within city limits, the percentage is probably even higher. Former owners had the right to claim restitution of property that the government "abusively" appropriated during the communist regime. According to Law no. 10/2001, the claims had to be registered before 30 November 2005.[153] Restitution can however still be claimed under the Romanian Civil Code and this is still largely untested[154]. One such case is currently up for trial in the Supreme Court[155] and the result in this case is of interest concerning how restitution will be handled in the future.

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[148] Patryk Figel, Lawyer Linklaters (2008-04-09)

[149] Romania Legal and Regulatory Report, Linklaters (2008) p 27

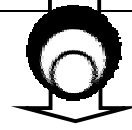[150] Investment in Romania, KPMG 2008 p 16

[151] Investment in Romania, KPMG 2008 pp 35-36

[152] Romania Legal and Regulatory Report, Linklaters (2008) p 26

[153] Investment in Romania, KPMG 2008 pp 58-59

[154] Salans – Law report 2007, p. 2

[155] Patryk Figel, Lawyer Linklaters (2008-04-09)

The due diligence including a comprehensive title check is very important before acquiring land. The title check is aggravated because of properties with changed addresses, previous owners, restitution claims and that the Land Book cannot be fully trusted. It is therefore possible to guarantee that the current owner is the registered owner in the Land Book, but it is not possible to guarantee that there are no other owners. Nowadays, a buyer can buy an insurance to terminate the risk of restitution. Title insurance has however never been tested in practice, therefore, no one knows exactly how it will work.

Transfer of the ownership

Ownership of immobile assets is acquired with sale-purchase agreement and in case of land must the agreement be executed in the presence of a Notary Public (i.e. in an authenticated form). The notarial fee is negotiable with the Notary Public, depending on the value of the transaction, but usually ranges from 0.5% to 2.5%. In the case where a real estate is indirect transferred by transfer of shares of a company that owns the real estate, the notarial fee is free.

The capital gain tax when selling real estate is 16 %. Since the 1 January 2007 real estate is free of stamp-tax. However, the local units of the Agency for Cadastre and Real Property charge a fee for the registration of the transfer of real property. The fee varies but can amount up to maximum 0.5% from the transaction value.

As written in *enforceability of contracts* above, the ownership right should be registered in the Land Book in order to protect the property from third parties.[156]

Tenant law

Mandatory contents for a valid lease agreement under Romanian law are: [157]

- The parties to the agreement

- The premises

- The rent

The rest of the rules are found in the Civil Code, which, concerning this subject are written very liberal. This allows the parties to freely determine most of the agreement terms and conditions, but it is at the same time very important to draft a detailed agreement that regulates all important aspects.[158]

There are however some special requirements for lease agreements, which are presented below: [159]
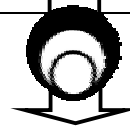
- The lease agreement shall be registered with the fiscal authorities

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[156] Romania Legal and Regulatory Report, Linklaters (2008) p 27

[157] Romania Legal and Regulatory Report, Linklaters (2008) pp 28-29

[158] Romania Legal and Regulatory Report, Linklaters (2008) pp 28-29

[159] Romania Legal and Regulatory Report, Linklaters (2008) pp 29

- The lease agreement shall have a "certified" date in order to be valid when the real estate is sold.

- If the lease agreement term exceeds three years, it must be registered with the Land Book in order to be valid when the real estate is sold.

The planning process of developing real estate

The first step before building on the land is to acquire a city planning certificate, which is a mandatory administrative document from the public administration. The certificate contains following rules:

- The legal framework of the land

- The economic status of the land

- The technical status of the land

The procedure of containing the certificate is generally not a complex process, however before a certificate can be issued a plan over the area must be done. There are three different urban plans that all constructions have to follow.

- *PUG*, the General Urban Plan is a technical document that regulates a locality.

- *PUZ*, the Zonal Urban Plan is a technical document that regulates the rules and conditions under which constructions may be built in the determined area.

- *PUD*, the Detail Urban Plan is a technical document that in detail regulates the rules and conditions under which constructions may be built on one or more neighboring plots.

Before acquiring the certificate a PUZ and/or a PUD must exist over the area. The plan is made by a professional and then approved by the authorities.[160]

The next step is to prepare a technical project, which is another necessary document required to obtain the building permit. The technical project is drawn by architects following the specifications from the city planning certificate and then overseen by special technical auditors.[161]

The last step before the construction can be built is to obtain the building permit. Such a permit is issued by the local authority and establishes the specific conditions

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[160] Romania Legal and Regulatory Report, Linklaters (2008) p 31
[161] Romania Legal and Regulatory Report, Linklaters (2008) p 32

for site construction. The building permit is valid for 12 months and can only be renewed once and for another 12 months.[162]

There have been problems with corruption in the planning process and the urban planning in Bucharest has been unrestrained. There is still more work to do but the process has improved the last years. Nowadays, if the rules are followed, the certificate should be granted.[163] The main risk in the planning process is that it may take longer time than expected. Working with consultants that know the requirements and have the right contacts might however ease and quicken the process.[164] It is of course of great importance to always have Skanska's Code of Conduct in mind and work with consultants with right knowledge and connections. In addition must the consultants be dependable and aware that no illegal activity is accepted.

Economic environment

Romania joined the EU 2007 and the EU-membership has stabilized the economy. The communist regime fell in 1989 and the transition from a centralized economy to a free market economy has taken time.[165] Since 2000 the country has had a strong economic development with a strong GDP growth, due to domestic consumption and foreign investment. This has however led to large current account imbalance and the low state income is a big concern for the economy. The state income is 30 % of BNP which is below the EU requirements of 35 %.[166]

Inflation rose in 2007 for the first time in eight years, the year average stopped at 4.8% but at the end of the year the inflation was 6.6%. The inflation was driven partly by the depreciation of the currency, rising costs on food and energy, and partly by a relaxation of fiscal discipline.[167] Problems with the validity of proper statistics have come to our knowledge during interviews[168]. This in combination with personal observations of very high food prices in Bucharest can be a warning sign of even higher inflation than the statistics show[169][170].

The economic growth is expected to continue at about 6% in 2008, driven by a strong domestic demand[171]. The domestic demand will probably slow from 2009, but will be enough to drive a real GDP growth of about 4% in 2009-2012. Actions to decrease inflation in order to cope with the euro adoption will temper the growth, but probably

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[162] Romania Legal and Regulatory Report, Linklaters (2008) p 32

[163] Patryk Figel, Lawyer Linklaters (2008-04-09)

[164] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[165] Romania Legal and Regulatory Report, Linklaters (2008) p. 8

[166] Land report, Romania, Swedish trade council (2008-04-23)

[167] The World Factbook Romania, CIA (2008-04-27)

[168] Prof. Ana Popa (2008-04-07)

[169] Mikael Olsson, Partner KPGM Romania, interview 2008-04-08

[170] Filip Ripa, Consult Swedish Trade Council Romania (2008-04-09)

[171] Country data Romania, Economist Intelligence Unit (2008-04-26)

not until the end of the period (2009-2012) since Romania is not likely to adopt the euro until 2013-2014.[172]
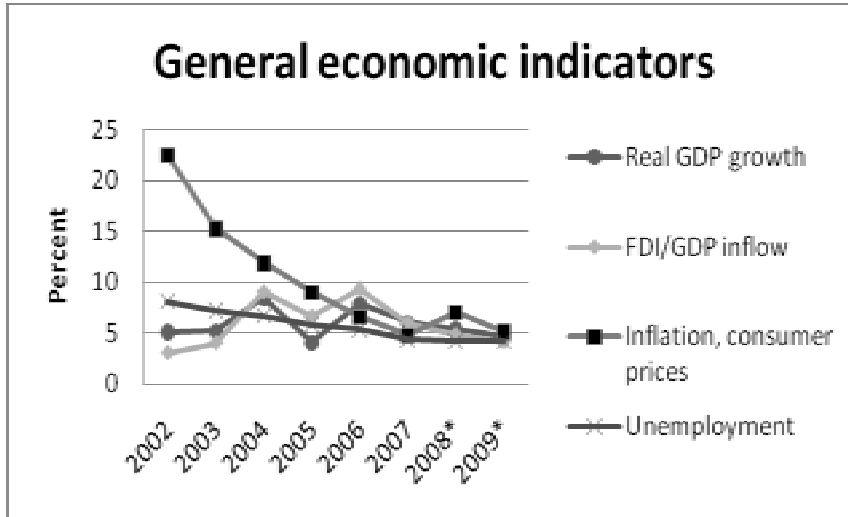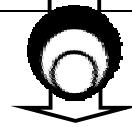

Figure 14 General economic indicators
Real GDP growth (%)[173]
FDI/GDP inflow (%)[174]
Inflation, consumer prices (%)[175]
Unemployment (%)[176]

High private consumption was fuelled by improved conditions on the labor market with rising wages, low unemployment rate and easier availability of credit, which expanded by over 80% year-on-year for the third year in a row[177]. A major part of the population owns their residence and prices on residencies have rapidly increased the last years[178].

