

Aspects and Trends in Real Estate Investment Accounting

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Abstract

Whether we refer to real estate investment or other types of investment, one of their most important aspects is the degree of risk. From this point of view, the investments are classified into two categories: those guaranteed (where there is someone who guarantees that you will get your money back plus a certain profit, whether this someone is the state, a certain company or another institution) and those that are not guaranteed. In the most general way, guaranteed investments bring lower profits than unsecured, although there are sometimes exceptions to this rule . Real estate investments obviously fall into the category of those that are not guaranteed. However, they are often considered as having low or even safe risks. And, at first glance, it would seem right. But this is not really true and depends very much on the particular characteristics of each one.

Key words: real estate, accounting, fair value.

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1. Theoretical background of real estate investment recognition

Real estate investment is the property (land or building - or part of a building - or both) owned (by the landlord or lessee under a finance lease) rather to earn rental income or to increase the value of the capital, or both, than for (Nicolae, 2010):

- a) be used in the production or supply of goods or services or for administrative purposes; or
- b) be sold during the normal course of business.

A landlord used by the owner is a property owned (by the owner or lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

A real estate investment is owned to earn rental income or increase the value of the capital or both. Therefore, a real estate investment generates cash flows that are largely independent of other assets held by an entity. Thus, real estate investment differs from the real estate used by the owner.

The production or supply of goods or services (or the use of property for administrative purposes) generates cash flows that can not be attributed only to real estate but also to other assets used in the production or supply of goods or services. In the case of real estate used by the owner, the applicable standard is IAS 16 *Property, Plant and Equipment* (Nicolae, 2015).

The volume of real estate investments in Romania in 2017 is estimated at about 1 billion euros, up by about 10% and represents 8% of the total in Central and Eastern Europe, a study by JLL shows, which predicts a positive evolution in 2018 (www.imobiliare.ro).

An unprecedented situation recorded last year at the local level is the passage of the hotel segment before the office, following the transaction that targeted the Radisson Hotel in Bucharest. Thus, the market was dominated by retail property transactions (43%), while the industrial and logistics segment accounted for 22%, but the next place advanced the hotel market by 18%, outpacing investment in the office area, which had a share of only 17%.

A real estate investment should initially be valued at cost, including transaction costs.

The cost of a proprietary investment purchased or built on own account includes the purchase price and any directly attributable costs (for example, fees for legal services, property transfer fees and other transaction costs) (Nicolae, 2015).

The initial cost of a leased property is the lowest of the fair value of the property and the present value of the minimum lease payments. An equivalent value must be recognized as a liability.

2. What are the risks to real estate?

These properties are subject to a relatively limited number of risks, the main ones being those that could lead to their destruction: earthquake, fire, floods, landslides, etc.

The big advantage is that these events are very rare, but especially the fact that we can ensure for them. And these insurance policies are very common, easy to contract and have fairly good costs (Nicolae, 2010).

Often, the degree of risk of a particular investment that is not guaranteed is compared to the risk of investing in shares.

This is because stock exchanges are considered to be among the most risky (but also profitable) types of investments for two reasons: on the one hand stock exchanges may have very high fluctuations (which may lead to substantial downward delays), on the other hand, these companies are constantly subject to many risks, including bankruptcy (Nicolae, 2015).

Well, this is the very reason many believe that real estate investments are safe due to the comparison with stock exchanges.

Beyond the catastrophic risks that would lead to their destruction, those real estate properties will continue to have some intrinsic value irrespective of the particular economic conditions, so they will never reach zero, that is, in bankruptcy (as long as people have housing needs).

What does not mean, however, that they can not be affected by these economic cycles. On the contrary. In recent years, real estate prices have shown us to be very much influenced by these factors.

3. How safe are investments in real estate?

In order to give us an opinion on the evolution of real estate prices we could use the information provided by two large specialized sites in this field: imobiliare.ro and anuntul.ro. Both sites point to the same conclusions:

1. After the peak reached in the years 2007-2008, with the financial crisis, real estate prices fell on average by approx. 55-60% (we refer mainly to house prices, because land plots have collapsed even more) (www.imobiliare.ro);

2. Prices have stabilized for a few years and even started to rise again, but their overall return is still quite weak (as the real estate index.com shows in the picture below).

