

The Property Regime in a Cyprus Settlement

*A Reassessment of the Solution Proposed Under the Annan Plan,
Given the Performance of the Property Markets in Cyprus,
2003–2006*

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FOREWORD

PRIO IS PROUD TO PUBLISH this second report from the PRIO Cyprus Centre, the first from a new, comprehensive project on the property issue in Cyprus, undertaken in collaboration with the economic research organisation S. Platis Economic Research.

PRIO's mission in Cyprus is to contribute to an informed public debate on key issues relevant to an eventual settlement of the Cyprus problem. We hope to achieve this by disseminating information, providing new analyses and facilitating dialogue. We wish to stimulate research cooperation and debates between Greek Cypriots and Turkish Cypriots, as well as within each of the two communities, and also between them and various immigrant groups and representatives of international society. In order to achieve our aim, we seek to establish joint research groups, with both Turkish Cypriot and Greek Cypriot participants, and to develop new venues of inquiry among researchers on either side of the communal divide.

The first report from the PRIO Cyprus Centre was a highly innovative study of settlers and other temporary and long-term immigrants in northern Cyprus, made by Mete Hatay on the basis of census material and electoral statistics. This second report is a thorough examination of the property regime and property markets as proposed in the Annan Plan, prepared by S. Platis Economic Research. As the authors say in their introduction, their hope is that their research may be used as a basis for 'moving beyond the Annan Plan' and may stimulate a number of investigations into the economics also of other issues of concern in the event of reunification of Cyprus.

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INTRODUCTION

THE PURPOSE OF THE FIFTH VERSION of the UN Plan for Cyprus, which was put to twin referenda on 24 April 2004, was to provide for a comprehensive settlement of the Cyprus problem. However, it was rejected by 76% of Greek Cypriots whilst being accepted by 65% of Turkish Cypriots. The Plan, which came to be called ‘the Annan Plan’ after UN Secretary-General Kofi Annan, attempted to tackle the major aspects of the Cyprus problem, such as the constitutional, territorial and property questions, plus a plethora of other issues such as the budgetary/financial provisions, federal laws, international treaties, etc. It aimed to provide for a solution based on the principles of bizonality and bicommunality and the formation of a federal state, consisting of two constituent states, one predominantly Greek Cypriot (called ‘the Greek Cypriot State’) and the other predominantly Turkish Cypriot (called ‘the Turkish Cypriot State’).¹

The Greek Cypriot community exercised its right to vote and reject the Annan Plan, and the Plan is not likely to emerge again. However, the problems vis-à-vis the property question and its effect on economic performance remain. In order to understand the dynamics of convergence and property markets under any solution that may be proposed in the future, it is important first to understand how property markets would operate under the scenario that was set out in great detail in the Annan Plan.

Indeed, one of the most important questions – if not *the* most important one – which the proposed plan was supposed to tackle was the property issue. As a result of the events of 1963–64 and 1974, a significant number of property owners from both communities became dispossessed. Thus, in both communities the referendum campaigners who were arguing either in favour of or against the Plan in 2004 often based their arguments on the effects of the Plan’s provisions on this crucial aspect of the Cyprus problem – the property question.

This report aims to carry out a thorough examination of the technical apparatus of the regime proposed in the fifth and final version of the Annan Plan (Annan V) for resolving the property aspect of the Cyprus problem. In doing so, we do not consider the property regime of Annan V from its human, legal, social or political angles. We attempt, instead, a ‘technical economic analysis’ of the Annan V provisions on property, which includes an analysis of the macroeconomic environment and the functioning of the property markets and the economics of the ‘Property Board’ as described in Annan V.

¹ The property provisions of the Annan Plan and a glossary of terms are provided in the appendices.

In fact, among the many and complex reasons for the Greek Cypriot rejection of Annan V were concerns about the property aspects of the proposed plan and what was perceived as its unpredictable impact on a reunited economy. Studies that were produced – mainly on the basis of earlier versions of the Annan Plan – differed in their conclusions, sometimes very widely. Moreover, as there were only three weeks between the publication of the final version of the proposed Plan (Annan V) and the referenda themselves, no comprehensive study was produced before the referenda (nor has there been one since) to assess the impact on the property market of Annan V – which, as regards property restitution and compensation, differed in some important aspects from the earlier versions of the Plan. The absence of any comparative study on the property markets in the North and South and the fact that most of the Annan III studies took a ‘static’ approach (without taking into account the essential impact of convergence), only compounded the confusion that has surrounded the issue among people in both communities.

This report seeks to redress this situation, in sum, by:

- Analysing in brief the main property provisions of Annan V (Section 1).
- Reviewing the literature on the previous versions of the Annan Plan (Section 2).
- Assessing the distribution of ownership if Annan V were implemented (Section 3).
- Discussing the different approaches to the calculation of ‘current values’ (Section 4).
- Analysing the factors that would affect economic convergence (a key determinant of property price behaviour), macroeconomic performance and property market behaviour according to current economic theory (Section 5).
- Through the application of these theories, examining the possible positive and negative pressures on property prices in a post-solution situation (Section 6).
- Based on compiled data (using the most comprehensive database of property prices on both sides of the ceasefire line to date), evaluating current and recent property price behaviour on each side of the ceasefire line (Section 7).
- Analysing the property-price conditions under which the Property Board of Annan V would be profitable and under which conditions it would be insolvent, through four different price-growth scenarios (Section 8).

The analysis attempted here enables us to draw conclusions, for the first time, on the economic viability of the property provisions of Annan V, based on the current real property market dynamics.

We hope that our research can be used as a basis for moving beyond the Annan Plan. Furthermore, we believe that it is time also to begin similar investigations into the economics of other issues of concern in the event of reunification of Cyprus. In particular, investigations should be conducted to identify the most favourable conditions for fiscal policy, monetary policy, macroeconomic policy and property policy under which a bizonal, bicommunal, federal state could thrive on a sustainable basis for the benefit of all Cypriots.

BASIC PROVISIONS OF THE PROPERTY REGIME OF ANNAN V¹

The Property Board

THE PROVISIONS OF THE PROPERTY REGIME would be implemented by the Property Board.² This would be an impartial, independent administrative body, and would have subdivisions, namely the Governing Council, the Claims Bureau, the Cyprus Housing Bureau and the Compensation Bureau (Compensation Trust).

Reinstatement in Territorial Adjustment Areas

Annan V provided that part of the territory presently not under the control of the Republic of Cyprus would become part of the ‘Greek Cypriot State’ (one of the two constituent states envisaged in the Plan, the other being the ‘Turkish Cypriot State’). In the areas that would be subject to this process of ‘territorial adjustment’ after the solution, properties of ‘dispossessed owners’ (locally known as ‘refugees’) would be reinstated to their original owners. As a result, around half of Greek Cypriots who had been dispossessed since 1974 would receive their property back in full in areas that would come under Greek Cypriot control. Almost all other Greek Cypriots would be entitled to at least one dwelling in the Turkish Cypriot State under the ‘one-third rule’ described below.

Reinstatement Outside Territorial Adjustment Areas: The ‘One-Third Rule’

In areas that remain outside territorial adjustment, property rights related to affected properties would be exercised through either reinstatement or compensation.

Dispossessed owners of properties located in the other constituent state would be given back their properties according to the so-called ‘one-third rule’. According to

¹ The property provisions of the Annan Plan in more detail, as well as a glossary are provided in the appendices to this report.

² Annan Plan V, Foundation Agreement, Main Article 10 (§4), p. 14.

this rule, such persons would have the right to be returned up to one-third of their property (in value and land area), and to receive ‘full and effective compensation’ for the remaining two-thirds.³

Exceptions to the One-Third Rule for Reinstatement

The right of reinstatement of one-third of the affected property would apply to natural persons or family businesses. Properties of institutions, including the Church and Evkaf, the main religious foundations of Greek Cypriots and Turkish Cypriots, would not be reinstated and would be transferred to the Property Board in exchange for compensation. As regards the Church and Evkaf properties, the only exception would be religious sites in use in 1963 or 1974, which would be fully reinstated.⁴ Also, dispossessed owners in specific areas (Karpasia and Tillyria) could be fully reinstated.⁵

There would be some preferential provisions for small landowners so that a dispossessed owner would be entitled to one dwelling and up to one skala/donum⁶ of adjacent land even if this exceeded one-third of his/her total ownership, provided s/he owned the property when the house was built or s/he lived in it for more than ten years. For large landowners, on the other hand, there would be a lease obligation: a dispossessed owner who would get back more than 100 skales/donums would have to offer whatever is in excess of 100 skales/donums for long-term lease (20 years) to the current user or another person from the constituent state where the property is located. (The lease would be arranged by the Property Board at market prices. If no lease could be arranged, the dispossessed owner would have full use of the property.)

