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Gibraltar
GX11 1AA

[ ]

28 July 2016

Dear Sirs

Gibraltar Residential Property Report

You have instructed us to report on the current state of the Gibraltar residential property market together with some advice on a sales and marketing strategy for an off-plan residential development that you are considering.

We confirm that we are fully qualified to report on such matters. We are the largest estate agent in Gibraltar.

For the purpose of this report, properties owned by the Ministry of Defence in the UK and occupied by their personnel are ignored. Furthermore, any mention of the number of jobs in Gibraltar exclude MoD employees.

1. General

Gibraltar has a land area of 2.5 square miles or 6.5 square kilometres.

The percentage of undeveloped land is extremely small when one excludes the rocky cliffs and steep sloping upper rock. It is thought that 70% of Gibraltar's 32,500 population live on reclaimed land, predominantly on the west side of Gibraltar. There are very few existing sites left which are available for development.

2. Land tenure

Land tenure in Gibraltar follows UK principles. Land and property are held on a freehold or leasehold basis, with the latter taking various forms, depending on the length of the lease term and whether residential or commercial. It is not the policy of the government to grant freeholds. Those freeholds that do exist are historical and are concentrated in the central town area. It is common to make available crown lands and property on long leasehold terms, usually for 99 or 150 years.

3. Law

Property law is also broadly based on the UK system. There are no restrictions on foreign nationals purchasing, except in some residential developments jointly owned by individuals and government, where purchasers must qualify as eligible for government housing (see paragraph 4).

4. Background to the property market

There are some 13,000 residential units in Gibraltar.

Gibraltar has two residential property markets: i) government owned and / or funded (local market) and ii) privately owned and / or funded (open market).

i. The local market is better defined as properties built with government funding which may only be occupied by persons with a minimum of 3 year Gibraltar residency. Most properties in this category are rented by the government to individual local tenants. Some are now owned by the occupant (with the 3 year residency rule prevailing) whilst an increasing minority are owned on a shared basis (usually 50/50) with the government as a means of encouraging property ownership. The local market properties account for some 50% of the entire housing stock.

   Local market properties must be utilised as the main residence and may not be let out. They are therefore, unsuitable for investors.

ii. The open property market in Gibraltar is available to any owner or occupant. Standard demand and supply principles apply. Property acquisition as an investment has a demonstrable track record in Gibraltar and we estimate that one quarter of the open market properties are rented privately by landlords for normally, but not necessarily, 12 month terms.

   The open market property prices trade at significantly more (up to 100% on a like for like basis) than the local market due to the lack of restrictive usage clauses.

5. Stamp duty and other purchase costs

The Gibraltar Stamp Duties Act 2005 (as amended by the Stamp Duties (Amendment) Act 2010) relates to all transactions involving real estate property situated in Gibraltar. The rates of duty applicable are as follows:

i. Nil % where:

   a) The property value does not exceed £200,000, or

   b) The property value does not exceed £260,000 in those instances where the purchaser is a first-time buyer or second-time buyer, or

   c) Where the property is being transferred between spouses or, following the dissolution of a marriage, between former spouses.

ii. 2% on the first £250,000 and 5.5% on the balance, where the property value exceeds £200,000 but does not exceed £350,000, and

iii. 3% on the first £350,000 and 3.5% on the balance where the property value exceeds £350,000.

Additionally, if the property is purchased with the assistance of a mortgage, stamp duty is charged at the rate of 0.13% where the amount borrowed does not exceed £200,000 and 0.20% for amounts in excess of £200,000.

Stamp duty may be calculated using the calculator on the Chestertons website: http://www.chestertons.gi/stamp-duty

Compared with the UK and Spain, these stamp duty rates are attractive to purchasers.

Other purchase costs are minimal with legal fees amounting to 0.5% - 1% of the purchase cost. Other various registration disbursements amount to a few hundred pounds.