In the World Bank Doing Business 2007 report, Romania was ranked as the top performer in Europe and the second in the world between 2005 and 2006.[179] Whilst the business climate has improved the last years, other problems have emerged. The advantage Romania achieved because of the adjustment of the currency 1999 has disappeared, at the same time have the salaries strongly increased and the productivity decreased. This has resulted in a weakening of the competitive

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[172] Country data Romania, Economist Intelligence Unit (2008-04-26)

[173] World Economic Outlook Database, IMF (2008-04-29)

[174] CEE Quartely 01/2008, p.28

[175] World Economic Outlook Database, IMF (2008-04-29)

[176] CEE Quarterly 01/2008, Bank Austria p 28

[177] CEE Quarterly 01/2008, Bank Austria p 29

[178] Prof. Ana Popa (2008-04-07)

[179] Commercial Property Market Overview Romania Spring 2008, DTZ p 2

advantage[180]. International companies are now locating the production in other cities than Bucharest.[181] Another problem is the infrastructure, which is inferior in the whole country.[182] Large investments in infrastructure projects from the EU are however in progress.[183]
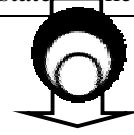
Social and cultural environment
The economic development in Romania has changed the social composition, reflecting in the rise of the working-class population[184]. The creation of a middle class has occurred relatively recently but the poverty is still widespread.[185] After World War II has the proportion of the population, that has higher education highly increased[186]. The level of education is nowadays high, many young people wants a higher education and have the opportunity to achieve it.[187]

The economy has developed in different pace in different parts of Romania which has increased the urbanization and today lives more than half of the population in urban areas.[188] When doing business in Romania it is essential to have local contacts and for a real estate developer who works with several different authorities, it is probably very important[189].

6.2.2 Key factors of change
The next step in the investment climate analysis is to find out how the critical variables are likely to change in the future in order to recognize how they will affect the organization and the entry on the new market.

Political
It is very hard to foretell about the political situation, though we believe that there will be some instability in the government and the parliament, especially since 2008 is an election year. The democracy is however stable and the EU-membership is probably a great influence for stability. A positive sign is that the political turmoil in 2007, when the president was suspended for some time had little negative effect on the economy, the investment- and the real estate market. This indicated a vote of confidence for the Romanian economy by the international investment community despite an incident of political uncertainty.[190]

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[180] Land report, Romania, Swedish trade council (2008-04-25)

[181] Mikael Olsson, Partner KPGM Romania, interview 2008-04-08

[182] Prof. Ana Popa (2008-04-07)

[183] Investment in Romania, KPMG 2008 p 61

[184] Romania Encyclopædia Britannica (2008-04-26)

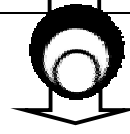[185] The World Factbook Romania, CIA (2008-04-26)

[186] Romania Encyclopædia Britannica (2008-04-26)

[187] Prof. Ana Popa (2008-04-07)

[188] Romania Encyclopædia Britannica (2008-04-26)

[189] Prof. Ana Popa (2008-04-07)

[190] Bucharest City Report September 2007, Jones Lang LaSalle p 3

Legal

The greatest legal concern is the restitution, which still is not fully straightened out. The Supreme Court can give some clarity when they present their decision in the restitution case, but restitution will probably be a concern for another 10 years. Therefore, a proper due diligence including a comprehensive title check will be crucial before acquiring land. Title insurance is also a way of decreasing the risk, though as mentioned before, the insurance has not been tested in practice so no one knows for certain how it will work.[191] This adverts yet again that a rigorous title check is necessary.

Economic

The rapid growth in the economy has lead to a macroeconomic imbalance, IMF has recommended the government to conduct a tighter budget policy and transform the fiscal system in order to increase the state income.[192] The global financial climate has become more risk-averse since the US "sub-prime" crisis, which have increased the pressure on the government to improve the budget policy to encourage investors[193]. A proper mix of macroeconomic policies is now absolutely crucial to restore investor confidence in the Romanian economy[194]. However, a consistently cautious fiscal policy is unlikely to be realized before the 2008 election[195].

We have through interviews got indications that, the private consumption has been fueled by increased borrowing levels. The rising prices of residential have most likely additionally increased the borrowing levels, since the residence value is commonly used as security for the loans. This development might lead to a credit "bubble" and is a potential risk on the real estate market.[196] [197] [198] Therefore, it is important to keep these indications in mind when evaluating the Bucharest market, we believe.

The currency (RON) is another factor that causes concern. During 2006 and the first seven months of 2007 the RON appreciated, but between August 2007 and February 2008 the RON depreciated by 15% against the euro. The exchange rate risk remains during 2008 and strong volatility and sensitivity to market mood is to be expected.[199]

There are macroeconomic issues that Romania must solve. However, consumption and investment levels are remaining strong and Romania is exiting the rapid economic growth stage and entering into the stable and moderate growth stage.[200]

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[191] Patryk Figel, Lawyer Linklaters (2008-04-09)

[192] Commercial Property Market Overview Romania Spring 2008, DTZ p 2

[193] Country data Romania, Economist Intelligence Unit (2008-04-26)

[194] CEE Quarterly 01/2008, Bank Austria p 29

[195] Country data Romania, Economist Intelligence Unit (2008-04-26)

[196] Filip Ripa, Consult Swedish Trade Council Romania (2008-04-09)

[197] Mikael Olsson, Partner KPGM Romania, interview 2008-04-08

[198] Prof. Ana Popa (2008-04-07)

[199] CEE Quarterly 01/2008, Bank Austria p 30

[200] Romanian Investment Market Q1 2008, Jones Lang LaSalle p 2

Therefore, we believe that in the long run, the country will be an interesting market for a real estate developer.

6.3 B. The real estate market

This step aims to examine the target country's real estate market and evaluate if it is profitable for a developer to enter the market. This step of the model consists of following three steps:
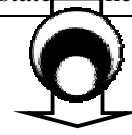
1. Real estate market conditions
2. Investigate the industry environment
3. An analysis of the real estate cycle

6.3.1 Real estate market conditions

In this step following factors is investigated in order to gain an understanding of the situation on the real estate market:

Supply, demand/take-up and vacancy rate

The Bucharest office market was in 2007 characterized by increased supply, rental growth of approximately 20% compared to same period 2006, rising demand and improvements in the quality of stock. The existing stock in Bucharest is today between 1 000 000 sq m and 1 200 00 sq m, prime- and intermediate class offices.[201] Collier estimates that in the next five years the demand for modern office space in Bucharest will drive the stock to over 2,500,000 sq m[202]. The existing stock of modern offices is of shifting quality and the demand of prime class offices is considerable. What the market needs is however more serious, long-term developers that contributes with professionalism and high quality office space.[203]

What is called class A office space in Bucharest is often not what would be class A in Western Europe, but rather class B or C[204], high quality is however becoming more common. There is no exact definition of class A and B office in Bucharest and DTZ and Jones Lang LaSalle therefore have different numbers of supply and take-up. We have for that reason chosen to take the average of the two consultant companies in figure 11.

Another dilemma which causes problem with the supply forecast is developers that announce new projects that will not be built, at least not on time[205]. In 2005 approximately 33% of the announced projects became reality and in 2006 and 2007 the numbers was about 65%[206].