Choice of Property To Get Back Under the One-Third Rule

A dispossessed owner would be able to use his/her ‘one-third entitlement’ to get back a part of each of his/her properties or to get back a whole property provided it was one-third of all the properties s/he owned in the constituent state, or any combination that s/he preferred. In general, a dispossessed owner’s choice of which part of his/her property to get back under the one-third rule would depend on some restrictions and certain conditions determining a particular property’s ‘eligibility for reinstatement’. These can be summarised as follows.

³ The Comprehensive Settlement of the Cyprus Problem (Annan Plan V), Foundation Agreement, Main Article 10 (§2, §3), pp. 13–14. See also United Nations (2004).

⁴ Annan Plan V, Foundation Agreement, Annex VII, Section 1, Article 4, p. 96.

⁵ Annan Plan V, Foundation Agreement, Annex VII, Section 2, Article 16 (§8), p. 102.

⁶ The most common measurement unit of land in Cyprus is ‘skala’ or ‘skales’ (plural) in Greek and ‘donum’ or ‘donums’ (plural) in Turkish, which both represent 1,338 square metres. Since there is no similar measurement unit in English we use the respective Greek and Turkish terms throughout our research.

- a) *The situation of current occupants or 'current users' of such property:* Current users who themselves also lost property located in the other constituent state and had used the property for the last ten years would have the right to keep such property in return for giving to the Property Board their property in the other constituent state.⁷ Also, in cases where the original (dispossessed) owner had neither built the property himself/herself nor had lived in it for at least ten years, the Property Board would be able to decide to grant the right to that property to its current user provided that the latter had lived in it for more than ten years.⁸
- b) *The 'significant improvement' condition:* This allowed a property that had been significantly improved (that is, improvement worth more than the 'current value'⁹ of the property without the improvement) to be kept by the owner of the improvement if s/he paid the 'current value' of the original property.¹⁰
- c) *Use for public benefit or military purpose:* Properties in use for objective public benefit or needed for military purposes (in accordance with the Plan) would not be available to be chosen for reinstatement.
- d) *Minimum size requirement:* As regards agricultural land, reinstatement would not occur unless a 'minimum size' requirement was met; that is such land would not be reinstated if this requires a sub-division into plots of less than five skales/donums, or less than two skales/donums for irrigable land. In this case, the owner would be able to sell his/her reinstatement entitlement to another dispossessed owner from the same municipality of village or receive compensation for it.

Provisions for Dispossessed Owners Unable To Get Back One-Third of Their Properties

Dispossessed owners who would not receive their one-third restitution entitlement due to the above conditions and exceptions or due to voluntary deferment to a current user would be entitled to receive another dwelling in the same village or municipality.¹¹ Such dispossessed owners would also be able to exchange their entitlement with the Property Board for an equivalent property that was not theirs in the same or a neighbouring village or municipality; sell their entitlement to other dispossessed

⁷ Annan Plan V, Annex VII, Attachment 1, Article 1 (§15), p. 101.

⁸ Annan Plan V, Annex VII, Attachment 1, Article 1 (§15), p. 101.

⁹ The current value of a property would be an artificial price, set by the Property Board with assistance from property valuation specialists and others. This would be on the assumption that the events of 1963–64 and 1974 had not happened. In effect, this would amount to taking the value of the property at the time of dispossession and adding to that the property price inflation in 'comparable areas'. (See Glossary of Annan Plan terms in Appendices)

¹⁰ Annan Plan V, Annex VII, Attachment 1, Article 1 (§15), p. 100.

¹¹ Annan Plan V, Foundation Agreement, Main Article 10 (§3), p. 14.

owners from the same place, who could aggregate it with their entitlement; or get paid compensation and, if they wished, buy any equivalent property in the same village or municipality, provided they were displaced after their tenth birthday.

‘Compensation Bonds’ and ‘Appreciation Certificates’

According to the Plan, for properties that would not be reinstated, owners would receive ‘full and effective compensation’. Compensation claims and payments would be handled by the Property Board, and its sub-division, the Compensation Bureau. Compensation would be in the form of ‘guaranteed compensation bonds’ with a maturity of 25 years and ‘property appreciation certificates’ backed up by real property assets.¹² For properties that are not reinstated to them, dispossessed owners would first receive ‘claim receipts’ indicating the current value of their holding in the Property Board’s portfolio. Five years after entry into force of the settlement, they would be able to exchange these claim receipts for interest-bearing compensation bonds with 25 years’ maturity and for property appreciation certificates. Dispossessed owners would be able to use the compensation bonds and property appreciation certificates, which they received in exchange for their property in the other constituent state, for the purposes of purchasing, at market value and via the Property Board, property located in their own constituent state.¹³

Non-reinstated property would be transferred to the Property Board, which would have to dispose of it or lease it at market prices. Revenues generated from the management, sale or use, of such ‘affected property’ in the portfolio of the Property Board would be deposited in the Compensation Fund,¹⁴ and any profits of the Property Board would be available to distribute as dividends to the owners of ‘property appreciation certificates’.

Compensation Fund

The Compensation Bureau would administer a Compensation Fund that would be founded in the Central Bank of Cyprus. No later than 18 months, and if possible within 9 months after entry into force of the settlement, the Compensation Fund would receive from the federal government, a long-term loan of CYP 100 million towards the initial capital. This amount would be returned to the federal government after the compensation bonds have been redeemed. Annan V also provided for the possibility of contributions to the Compensation Fund by international donors.¹⁵

¹² The amount of compensation would depend on the ‘current value’ of a property at time of dispossession, adjusted to reflect its probable appreciation to price levels of properties in comparable areas.

¹³ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18(3), p.125

¹⁴ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 9 (§4), p. 119.

¹⁵ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 17, p. 124.

After completion of reinstatement (via territorial adjustment and by way of the ‘one-third rule’) and exchange of properties, compensation corresponding to one-third of the current value of all properties in the portfolio managed by the Compensation Fund, would be in form of compensation bonds measured on the day of entry into force of the settlement.¹⁶ The remaining two-thirds of the total ‘current value’ of the properties in the portfolio of the Compensation Fund would be compensated with ‘property appreciation certificates’.¹⁷ In Section 3, we estimate how much property available for sale the Compensation Fund would hold. Compensation bonds would bear interest from the date of issue and at a rate no less than that applying to federal government bonds of equal maturity issued at the same time as the compensation bonds. Certificates would be entitled to a dividend if payable. The nominal value of the bonds at maturity would enjoy a guarantee by the federal government.¹⁸ The bonds would mature after 25 years and would otherwise be callable at the discretion of the Compensation Fund five years after their issue at their nominal price (ten years after entry into force of the settlement).¹⁹

Once all bonds had matured, the holders of ‘property appreciation certificates’ would be entitled to receive any subsequent revenues generated from the sales and lease of affected property by the Compensation Trust.²⁰

Alternative Accommodation

As mentioned above, the territorial adjustments proposed in the Annan Plan would result in the relocation mostly of a significant number of Turkish Cypriots. Also in areas outside territorial adjustment, there would be need for relocation of the current users of reinstated properties. Annan V provided for the creation of ‘adequate alternative accommodation’ to house the affected population, which would be purchased by them using their compensation or their own funds including with the help of financial assistance such as preferential loans. For the current inhabitants of the areas affected by territorial adjustment, special arrangements were provided for in Annan V to safeguard their rights and interests, taking into consideration their occupations, the communities they belong to, their financial capabilities, their family status, health etc.²¹ The whole relocation procedure would be managed by a special body, called the Relocation Board, which in cooperation with international agencies, would have to work with the constituent states to develop and support the implementation of a comprehensive resettlement plan based on a social assessment

¹⁶ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18 (§1), p. 124.

¹⁷ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18 (§2), p. 124.

¹⁸ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18 (§4), p. 124.

¹⁹ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18 (§5), p. 125.

²⁰ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 18 (§6), p. 125.

²¹ Annan Plan V, Foundation Agreement, Annex VI, Article 5 (§1), pp. 76–77.

survey of households that would be affected by relocation and a land use plan for areas to receive relocated households.