6. Recent history in residential property demand

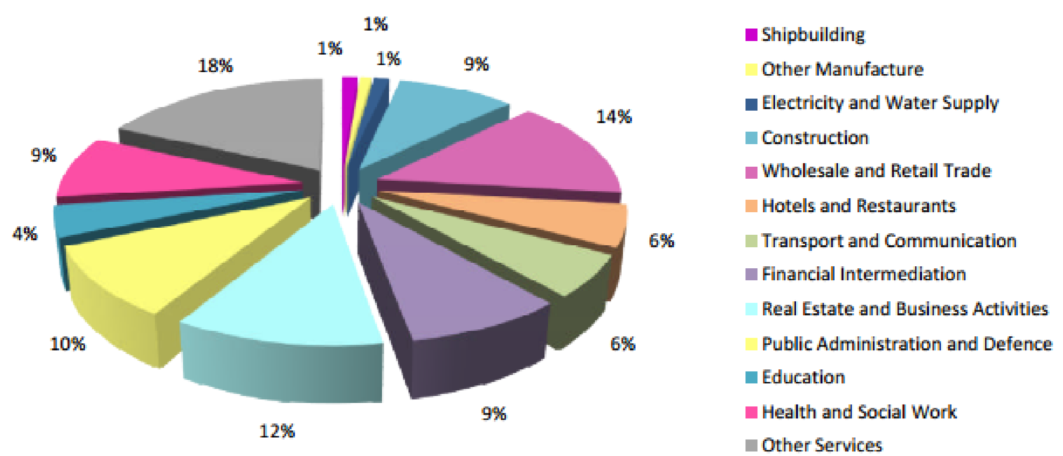
In 2002 there were 14,000 jobs in Gibraltar (of which 5,000 were filled by non-Gibraltarians). Today, the number of jobs is some 23,000 (of which some 12,500 are filled by non-Gibraltarians), an increase of 9,000 jobs (64%) of which 7,500 have been filled by non-Gibraltarians.

In the same period the population has grown from 28,500 to 32,500, an increase of 4,000 (14%), whilst the economy has grown from £507m to £1.77bn (2015/16 estimate) which, after inflation, reflects real growth of 155%.

The growth in demand for property, year on year in the last decade, is a direct result of Gibraltar's successful economy which has increased by two and a half times in real terms in a little over 10 years.

This economic growth is diversified across a number of sectors, predominantly gaming, funds, retail and tourism.

Employee Jobs by Industry, October 2013



Notes:
(i) The industry classification follows that of the UK's Standard Industrial Classification (S.I.C. 92).

The economy continues to grow year on year largely due to:

i. the attraction of its low tax regime (10% corporation tax, no VAT, no capital gains tax, no wealth tax, no inheritance tax, no tax on interest or dividend income from quoted companies attract income tax rates to different categories and persons and its restriction on tax to that income accrued and derived in Gibraltar)

ii. the backdrop of a well regulated business environment endorsed by the IMF and OECD

iii. common market status within the EU and other countries courtesy of the UK's international arrangements

iv. the basis of UK law, the status as a British Overseas Territory, sterling as the currency and UK interest rates