"New projects are announced all the time but it is only a media game, where they try to scare other developers not to start new projects. At least 30% of the projects will

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[201] Office Market Overview Q1 2008, Jones Lang LaSalle

[202] Real Estate Review Romania 2008, Colliers p 13

[203] Tim Wilkinson, DTZ (2008-04-08)

[204] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[205] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[206] Office Market Overview Q1 2008, Jones Lang LaSalle p 7

not be built and another 30% will be delayed." Troy Javaher, Jones Lang LaSalle (2008-04-08)
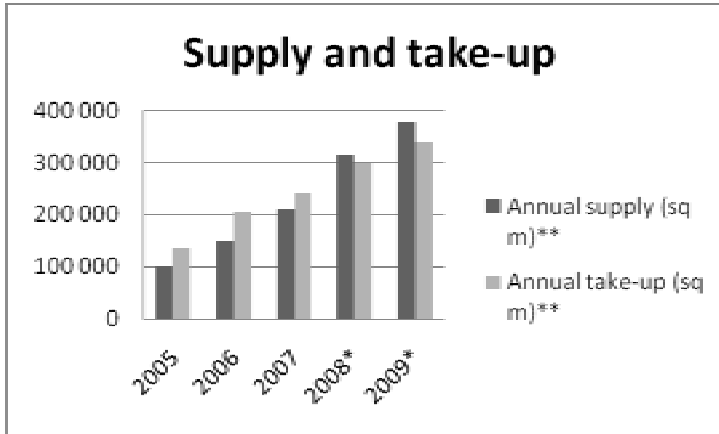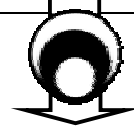
Figure 15 Supply and take-up in Bucharest[207] [208]
*Forecast
**An average of Jones Lang LaSalle's and DTZ's indicators

The vacancy rate is under 2% for Bucharest as a whole and 0% in the city centre, which reflects the undersupply of office space. However, for the first time in several years the supply is expected to exceed the take-up in the end of 2008 (figure 15), which will increase the vacancy rate. The take-up is primarily driven by multinational companies seeking to enter or expand their business in Romania but also through upcoming domestic firms.[209]
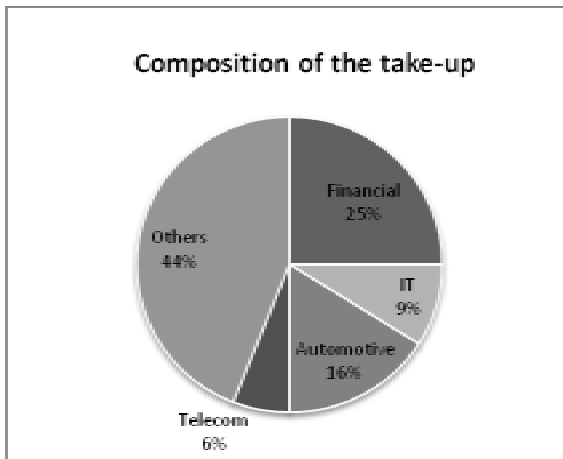
Figure 16 Composition of take-up[210]

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[207] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

[208] Office Market Overview Q1 2008, Jones Lang LaSalle p 3

[209] Tim Wilkinson, DTZ (2008-04-08)

[210] Office Market Overview Q1 2008, Jones Lang LaSalle p 4

Rent level

Between 2003 and 2005, the rents decreased to a bottom level at 15-16 euro per square meter and month. During 2006 and 2007 the rental growth was very strong and the average rent is now expected to stabilize at a rate between 15-19 euro sq m/month for 2008-2009.[211] Both central and decentralized stock is however included and rent levels at up to 24 euro sq m/month is possible for prime office space located in central or central north, the locations will further be examined below[212].
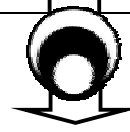
Yield

2006 was a record year in terms of investment into property and 2007 as a record year in terms of transaction volume. Transaction volume reached 1.7 billion euro, which meant a doubling of the 2006 volume on 800 billion euro. It has been a major yield compression over the last five years, the yield for office properties have decreased from 12.5% in 2003 to 6% in 2007 (Figure 17)[213]. Moreover, the rents and transaction values have become affiliated to the euro instead of the dollar, which increased the value of real east with the exchange rate over night (approximately 30%)[214]. Prime office yields in other European capitals were in June 2007:

London: 3.5%
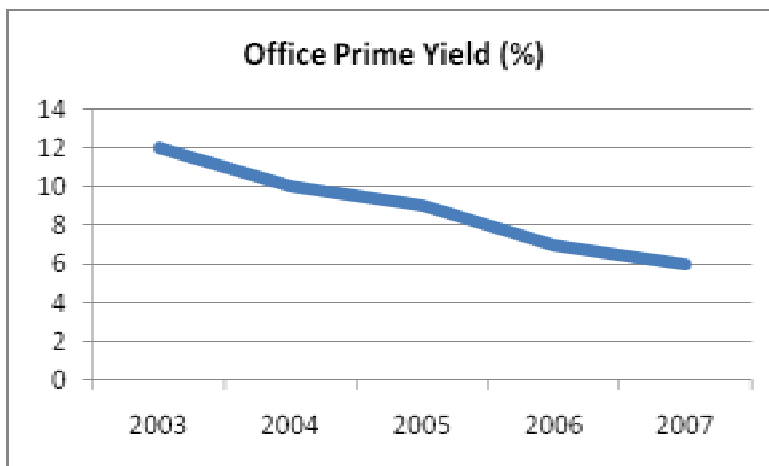Stockholm: 4.3%
Warsaw: 5.5%
Moscow: 8%

Figure 17 Office Prime Yield[215]

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[211] Commercial Property Market Overview Romania Spring 2008, DTZ p 4

[212] Office Market Overview Q1 2008, Jones Lang LaSalle p 6

[213] Commercial Property Market Overview Romania Spring 2008, DTZ p 10

[214] Tim Wilkinson, DTZ (2008-04-08)

[215] Romanian Investment Market Q1 2008, Jones Lang LaSalle p 8

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Land supply and land price

The city centre is struggling with availability of appropriate sites for development of office buildings. This has led to increased land prices and a migration on developments to the north and north eastern areas of the city.[216] *Baneasa* and *Pipera* are two areas north of the city centre, where the vast majority of office construction is concentrated[217]. The land availability, the lower land price and, the close proximity to the two international airports has made these areas attractive[218]. The traffic situation is poor in Bucharest but the city centre suffers even more than the outskirts of the city from heavy traffic and lack of parking, which is another reason for development in the northern areas.[219]
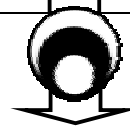
Land prices have drastically increased the last few years and are now around 2,500 euro per sq m in central locations. North of the city, prices are between 1,000 and 1,700 euro per sq m, depending on zoning and development requirements. These prices are approximately three times what they were in 2002.[220] In 2008 the demand for land will probably continue to be higher than supply, the crisis on the international financial market can however cool down the market.
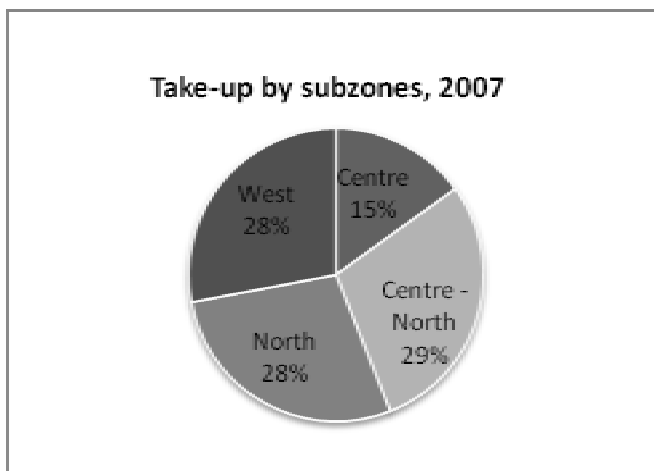
Figure 18 Take-up by subzones, 2007[221]

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[216] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

[217] Bucharest City Report September 2007, Jones Lang LaSalle p 3

[218] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

[219] Bank Austria, Real Estate County Facts, Romania, May 2007, p. 7

[220] Real Estate Country Facts Romania May 2007, Bank Austria p 8

[221] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

Main Office Areas in Bucharest
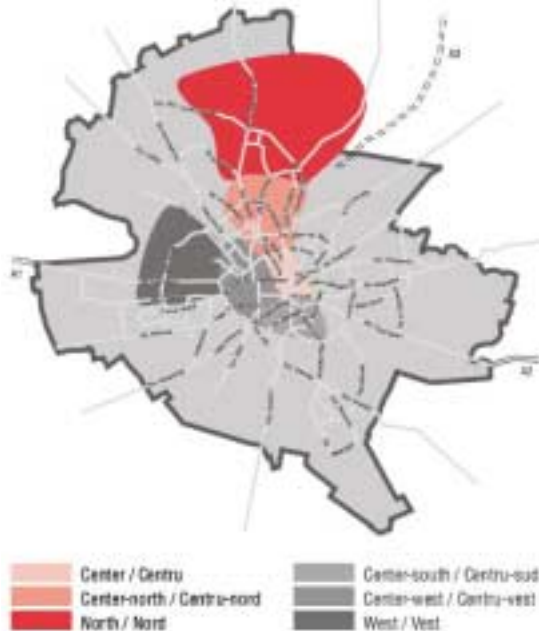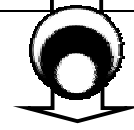
Figure 19 Main Office Areas in Bucharest[222]

6.3.2 The industry environment

Evaluate the industry environment in order to understand the actors on the market and determine if the market is attractive to be on. The industry environment consists of following actors:

- Customers
  - Tenants
  - Investors
- Suppliers
  - Land suppliers
  - Construction suppliers
- Competitors

Customers

Tenants

The limited supply of class A office real estate in Bucharest has created a great demand, more than 55% of the supply that are supposed to be delivered by the end of 2008 and quarter 1 2009 has already been leased before completion. This indicates that the strong position of landlord's negotiation in the leasing process will remain[223]. The market thereby can be seen as the landlord's market, where the tenants have a weak position.

