

## State of the Residential Market in Ukraine and Investment Guidelines for Foreign Investors

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ABSTRACT	
<p>Purpose – To research the real state of development of the Ukrainian residential real estate market and its attractiveness for foreign investors</p> <p>Design/methodology/approach – The article is a review. The main scientific approach was aimed at analyzing the publication of Ukrainian authors on the issue of foreign investment in residential real estate in Ukraine, followed by identification of benefits, risks and grounds for this.</p> <p>Findings – The main findings of the article are sound recommendations on ways and directions of investing in residential real estate in Ukraine for foreign investors</p> <p>Research limitations – Limited access to data and Issues with sample and selection</p> <p>Research implications – A study might have implications for foreign investors, interested in investing in residential real estate in Ukraine, but anyway they will need the professional consultation from Ukrainian real estate professional before doing operations at this market.</p>	
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## **INTRODUCTION**

The Ukrainian market becomes interesting for foreign investors, interested in operations with residential real estate. Polish investors can be the example. It can be a profitable business, but they should know the peculiarities and law restrictions for this market. The residential real estate market in Ukraine is developing rapidly after the recession of 2014-2015. Both residential and commercial real estate are under construction. Even the COVID-19 epidemic only partially slowed down the pace of construction, and from July 2020 the pace of work began to resume. The residential real estate market in Ukraine will be attractive for investment, because after 2014 its prices are growing almost steadily, despite the economic situation. Real estate investment for further rental is objectively more effective than investing in foreign currency deposits in banks, rates on which are constantly decreasing. Residential real estate can be attractive not only for Ukrainian but also for foreign investors, although there are some peculiarities of their activities in this market.

The purpose of this article is to analyze the current state of development of the primary and secondary residential real estate market in Ukraine and determine the specifics of the foreign investors' participation in it. The publication is an overview and contains general information about the residential real estate market in Ukraine, formed as a result of publications of other Ukrainian authors, as well as the author's conclusions and recommendations on the most optimal forms of investment to this market.

The paper analyzes the state of development of the primary and secondary real estate market in Ukraine, as well as analyzes mortgage opportunities and profitability of rental operations with residential real estate. Prices are in Ukrainian hryvnia, the exchange rate of which against the euro at the time of writing of this paper was 32.5-33 UAH for one EUR.

The structure of the article consists of the topics following in sequence: the literature review of the residential real estate market in Ukraine; analyses of prices at the residential real estate market and its dynamics; information about the development of mortgage lending; lease and efficiency of real estate investments for the purpose of further leasing in Ukraine; peculiarities of acquisition of residential real estate by foreigners (especially taxation); risks of investment in residential real estate; the conclusions of the article.

## **LITERATURE REVIEW**

Foreign investments to the real estate market are quite widely studied in the scientific literature. For instance, (Gholipour, Al-mulali & Bin Mohammed

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2014) researched foreign investments in real estate, economic growth and property prices in OECD countries. Foreign Investment in Real Estate and Housing Affordability was described at work (Masron & Shaari, 2016). The globalization aspects of the real estate market were researched in work of (Dallas Rogers & Sin Yee Koh, 2018). Ross developed the model for examining foreign direct investment in Real Estate (Ross, 2011).

Petryshenko (2018) and Shybirina (2015) discussed some aspects of the real estate market in Ukraine development. However, there are currently no detailed scientific papers on foreign investments in the residential real estate market of Ukraine.

If we give a general description of the residential real estate market in Ukraine, then 70% of it consists of houses built in the USSR in 1960-1980. Only 11% of the population live in relatively new real estate (built after the 1990s). At the same time 7.5% of the market, which is 75 million square meters - according to the official data – are completely uninhabitable. Approximately 54% of Ukrainians now live in overcrowded houses, compared to an average of 7% in the United Kingdom, France and Germany. Almost 40% of families live in conditions when one inhabitant has less living space than the sanitary norm (less than 13.65 meter square) (Komnatnuy, 2020).