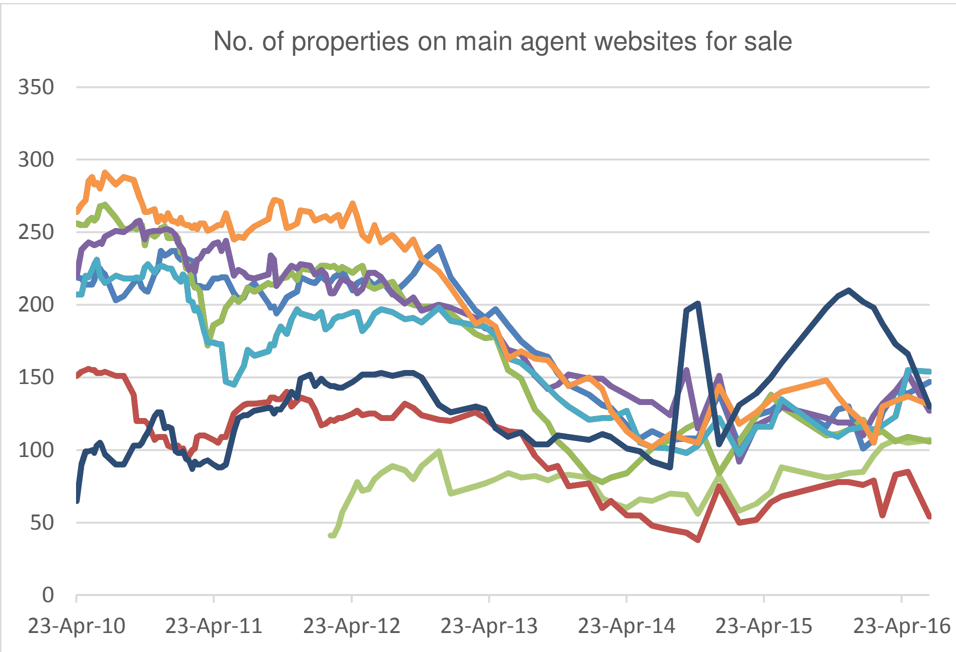
7. Recent history in residential supply

The housing supply in 2002 was some 10,000 units. Today we estimate that to be some 13,000 units. The 3,000 increase in the number of properties were mostly built between 2005 and 2010 and are probably evenly shared between the local and open markets.

It is quite apparent that this 30% increase in supply is insufficient to deal with the 155% increase in the size of the economy and the 64% increase in the number of jobs in the same period.

This lack of supply can be evidenced by the number of properties available at local estate agents. We have maintained records of the number of properties available for sale from the 8 largest estate agents. Many of the properties will be duplicated at other agents (multiple agency), so the purpose of this information is to identify trends and not absolute numbers.

What is clear is that the supply of properties for sale has decreased steadily since 2010, the end of the last building boom, until the increase recently (new off-plan entering the market, see paragraph 9).



In 2010, all 7 agents trading at that time had more than 150 properties for sale excluding Chestertons (only established in 2009). By July 2016, just one agent has more than 150 properties on their books. The recent increase in supply is due to agents listing off-plan properties on their websites, virtually all of which are sold now.

Save for off-plan sales, we estimate the number of open market residential properties currently on the market at no more than 130.

8. Current demand and supply in residential property

Since 2010, there has been no new mass supply of open market residential property which has been completed. The lack of availability of bank funding and the world's economic woes generally, effectively removed any chance of property development up until about eighteen months ago.

During the same period, the demand for property continued, steadily and surely year on year. As can be seen from the graph above, availability of residential property has gradually declined since 2010 and only in the last year is that trend reversing.

At the end of 2012, Spain introduced its Form 720, which requires Spanish residents to report all owned overseas assets to Hacienda. Form 720 did not impose new taxes, however, there was a fear that it was the prelude to a new aggressive tax regime. A significant number of cross-border workers, and many living in Spain who simply did not wish to report their worldwide assets for privacy reasons, chose to move to Gibraltar as a result. This added to the consistent demand for new property and in the last 2 years we have dealt with many clients moving into Gibraltar from Spain for tax reasons.

In June 2016, the UK voted to leave the European Union. The immediate impact of that vote was a surge in interest in demand as Spanish based ex-pat workers of Gibraltar companies took an effective 10% pay cut (with the fall in GBP) and feared a freedom of movement border risk. As time has gone on, the latter fear has subsided and GBP has steadied and we appear to have returned to the same level of activity pre-referendum.

Our current forecast at Chestertons is that quarter three activity (July – Sept) 2016 will be in line with that of 2015.