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[222] Romanian Investment Market Q1 2008, Jones Lang LaSalle p 8

[223] Commercial Property Market Overview Romania Spring 2008, DTZ p 3
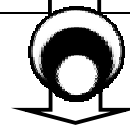
The BPOs for western companies will however decrease in the Bucharest market, because of lower rents and valuable labor force at lower salary costs than in Bucharest[224]. Another problem is to find employees with the right competencies since many Romanians has left the country and working in other parts of Europe.[225] This will affect the demand negative but it will not create any greater effect on the total demand of class A offices in Bucharest, we believe.

Due to the increasing supply of offices during 2008 and 2009 the demand will decrease, but the demand for class A offices will continue because of the limited supply of high quality offices and also because of the forecasted future growth of the Romanian economy.

Investors

Immoeast is the largest investor on the Romanian market but in 2007 several new international investors such as *ING Real Estate* and *GE Real Estate* did their first investments.[226] The current nervousness among international investors because of the global credit crunch has cooled the investment market and made financing conditions stricter. In the beginning of 2007 about 5 euro searched 1 euro real estate and in the beginning of 2008 the rate was instead 1.5 euro seeking 1 euro real estate.[227] The positive side of this is that when financing institutions become more selective, the average quality of the financed projects will increase since lower quality projects will find it more difficult to get funding.[228] And according to Troy Javaher at Jones Lang LaSalle is there still a demand for high quality real estate

Suppliers

Land suppliers

At present, about 90 % of the land is in private hands and within city limits, the percentage is probably even higher[229]. There have been cases where land owners chose not to sell because the developer could not pay enough. The problem occurs because of a perception gap between the seller and the buyer of what the correct value of the land is. The result is that the price the seller requires is so high that the buyer will not make any return on the investment unless he reduces the quality on the office.[230] Land owners have therefore a strong position in the land sales negotiations and this situation will probably remain since the demand for land probably will continue to be higher than supply.

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[224] Real Estate Review Romania 2008, Colliers p 13

[225] Mikael Olsson, Partner KPGM Romania, interview 2008-04-08

[226] Commercial Property Market Overview Romania Spring 2008, DTZ p 10

[227] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[228] Real Estate Review Romania 2008, Colliers p 7

[229] Investment in Romania, KPMG 2008 pp 58-59

[230] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

Construction suppliers
The construction market was 2007 characterized of a shortage of a labor force, which is caused by; a dramatic increase in the demand for professional construction services, a drop in the available qualified labor force (because of the migration abroad of Romanian workers), and insufficient training opportunities for the recruitment of new workers.[231] It has therefore become customary for most office buildings to be finished three to nine months late. These problems are likely to continue throughout 2008 and 2009, since there are no predictable remedies.[232]
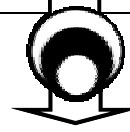
"There are not enough construction companies or construction workers to build everything that is said to be built" Troy Javaher, Jones Lang LaSalle (2008-04-08)

Competitors
Real estate developers from Turkey and Israel were the first actors to enter the market in Bucharest[233]. Today several developers, both local and international, are active on the market[234] however, foreign developers play a dominant role[235]. It is the strong local demand and lacks of supply that have attracted a large number of international developers and these actors have in 2007 and 2008 continued to be the most active buyers of land.[236]

"It is only the last 1.5 years that there has been proper institutional activity here in Bucharest and it is during this time the more serious developers have been active here." Troy Javaher, Jones Lang LaSalle (2008-04-08)

During the last few years the market have been overheated[237] and there are and have been situations where logic and common sense have been left behind by developers with ambition and too much financial resources and personal confidence. Because of their track record, they believe that they will succeed, no matter how difficult it is. However, the international finance crisis has lead to a more careful approach from the banks, which established much stricter conditions when granting financing to developers.[238]

The supply is expected for the first time in several years to exceed take-up in the end of 2008 and the excess supply will probably increase the vacancy rate. However, the office space per capita in Bucharest is by far the lowest among both Europe's emerging markets as well as the developed markets. This indicates that there is a

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[231] Real Estate Review Romania 2008, Colliers p 37

[232] Real Estate Review Romania 2008, Colliers p 11

[233] Tim Wilkinson, DTZ (2008-04-08)

[234] Romanian Investment Market Q1 2008, Jones Lang LaSalle p 10

[235] Bank Austria, Real Estate County Facts, Romania, May 2007, p. 10

[236] Real Estate Review Romania 2008, Colliers p 32

[237] Tim Wilkinson, DTZ (2008-04-08)

[238] Real Estate Review Romania 2008, Colliers p 19

significant growth potential on the market for office space in Bucharest. What the market needs is however more serious, long-term developers that contributes with professionalism and high quality office space[239].
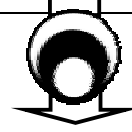
6.3.3 The real estate cycle

Commercial real estate markets are cyclical and before entering a new market it is important to understand the present market situation and where in the cycle the market is situated. The real estate market is affected by two cycles, both the physical and the financial real estate cycles. This step consists of an analysis of the following parts:

1. The physical real estate cycle
2. The real estate financial market cycle

The physical real estate cycle
The physical real estate cycle is affected by four aspects; supply-, demand/take-up-, rent level- and vacancy level. In this step the trends on the real estate market are connected with the theory, in order to find out where in the cycle the real estate market in Bucharest is situated.

Market trends
Between 2003 and 2005 the rent level decreased, to start increase strongly during 2006 and 2007. In 2008 and 2009 the rent level is expected to stabilize.[240] The vacancy level is below 2% for Bucharest as a whole and 0% in the city centre, which reflects the undersupply of office space[241]. However, for the first time in several years the supply will probably exceed take-up in the end of 2008 and the excess supply will most likely increase the vacancy rate.

Mueller's Cycle Theory
From the market trends we have identified that the expansion- and hypersupply phases are of interest to further investigate. According to the real estate cycle theory following factors characterizes the expansion and hypersupply phases.
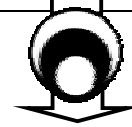
Expansion phase characteristics:[242]
- Vacancy level reaches its lowest point
- Rents increases rapidly
- New supply is generated

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[239] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[240] Commercial Property Market Overview Romania Spring 2008, DTZ p 4

[241] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

[242] Mueller (1995) pp 47-53

Hypersupply phase characteristics:[243]
- Rent growth positive but declining
- Supply growth higher than demand
- Vacancy level is low but increases

Position in the physical real estate cycle

We believe that the commercial real estate market in Bucharest was in the recovery phase between 2003 and 2005 because of the rent level decrease. During 2006 and 2007; the rent level has increased, the vacancy level became practically zero, and new supply was generated. This indicates that the market moved over to the expansion phase in 2006 (compare with the theoretical characteristics given above). From 2006 the market has been in the expansion phase and is today at the top of the cycle, which is the end of the expansion phase of the physical real estate cycle (see the star in figure 20). Since the market is at the top if the physical cycle, the downside risk on the market is apparent. The consequences will then be increasing vacancy rate, lower rents and a drop in land and construction prices. We expect this to happen in the end of 2008 and 2009.
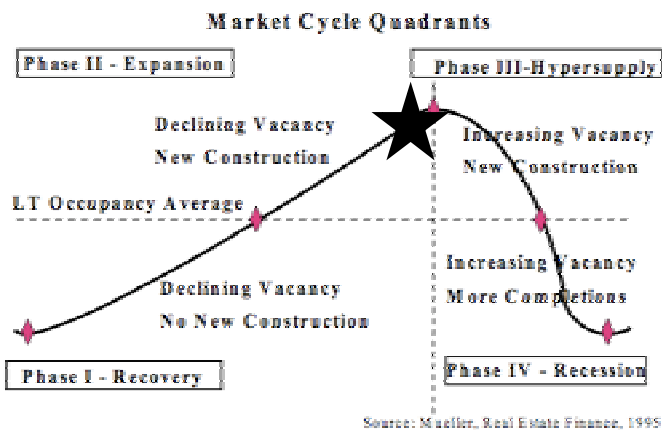
Figure 20 Real estate market cycle, Mueller (1995)

How deep the recession phase will be is impossible to say. However, the low office space per capita in Bucharest, compared to other markets in Europe indicates that there is a significant growth potential in the long run, which can make the recession relative moderate. Moreover, our beliefs are that the market would benefit from a recession with a drop in land and construction prices as a result. This is probably a requirement before the market can stabilize and become a truly attractive market for high quality office developers.