Restrictions on Acquisition of Property and Establishment of Residency

In order to facilitate the bizonal character of the United Cyprus Republic, some special provisions were included in Annan V. In some cases they comprised temporary derogations from the EU *acquis communautaire* (the body of EU law), while a special ‘safeguard clause’ would allow these derogations to be extended for fixed periods with the assent of the EU.

Acquisition of Property

The most relevant provisions for this study concern restrictions on acquisition of property in the Turkish Cypriot constituent state. Annan V provided that the Turkish Cypriot constituent state would have the right to require that natural persons who had not resided in that constituent state for the last three years, as well as legal persons, obtain permission from the authorities of that constituent state in order to purchase immovable property in that constituent state. This restriction would be permissible for 15 years after the solution or until the per capita gross domestic product (GDP) of the Turkish Cypriot constituent state reached 85% of that of the Greek Cypriot constituent state, whichever came earlier.²²

At the same time, the criteria applied by the authorities of the Turkish Cypriot constituent state for granting (or denying) permission for the acquisition of immovable property would have to be ‘published, objective, stable and transparent’. Also, these criteria were to be applied on a non-discriminatory basis.²³ This was meant to avoid a situation where, for example, Greek Cypriots were prevented from buying property while non-Cypriot nationals were able freely to buy property.

Residency

Furthermore, in order to preserve the bizonal character of the federation, the Annan Plan introduced as permissible quotas regarding a Cypriot citizen’s right to reside in a constituent state other than his/her own. This meant that when the quota was reached it would be possible to prevent a person from the Turkish Cypriot constituent state becoming a permanent resident in the Greek Cypriot constituent state and vice versa.

²² Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 1 (§1), p. 167.

²³ Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 1 (§2), p. 167.

Such provisions could affect the property market indirectly as they implied a restriction on the acquisition of property to be used as primary residence.

Initially, and for a period of five years after entry into force of the settlement, a moratorium was permissible, which would mean no Turkish Cypriots establishing permanent residency in the Greek Cypriot State or no Greek Cypriots establishing permanent residency in the Turkish Cypriot State.²⁴

After five years, the permissibility of a moratorium would be replaced by the permissibility of maximal quotas. These quotas would be increased in the following stages but would not be completely abolished:

- Between the 6th and the 9th years after entry into force of the settlement, a constituent state would be allowed to apply restrictions on the right of a Cypriot citizen to reside in a constituent state other than his/her own if the percentage of such residents of the total population in one of its villages or municipalities exceeded 6%.
- Between the 10th and 14th years after entry into force of the settlement, this maximum quota would rise to 12%.²⁵
- Between the 15th and 19th years after of entry into force of the settlement or until Turkey joined the European Union, whichever was earlier, this quota would be increased to 18%.²⁶
- After the 19th year, a constituent state would be allowed to take measures to ensure that at least two-thirds of its Cypriot permanent residents have as their mother tongue its official language.²⁷

²⁴ Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 2 (§1.a), p. 167.

²⁵ Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 2 (§1.b), p. 167.

²⁶ Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 2 (§1.c), p. 168.

²⁷ Annan Plan V, Draft Act of Adaptation of the terms of accession of the United Cyprus Republic to the European Union, Article 2 (§2), p. 168.

ASSESSMENT OF EARLIER VERSIONS OF THE ANNAN PLAN IN THE LITERATURE

THE PROPERTY REGIME of earlier versions of the Annan Plan received a great deal of attention from researchers, not only because of its political and social importance but also because of its complex provisions and their probable effects. In particular, the issue of the federal government-guaranteed compensation bonds raised concerns about the economic viability of the public finances of the proposed United Cyprus Republic. As outlined in Section 1, under Annan V (and also in previous versions), the Property Board would pay compensation in ‘current values’ but would sell titles at market value. ‘Current value’ is an artificial price, which would be calculated on the basis of property prices in comparable locations which ‘were not positively or negatively affected’ by the events of 1963–64 and 1974. Market value, on the other hand, is simply the price at which a buyer is prepared to pay and a seller is prepared to sell. Current values were to be calculated by the Property Board with the assistance of specialists. If ‘current values’ turned out to be significantly higher than market values (over the medium term), then the Property Board would find that its liabilities exceeded its assets.

Assessment by the Republic of Cyprus Planning Bureau (2003) – Based on Annan I & II

The Planning Bureau, based on the early versions of the Annan Plan, where the total compensation to be paid for non-reinstated properties would be higher than in Annan V (reinstatement was less in earlier versions), estimated that the difference in ‘current value’ between (a) the non-reinstated Greek Cypriot property that would remain in the Turkish Cypriot constituent state, and be transferred to the Property Board, and (b) the non-reinstated Turkish Cypriot property that would remain in the Greek Cypriot constituent state and be transferred to the Property Board, would be as much as CYP 10 billion.¹ The Planning Bureau calculated the ‘current value’ using the value of Greek and Turkish Cypriot properties in 1974 on both sides of the ceasefire line and assuming an annual price increase of 10%. As a result, it argued that the issue of

¹ Planning Bureau (2003), pp. 12–13.

compensation bonds of equal value would result in annual interest payments of approximately CYP 400 million with an assumed interest rate of 4%.

Assessment by George Vassiliou et al. (2003) – Based on Annan III

Even though the research team under the former president, Dr George Vassiliou, disputed the Planning Bureau's calculations and conclusions regarding the final amount of the Property Board liabilities, it nevertheless used them as a basis for its calculations. On the assumption that the Property Board would sell 3% of the property in its holdings every year, it found that the Compensation Fund would run into a deficit in the early years but would be able to break even in terms of accumulated cash in the 25th year after the solution and afterwards accumulate CYP 22 billion. The deficit of the Compensation Fund would have to be covered by short-term loans when the 10-year and 15-year bonds have matured.² However, if the Property Board's operation were extended to 35 years, the Vassiliou et al. (2003) study concluded that it would be self-supporting and able to create significant profits, while also providing compensation to those whose properties would not be reinstated.

Assessments by Symeon Matsis – Based on Annan III

The Planning Bureau's current value calculations were disputed by a former Planning Bureau director, Symeon Matsis (Matsis 2004a,b; for more details, see Section 4) According to Matsis, the 'current value' of the properties belonging to Greek Cypriots and Turkish Cypriots that would come into the holdings of the Property Board would be CYP 5 billion,³ later revised to CYP 6 billion.⁴

Assessment by Eichengreen et al. (2004) – Based on Annan III

A study conducted on behalf of the Government of the Republic of Cyprus by Eichengreen, Faini, Hagen and Wyplosz (Eichengreen et al., 2004) on the economic aspects of Annan III, argued that the process could lead to important economic inefficiencies if it impeded the establishment of well-defined property rights and the development of property markets. The four economists named the Compensation Fund as one of the 'essential issues' in their general assessment. They described Annan III as 'flawed' and as a 'threat' to the financial viability of the federal government, and proposed its redesign. One of their proposals suggested that the Property Board be established instead as a closed-ended real estate fund, created for a limited period, at

² Vassiliou et al, (2003), p. 34.

³ Matsis (2004a), p. 13.

⁴ Matsis (2004b), p. 6.

the end of which it would be liquidated.⁵ (This recommendation was taken up in Annan V, except that the Compensation Trust had no fixed period of operation.) The idea was that linking the compensation of dispossessed owners to the proceeds of the Property Board could protect the federal government from a ‘very real risk of bankruptcy’. Therefore, they proposed a compensation scheme based on tradable shares rather than on bonds. The suggestion for shares was partly taken up in Annan V by the introduction of ‘property appreciation certificates’.

The four economists disputed further the scope of providing compensation to the non-reinstated owners based on ‘current values’, as proposed by the Annan Plan, and in connection with this raised also the question about whether post-1974 property prices would have developed in the way they did if the events of 1974 had not occurred.⁶

Assessment by Constantinos Lordos (2004) – Based on Annan III

Voices of concern on the property regime of the Annan Plan were also expressed by Constantinos Lordos (2004). He argued that the value of compensation to owners who would not be reinstated would amount to CYP 12–13 billion, thus resulting in even higher annual interest payments than those calculated earlier by the Planning Bureau.⁷ He argued that the increased supply of properties by the Property Board (calculated as CYP 10 billion distributed over a 30-year period, or approximately CYP 300 million annually) could cause an annual depreciation of property values by 22%, as demand would remain unchanged.