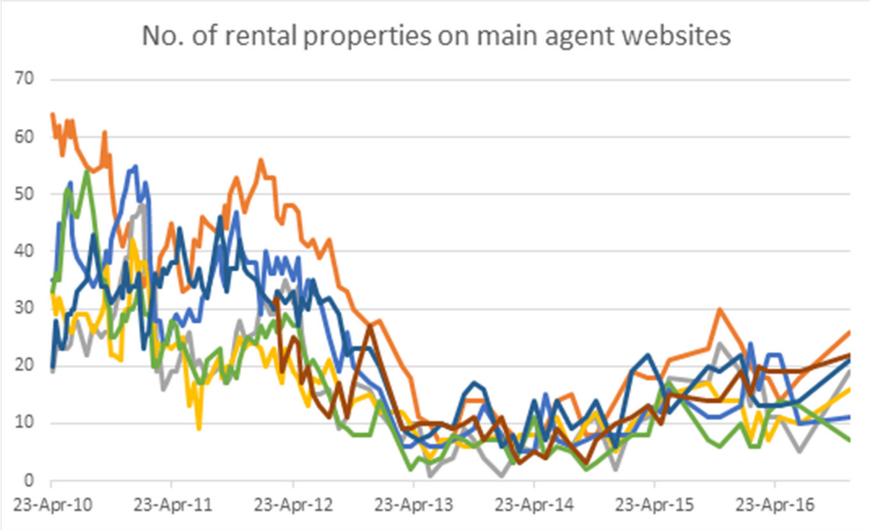
We refer more to the impact of Brexit in paragraph 12.

What is apparent in today's market, is that properties below £500k are selling and there is a real lack of supply. Meanwhile, quality properties above £500k are also attractive to purchasers. The properties less popular at the moment are those larger, older properties where vendors have assumed that the price increases of recent years apply to them as well. That is not always the case, the demand is for modern, well-built properties in attractive locations.

9. The impact of the rental property market

The rental market underpins much of the open property market. We estimate that up to 1,500 open market properties may be let out by private landlords on a buy to let basis albeit no formal record of the number of buy to lets exist.

The availability of rental properties in the open market on the main letting agents' websites follows that explained in paragraph 7 for properties for sale.

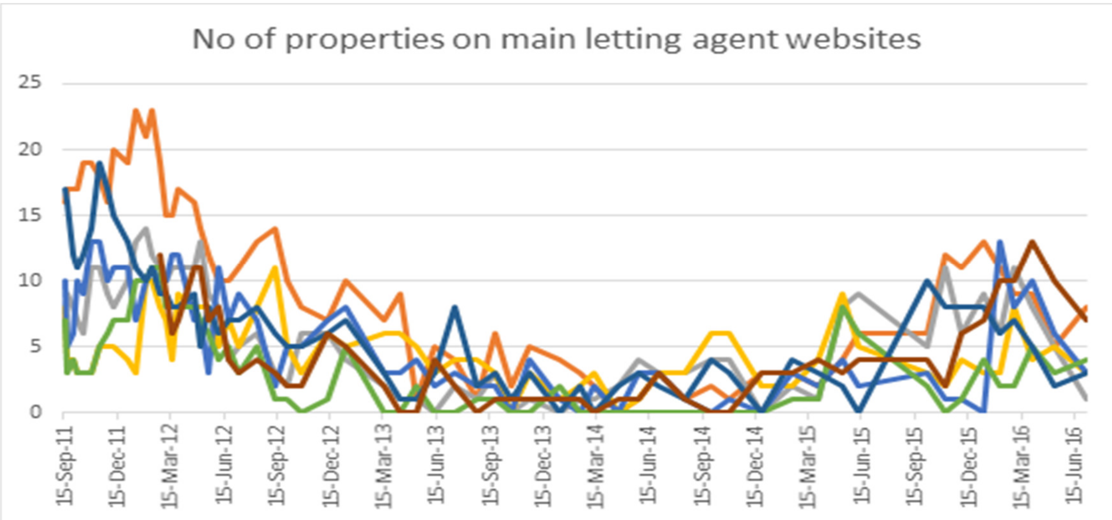


Properties are rented by ex-pat employees (cheaper end) and those moving to Gibraltar for tax purposes (higher end). A popular request from a new employee to Gibraltar is the cheapest available rental. This is then lived in by the employee who does not want to live in Spain. The tax resident requires a higher class property which is in short supply in the rental market.

The minimum requirement for Gibraltar residency is a 12 month tenancy.

The continuous demand for property whilst the stock of property remained static led to a situation in 2014 that no agent could offer 10 or more rental properties. This led to a tendency for some tenants to purchase whilst owners of old properties around the town centre rapidly refurbished their old buildings into a new supply of residential properties. The lack of supply increased prices and inevitably more tenants were pushed towards cheaper accommodation in Spain.