Sure, except for a few cities (like Cluj), where prices have already reached values from 2007-2008. It is, therefore, that these real estate properties, however safe at first glance, appear to be subject to large declines, which persist largely after almost 10 years since the last financial crisis.

To see what was the evolution of shares, we can take into account the main index of the Bucharest Stock Exchange, the BET index.

Thus, we note that:

1. After the peak reached before the crisis, the BET index decreased by approx. 80%, so clearly more than the decline for real estate.

2. Once these declines have stopped (in 2009), the index has experienced a significant recovery (for 2010 it was only 40% below the 2007 peak).

It then followed a period of high fluctuations (during the euro area crisis), and since 2013 the BET index has resumed its growth. And in the past year, the BET index has reached new peak levels after the crisis, which is only 18% below the 2007 peak.

Interestingly, stock market indices in other countries had relatively similar evolutions, but those in the most developed countries (USA, Germany) had lower declines (around 50%) in 2008-2009 and then the return was much stronger since they have already exceeded the maximums achieved before the financial crisis.

In conclusion, by the nature of the risks to which they are subject, real estate investment appears to be safer than other types of investment, at least in terms of equity investments.

But in times of crisis, they are very much affected, even if less than stock exchanges.

However, stock prices are recovering faster than real estate, at least if we are talking about the situation in Romania.

It turns out that a very important aspect of an investment (real estate or other type) is when it is done, beyond its risk category.

And now you can find out more detailed and extremely practical information about these types of investments - and many other types of investments - that will help you get an overview of the most interesting opportunities available at the moment.

4. Real estate investment with full payment of the amount from own income

Real estate investments are amongst the safest investments, making them preferable by the majority. The yields can vary between 5% and 10% depending on the building's destination, location, etc. I've been analyzing what it means today to buy a home real estate. So you buy a house, cash or credit and rent it for the sake of making a profit, making a long-term investment.

Let's take as an example the purchase of a 1 or 2 -room apartment worth up to 50,000 euros (www.imobiliare.ro). The main criterion when choosing an apartment for investment is to locate. More accurate analysis of the city / district with the best rentals. Enable time to analyze the offers on the market, talk to realtors and make a list of 3-5 areas where you deserve to have a real estate. Then see what you can buy with the budget you have available. Consider that studios generally have better returns. The initial investment is considerably lower than for a 2-room apartment, and the rent difference is not too high.

For example, a studio where you invested 45,000 euros, in the semicentral area in Bucharest can be rented 300 euros / month (www.imobiliare.ro). So it brings them a gross income of 3600 euro / year. This means a gross yield of 8%. Instead, a 2-room apartment in the same area rents 400 euros per month, but it costs 65,000 euros (higher cost on acquisition + higher cost on furnished and equipped), so gross returns fall to 7.3% .

To maintain the highest return, you can try to rent directly without intermediaries. If you rent a real estate agent, 50% of the first rent goes to him, so he reduces your return. Then, the more a tenant stays, the greater your chances and the higher returns. Choose good and cheap home furnishings and appliances with high warranty, neutral colors and textures, wear-resistant. This way you assure that for a period of five years you do not have to invest in the apartment except for small repairs (if they appear).

So if you have 50,000 euros and you do not know how to invest, you can choose your real estate investments and watch a gross return of at least 8%. If you are inspired and buy at a time when prices are at a reasonable level, in a few years you can make a nice profit by selling the property if prices are rising. Even if you do not sell, rentals provide you a passive income and can be your private pension. The safest way from my point of view is to secure a passive income for a very long time. Rental income is taxed 16 %.

5. Real estate investment with real estate payment through a mortgage

This is a method commonly used in west, and I notice that it is a land of ours. If you already have a home, you have a good salary and some savings, you can analyze the idea of a real estate investment. Let's say you want to invest 20,000 euros. Obviously you do not get to buy a studio. But you can make a mortgage. Here's a simple calculation : Purchase Studio: 40,000 euro; Investment in development: 5,000 euros.