Cost of Relocation

Estimates differ regarding the population in areas that would be affected by territorial adjustment and therefore regarding the cost of relocation of this population. First, according to the RoC Planning Bureau estimates based on Annan II, a total of 40,000 current residents in the North would be affected by territorial adjustment. Of these, 17,000 would be Turkish settlers expected to return to Turkey after receiving relevant financial incentives.⁸ Therefore, 23,000 Turkish Cypriots would have to be relocated. According to the Planning Bureau, this would require 6,390 dwellings with an average area of 125 square metres each and the cost would amount to CYP 240 million.⁹

⁵ Eichengreen, Faini, Hagen, Wyplosz (2004), p. 2.

⁶ Eichengreen, Faini, Hagen, Wyplosz (2004), p. 26.

⁷ Lordos (2004), p. 5.

⁸ Both, in Annan Plan III and Annan Plan V, provide a financial incentive for ‘persons, other than Cypriot citizens’ who, on the date of entry into force of the Foundation Agreement, reside in areas subject to territorial adjustment. This incentive amounts to €10,000 per household of four. Annan Plan III, Foundation Agreement, Annex VI, Article 5 (§2), p. 109, Annan Plan V, Foundation Agreement, Annex VI, Article 5 (§2), p. 77.

⁹ Planning Bureau (2003), pp. 8–9. This study was based on Annan I and Annan II.

The Vassiliou et al. study concluded that resettlement as a result of territorial adjustment would affect 47,000 Turkish Cypriots, and would require CYP 450 million for the creation of alternative accommodation.¹⁰ In addition, the aforementioned study included an amount of CYP 150 million for the resettlement of an unspecified number of Turkish Cypriots who would be affected by the return of Greek Cypriots to their property in the Turkish Cypriot State.¹¹

In a study by Tahir Celik (2003), it was estimated that under Annan III a total of 68,164 Turkish Cypriots would need to be relocated: 50,122 owing to reinstatement of properties in the territorial adjustment areas and in the four Karpasia villages, and 18,050 owing to reinstatement of properties in other areas.¹² Construction of new housing would amount to USD 1.5 billion and infrastructure to USD 628 million. Thus, the total cost for the relocation of the Turkish Cypriot population would amount to USD 2.1 billion.¹³

¹⁰ Vassiliou (2003), p. 22. Note that this study was based on Annan III.

¹¹ Vassiliou (2003), pp. 22–23.

¹² Celik (2003), pp. 5-6. Note that this study was based on Annan III.

¹³ Celik (2003), p. 26.

POST-SOLUTION DISTRIBUTION OF OWNERSHIP

THE PROCESS OF REUNIFICATION would entail some significant changes to the status quo of the two property markets as outlined in Table 1. The territory effectively controlled by the Greek Cypriots would increase significantly and would include some major urban areas such as Famagusta and Morphou, as well as some large portions of the Morphou and Mesaoria plains. These areas would be ceded by the Turkish Cypriot constituent state to the Greek Cypriot constituent state according to a specified timetable. Therefore, the supply of property initially under the jurisdiction of the Turkish Cypriot State would decrease significantly, while it would increase to the same degree (plus the Buffer Zone) for the Greek Cypriot State.¹ The changeover in ownership has three main features: territorial adjustment, application of the ‘one-third rule’ and provisions for special areas, and property exchanges.

Post-Solution Land Ownership by Private Greek Cypriots

Today, while private Greek Cypriots are legal owners of a total area of 3,982 thousand skales/donums of land, they can exercise their property rights on only 62% of it. A settlement of the Cyprus problem under the provisions of the Annan Plan would extend the area of privately owned Greek Cypriot land that would also be in full possession of its legal owners. Owing to territorial adjustment, the area effectively controlled by what can be loosely termed as the Greek Cypriot authorities would gradually grow from the present total of 4,131 thousand skales/donums to 4,824 thousand skales/donums after the completion of the territorial adjustment process.² Under this process, the ownership of private Greek Cypriots would be adjusted as follows:

- After territorial adjustment, effective ownership by private Greek Cypriots of property located areas under Greek Cypriot administration would increase by 469

¹ Under Annan Plan V, almost 50% of the Sovereign Bases Area would be ceded to the Greek and Turkish Cypriot States at a ratio of 9:1. This area of approximately total 90 thousand skales/donums is not taken into consideration unless otherwise noted.

² Taken together from Matsis (2004a,b) and Lordos (2004b). Some differences between Matsis’s and Lordos’s estimations may be attributed to rounding. Properties located in parts of the Sovereign Bases (2.7% of total area of Cyprus) are excluded from the current study.

thousand skales/donums, from 2,470 thousand skales/donums (area of privately owned Greek Cypriot land in the South) to 2,939 thousand in the would-be Greek Cypriot State, including the land currently located within the Buffer Zone.

- Application of the one-third rule would, of course not affect the ownership of Greek Cypriot titled property in the Greek Cypriot State, so it would remain at 2,939 thousand skales/donums.
- Finally, after territorial adjustment and application of the one-third rule, the Property Board holdings would consist of large amounts of Turkish Cypriot property in the Greek Cypriot State and Greek Cypriot property in the Turkish Cypriot State. We assume that this situation would enable the sale of properties located in one constituent state to persons hailing from that state in exchange for compensation bonds and/or property appreciation certificates at their market value,³ leading to a quasi-exchange of properties between Greek Cypriots and Turkish Cypriots. This quasi-exchange of properties, if applied to all the property in the holdings of the Property Board, would further increase the ownership of property by private Greek Cypriots in the Greek Cypriot State to 3,297 thousand skales/donums.

After all of the above, the total increase in the *de facto* stock of Greek Cypriot private property in the Greek Cypriot State would be around 34%.

Post-Solution Property Ownership by Private Turkish Cypriots

Today there are approximately 2,415 thousand skales/donums of land in total to the North of the ceasefire line. This area represents around 35% of the total area of Cyprus. As a result of territorial adjustment, the area effectively under the control of what can be loosely termed as the Turkish Cypriot authorities would gradually fall from 2,415 thousand skales/donums to 1,903 thousand skales/donums after the completion of the territorial adjustment process.

After territorial adjustment, the effective ownership by private Turkish Cypriots of property located in Turkish Cypriot administered areas would then decrease by 62 thousand skales/donums, from 391 thousand skales/donums (area of privately owned Turkish Cypriot land in the North) to 329 thousand skales/donums in the would-be Turkish Cypriot State.⁴ Application of the one-third rule would, of course, not affect the ownership of Turkish Cypriot titled property in the Turkish Cypriot State, so it would remain at 329 thousand skales/donums. Finally, the abovementioned quasi-exchanges of properties would lead to a further gradual increase in the ownership of property held by private Turkish Cypriots in the Turkish Cypriot State, to 687 thousand skales/donums.

³ Annan Plan V, Annex VII, Article 9 (§2), p. 119. Note that compensation bonds and ‘property appreciation certificates’ would be issued five years after the solution.

⁴ The Turkish Cypriot property owners are not to be dispossessed in this case but they would probably opt to exchange their property in the areas under territorial adjustment with Greek Cypriot property located in the Turkish Cypriot State which would be transferred to the Property Board.

Table 1: Property ownership by area before and after a solution

Current ownership (000s skales/donums)	South of ceasefire line	Buffer Zone	North of ceasefire line	Total
Greek Cypriot	2,470	107	1,405	3,982
Turkish Cypriot	401	25	391	818
Foreign	10	3	7	19
State	1,165	40	551	1,757
Church	73	5	58	136
Evkaf	12	0	2	14
<i>Total</i>	<i>4,131</i>	<i>180</i>	<i>2,415</i>	<i>6,727</i>
Ownership after 'territorial adjustment' (000s skales/donums)	Greek Cypriot State		Turkish Cypriot State	Total
Greek Cypriot	2,939		1,043	3,982
Turkish Cypriot	489		329	818
Foreign	14		5	19
State	1,268		489	1,757
Church	101		35	136
Evkaf	12		2	14
<i>Total</i>	<i>4,824</i>		<i>1,903</i>	<i>6,727</i>
Ownership after '1/3 rule' & special areas (000s skales/donums)	Greek Cypriot State		Turkish Cypriot State	Total
Greek Cypriot	2,939		401	3,340
Turkish Cypriot	142		329	471
Foreign	14		5	19
State	1,268		489	1,757
Church	101		2	103
Evkaf	0		2	2
Transferred to Property Board	358		675	1,033
<i>Total</i>	<i>4,824</i>		<i>1,903</i>	<i>6,727</i>
Ownership after property exchanges (000s skales/donums)	Greek Cypriot State		Turkish Cypriot State	Total
Greek Cypriot	3,297		401	3,698
Turkish Cypriot	142		687	829
Foreign	14		5	19
State	1,268		489	1,757
Church	101		2	103
Evkaf	0		2	2
Transferred to Property Board, net	0		317	317
<i>Total</i>	<i>4,824</i>		<i>1,903</i>	<i>6,727</i>

Note: 1 skala/donum = 0.33 acres, 0.133 hectares, 1,388 square metres. The data are taken from Matsis (2004a,b). Karouzis (1977) delivers data on land in private ownership that differ to some degree from the abovementioned data. For further research, see also Karouzis (1976).