The result of all of this is that the stock of rental properties below £1,500 pcm remains exceptionally low for the needs of Gibraltar as identified in the graph below (records only started Sep 11).



As is clear from the graph, there is a clear need for a greater stock of rental properties at below £1,500 pcm and if they existed, the number of employees commuting across the border into Gibraltar would most likely decrease.

£1,500 pcm rent equates to a capital value of £330,000 at 5.5% gross yield.

10. Recent off-plan activity

In September 2013, the Government announced the tender award for the construction of 528 apartments on the Ariel Farm site on the east side of Gibraltar and 380 apartments on the ex-coach park site by Watergardens adjacent to Ocean Village. Both developments sold out on launch in early 2014. Prices started at approx. £50k for a 1 bedroom property to £200k for a 4 bedroom property (excludes a kitchen and certain finishes). The 50/50 shared ownership scheme was available. This increase in supply in the Government housing sector has reduced the Government's housing list to c 1,000 applicants. Completion of both schemes occur in phases throughout 2016.

In early 2014, Tarik Views, an Upper Town development of 21 apartments with prices ranging from £85,000 to £270,000 sold out within a matter of days. Pricing was c £3,300 per sq m.

Meanwhile, the first major off-plan launch for 7 years (at the quality end of the open residential property market) was in September 2014. The entire Ocean Village phase 3 development of 116 apartments ranging from studios of 35 sq m (£159k) to a penthouse of 160 sq m (£1.1m), sold in just 6 days. That equated to a gross development value of £46m of property sold at an average price of £4,712 per sq m (where the terrace is valued at 50% of the internal space).

The sales process was a phenomenal success story and a real confidence indicator of Gibraltar's economy. It evidenced the pent up demand for open market property at the high end.

The buyers were predominantly investors with a track record of buying property in Gibraltar. There was an even divide of indigenous Gibraltarian investors and ex-pat investors who have moved to Gibraltar in recent years for their own tax, employment or lifestyle reasons. Gross rental returns average 5% to 6% which with a forecast capital gain, was enough to ensure the sell-out. Construction will start late 2016 and delivery is forecast late 2018.

In November 2014, the Montagu Group launched 72 off-plan apartments in the Midtown development of which 6 apartments remain unsold. The average size of the apartments and average price per sq m are both just above that of the Ocean Village development. The development's amenities are far less in scope than Ocean Village. Buyers are more evenly spread between owner occupiers and investors. Construction is underway.

In January 2015, a new developer launched 'Plata Villa', 22 apartments in the south district at an average price of £4,200 per sq m which we thought was high for the site concerned. All 22 sold and construction has begun. Gross Development Value is £9m. Buyers were mostly owner occupiers attracted by the pools and communal gardens.

In July 2015, the owner of Eurotowers, an existing building in the business district of some 227 apartments, launched a new development on the adjacent site of 96 predominantly studios and one beds plus a small number of two and three bedroom apartments. The studios, some as small as 25 sq m, sold within 48 hours, the one beds took 72 hours whilst the development was sold in its entirety in 5 days (except both penthouses which have been held back). A full launch using a number of estate agents had been planned yet every apartment sold in the pre-launch period managed by the developer and Chestertons. Buyers were predominantly investors knowing that the demand for apartments at below £1,200 pcm is near insatiable currently.

In September 2015, Ocean Village launched another development called Ocean Spa Plaza, consisting of 125 apartments just outside the main Ocean Village resort. The amenities include pools, sauna, Jacuzzis and hyrdro spas. With a gross development value of £44m, all properties were sold within five days.

Quay 29, or sometimes called Kings Wharf 2 (c 120 apartments) launched Autumn 2015 and has sold some 70 out of 90 apartments to date. Construction starts imminently.

Late 2015 saw the launch of The Arches, 48 properties in the Upper Town, at the cheaper end of the spectrum. All properties sold and are now trading at a premium a year before completion.

West One properties are also now trading at a premium.

11. Pricing

Anecdotally (because no formal records are maintained), we believe that property prices have increased 2% to 8% per annum for the last 10 years with 2008 being the weakest year (as much to do with the increase in supply of new builds as the post Lehman's era).