The financial real estate cycle
The financial real estate cycle is dependent on; which types of investors, the supply of investment capital and in which direction the yield level is moving.

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[243] Mueller (1995) pp 47-53

Market trends

2006 and 2007 was record years in terms of investment into property of transaction volume and several new international investors entered the market in especially 2007.[244] Large international developers continued in 2007 to be the most active land buyers, while demand from speculative investors decreased significantly[245].
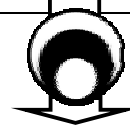
There has been a major yield compression during the last five years and the yield has decreased from 12.5% in 2003 to 6% in 2007[246]. At the same time the real estate values have increased by approximately 30 % because of a change from US dollar to euro[247]. However, the global credit crunch has affected the investors and made financing conditions stricter even if it still is a demand for high quality real estate[248].

Mueller's cycle Theory

Concerning the financial cycle we have identified that the expansion- and hypersupply phases are of interest to further investigate. According to the real estate cycle theory following steps occurs in the expansion and hypersupply phases.

Steps in the expansion phase:[249]

1. Rent level increase results in higher expectations from investors and traditional equity capital investors appear on the market

2. Substantial capital flow increase through purchase of existing buildings and investments in new construction

Steps in the hypersupply and recession phase:[250]

1. When the peak on the physical real estate market is reached, investors continue to invest in existing properties and in new construction because of the low vacancy level
2. The liquidity on the market is still high but when investors realize that the market is on its way down, they lower their expectations.
3. Consequently the bid prices from the investors drops, which creates illiquidity on the market since the asking prices from the owners do not decline as fast as the bid prices.
4. The investors usually at this moment perceive a great downside risk, which in many historically cases has led to a major drop in demand of properties on the real estate market.

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[244] Commercial Property Market Overview Romania Spring 2008, DTZ p 10

[245] Real Estate Review Romania 2008, Colliers p 32

[246] Commercial Property Market Overview Romania Spring 2008, DTZ p 10

[247] Tim Wilkinson, DTZ (2008-04-08)

[248] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[249] Mueller (1995) pp 47-53

[250] Mueller (1995) pp 47-53

5. At the same time the supply of the product are at its highest level in the cycle, which further impacts the recession.
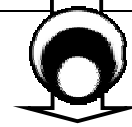
Position in the financial real estate cycle

We believe that the financial cycle has been following the physical cycle (with a little lag as is usual) until the credit crunch 2007. This means that the financial cycle was in the expansion phase until the credit crunch. Because of the credit crunch the financial cycle moved over to the hypersupply phase where the financing conditions are stricter (step two and three in the hypersupply phase, given in Mueller's cycle theory above). The positive side of this is that as long as the global credit crunch crisis does not get worse, it may have reduced the peak of the physical cycle. But most of all it may ease the recession since the usual lag between the two cycles disappeared. This means that the first hypersupply step where more capital is invested on the market was reduced. The result of this can be that the fourth step will be preceded which will make the recession in the fifth step more moderate than it would have been without the credit crunch.

Market Cycle Quadrants

Phase II - Expansion
Phase III-Hypersupply

Declining Vacancy
New Construction

Increasing Vacancy
New Construction

LT Occupancy Average

Increasing Vacancy
More Completions

Declining Vacancy
No New Construction

Phase I - Recovery
Phase IV - Recession

Source: Mueller, Real Estate Finance, 1995

Figure 21 Real estate market cycle, Mueller (1995)

If the crisis passes in reasonable time and the physical real estate cycle catches up with the financial cycle with a drop in land- and construction prices as a result. There might emerge business opportunities for a high quality office developer, since the demand probably will be high in quality real estate, we believe.
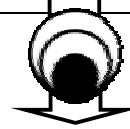
6.4 D. Project risk management

In this step a stakeholder analysis is conducted to provide a risk assessment of the most important stakeholders. The stakeholder analysis is done in context of the business process of a real estate development project, which consist of following steps; acquiring land-, planning/zoning-, leasing-, construction-, and disinvestment. The analysis is made by complying following three steps:
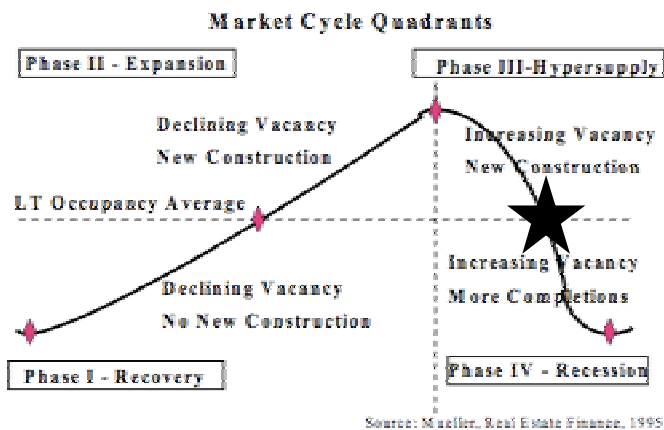
1. Mapping the stakeholders

2. Assessment of the power and predictability

3. Risk assessment of the most important stakeholders

6.4.1 Mapping the stakeholders

The external strategic stakeholders (se the chapter about stakeholder theory for explanation) are mapped in the different parts of the business process:

1. Acquiring land	2. Planning/ Zoning	3. Leasing	4. Construction	5. Disinvest-ment
Land owners	Municipality	Tenants	Construction companies	Investors
Municipality	Government	Agents	Construction management companies	Municipality
Government	Neighbors	Lawyers	Subcontractors	Government
Notary Public	Technical consultants	Competitors	Municipality	Agents
Agents	Other consultants/ "contacts"		Government	Lawyers
Technical consultants	Architects		Technical consultants	Competitors
Other consultants/ "contacts"	Lawyers		Other consultants/ "contacts"	
Lawyers			Architects	

Table 5 Mapping the stakeholders

6.4.2 Assessment of the power and predictability

In this step the stakeholders' power and predictability are assessed, the stakeholders are then placed in a matrix for each part of the business process. The position in the matrix is dependent on the assessment of the power and the predictability of their actions.
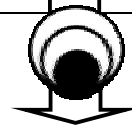
Power

The power is a result from a qualitative assessment from one to five (1=low, 5=high) of the following four categories and thereby an average power index is given:[251]

1. Concentration
2. Controllability
3. Nonsubstitutability
4. Essentially

See Appendix II for the estimation of the categories. If the power is high it means that the stakeholder have power to affect the project.

Predictability

The predictability is an estimation of how predictable we believe that the stakeholders are. If the predictability is high it means that the stakeholder and the actions it might take are predictable.

	Predictability	
	High	Low
Low (Power)	A. Few problems	B. Unpredictable but manageable
High (Power)	C. Powerful but predictable	D. Greatest danger or opportunities

Figure 22 Stakeholder mapping, Power/Predictability matrix, Newcomb (2003)

Result

The result from this step is presented in Appendix III since we believe the outcome from the assessment is too extensive to present in this part. However, the most critical stakeholders that are unpredictable and have strong power (placed in box D) is further presented in the next part.

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[251] Frooman (1999) pp 191-205
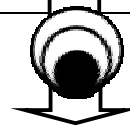
6.4.3 Risk assessment of the most important stakeholders

The stakeholders in the matrix's D box are considered as the greatest risk since they both have power and are unpredictable. Consequently analyze them further in this step.

Acquiring land

Stakeholder 1 – Land owners

There have been cases where land owners chose not to sell because the developer could not meet the land owner's price. The problem is that the price they require is so high that the developer has difficulties with acquiring the return on the investment.[252] Land owners have therefore a strong position when they negotiate of selling land. This situation will probably remain since the demand for land probably will continue to be higher than supply.

Stakeholder 2– Other consultants/"contacts"

Partners or consultants with the "right" connections are important when doing real estate business in Romania. These consultants do not have to be persons that take care of the "dirty work" but rather persons that have knowledge of how the process works and which persons that takes the important decisions.[253] The purpose is therefore not to let someone else bribe potentiates, since that is illegal and not necessary anymore.

Planning/zoning

Stakeholder 3 – Municipality

The municipality has very strong power in the zoning process and as written above, several permits are required before you are allowed to start a construction. There have been problems with corruption in the planning process and the urban planning in Bucharest has been unrestrained. Even if there still is work to do, the process has improved the last years and if the rules are followed you should get the permits.