## **RESULTS & DISCUSSION**

### **The pace of construction of residential real estate in Ukraine**

According to statistics from the State Statistics Committee of Ukraine, the pace of construction and commissioning of residential buildings is growing. If in 2018 – 8.7 million square meters of houses were put into operation, in 2019 it is already 11 million square meters. In the process of construction in 2018-2019 the figures were respectively 12.8 and 14.7 million square meters of houses. Kyiv, Dnipro, Odessa, Lviv and Kharkiv are the leaders in terms of the pace of residential real estate construction (Ukrainian Committee of Statistics data).

#### *Real estate prices 2020*

According to the statistics of prices for new houses, according to the portal (dom.ria.com) the price for a square meter in new houses (the offered price, but usually there is no possibility to negotiate on the primary market in Ukraine) in Kiev is 33,260 UAH, and in Lviv - about 22,200 UAH. On the secondary market, a square meter in Kyiv is already priced 47,360 UAH, and in

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Lviv - 26,065 UAH. As of March 2020, the average cost of dwelling in Ukraine is presented in Table 1.

**Table 1. Total price at primary residential real estate market in Ukraine (in thousands of UAH)**

City	1-room apartment	2-room apartment	3-room apartment
Kyiv	≈1500	≈1500-3000	from 1000
Kharkiv	≈775	≈1250-3000	from 800
Dnipro	≈840	≈900-1200	from 1100
Lviv	≈ 990	≈1500-3000	from 900
Odessa	≈ 1000	≈1100-2000	from 950

Source: Data retrieved from: <https://news.finance.ua/ua/news/-/468478/>.

In June-July 2020, investments of Ukrainians in new dwelling at the initial stage of construction increased by 15% compared to May. By mid-July, about 40% of all purchases of apartments were at the initial stage of construction works. More than 25% of the demand is concentrated on the objects, the construction of which is in the "monolithic" stage - the construction of the building frame (6 to 12 months from the beginning of construction works).

At the same time, 20% of purchase transactions take place at the stage of engineering networks, installation of double-glazed windows, facade work (from 12 to 15 months) are already underway, and demand in the final stages of construction is only 15% of total sales.

Depending on the economic situation in the country, including the national currency exchange rate, as well as the stable cost of building materials and construction and installation works, in October-November the volume of selling apartments at the initial stages of construction may average up to 45% of total sales. More than 70% of all demand at the initial stages of construction is invested to the objects of new formats, construction of which began in 2020 and did not stop during the quarantine period: these are primarily multifunctional residential complexes, objects of "city within city" formats, live-work-play.

The average growth of the market price for 1 square meter from the moment of the beginning of construction and before completing objects of an economy class reaches 22-25%, objects of a comfort class - 30%, those of business class - 35%. At the same time, the increased demand for new formats (mentioned earlier) is caused by the high liquidity of investments (this type of property has above average market demand): up to 50% for the entire construction period (data from Portal Finance.ua)

### *Development of mortgage lending*

Mortgage lending is currently very underdeveloped in Ukraine, and its development is one of the main issues announced by the Ukrainian Government. Mortgage terms from Ukrainian banks are shown in Table 2. It is obvious that if the economic situation stabilizes, mortgage rates will decrease and the number of banks providing them will increase. The official inflation rate in Ukraine in 2020 was 5% annually.

**Table 2. Terms of mortgage lending in the primary market**

Bank	Mandatory own first payment	Annual interest rate
PrivatBank	25%	14.9%
Saving Bank	30%	First 2 years - from 8.9% next periods – 19.99%
UkrGasBank	20%	15.5%
Credobank	20-40%	16.59%

Source: Data retrieved from: <https://finance.ua/ua/mortgage>.

**Table 3. Terms of mortgage lending in the secondary market**

Bank	Mandatory own first payment	Annual interest rate
PrivatBank	25%	15.5%
Saving Bank	30%	from 15.5%
UkrGasBank	20%	15.5%
Credobank	20-40%	15.99%

Source: Data retrieved from: <https://finance.ua/ua/mortgage>.

