

# The agricultural land market in Bulgaria and farmland investment opportunities

## 1. Short History (1990 – 2005) and Legal Framework Overview

Between 1991 and 1997 in Bulgaria occurred the process of restitution of private property, specifically of agricultural land. The land was returned to its original owners or to their inheritors within the boundaries and the size originally owned before the collectivization after World War II. This resulted in high fragmentation of the land and the emergence of several million small holders, most of whom are not involved in agricultural production and even do not live in the villages, where their land is located. The ownership is extremely parceled out as the average size of a land property is about 0,5 hectare. The agricultural producers cultivate mainly leased land.

The market for agricultural land in Bulgaria started to grow at the end of the 90s. It was relatively underdeveloped until 2004 and the prices of the agricultural land were extremely low.

Currently, the legal framework and infrastructure of the market for agricultural land is modern and stable and fulfills all requirements of the European Union. The well-functioning land register, records services and notary offices guaranty the safety of real estate property deals execution, including transactions with agricultural land. Further, there are no restrictions in regards to the Bulgarian private and legal entities in respect to property ownership and control. Foreign citizens and companies do not have the right to possess agricultural land, however this restriction is in force only until January 1, 2014 for citizens and companies, residents in the European Union. Legal entities that are registered in Bulgaria have the right to possess agricultural land, even if they are fully owned by foreign individuals or companies.

## 2. Development of the market between 2005 and 2012

In 2005 began very rapid development of the market in respect to number of deals, amount of farmland sold, volume of the market in EURO and price growth.

**Development of the farmland market 2004-2012**

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012
Number of deals	45 885	67 000	92 000	125 062	121 568	110 000	107 000	126 000	
Amount of farmland sold in hectare	45 263	60 000	90 000	115 294	128 681	100 000	108 000	118 500	
Average price for farmland Euro/hectare	757	864	1 007	1 202	1 595	1 519	1 636	2 250	2 812
Size of the market - million EURO	34,25	51,85	90,65	138,53	205,27	151,85	176,70	266,59	
Change in the prices/ year on year	-	14,2%	16,6%	19,3%	32,8%	-4,8%	7,7%	37,5%	25,0%
Change in the prices/ compared to 2004	-	14,2%	33,1%	58,8%	110,8%	100,7%	116,2%	197,3%	271,6%

*Source: Ministry of Agriculture and Bulgarian Association of Agricultural Land Owners, price data for 2012 is estimated*

**The average annual growth rate of the agricultural land price**, for the period 2005-2012, is **18.5%**. The decrease of the price levels, number of deals and the amount of land sold in 2009 is insignificant and the market recovered very quickly at the beginning of 2010. This sector of the Bulgarian real estate market is the only one that overcame easily the consequences of the 2008 financial crisis and experienced significant growth rates in the last couple of years.

The main factors influencing the development of the market and the growth of the prices of agricultural land in Bulgaria are:

- Since 2005, the agricultural land in Bulgaria has become **an investment asset**. In 2005, three public investment funds were established (Elana Agricultural Land Opportunity Fund REIT, Advance Terrafund REIT, Bulland Investment), and in the next couple of years few others were established as well. These fund have been raising capital from Bulgarian and foreign investors to invest specifically in agricultural land. Private investment funds, private entities and companies, which do not deal with agricultural production, also started buying agricultural land for investment purposes;
- Bulgarian accession to the European Union in January 1, 2007 and the related **substantial increase in the subsidies**, which the agricultural producers receive per hectare of arable land.

**Subsidies per hectare 2007-2011 in EURO**

2007	2008	2009	2010	2011
74.29	112.94	121.59	147.25	130.38

- **Significant increase in the average rent**, which the leaseholders pay to the landlords. This price increase has been driven by the rise in the subsidies, as discussed, the growth in the prices of agricultural produce (especially after 2009), and the competition between leaseholders to aggregate bigger plots of arable land.

**Average rent 2005-2013**

marketing year	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
<b>average rent</b> EURO/hectare	51	64	72	82	92	112	138	169
rental yeild	5.9%	6.3%	6.0%	5.1%	6.1%	6.9%	6.1%	6.0%
rent increase		25.0%	12.0%	14.3%	12.5%	22.2%	22.7%	22.2%

- Since 2010, an important factor, influencing the development of the market and the growth in land prices, is the increase in demand for land, as **many agricultural producers started purchasing land** more actively, aiming at expanding the land owned for production as compared to land leased. The majority of the investment funds, focused on investing in agricultural land, turned from net buyers into net sellers due to this trend. Funds have been able to sell large plots, aggregated via the purchase of smaller plots, at a higher price than the total price of the original purchases.