Stakeholder 4 – Neighbors

Neighbors are always a risk when developing real estate since they have the possibility to delay building permits and planning certificates. The risk always exists and the best way to decrease the risk is to work preventive, we believe.

Stakeholder 2 – Other consultants/"contacts"

See the part above about other consultants/"contacts" in the acquiring land part. The same premises apply in this part of the business process.

Leasing

Stakeholder 5 – Tenants

The strong position of landlord's negotiation in the leasing process will most likely remain the next few years.[254] The tenants are therefore not one of the strongest stakeholder groups at the moment. A developer is however dependent on the tenants

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[252] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[253] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

[254] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

and when the supply exceeds the demand, the strong negotiation position may quickly change.
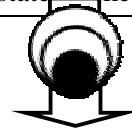
Construction
Stakeholder 6 – Construction companies
The construction market in Bucharest is overstrained and characterized of a shortage of labor force[255]. Therefore, this stakeholder group is and will be a significant risk for some years to come.

Disinvestment
Stakeholder 7 – Investors
This stakeholder group is very important since they are the final buyer of the developer's product and fluctuations on the global finance market affects local market investments, which can eliminate the demand for real estate.

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[255] Real Estate Review Romania 2008, Colliers p 37
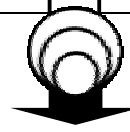
6.5 E. Evaluation of the critical factors

In this final part of the model, the most important factors from the previous steps are selected in order to present the critical factors for a developer to consider when making the decision to reject or to enter the market. This step and the model are concluded with a recommendation of what we believe Skanska Commercial Development should do about the entry in Bucharest.

6.5.1 Critical factors

- Restitution and land ownership

- Macroeconomic imbalance

- The real estate cycle

- Code of conduct

- Supply of land

- Overstrained construction market

Restitution and land ownership

The greatest legal concern is land ownership and restitution claims, which still is not fully straightened out. The land book cannot be fully trusted and restitution claims will probably be a concern for another 10 years. A proper due diligence including a comprehensive title check in order to establish if the owner really is the owner is crucial before acquiring land. Title insurance is also a way of decreasing the risk, though as mentioned earlier in the investigation, the insurance has not been tested in practice so no one knows for certain how it will work.[256] The Supreme Court can give some clarity when they present their decision.

Macroeconomic imbalance

The rapid growth in the economy has lead to a macroeconomic imbalance, IMF has recommended the government to conduct a tighter budget policy and transform the fiscal system in order to increase the state income.[257] The global financial climate has become more risk-averse since the US sub-prime crisis, which have increased the pressure on the government to tighten policy to encourage investors[258]. The government must therefore adapt appropriate macroeconomic policies in order to restore investor confidence in the Romanian economy[259].

The high inflation and the high private mortgage degree are other issues we have identified that could cause problems in the Romanian economy. Actions to decrease
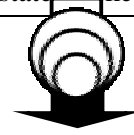
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[256] Patryk Figel, Lawyer Linklaters (2008-04-09)
[257] Commercial Property Market Overview Romania Spring 2008, DTZ p 2
[258] Country data Romania, Economist Intelligence Unit (2008-04-26)
[259] CEE Quarterly 01/2008, Bank Austria p 29

inflation will probably not be taken until 2011 or 2012 since Romania is expected to adopt the euro in 2014.[260]

 The 15% depreciation of the currency against the euro, the last months is another factor that causes concern. The exchange rate risk will remain during 2008 and strong volatility and sensitivity to market mood is to be expected.[261]

Consequently, there are macroeconomic issues that Romania must solve. However, consumption and investment levels are remaining strong and Romania is exiting the rapid economic growth stage and entering into the stable and moderate growth stage.[262] Therefore, we believe that in the long run, the country will be an interesting market for a real estate developer.

The real estate cycle
We believe that the commercial real estate market in Bucharest is at the top of the physical real estate cycle. Further the market has passed the top of the financial real estate cycle because of the credit crunch (see the stars in figure 23).

During 2008 we expect the market to pass the top of the physical cycle and move into the hypersupply phase and the downside risk is therefore apparent. However, the low office space per capita in Bucharest indicates that there is a significant growth potential in the long run, which can make the recession relative moderate. Moreover, our beliefs are that the market would benefit from a recession with a drop in land- and construction prices as a result.

The unstable situation on the financial market has cooled the real estate market, reduced the peak of the physical real estate cycle and it might enforce a recession. At the same time it may also reduce the possible downturn, as long as the credit crunch does not get worse. If the crisis passes in reasonable time and the physical real estate cycle catches up with the financial cycle with a drop in land- and construction prices as a result there might emerge business opportunities for a high quality office developer, since the demand probably will be high in quality real estate.

The physical real estate cycle   **The financial real estate cycle**

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[260] Country data Romania, Economist Intelligence Unit (2008-04-26)

[261] CEE Quarterly 01/2008, Bank Austria p 30

[262] Romanian Investment Market Q1 2008, Jones Lang LaSalle p 2
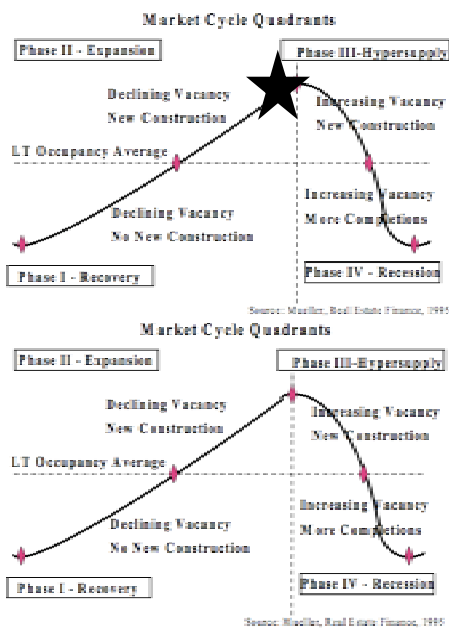
Figure 23 The real estate cycles, Mueller (1995)

Code of conduct

The municipality has very strong power in the zoning process and as written above several permits are required before you are allowed to start a construction. Even if there still is work to do, the process has improved the last years and if the rules are followed you should get the permits. The main risk in the planning process is that it may take longer time than expected. Working with consultants that know the requirements and have the right contacts might ease and quicken the process.[263] When doing business in Romania it is important, as it is in most countries, to have connections and for a new developer a solution could be to work with a local partner or consultant with the connections. It is of course of great importance to always having Skanska's Code of Conduct in mind and work with consultants with right knowledge and connections. In addition must the consultants be dependable and aware that no illegal activity is accepted.

The conclusion of the business climate in Romania is that it is possible to do business and follow Skanska's Code of Conduct. However, it might take longer time than it would have otherwise. When doing business it is important to find partners that are trustable and that have an understanding of the Code of Conduct but also to understand that the process can take long time.

Supply of land

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[263] Troy Javaher, Director of Business Development Jones Lang LaSalle (2008-04-08)

Most of the land in Bucharest is in private hands[264] and there is a problem with high land prices, which has decreased the number of land transactions. The problem occurs because of a perception gap between the seller and the buyer of what the correct value of the land is. Land owners have therefore a strong position in the land sales negotiations. This situation will probably remain since the demand for land probably will continue to be higher than supply. The global credit crunch can cool down the market but we believe that it will be crucial for a developer to establish good connections with present land owners in order to be able to acquire proper sites. This is therefore a group of stakeholders that are of great importance to have good knowledge about.
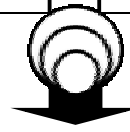
Overstrained construction market
The construction market in Bucharest is overstrained and characterized of a shortage of labor force[265]. Most office buildings have therefore been finished three to nine months late and these problems are likely to continue throughout 2008 and 2009[266]. Quality and cost are other concerns, good quality is possible to acquire and therefore not a great risk. However, construction prices will probably continue to be high due to the undersupply, which must be taken into consideration when calculating new projects. The greatest risks concerning construction are therefore to find available construction companies, construction cost, and time delays when building.

Consequently, this stakeholder group is and will be a significant risk for some years to come. To handle the problem, we suggest that SCD should establish a network with construction companies. If SCD will work with a construction management company it will be important that they have good contacts with construction companies instead. The problems on the construction market will probably more or less still be left, but good relations can ease the situation for the developer and decrease the risk.

6.5.2 Recommendation
By applying the model on the commercial real estate market in Bucharest, several significant risks were identified. The most essential risks for SCD to consider before entering the market are; the issue of restitution, the macroeconomic imbalance, the position in the real estate cycle, the supply and the price levels of land and the overstrained construction market. Another issue might also be corruption in the planning process.