To get a mortgage loan in 2017, most banks ask for an advance of 30% of the value of the property. So 15,000 euros you put, the difference of 25,000 euro puts the bank.

With a credit of 25,000 euros for 10 years you will have a rate of about 270 euros / month.

Renting the studio with 300 euro / month you can make a small profit. The idea is that over 10 years, you will have a property that you only paid 20,000 euros and that will bring you a passive income for your pension. For 10 years, the rate at the bank will be paid by the tenants. When you have finished paying your credit and your property becomes yours, then the return will be well over 10%. When there was the first house credit, this kind of investment was more profitable, because the credit was cheap. You can smartly use the bank's money. It's all you want and courage, think long-term and want to make a profit.

Each city has its own specificity. If you are tempted to make real estate investments, it analyzes well the market and the moment of the acquisition. If prices are rising for more than 5-7 years, maybe it's not a good idea to buy, but to expect a new crisis to turn the investment into a truly profitable one.

In Bucharest, prices have reached a low in the first half of 2014. From the second half they are already rising and expecting growth for another few years (www.imobiliare.ro) .

6. What are the most attractive real estate investments in 2018

After 2017 year, which brought to market more attractive concepts for investor buyers, in 2018 unconventional apartments and houses with the potential to be transformed into company headquarters will be more and more demanded for investment. According to imobiliare.ro specialists, the profitability of such investments is given by the value of the yield index, an important measure of the return on a real estate investment (www.imobiliare.ro). The yields of these residential properties depend on many factors such as location, partitioning, endowment, or finishing.

The real estate investment market has in recent years seen a dynamic development marked by the increasingly specific needs of buyers interested in profitable investments. Under current conditions, customers are looking for opportunities that will provide them with a satisfactory return but also fit under certain conditions they pursue, such as quality or safety (www.imobiliare.ro).

According to real estate specialists , the most profitable investments in 2018 will be those that stand out from the normal buildings, either large apartments (90 sqm - 120 sqm) or small apartments (28 sq m - 42 sq m) (www.imobiliare.ro) . On the other hand, apartments in low-rise buildings located in areas close to points of interest such as business centers, private schools, medical institutions will become more and more attractive for those interested in investing. The yield for such investments, calculated on the basis of the price of the property and the amount of rent generated annually, will have different values depending on the particularities of the area and the apartment. For example, for a 3-room apartment at an approximate price of 140,000 euros, rented at 750 euros / month, a return of 6.5% will result, with the investment amortized in about 15 years.

On the other hand, homes have become more and more demanded by investors, being considered opportune investment, which offers a higher degree of comfort to buyers. Thus, buying a house, they have the opportunity to rent it for a long time, so they will manage a single building instead of 4-5, as is the case with apartments.

According to real estate specialists, in 2018 houses located in areas allowing their transformation into office spaces or even commercial spaces for company headquarters will be even more profitable for prospective investors. Thus, the owner is able to turn the house into a office where it will have a high return or even a commercial space, which will further increase the yield from that investment. For example, a house of approximately EUR 265,000, with a rent of EUR 1,550, will generate a return of 7%, the investment being recovered in about 14 years (www.imobiliare.ro) .

Romania, among the highest performances in the office / commercial segment.

Yield, property occupancy rates and confidence in real estate investments are the main engines of the commercial and office real estate market. They are, however, constantly affected by the country's economic and political situation as well as investors' confidence.

Commercial property yields are more sensitive to market conditions than residential property. The reason is simple: the need for people to have a living space is generally greater than having an office space for a business - which you can start or close at any time. This risk is reflected in the higher returns that commercial / office properties attract .

According to real estate specialists on the office and commercial segment, Romania offers more attractive returns than countries in the same region as Hungary, the Czech Republic, Poland or Slovakia. In terms of the best performing cities in the same segments, Bucharest, Timisoara, Cluj-Napoca and Iasi are the most effervescent (www.imobiliare.ro) .