### 3. Development dynamics expected over the next 5-7 years.

In the next 5-7 years the following factors are expected to influence the price of the agricultural land in Bulgaria:

#### External Factors:

- **The rapid growth of the world's population and the increase in the disposable income in the developing world** lead to a significant upsurge of the demand for food production, which influences positively, globally and in the long-term not only the prices of agricultural products, but also the main source of production- arable land.
- In Europe, particularly in the European Union, **the opportunities for an increase of the amount of arable land are limited**, which will drive the rise in the prices of the existing arable plots.
- Even though the price of the agricultural land in Bulgaria has grown significantly during the last 7-8 years, it **remains highly undervalued when compared to the other EU members**. Price convergence is expected to result in price increases in the medium term. Numerous Western European agricultural producers are interested in buying land in Bulgaria for the purposes of establishing farming activities locally and are expected to be active buyers of land in the next 3-5 years.
- **On January 1, 2014 the restriction for individuals and companies from EU member states to purchase agricultural land in Bulgaria will lapse**. At the moment, ownership is possible only indirectly, through Bulgarian legal entities, owned by foreigners.
- The EU Common Agricultural Policy for the next programming period, 2014-2020, forecasts **an increase in the subsidies** for agricultural production in the newly joined members of the European Union, including Bulgaria. It also stresses on organic farming, for which Bulgaria possesses substantial advantages.

#### Local Factors:

- The interest towards agricultural land as **an investment asset** by various groups of investors will remain strong in the medium term, due to extremely slow recovery of the other segments of the real estate market, and the limited and illiquid stock market in Bulgaria
- **Numerous large and mid-size producers continue to purchase plots** in order to increase the ratio of owned-to-leased land to ensure the stability of their positions in specific regions and also to implement long-term investment projects such as plantations and irrigation systems establishment, accretive when the land is owned.

- **Rents are expected to increase** driven by land prices growth and the increase in the subsidies from the European Union

**Based on the above mentioned factors, a conservative forecast for the average annual growth rate in agricultural land prices in Bulgaria in the next 5 years is in the range of 12%-14% and in the range of 6-7% for the average annual return on leased land.**

#### **4. Land Banking**

The agricultural land in Bulgaria is extremely fragmented, resulting in a large number of very small-sized land parcels and a big number of owners and co-owners. By virtue of this market profile the main sellers of agricultural land are small-sized owners (the original owners or their inheritors), while the main buyers are public and private investment funds and large agricultural producers. This demand/supply profile makes the purchase of large amount of land and its consequent consolidation very complicated, time-consuming and expensive and, at the same time, creates a significant spread between the prices of small, segregated plots and big, aggregated plots (aggregated in a single location or a portfolio of plots located in different places). Post 2010, many of the investment funds became sellers of land as well, selling the land purchased and concentrated to a certain extent during the last 4-5 years. Thus the secondary market for agricultural land is created with the main buyers being agricultural producers and financial investors (local and foreign), who don't have the capabilities to participate in the primary market (e.g.: time and resources to buy small dispersed plots and concentrate them). **Thus, the investment funds operating in the primary market, purchasing segregated, small plots and concentrating them into bigger ones, execute land banking.** In Bulgaria there is no governmental authority, which carries out this function and there are no plans of founding one. Therefore, land banking will remain an operation executed by private entities and is expected to be very profitable. An analysis of the financial statements of some listed funds proves the existence of arbitrage opportunities in this market space. For instance, during the first ten months of 2012 Bulland Investments purchases agricultural land at an average price of 3900 BGN/hectare and sold at an average price of 7630 BGN/hectare, the figures for Advance Terrafund are 5780 BGN/hectare and 8630 BGN/hectare, respectively.

#### **5. Investing through Specialized Funds**

The analysis of the market for agricultural land in Bulgaria and the internal and external drivers, discussed above, show that in the medium and long term investments in agricultural land will lead to stable returns with low levels of investment risk. The recommended way to invest in agricultural land in Bulgaria is through specialized funds. The advantages are the following:

- The purchase, sale and management of agricultural land, which in the case of Bulgaria are hard and time-consuming, are implemented by the fund's team

- The larger amount of accumulate capital in the fund allows for the acquisition and control of greater amount of land, which is a factor for achieving higher returns, including through participating in land banking.
- The indirect investment in the fund is significantly more liquid and ensures an easier exit as compared to direct investments in agricultural land

The Bulgarian legislation allows the following types of legal structures of the fund:

A. A **special purpose entity (REIT)**, which is regulated according to the Special Investment Purpose Companies Act, licensed and under the regulation of the Financial Supervision Commission; it is a public company, which shares are publicly traded on the Sofia Stock Exchange. At the moment, these companies are exempt from corporate tax (10%) and there is an obligatory dividend payment amounting to 90% of the annual profit.

B. A **public join stock company**, regulated according to the Commerce Act and the Public Offering of Securities Act, which shares are traded on the Sofia Stock Exchange; it does not require licensing, but it is under the supervision of the Financial Supervision Commission to a certain extent.

C. A **private (non-public) entity- join stock company** as stipulated by the Commerce Act, which is not under the supervision of specific authorities or regulators, and which shares are not publicly traded on a stock exchange

A public company form guaranties higher liquidity of the investments and stricter control on the management; however, it requires higher administrative costs and limits the management flexibility (particularly in the case of a special purpose entity (REIT)). It is suitable for corporate investors that are allowed to invest in publicly traded securities only. It is also beneficial for attracting larger number of small-sized investors.

A private structure provides the opportunity for more flexible management and requires lower administrative costs. It is suitable for fewer, large-sized investors (up to 50), for whom there is no obligation to invest in publicly traded securities.