However, major opportunities for a developer on the Bucharest market were as well seen through the evaluation. This mainly due to the low office space per capita in Bucharest compared to other markets in Europe, which indicates that there is a significant growth potential in the long run. The even lower supply of prime class office space especially indicates a high future demand for high quality offices. The

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[264] Investment in Romania, KPMG 2008 pp 58-59

[265] Real Estate Review Romania 2008, Colliers p 37

[266] Real Estate Review Romania 2008, Colliers p 11

economic growth potential of Bucharest and Romania in terms of new establishment of multinational companies and the recently strong development among Romanian companies is other reasons why we believe the Bucharest commercial real estate market has considerable potential for a developer.

Our recommendation for SCD is to continue the search for suitable sites in Bucharest, but not to acquire land until the prerequisites are right. It will be crucial to follow the fluctuations on the market closely, in order to avoid purchasing expensive land and then realizing that the recession will be deeper than expected. The outcome of the credit crunch is of interest to monitor since there might emerge business opportunities for SCD, from a cooling of the market in terms of a drop in land- and construction prices.

But, to achieve a good market position and become a successful developer it will be important to show presence on the market and to establish a rich network at an early stage, mainly with the acquiring of land-, the planning- and the construction stakeholders in the business process.

7 Conclusions and discussion

This final part of the study will address if the purpose of the thesis has been fulfilled by the presented findings. The potential contributions of the research will also be examined. Further a critical review of the research process will be discussed and moreover, suggestions of further research will be presented.

7.1 Fulfilling the purpose of this study

The aim of this study was primary to develop a model for evaluating commercial real estate markets. The starting point for the model generation was to contribute with a model that; (a) is of practical use for a developer and (b) to contribute with something innovative to the academic world. Moreover, the model aims to contribute with a structured approach for evaluating the potential and the risks of a commercial real estate market, which will ease the process of appraising potential new markets for a developer.

A market evaluation model was created primary on the basis of the empirical- and theoretical findings from the interviews conducted in the early stage of the study. This model was then applied on the Bucharest commercial real estate market, which functioned as iteration, with the aim of improving the model. From this iteration points of improvements in the model was found and adjusted. The improvements mainly concerned; making the model more concise and to put more emphasis on critical aspects. This was done in order to not examine aspects of limited value for the evaluation and consequently improve the practical use of the model.

On the basis of the evaluation model, we found the model to be appropriate for evaluating potential and risks of a commercial real estate market. The three theoretical perspectives chosen to form the model have added perspectives, which made the evaluation of the Bucharest market rich, nuanced and relevant.

The development of the model; going from aspects with a broad perspective to end with specific aspects concerning a developers business, gave a structured way of addressing the market evaluation. The macro environmental perspectives gave the prerequisite for being able to operate on the market and the theoretical perspective given about real estate cycles added a valuable perspective to the model, we believe. This since it brought the situation of the cyclicality of the real estate market into light. Moreover, the stakeholder perspective of the business process of a developer on the specific real estate market contributed with the clarification of the potential risks of pursuing a project on the specific market.

A final model was then presented in chapter 5, *The G.U.T. Model,* and thereby the purpose of; "Developing a model for evaluating risks and opportunities of entering a new commercial real estate market" was fulfilled.

The study also aimed to evaluate the Bucharest commercial real estate market, which was addressed in chapter five. The study concluded that the Bucharest market of real estate had several considerable risks but also major opportunities for developing real estate.

The most prominent risks to be considered before entering the Bucharest commercial real estate market are; the issue of restitution, the macro economical situation, the real estate cycle situation, the supply and the price levels of land and the overstrained construction market. Another issue might be corruption in the planning process. Though, the study also has concluded considerable opportunities for a developer on the Bucharest market mainly due the low supply of prime class offices and the economic growth potential of Bucharest and Romania in terms of new establishment of multinational companies and also because of the recently strong development among Romanian companies.

The purpose of evaluating the risks and opportunities on the Bucharest commercial real estate market has thereby also been accomplished.

7.2 Criticism to the study

Since the decision-making process of entering a real estate market is a complex process and normally is done by experienced professionals over longer period of time. A proper evaluation consequently concludes an understanding of both the broad- and the detailed "picture" regarding a commercial real estate market. In the study it was thereby hard to define a suitable balance between capturing the broad aspects as well as the detailed aspects of the specific market. A criticism to the study can thereby be that it covers a too great field, since it aims to capture both the general and the specific. Though we believe that we have considered this problem in the study, but the analysis of the real estate cycle and the stakeholders in the business process, could probably be given even more emphasis in the study, we believe. However if more emphasis would have been put on these areas, we might not have identified major risks such as the restitution issue and the risks in the Romanian macroeconomics. This since, efforts of evaluating the macro environment probably then would have been suffering due to the focus of evaluating details.

The model creation has mainly been conducted through interviews with respondents at SCD. This might have given a too unilateral view on the process of evaluating a commercial real estate market. The theoretical research and the research of other external sources, mainly through consultancy reports of real estate, were done in order to find appropriate perspective for constructing the model. These perspectives however contributed to neutralize, the potentially one-sided view from the empirical findings, we believe. However, it would have been desirable to have complemented the empirics with respondents outside SCD. Though, we have found it hard to find respondents with these specific competencies and to get them interesting to participate in this kind of study.

The process of how to conduct this study has been emphasized in great extent due to

the complexity to construct a comprising model. At an early stage of the study a proper research concerning the methodological approach of the study was done, mainly in the theoretical field of Grounded theory. Moreover, the process in great extent can be characterized by a great number of iterations between the empirical findings and the theories, especially in the model creation phase in order to capture common themes and patterns, which reflected factors of importance when evaluating a real estate model. The criticism we would like to address concerning the process of the study is that the conducted interviews could have been more appropriate structured in order to better meet the methodological approach of the study. More appropriate in the sense, that the interviews would have considered the aspects given in the purpose column seen in Melnyk & Handfiled's table 1 in greater extension. The interviews conducted cover however the relevant information for creating the model, we believe. But they could probably have been even stricter if they would have followed the aspects described above. Further, the process could most likely gain from looking at a greater number of similar cases from other industries, concerning entry models. Additionally the model most likely could be improved by going through a greater number of iterations with the respondents. However the model has been iterated several times mainly with our supervisors at Skanska and by some of the respondents, which most likely has improved the model.

Concerning the Bucharest evaluation it could probably been improved if the selection of the study had been broader and covered a greater part of the real estate market. Further the number of sources could have been greater, which possibly had improved the validity of the evaluation additionally. However, we consider the information collection process in Bucharest as a whole to be satisfying since it generated rich and relevant information for evaluating the Bucharest commercial real estate market.

7.3 Research contribution

The model has primary contributed with a structured approach of analyzing the potential and the risks of entering a commercial real estate market. The model has combined three different theoretical perspectives of relevance of evaluating a real estate market in a unified way, which we believe is a new theoretical approach of addressing a market evaluation of commercial real estate. Of course the theoretical validity of the model can be discussed since the study has been done during a short period of time and included a limited amount of empirical information. We still believe that this model can contribute with perspectives of value both seen from a theoretical point of view as well as seen from a developer's perspective.

A purpose, which not was explicit at the beginning of the thesis, has emerged during the process of working with this thesis. The purpose has been to contribute to the process of developing new theories from empirical findings. This purpose was not set in advance of the study, but has during discussions with different parts regarding the working process become explicit. The product of this work has thereby also contributed with an approach of developing theory from empirical findings. The contribution within this field should though be seen within the frames of a master thesis and not to be compared with for example complete Grounded theory study,

reaching over several years. We however consider and hope that the approach used in this study can be inspiring and of interest for other research studies in the future.

7.4 Further research

The model is a market evaluation model, which solely aims to evaluate the potential and the risks of entering a commercial real estate market. This means that the market evaluation has been done without the consideration of the ability of a developer, in terms of competencies and resources needed to succeed with the market entry. Thereby we recommend further exploration in the field of how a developer can succeed with a market entry, by for example evaluating the resources and the competencies of the developer. Moreover we recommend further research concerning the real estate cycle theory and how it further can be used in the evaluation process of a commercial real estate market. We also consider it to be of both theoretical and practical interest to further examine how the stakeholder perspective can be applied in the business process of developer. This since the development process of real estate is long and complex, and thereby we see the need of using a structured approach in order improves the risk management in this process. Finally we believe that it could be useful to add a more explicit risk management perspective to the model, where risks can be quantified and structured, which additionally could reduce the complexity of the decision-making process.