APPROACHES TO CALCULATING ‘CURRENT VALUE’

SINCE THE QUASI-EXCHANGE OF PROPERTIES, as described in Section 3, would take place using compensation bonds and property appreciation certificates, the total amount of property that can be indirectly exchanged in this way would depend not only on the market value of properties after a solution but also on the ‘current value’ (that is, the value of an affected property at the time of dispossession, plus an adjustment reflecting appreciation of properties in Cyprus in comparable locations).¹ Therefore, before we proceed with any assumptions regarding the possible impact of such an indirect property exchange, we must first decide on the methodology we want to apply.

The Need To Take Into Account All Factors

There have been some attempts to estimate the probable net amount of compensations that would be paid to dispossessed owners for properties that would not be reinstated. While *Annan V* does not explicitly prescribe any concrete methodology, the Planning Bureau’s (2003) calculations (based on *Annan Plan II* provisions) estimate as outlined in Section 2 the total net value of property to be compensated at CYP 10 billion.

However Matsis (2004a,b) argues that these are based on unrealistic assumptions, since the Planning Bureau’s (2003) methodology on assessing ‘current value’ is estimated by the market value of a property in 1974 multiplied by 14.42 (that is, 1.10^{28}) or annual property price appreciation of 10% per year between 1974 and 2003. Matsis notes that property prices in the South had not started to reach pre-1974 levels until 1978,² and that the annual appreciation rate was in fact 8%. Moreover, Turkish Cypriot property prices were significantly lower than prices of properties owned by Greek Cypriots, reflecting the Turkish Cypriots’ political and economic situation after 1963–64. For these reasons, based on the provisions of *Annan III*, but still using the

¹ *Annan Plan V*, Annex VII, Attachment 1, p. 107. *Annan Plan V* does not propose any specific methodology on how ‘current value’ should be assessed. Instead, it proposes/provides in a footnote that ‘expert advice shall be sought from quantity surveyors, economists and/or specialists in property valuation on the final formulation of provisions relating to assessment of value’.

² This claim is supported also by Hajispyrou and Pashardes (2003).

Planning Bureau's data on property prices in 1974, Matsis concluded that the difference of property values in 2003 would be approximately CYP 6 billion.³

The Price Effect of the Events of 1963–64

Results can be misleading in case of assumptions based on data containing bias due to the abnormal political situation between 1963 and 1974. The calculation of 'current value', by definition, needs adjustments to take into account the events of 1963–64 and 1974. We do this in the following steps:

- **Step 1.** We make a large upward adjustment to the market value in 1974 of Turkish Cypriot property located in the South. According to figures used by Matsis (2004a,b), in 1974 Turkish Cypriot-owned property located in the South had a market value of only CYP 206 per skala/donum, compared with CYP 663 for Greek Cypriot property in the same area. We assume that, had the events of 1963–64 never occurred, Turkish Cypriot property prices in the South would be at a similar level to that of Greek Cypriot prices. We therefore set the values for both Greek Cypriot and Turkish Cypriot property located in the South at the Greek Cypriot level of CYP 663 in 1974.
- **Step 2.** We make a similar upward adjustment for property prices in the North. Prices of property owned by both communities were higher overall in the North than in the South before 1974, because of their locational characteristics – for example, being close to developed tourist areas. In 1974, Greek Cypriot-owned property was CYP 1,346 per skala/donum according to figures used by Matsis (2004a,b) and Lordos (2003), whereas Turkish Cypriot-owned property was only CYP 519. We assume that, had the events of 1963–64 not occurred, Turkish Cypriot-owned property in the North would be at a similar level to that of Greek Cypriot property in the North. We therefore value them both at CYP 1,346 per skala/donum.
- **Step 3.** By taking all of the skales/donums which would be assumed by the Property Board after 'territorial adjustment' and the application of the 'one-third rule' (see Section 3), we inflate the above-mentioned adjusted 1974 market value per skala/donum by 8% per annum. This is the average growth rate of property prices in the South in the period since 1974, according to the former Planning Bureau chief Symeon Matsis (2004a,b). This is therefore our proxy for 'appreciation of property values in comparable locations'.⁴ Since this is a deliberately cautious scenario, we ignore the possibility that prices in the South may have been boosted for some of the years after 1978 by the large

³ These figures do not take into account that a significant number of Turkish Cypriots were dispossessed already by 1964, and therefore their possible claims for compensation would be based on 1963 property values. For further research, see Patrick (1976).

⁴ Annan V, Main Articles, Article 10(a), p. 14.

demand for property created by the need to rehouse Greek Cypriot refugees. As mentioned, political instability also had a negative impact on the overall prices in 1974–77, which the Planning Bureau ignored when it applied growth rates of 1978–2003 to the whole 1974–2003 period. In effect, therefore, we assume that the positive and negative impacts on prices of the events of 1974 were neutral. This yields a 'current value per skala/donum' of CYP 9,218 for both Greek Cypriot and Turkish Cypriot titles in the North and CYP 4,541 per skala/donum for Turkish Cypriot property in the South. (Greek Cypriot property in the South would, of course, not need to be reinstated).

- **Step 4.** Multiplying the 'current value' per skala/donum by the skales/donums to be reinstated yields (before rounding) CYP 6.2 billion for Greek Cypriot property in the North, CYP 1.3 billion for Turkish Cypriot property in the South, and CYP 572 million for Turkish Cypriot property in the North.
- **Step 5.** We initially follow the methodology of the Planning Bureau and, for the sake of simplicity, assume that all Turkish Cypriots and other qualifying persons (such as those to whom they have sold property), in effect, swap their titles in the South for the Greek Cypriot-titled property located in the North where they are currently living. They would also have to pay the Property Board for any differences in value but we did not include this in Property Board revenue. This leaves the total 'current value' of titles held by the Property Board after property exchanges at CYP 4.5 billion (rounded up) in 2005.

Table 2: Calculation of current value

Effect on compensation after a territorial adjustment and 'one-third' rule in 2005	Donums/skales assumed by Property Board	Adjusted price per donum/ skala 1974 ^a	'Current value'/donum/ skala ^b C£	Total 'current value' before rounding C£ ^c
Greek Cypriot property (North)	675,000	1,346	9,218	6,222,182,140
Turkish Cypriot property (South) ^d	296,000	663	4,541	1,343,999,560
Turkish Cypriot property (North) ^d	62,000	1,346	9,218	571,518,952
Net total after property exchange	317,000	–	–	4,306,663,627

Source: S. Platis Economic Research

^a Upward adjustment to Matisis (2004a and 2004b) figures.

^b Calculated at the average price increase in the South of 8% per annum.

^c As in Planning Bureau methodology, we initially assume that all Turkish Cypriots exchange their titles for property in the North.

^d Adjusted upwards to Greek Cypriot values in the same year.

Further, we may assume that the operation of the Property Board, and the Compensation Trust that would succeed it after ten years, would resemble the operations of a Real Estate Investment Trust (REIT),⁵ with about 5% of the total area of Cyprus in its holdings. This would probably turn it into a price maker in the Cyprus property market. The rate of disposal of properties by the Property Board would depend on the economic conditions in the island, and this process has to be conducted in a *prudent manner*, as Annan Plan V prescribes.⁶

⁵ For further information on the subject of REIT, see, for example, Ambrose, Highfield and Linneman (2004), Ambrose and Linneman (2001).

⁶ Annan Plan V, Annex VII, Attachment 2, Article 9 (§2.d), p. 119.

CONVERGENCE: THEORY AND RECENT ACTUAL DEVELOPMENTS

The Separate Development of the Two Economies

A REUNIFICATION OF CYPRUS under the provisions of Annan Plan V would result in a (bizonal) adjustment of the territory currently inhabited by the two communities, making the question of the dispossessed property more complex compared to other cases of reunified countries. In the case of Cyprus, we deal with the reunification of two communities that have *de facto* been living separately geographically, politically, administratively, economically and monetarily for the last three to four decades. After the events in 1974, which led to the displacement of Greek Cypriots from the North to the South and of the remaining Turkish Cypriots from the South to the North, economic relations between the two communities ceased (until very recently), and, as a result, the economies of the two communities have since performed quite differently.