Since the turn of the century there has not been any boom and bust in the property market in Gibraltar as there has been in just about every other European country. Indeed, off-plan as a property investment has had a near perfect record for developers, funders and purchasers in Gibraltar since 2000.

Ocean Village and Midtown push average prices of a new quality off-plan development ever closer to £5,000 per sq m. It is rare to find a modern open market property at below £4,000 per sq m. Existing Ocean Village and Atlantic Suites pricing is nudging £6,000 per sq m for the best located properties within each development.

There is very little supply of property in the open residential market in the sub-£4,000 per sq m price bracket other than older properties situated around the town centre and upper town. These properties are unlikely to have parking spaces and may have difficult access issues, or inhibited natural light or are in poorly maintained buildings without a proper management company infrastructure.

In the 15 months we have sold two detached properties with pools at over £9,000 per sq m. These are new builds with views and modern layouts and amenities.

12. Future demand and supply in residential property

We believe that there is much more scope for further residential property development. Statistically, it can be demonstrated that much of the new employee pool in the last 10 years comes from Spain (whether Spanish, ex-pats or other foreign nationals living in Spain and working in Gibraltar).

Indeed, some 12,000 workers commute across the border between Spain and Gibraltar each day. 50% of these are non-Spanish. Many of these non-Spanish workers would prefer to live in Gibraltar if they could afford to do so.

Ironically, Brexit has accelerated the need for more property in Gibraltar. The greatest threat to the gaming community is not EU membership but business continuity given that 70% of their staff live in Spain and there are theoretical border issues looming. Since the referendum, the government has promised that it will do all it can to increase the supply of property. This will enable Gibraltar to become more self-sufficient in terms of housing more of its employees.

We understand that some 80% of the finance sector and some 90% of the gaming sector's EU trade is with the UK. Worst case scenario is not a calamitous situation. Yet now, new opportunities will open up. It is likely that Gibraltar will piggy back the UK in its trade deals around the world. The UK has already stated categorically that the future of Gibraltar is not up for debate in terms of Sovereignty.

So we believe that Gibraltar's employment and property future is secure. Indeed, there is already excess demand for new property, even without further growth in employment levels.

If the rate of job growth continues at c250 – 500 per annum, which is quite possible, then these new employees (and their families where relevant), most of whom will come from outside of Gibraltar, will also have to live somewhere.

The mass demand is for the sector currently not being catered for, ie average pricing of £3,500 per sq m to £4,500 per sq m and with absolute prices below £350,000. Then there is the demand from within Gibraltar from would be owner occupiers for properties with outside areas ie gardens and garages. Few townhouses or houses are being built at all. Buena Vista phase 3 consists of 10 such properties above £2m for bespoke sales. We are not aware of any land being made available for housing other than in respect of the subject land.

13. Government support

The Chief Minister said in parliament on the afternoon of Fri 8 July and we quote word for word below.

"I want to announce a new measure as a result of meetings I held this week after coming to this house and the very positive progress that I believe there will be in the market to build homes for key workers in Gibraltar sooner than I expected. So, therefore, I announce a new budget measure today that where any property is constructed in the next thirty months from the 1st July 2016 and that property is rented for residential purposes, the owner of that property will receive a tax credit equal to the tax payable on the profits earned on the first twenty-four months of rent occurring in the first five years after the completion of construction of that property. The tax credit is not refundable and can be offset against the tax payable to extinguish any liability to tax."

We await details, however, this demonstrates government's support of the housebuilding sector generally.

14. Offices

A new World Trade Centre is nearing completion which will deliver 15,000 sq m of modern office space in late 2016. The Midtown development is also under construction and includes 11,000 sq m of office space. These buildings will provide space for some 2,600 employees. The relevance of this is twofold: firstly that both developers believe in the continuation of the economic growth for these jobs to be created, and, secondly, new employees will need somewhere to live.

15. Disclaimer

This report has been provided for the addressee only. It may not be relied upon by any third party. The contents may not be published in whole or in part or shared with any third party without the express consent of Chestertons.

Yours sincerely

Mike Nicholls BSc FCA
Managing Director