Table no. 1: Yields in Central and Eastern Europe

Year 2017	Romania	Hungary	Czech Republic	Poland	Slovakia
Office	7,50%	6,50%	5,00%	5,00%	6,50%
Comercial	7,25%	5,90%	5,00%	5,00%	6,00%

Source: www.imobiliare.ro

Table no. 2: Yields in Romania

Year 2017	București	Timișoara	Cluj-Napoca	Iași
Office	7,50%	7,50%	7,50%	7,00%
Comercial	7,25%	7,00%	7,25%	7,00%

Source: www.imobiliare.ro

7. Accounting for real estate investments using the cost model

An entity purchases on January 1, 2016 a building whose acquisition cost is 30,000,000 lei. The building has a useful life of 30 years and will be used for renting to third parties, thus being classified as real estate investment. In accordance with internal policies, for the subsequent valuation of real estate investments, the entity chose the cost model, with the depreciation method being the straight line method (Nicolae, 2010).

Under its accounting policies, at the end of each reporting period, the entity performs tests to determine whether there are any impairment indications for the building. On December 31, 2016, the entity notes that there has been a depreciation and the amount of the impairment adjustment is lei 4,000,000. On 31 December 2017, the entity notes a decrease of the impairment adjustment by lei 1,800,000.

On December 31, 2018, the entity decides to sell the building for 35,000,000 lei.

1. Accounting records on 1 January 2016

Purchase registration:

Debit *Real estate investments recorded at cost* 30,000,000

Credit *Providers of real estate investments* 30,000,000

2. Accounting records as at 31 December 2016

On 31 December 2016, the entity records amortization for the period 1 January 2016 - 31 December 2016 = 30,000,000 lei / 30 years = ROL 1,000,000

a. Recording the depreciation of the real estate investment for the period 1 January 2016 - December 31, 2016:

Debit *Operating Expenses on amortization of fixed assets, real estate investments and biological assets at cost* 1,000,000

Credit *Depreciation of real estate investments at cost* 1,000,000

b. Registration of building depreciation on 31 December 2016:

Debit *Operating expenses related to impairment adjustments for immovable, investment property and biological assets at cost* 4,000,000

Credit *Adjustments for building depreciation* 4,000,000

3. Accounting records as at 31 December 2017

a. Recording the depreciation of the investment property for the period 1 January 2017 - December 31, 2017.

After recording the impairment adjustment on 31 December 2016, the amount of the annual depreciation of the building is recalculated according to its new net book value. So:

Annual amortization = 25,000,000 lei / 29 years = 862,069 lei

Debit *Operating Expenses on amortization of fixed assets, real estate investments and biological assets at cost* 862,069

Credit *Depreciation of real estate investments at cost* 862,069

b. Recording of the partial reversal of the *previously recognized impairment loss*:
Debit Adjustments for building depreciation 1,800,000
Credit Income from adjustments for depreciation of fixed assets, real estate investments and biological assets at cost 1,800,000

4. Accounting records as at 31 December 2018

a. Recording the depreciation of the investment property for the period 1 January 2018 - December 31, 2018

After recording the adjustment for impairment adjustment on 31 December 2017, the annual amortization of the building is recalculated according to its new net book value.

Annual amortization = 25,937,931 lei / 28 years = 926,354 lei

Debit Operating Expenses on amortization of fixed assets, real estate investments and biological assets at cost 926,354

Credit Depreciation of real estate investments at cost 926,354

b. Registration of the sales operation:

Debit Miscellaneous debtors 35,000,000

Credit Income from the disposal of real estate investments 35,000,000

c. Recording of asset removal:

Debit Depreciation of real estate investments at cost 2,788,423

Debit Adjustments for building depreciation 2,200,000

Debit Expenditure on the disposal of real estate investments 25,011,577

Credit Real estate investments recorded at cost 30,000,000

8. Conclusions

The real estate investments are an interesting alternative for all categories of entities in the Romanian economy. In the current period, the chances of a sustained increase in the volume of real estate investments are seen.

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