However, the starting positions during the time of separation were already different for each community. Even though the Cyprus economy grew rapidly after independence in 1960, the two communities had not benefited in equal measure. In 1974, the per capita income of Turkish Cypriots (in the North) was about half that of Greek Cypriots (in the South), while labour productivity was 40% of that in the South.¹ This, according to Patrick (1976) probably reflects the political developments between 1963 and 1974 that created a wide income gap between the two communities and a sudden decline of the per capita income of Turkish Cypriots. Average annual GDP growth during 1977–2000 reached about 3.9% in the North against 4.9% in the South. Referring to Demetriades et al. (2003), Noë and Watson (2005) state that, by 2000, labour productivity in the North had remained unchanged at 40% of that in the South. At the same time, they note that per capita income for Turkish Cypriots was at about €5,240 and for Greek Cypriots €15,600. Eichengreen et al. (2004) as well as Noë and Watson (2005) attribute the favourable growth experience of the economy in the South to policies such as the peg of the Cyprus pound to hard currencies such as

¹ Noë and Watson (2005), p. 1.

the pound sterling and currently the euro. This assisted low inflation and a long period of macroeconomic stability.

In the meantime, in the decades that followed 1974, the economy in the North moved from a largely agricultural base towards light manufacturing. In the early 1990s, export-oriented services such as tourism and higher education took off. Despite this, the economy in the North was not able to reach its full potential, say Noë and Watson (2005). Its relatively poor performance compared with the South is attributed to a range of factors that include the international non-recognition, economic isolation² and limitations in direct trade with the EU since 1994, as well as a poor development strategy and key structural policy weaknesses, such as widespread public ownership, resort to price controls, low private and public investment (partly related to uncertainty and disputed ownership), and a banking sector weakened by crisis and bouts of instability. Between 2000 and 2003, the average government budget deficit in the North was 16.7% of GDP, while the average inflation rate for the same period reached 41.8%.³ The high inflation rates until recently seem to be related to the fact that the Turkish lira is the currency of use in the North.

Despite the limited access to markets, the economy in the North has also shown considerable potential for further development. Already, universities have become an important source of income, attracting students from Turkey, Asia and the Middle East, generating around 15% of GDP, while tourism with a similar contribution to the GDP enjoys prospects for further development.⁴ Given the situation of the economies of both communities in Cyprus, Noë and Watson argue that a political settlement of the Cyprus problem that would provide the reunification of the island would most probably lead to the convergence of the two economies.

The economic aspects of the reunification have been the subject of two studies carried out by Noë and Watson (2005) and Vassiliou et al. (2003), with the latter being based on Annan Plan III. They both refer to the economic challenges related to reunification, as well as the opportunities and also the relevant effects on the economy in such a case. Further, they both conclude that the two economies could benefit from a convergence process. In Vassiliou et al. (2003), it is argued that the positive effects on the economy would be visible even in the first years after the solution, as growth rates would accelerate considerably and for the first time Turkish Cypriots would have a clear prospect of modernisation and achieving parity with the Greek Cypriot state. Since, in the event of a solution, Cyprus would join the EU with its average GDP measured on a PPS⁵ basis amounting to less than 75% of the EU average, then Cyprus would under the EU budget rules prevailing at the time be eligible to receive additional funding from the EU structural funds under Objective 1. At the same time, Vassiliou et al. (2003) recommended changes on the proposed functions of the

² Noë and Watson (2005), p. 3.

³ Noë and Watson (2005), p. 3.

⁴ Noë and Watson (2005), p. 3.

⁵ Purchasing Power Standards.

Property Board and the allocation of VAT receipts between the federal government and the governments of the constituent states (the recommended change was for the latter to receive back two-thirds of the receipts in VAT instead of one-third provided by the plan for a period of at least ten years). This, they argued, would ensure that the constituent states would avoid excessive budget deficits. Such a measure, combined with the high growth rates after the solution (up to 6% for the Greek Cypriot and 8% for the Turkish Cypriot constituent state), would lead to a considerable improvement of the public finances already by 2007.⁶

Similar optimism regarding the prospects of growth and convergence is shared also by Eichengreen et al. (2004), who predicted that in the case of a solution (based on Annan III), incomes in the North would rise by almost 12% as a result of the flow of migration-related remittances (e.g. preferential loans).⁷ However, the same report emphasises the existence of a contradiction between the objective of ‘eradication of economic inequalities between the constituent states within the shortest possible time’ and the open-ended safeguard regarding labour mobility and the acquisition of properties in the Turkish Cypriot constituent state by non-residents that was provided for in Annan III (and later amended).⁸

Noë and Watson (2005) argue that the process of converging of the two economies would not be an automatic one, but would rather result from the orchestration of macroeconomic and structural policies. Within this context, the public sector’s role in the North as a facilitator of growth would have to be re-targeted from consumption to investment. Based on the experience of German reunification as documented in European Commission (2002) and Jansen (2004), even though they note that it was in an entirely different political and economic setting, Noë and Watson (2005) argue that its key lesson was that the battle for convergence is won or lost in the functioning of the labour market and the conditions for private investment, including property rights.⁹ The case of the reunified Germany could offer lessons on possible negative effects on property prices of a stagnant economy (see Section 6), as examined by Ball (2005).¹⁰

Noë and Watson (2005) avoid delivering their own predictions regarding the possible growth rates. However, they do make references to the forecasts by Eichengreen et al. (2004) of a potential growth rate of 12% for the economy in the North and 3.7% for the economy in the South, or to the abovementioned Vassiliou et al. (2003) forecasts, and also to the official estimates of the Republic of Cyprus Ministry of Finance (the latter were included in Appendix III of the 2003 Pre-accession economic programme and of the convergence programme, Ministry of Finance of the Republic of Cyprus, 2003 and 2004). In these reports, according to Noë and Watson (2005), it is argued that as a result of reunification-related increase in

⁶ Vassiliou et al. (2003), p. 17.

⁷ Eichengreen et al. (2004), p. 39.

⁸ Eichengreen et al. (2004), p. 6.

⁹ Noë and Watson (2005), pp. 5–6.

¹⁰ Ball (2005), pp.66–73.

investment spending, real GDP growth would accelerate to 5.5% for the South and 7.5% for the North for a period of 5–10 years.¹¹

Separately, after the publication of the first version of the Annan Plan in December 2002, the Economist Intelligence Unit (2002)¹² forecast that the boost to consumer and business sentiment would lead to an acceleration of real GDP growth from an estimated 1.7% in 2002 to 4% in 2003 and 5.1% in 2004 (based on the assumption that a settlement would be found by April 2003). It noted that a substantially higher growth rate could not be excluded, but this would be unsustainable and could be followed by a hard landing. In its report published ten days before the referendum in April 2004, it forecast that a solution to the Cyprus problem would boost growth in the South from 1.9% in 2002 to 3.7% in 2004 and 5.9% in 2005.¹³

The optimistic attitude towards the prospects of convergence of the economies of the two communities in Cyprus was not universal, however. Strong reservations can be found in Palley (2005), the Ministry of Finance (2004b) and Theophanous (2004), although neither Palley nor Theophanous produced growth forecasts as such. Palley's concerns are mostly related to technical aspects, such as a possible lack of effectiveness in the operations of Central Bank organs, ambiguities vis-à-vis the currency in the United Cyprus Republic, how the banking system in the North would be restructured, mechanisms safeguarding the borrowing limits for the federal and constituent state governments, and a possible rise of tax competition between the two constituent states.¹⁴ Similar reservations towards Annan Plan V were included in a 20-page document published on the basis of Annan III by the Ministry of Finance of the Republic of Cyprus on 6 April 2004 (no study was produced on how the economy would perform in the case of a solution based on Annan Plan V). Theophanous (2004) argued that the lack of mobility of factors of production would 'castrate' the dynamism of the economy, while the three-state structure would lead to an increase of the fiscal deficit and public debt would make the derailment of the economy unavoidable.¹⁵

Recent Developments in Convergence

However, recent macroeconomic developments provide some indications about the likely pattern of convergence in a reunited island even under conditions of restricted investment. According to our analysis, within just four years, incomes in the North as a proportion of incomes in the South have risen by over 18%: gross national income

¹¹ Noë and Watson (2005), p. 4. As they note, 'the investment ratio in the South or G/C constituent state would increase from (only) 18.5% of GDP today up to 25% during that period, while for the North or T/C constituent state the investment ratio would increase from the current 17% of GDP to up to 30%'.