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Appendix I – General economic- and key office indicators

General economic indicators	2002	2003	2004	2005	2006	2007	2008*	2009*
GDP/ capita (1000 U.S $)[267]	2 088	2 721	3 465	4 552	5 668	7 697	8 744	10 042
Real GDP growth (%)[268]	5,1	5,2	8,4	4,1	7,9	6,0	5,4	4,7
FDI/GDP inflow (%)[269]	3,0	4,0	9,0	6,6	9,3	6,0	4,8	4,1
Inflation, consumer prices (%)[270]	22,5	15,3	11,9	9	6,6	4,8	7,0	5,1
Unemployment (%)[271]	8,1	7,2	6,7	5,8	5,4	4,3	4,2	4,2

* Forecast
Real GDP growth (%)[272]
FDI/GDP inflow (%)[273]
Inflation, consumer prices (%)[274]
Unemployment (%)[275]

Key Office Indicators	2005	2006	2007	2008*	2009*
Total supply (sq m)	540 000	700 000	950 000	1 280 000	1 690 000
Annual supply (sq m)**	100 000	150 000	210 000	315 000	380 000
Annual take-up/demand (sq m)**	135 000	205 000	240 000	300 000	340 000
Vacancy rate (%)	5	2	2	3	7
Prime rents (€ per sq m/month)	18	19	22	22	20

Source Jones Lang LaSalle Research and DTZ Research[276] [277]
*Forecast
**An average of Jones Lang LaSalle's and DTZ's indicators

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[267] World Economic Outlook Database, IMF (2008-04-29)

[268] World Economic Outlook Database, IMF (2008-04-29)

[269] CEE Quarterly 01/2008, Bank Austria p 28

[270] World Economic Outlook Database, IMF (2008-04-29)

[271] CEE Quarterly 01/2008, Bank Austria p 28

[272] World Economic Outlook Database, IMF (2008-04-29)

[273] CEE Quarterly 01/2008, Bank Austria p 28

[274] World Economic Outlook Database, IMF (2008-04-29)

[275] CEE Quarterly 01/2008, Bank Austria p 28

[276] Commercial Property Market Overview Romania Spring 2008, DTZ p 3

[277] Office Market Overview Q1 2008, Jones Lang LaSalle p 3

Appendix II – Assessment of the stakeholders' power and predictability

1. Acquiring land	Concentration	Controllability	Nonsubstitutability	Essentially	Power	Predictability
Land owners	4	5	4	5	**4,5**	**5**
Municipality	5	1	5	3	**3,5**	**2**
Government	5	1	5	3	**3,5**	**2**
Notary Public	4	2	5	5	**4**	**1**
Agents	2	1	3	3	**2,25**	**1**
Technical consultants	2	2	3	4	**2,75**	**2**
Other consultants/"contacts"	4	3	4	5	**4**	**3**
Lawyers	2	1	4	4	**2,75**	**2**

2. Planning/Zoning	Concentration	Controllability	Nonsubstitutability	Essentially	Power	Predictability
Municipality	5	5	5	5	**5**	**4**
Government	5	3	5	3	**4**	**3**
Neighbors	4	3	5	2	**3,5**	**3**
Technical consultants	4	3	4	5	**4**	**2**
Other consultants/"contacts"	4	4	4	5	**4,25**	**3**
Architects	3	4	3	5	**3,75**	**2**
Lawyers	2	3	3	5	**3,25**	**1**

3. Leasing	Concentration	Controllability	Nonsubstitutability	Essentially	Power	Predictability
Tenants	4	4	4	5	**4,25**	**3**
Agents	2	3	4	4	**3,25**	**2**
Lawyers	2	2	4	5	**3,25**	**2**
Competitors	4	2	3	3	**3**	**4**

4. Construction	Concentration	Controllability	Nonsubstitutability	Essentially	Power	Predictability
Construction companies	5	4	4	5	**4,5**	**3**
Construction management companies	4	4	4	5	**4,25**	**1**
Subcontractors	5	3	4	5	**4,25**	**2**
Municipality	5	3	5	2	**3,75**	**2**
Government	5	2	4	2	**3,25**	**1**
Technical consultants	3	4	3	4	**3,5**	**2**
Other consultants/"contacts"	4	2	3	2	**2,75**	**2**
Architects	3	4	3	5	**3,75**	**2**

5. Disinvestment	Concentration	Controllability	Nonsubstitutability	Essentially	Power	Predictability
Investors	4	4	4	5	**4,25**	**3**
Municipality	5	1	3	1	**2,5**	**2**
Government	5	2	3	3	**3,25**	**2**
Agents	2	3	3	4	**3**	**1**
Lawyers	2	3	3	4	**3**	**1**
Competitors	4	2	3	3	**3**	**3**

Appendix III – Mapping of the stakeholders' power and predictability

1. Acquiring land

No.	Stakeholder	Predictability	Power
1	Land owners	1	4,5
2	Municipality	3	3,5
3	Government	4	3,5
4	Notary Public	4	4
5	Agents	5	2,25
6	Technical consultants	5	2,75
7	Other consultants/"contacts"	2	4
8	Lawyers	5	2,75
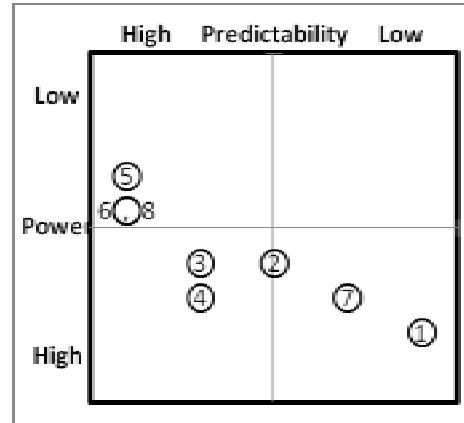
2. Planning/zoning

No.	Stakeholder	Predictability	Power
1	Municipality	2	5
2	Government	3	4
3	Neighbors	1	3,5
4	Technical consultants	5	4
5	Other consultants/"contacts"	2	4,25
6	Architects	4	3,75
7	Lawyers	5	3,25
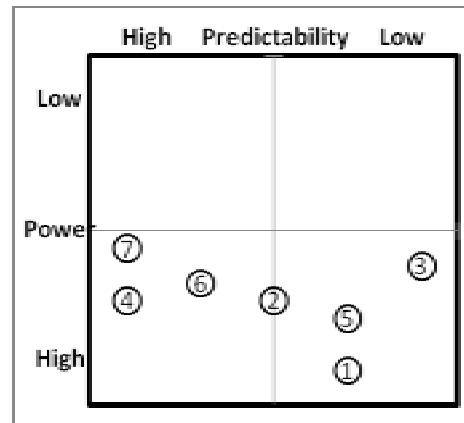
3. Leasing

No.	Stakeholder	Predictability	Power
1	Tenants	2	4,25
2	Agents	5	3,25
3	Lawyers	5	3,25
4	Competitors	2	3
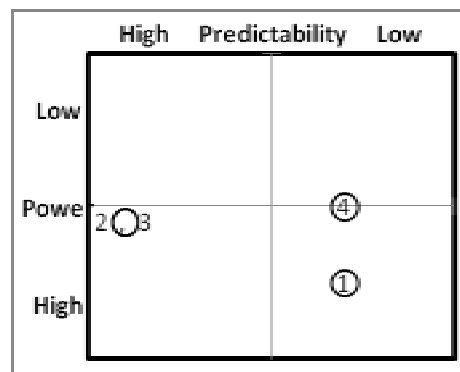
4. Construction

No.	Stakeholder	Predictability	Power
1	Construction companies	2	4,5
2	Construction management companies	4	4,25
3	Subcontractors	3	4,25
4	Municipality	3	3,75
5	Government	4	3,25
6	Technical consultants	5	3,5
7	Other consultants/"contacts"	4	2,75
8	Architects	4	3,75
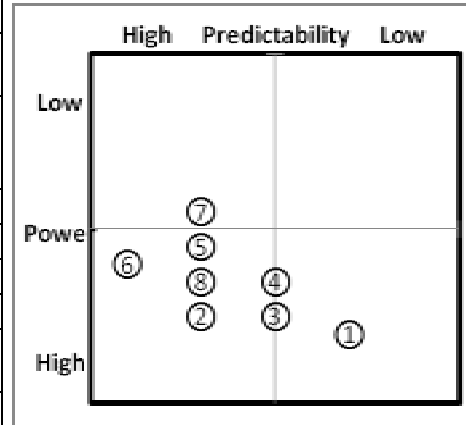
5. Disinvestment

No.	Stakeholder	Predictability	Power
1	Investors	2	4,25
2	Municipality	4	2,5
3	Government	3	3,25
4	Agents	5	3
5	Lawyers	5	3
6	Competitors	2	3