### **Lease and efficiency of real estate investments for the purpose of further leasing in Ukraine**

A significant part of apartments in Ukraine are bought for investment purposes. A significant proportion of them are then leased. Of course, the level of efficiency of these investments will depend on many different factors, but we can give one example of such calculations. Real estate selection criteria:

- it is purchased in a new, completed comfort-class residential complex;
- in an area with good transport links and developed infrastructure;
- one-room apartment, with a space area of 48-55 square meters;
- not the first and not the last floor;
- not the most expensive, but good interior works;
- it must have the necessary furniture and appliances.

- according to the author's calculations the cost of an apartment bought in a new building, without repair works, will be in Kiev, about 1 925 thousand UAH, in Lviv 975 thousand UAH, Dnipro - 750 thousand UAH, Kharkiv - 700 thousand UAH, Odessa - 1 115 thousand UAH. The costs of repairs and equipment are added. This is from 200 to 300 USD per m<sup>2</sup>.

**Table 4. Yield of real estate lease in Ukrainian cities**

City	Monthly income from lease (in UAH)	Payback (in years)	Yield, per year (in %)
Dnipro	8000	14	7.15
Kharkiv	8000	13	7.43
Odessa	10000	15	6.59
Lviv	10000	14	7.37
Kyiv	14000	17	5.23

Source: Data retrieved from: <https://news.finance.ua/ua/news/-/478086/dostupnist-orendy-zhytla-v-mistah-ukrayiny-infografika>.

To continue the issue of profitability of real estate investments for the purpose of further renting - i.e. direct purchase of completed real estate and its subsequent delivery - then from our personal experience and as a result of communication with investors we can say that the level of interest (to avoid devaluation and revaluation of hryvnia, its calculated in USD) can range from 5 to 7% per year. Today, an individual landlord who rents out their own apartment must pay 18% income tax and 1.5% military tax.

#### *Real estate taxes*

Residential real estate tax is paid by natural persons - owners of residential real estate, if the area of housing owned by them exceeds the established limit: for apartments - more than 60 square meters and for private houses - over 120 square meters. The tax is paid for real estate exceeding the established limit, for example, if the area of the apartment is 80 square meters, the tax will be charged for 20 square meters. These specified benefits are not provided if the objects of taxation is used by their owners for the purpose of obtaining income (rented, leased, used in business activities) (Finance.ua 2020). The tax rate at the national level is limited - no more than 1.5% of the minimum wage established by law on January 1 of the reporting year, per 1 square meter (in 2020, the minimum wage is 4723 UAH, so the maximum tax rate will be 70.84 UAH per 1 square meter). In case of lease, a landlord should pay this real-estate tax + tax from his lease profits (18+1,5 percent as an individual person or 5% as an self-employed person).

### *Acquisition of residential real estate by foreigners*

In recent years, the construction of residential complexes has flourished in Lviv. Therefore, many foreigners buy apartments in new buildings. Such a purchase has its own peculiarities that are worth being aware of.

- If you want to buy a house in Ukraine, you will need to obtain an identification code. To do this, you must submit a translation of a your passport certified by a notary and an application. The identification code is made within ten days. After receiving it, you can open a bank account and buy the right property.
- Before buying an apartment in a new building, it is usually booked. This is necessary in order to have time to make legal checks, prepare money for payment, and so on. No deposit is required when booking.
- Once all issues have been resolved, a contract is made and payment is made. You can pay for an apartment in a new building by bank transfer or by depositing cash at the box office to the developer's account. Total amount can be divided into a few payments scheduled after particular stages of development have been finished. It is impossible to buy an apartment directly for cash. It is worth remembering that if you import more than ten thousand euros in cash to Ukraine, you need to declare this money to the customs authority. If you pay in cash at the bank, you will need to present this declaration there.
- The amount of taxes, registration fees and other additional costs depend on which sales scheme the developer uses. Usually, you need to pay for the registration of the ownership later. If you have certified the previous and main contracts with a notary, you will have to pay a tax of 2% of the price of the apartment.

When a foreigner buys an apartment in a new building, there are many risks for him. You need to assess how reliable this agreement is, check the documentation and reputation of the developer. It is best to consult a professional lawyer.