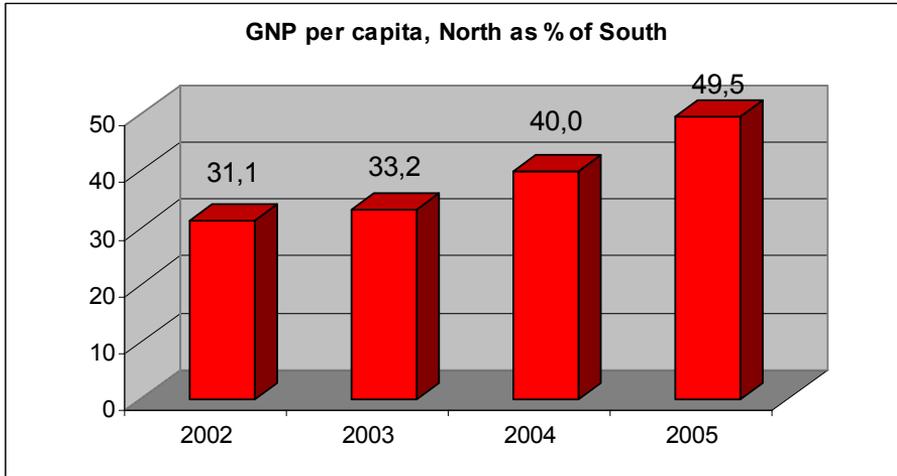
¹² Economist Intelligence Unit (2002).

¹³ Economist Intelligence Unit (2004).

¹⁴ Palley (2005), pp. 154–157.

¹⁵ Theophanous (2004), pp. 164–165.

Figure 1: Comparative income per capita



Source: S. Platis Economic Research

(GNP)¹⁶ per capita at current prices in the North rose from 31.1% of the South in 2002 to 49.5% of the average in the South in 2005. In the eleven-year period 1995–2005, the same ratio was only 35.2%.¹⁷ This occurred despite the large budget deficit and *de facto* barriers to trade, investment and tourism that exist in the North.

The catch-up can be witnessed also by the respective growth rates. The economy in the North has been growing much faster than the more mature and open economy in the South, and especially so since 2002, the year after the Turkish lira was devalued. Average real GNP growth in the North was 10.9% per annum in 2002–05, compared with only 3.3% in the South. In the eleven-year period of 1995–2005, average real GNP growth was 5.4% per annum in the North, compared with 3.6% in the South. One of the reasons for the rapid acceleration in growth in the North is the devaluation of the lira, which raised the price competitiveness of exports, including tourism. Another important factor is the partial lifting of restrictions on freedom of movement across the Green Line from April 2003. According to Apostolides (2005),¹⁸ an estimated 5,500 Turkish Cypriots travel daily to the South to work. Income from employment, combined with income from visitors, results in the transfer of an annual equivalent of CYP 97 million (net CYP 74 million after Turkish Cypriot spending in the South). A third reason, as outlined in Section 7, is a certain shift in demand for property by foreign buyers from the South to the North.

¹⁶ We use GNP, rather than GDP (gross domestic product), because it is the main point of reference for economic growth in the North and therefore more reliable than the GDP figure.

¹⁷ In 2000, GNP per capita in the North did briefly surpass 40% of the average in the South, but, unlike in 2003–05, this was entirely a function of an overvalued exchange rate and did not last. The Turkish lira was devalued in early 2001, and GNP per capita dropped to 33.9% in the same year.

¹⁸ Apostolides (2005).

Conclusion

Based on convergence literature and on recent economic performance, we can conclude that a reunification of Cyprus would benefit the economies of both communities by leading to accelerated investment-driven growth, despite the presence of restrictions in the economic process. With the right policy mix facilitating growth, including clarification of property issues and a functioning labour market, the process of convergence could lead the economy in the North to high catch-up rates, offering the South opportunity to increase its pace of convergence with the more developed EU economies.

Table 3: Comparative macroeconomic performance

Macroeconomic Performance	2000	2001	2002	2003	2004	2005	2002–05	1995–2005
<i>Real GNP growth (%)^a</i>								
South	2.4	4.7	2.9	3.8	2.1	4.6	3.3	3.6
North	-0.6	-5.4	6.9	11.4	15.4	10.0	10.9	5.4
<i>GNP per capita (CYP)^{a,b}</i>								
South	7,744	8,280	8,600	9,208	9,406	9,834	9,262	7,937
North	3,157	2,811	2,677	3,055	3,762	4,866	3,590	2,837
as % of South	40.8	33.9	31.1	33.2	40.0	49.5	38.4	35.2
<i>Real GDP growth (%)^c</i>								
South	5.0	4.1	2.1	1.9	3.9	3.8	2.9	3.7
North	0.0	-5.4	6.2	10.6	14.2	13.5	11.0	5.8
<i>GDP per capita (CYP)^{b,c}</i>								
South	8,183	8,701	8,968	9,428	9,804	10,169	9,592	8,148
North	3,157	2,807	2,656	3,008	3,666	4,632	3,769	2,793
as % of South	38.6	32.3	29.6	31.9	37.4	45.5	38.3	33.8

Sources: Statistical Service in the Republic of Cyprus and the planning organization of the administration in the North

^a 2005 GNP data are Economist Intelligence Unit (EIU), Cyprus Country Report, Sep 2006 estimates.

^b Per capita data derived from the Statistical Service of the Republic of Cyprus and the planning organisation of the administration in the North.

^c 2005 GDP data are authors' estimates.

NEGATIVE AND POSITIVE PRICE PRESSURES UNDER ANNAN V

THE NEW SITUATION arising from the redistribution of ownership map, as outlined in Section 3, and the new economic conditions would have a considerable impact on the property markets, which until very recently have functioned completely separately.¹ If the post-solution property market does not function properly (i.e. real estate prices do not rise in the medium to longer term), then the Property Board would not be able to pay out (the nominal) compensation by selling property transferred to it. Thus, it is necessary to examine any negative price pressures on the market and any mitigating factors, as well as the positive price pressures.

Negative Price Pressures

Potential Restrictions on Investment

The right, as stipulated in *Annan V*, of the Turkish Cypriot state to impose restrictions ‘in a non-discriminatory manner’ on ownership by non-residents of that constituent state, if indeed implemented, would have a negative impact on prices by locking out wealthier investors from outside the constituent state: non-nationals and non-resident Greek Cypriots and Turkish Cypriots. This is probably one of the most serious downside risks to prices, given the lower purchasing power in the Turkish Cypriot community and the small size of the market. It would also lengthen the period in which the island’s property market remained geographically fragmented. Because of the price gap between North and South and the need to relocate a large number of Turkish Cypriots, we consider this a bigger risk to price developments than the right of Turkish Cypriots to acquire land in the Greek Cypriot State on the free market.

¹ While currently both neighbouring property markets are unrelated to each other directly, there is an indirect relation between them as described by Platis and Orphanides (2005) via external demand for the second-home market.

Increase in Property Supply

We would expect negative pressure on prices to arise from a significant increase in the supply of property, albeit a gradual one. From a methodological point of view, we could consider this enormous increase in land supply as being similar to a generous political decision regarding land zoning. According to Zentelis (2001), land planning can influence property values on a national level.²

The increase in supply, as outlined in Section 3, would come from three main sources.

- **First**, from property returned over 3.5 years to Greek Cypriots in the areas subject to territorial adjustment such as Famagusta – affecting around half of all displaced Greek Cypriots. This would form part of the Greek Cypriot state post-solution. We estimate that, through reinstatement, around 469,000 skales/donums of ‘new’ property would enter the current market in the South over the 3.5-year period. This is 20% of the Greek Cypriot-titled property currently in the area controlled by the Government of the Republic of Cyprus, and would therefore represent an increase in *de facto* supply to Greek Cypriots of around 20%.
- **Second**, in areas not subject to territorial adjustment, a gradual increase in supply of property in the Turkish Cypriot state to Greek Cypriots, and of property in the Greek Cypriot state to Turkish Cypriots, would come from the ‘one-third rule’, as outlined in Section 1. Overall, we estimate that via the one-third rule, 142,000 skales/donums in the Greek Cypriot state could be reinstated to Turkish Cypriot owners and 401,000 skales/donums in the Turkish Cypriot state could be reinstated to Greek Cypriot owners after all claims have been processed.
- **Third**, the Property Board would hold title deeds corresponding to the two-thirds of property that would not be reinstated in the areas not subject to territorial adjustment. It would also hold title deeds to properties of dispossessed owners who opted to receive full compensation instead of one-third return and two-thirds compensation. As described in Section 3, we estimate that total property transferred to the Property Board could reach an estimated net total of 317,000 skales/donums after property exchanges, and that all of this would be located in the North. Since the Property Board would be free to sell such titles, this would obviously increase real estate supply significantly over the period of operation of the Property Board. We estimate that it would correspond to about one-quarter of the entire size of the property market in the North excluding federal property, or 17% of the land area of the Turkish Cypriot state.