Buying on the secondary real estate market means that you buy land or housing directly from the owner. Such a purchase can only take place under a notarized contract. In order to make such an agreement, you will only need to present your passport and identification code. If you have a husband or wife, you will need their consent, which should be notarized. You will also need to provide a marriage certificate.

The seller must submit many more documents:

- documents on the right of ownership of real estate;
  - technical passport of the object;
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- real estate appraisal report;
- certificate of family composition of the person selling the property;
- copies of passport and identification code.

The main document that confirms the ownership of real estate is an Extract on the registration of rights from the state register. This document should be treated with special care. It must bear the signature and the seal of the notary.

In addition, there are other documents, in particular, a certificate of ownership; the contract under which the owner purchased the object or registration certificate.

You can also check the ownership of the property online. On the website of the Ministry of Justice, you can find the desired object at its address or the owner's details, if you have them, and get a certificate from the state register in PDF format. This service is paid, but costs little. It is advisable to check the ownership to make sure the transaction is legal and to protect yourself from possible fraud.

#### *Expropriation of real estate by a foreigner*

If you want to sell your property in Ukraine, you can do it without much difficulty. The usual contract of sale is concluded. However, if you are selling a property that you have owned for less than three years, not the first property in a year, or non-residential premises, you will have to pay a fairly high tax. First, you will have to pay personal income tax, which is 18% of the contract price, and secondly - a military tax of 1.5%. In a similar situation, a resident of Ukraine will pay only 5% and 1.5% respectively.

In this situation, it is advisable to sell real estate at the stage before the real estate is put into operation by the developer. Most developers provide such an opportunity and in this case, it is a transfer of property rights and is not subject to these taxes (Max Estate, 2020).

#### *Risks of investment in residential real estate*

Of course, one of the key issues of investing in residential real estate in Ukraine is risks. These include: the risk of late completion of the facility; the risk of non-compliance of existing communications with the declared in the agreement; the risk of low quality of work performed by the developer and the risk of bankruptcy of the developer (for various reasons).

As for the terms of putting into operation, in Ukraine, it is mostly normal to delay the putting of the object into operation for up to 6-9 months. As for the connection of communications, the agreement on the supply of

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energy can be signed in a year, and sometimes later, and during this period the electricity is supplied through the building company.

As for the quality of work, it mainly depends on the developer, and if you choose a well-known company with positive experience and its quality, it should not be below average. As for the legal registration of documents, it is carried out in various forms and you need to consider each situation, so you should use the services of a professional lawyer with experience in the Ukrainian real estate market.

The risk of the developer's bankruptcy / failure to meet its obligations must be described separately. A striking example is the situation with one of the largest Kyiv developers - Ukrbud. More than a year, investors into 26 residential complexes in Kyiv are waiting for a solution to the situation with their investments and the construction, as this developer has stopped fulfilling its obligations. The President of Ukraine personally controls this situation, but its resolution is very difficult and slow, complicated by legal aspects and looks at least problematic. And we had at least 2 such mass cases in Kyiv. This risk is actually significant, and it is difficult to avoid it even by choosing a large company with experience in the market.

It also was mentioned in the article, that inflation rate in Ukraine was around 5 % in 2020. The forecast for 2021 - 7-8 %. It also can cause some risks for the investors on primary market. However, prices at the secondary market are pegged to the USD, which minimizes that type of risks.

## **CONCLUSION**

Summing up the results of the study, we can conclude that despite all the economic crises that have occurred in Ukraine in recent years, real estate has been, is and will be attractive for investment. Depending on the economic situation, investors choose different strategies. Now, for example, in the context of the crisis caused by the COVID-19 virus, they invest mainly in real estate on the secondary market or at the last stages of construction and focus less on further rent, especially daily rent.

Foreign citizens are active participants of the investment processes in the Ukrainian residential real estate market. Unfortunately, there is no official statistics on this subject. There are certain specific peculiarities of their participation, in particular in the field of taxation. Nevertheless, given the significant difference in real estate prices in the EU and Ukraine, real estate transactions remain attractive for European investments and risks of this activity can be normally managed.

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The suggestion for the future researches is the development of the effective ways of communication and cooperation of Ukrainian intermediaries (real estate and law agencies) with foreign investors.

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