² Zentelis (2001), p. 95.

If the Property Board's Liabilities Significantly Exceeded Its Assets

The maximum amount of compensation to be paid out in bonds was significantly reduced between Annan III and Annan V, since in the latter only 2/9ths of the current value of property that would fall outside the dispossessed owners' constituent state would be compensated in the form of bonds.³ The main risk to the viability of the Property Board, therefore, would be if the Property Board had to pay substantially more in the form of bonds than it could earn by selling titles; in other words, if its liabilities significantly exceeded its assets. This is why the growth rate of the market value of property in the North would be of such importance (see Section 8).

Under Annan V, the Property Board would be obliged to pay compensation in 'current values' (in effect, an artificial value based on prices in 'comparable locations that had not been positively or negatively affected' by the events of 1963–64 and 1974) but would sell titles at market value (the price a buyer is prepared to pay based on market forces). As discussed in Section 4, different attempts to produce estimates for the level of 'current values' have produced different results. If the 'current values' of properties are estimated to be at a level significantly higher than market values over the medium term, then the Property Board could see its liabilities exceeding its assets, depending on the pace of price growth in the North. In fact, based on our analysis, we find that apart from Kyrenia (in the North), where values appear to be converging with the South very fast, 'current values' elsewhere in the North could conceivably exceed market values.

'Boom–Bust' of Bonds and 'Property Appreciation Certificates'

A final downside risk for property prices comes from the demand side. This could occur if there were a 'boom–bust' scenario, under which a speculative secondary market for bonds and 'property appreciation certificates' took off. In this case, the prices of such assets could rise beyond their real value (that is, faster than the rise in the value of properties as a whole) before finally crashing as holders realise that the assets are worth less than they paid for them. Much as a stock market crash that began in Cyprus in late 1999 produced a negative wealth effect and eventually dampened overall demand, a similar crash in bond and property appreciation certificates would dampen demand for real estate and thus have a negative impact on prices.

Mitigating Factors

The above-mentioned negative price pressures are, however, not equal in weight and effect. A number of factors also have the potential to limit the impact of these negative

³ Barring some exceptions, one-third (3/9ths) of total ownership is returned. Of the remaining two-thirds (6/9ths), one-third of the remainder (i.e. 2/9ths) is in the form of compensation bonds and two-thirds (i.e. 4/9ths) is in the form of 'property appreciation certificates'.

price pressures and have to be considered and critically evaluated in combination with the above. We list such factors below as ‘mitigating factors’.

Turkish Cypriot State Authorities’ Behaviour

In view of the recent boom in sales of tourist real estate to foreigners in the North, one has to question whether the right to restrict property sales to non-residents would ever be exercised in practice, at least for prime tourist real estate. Under the provisions of *Annan V*, any restrictions on ownership have to be exercised in a ‘non-discriminatory’ manner, meaning that if the Turkish Cypriot state wanted to keep out Greek Cypriot investors, it would have to keep out all non-resident investors too – including Turks and non-resident Turkish Cypriots. There could be few restrictions in practice on projects that would increase the value of the tourism product. Foreign investment in developments to boost the higher education sector, which is now an important source of foreign exchange in the North, could also be excluded from restrictions. Moreover, given the provisional character of the above-mentioned restricting measures, we should not assume that this would prevent property prices in the two constituent states from converging to comparable levels in the long run.

The Impact of Locational Characteristics

The literature has shown that a market is only created where the supply of land and housing is of the right ‘type’ – crucially, if it offers the desired locational characteristics, such as infrastructure.⁴ Bramley (2003) also concludes that the local impact of greater supply is quite moderate.⁵ Property in a bad location is therefore effectively out of the market, because there is no demand for it. In simple terms, it is possible that only the most desirable additional skales/donums of property ‘added’ to the market in the Greek Cypriot state during the reinstatement process would have a negative impact on prices in high price locations – such as Paphos, for example – and that this would be a small proportion in terms of value of the total. This would therefore limit the impact of an increase in supply.

Supply Increase Could Be Limited in Practice

Restitution and compensation takes place over several years, and the Property Board is mandated in *Annan V* to dispose of properties in a ‘prudent’ manner. Therefore, it is questionable whether the Property Board would dispose of properties all at once, under normal conditions. Moreover, to a certain extent the property in the North to be returned is already *de facto* ‘in the market’; therefore, the impact of a supply shock

⁴ For recent examples, see Platis and Nerouppos (2004), Galster (2005) and EEAG (2005).

⁵ Bramley (2003), p. 217.

would be limited, at least to some degree. Based on our scenario and calculations, the Property Board could in fact introduce annually only about 3% of its holdings (compared to about 9% of value of the market sold in the South annually, at present).

How 'Current Values' Are Set

The 'current values' would be set by the Property Board itself, albeit with assistance from professionals. This could no doubt also act as an important safety valve, given the vagueness inherent in the definition of the 'current value' calculations. It would be difficult for anyone to imagine a scenario under which the Property Board would set 'current values' so high that would automatically make itself insolvent.

The above-mentioned possibility of 'current values' in the North exceeding market values also works the other way round. Before Cyprus was divided, Paphos was largely undeveloped and British second-home owners tended to flock to Kyrenia, whereas now they tend to flock to Paphos. Arguably, if Paphos property had had to compete for foreign buyers with Kyrenia (i.e. if the events of 1963–64 and 1974 had not occurred) market values in Paphos would be lower than they actually are today, which implies that 'current values' in Paphos could be set at below market values.

Convergence of Property Prices

Moreover, as outlined in Section 7, market values for property in the North (most of the compensation in 'current values' would be paid for properties in the North) seem to be converging rapidly with market values in the South. If the pace of this price growth were to continue, 'current values' would be unlikely to exceed market values over the medium term.

The Impact of Financial Regulation

The absence of detail on how any secondary market for bonds and 'property appreciation certificates' would be regulated means that the above-mentioned boom–bust scenario is a longer-term risk that cannot be discounted. However, the impact of the more rigorous EU rules on financial markets that exist today could temper such risks.

Positive Price Pressures

On the other hand, we would also expect upward pressures on prices. These would include some important (dynamic) factors on the demand side and additional factors on the supply side, especially in the North. These were not taken into account in much of the literature that analysed Annan III, which tended to analyse the property provisions on a static basis.

Legal Certainty

Legal certainty has been shown in the literature to be one of the most important factors in raising demand and subsequently house prices. Noë and Watson (2005),⁶ for example, have indicated the significance of the conditions for private investment – which include property rights – for the convergence of the two economies. The settlement of the Cyprus problem, with detailed provisions for property restitution and compensation, would remove the major element of legal uncertainty in the North. This would contribute not only to increased external demand in the Turkish Cypriot state but also to increased economic activity via private investment. According to Zentelis (2001), investment is a significant determinant of property prices.⁷ Since more than half of the property in the North belongs to Greek Cypriots, any business in the North that currently wants to expand and buy new premises has legal risks to consider, especially since cases such as *Apostolides v. Orams* have been brought to court (we refer to this as the ‘Orams effect’).⁸ This observation is underpinned by our finding that land prices declined in the North after the first ruling in that case in November 2004, although the effect was shortlived, for reasons we attempt to explain below.

Indeed, in analysing property prices in the North (see Section 7), we clearly found evidence of a strong influence of a ‘legal uncertainty penalty’ (of around 40%). Moreover, our empirical research has indicated that the market differentiates between original Turkish Cypriot titles prior to 1974, which carry a legality premium; refugee title deeds, which also carry an entitlement premium (reflecting the property left behind in the South); and the settler title deeds, which carry no premium and are therefore the cheapest in the market. We can therefore assume that a clarification of the property issue would create positive pressures on property prices.

Safety and Increased Attractiveness of Property

A related issue is physical security. Large areas of both urban and rural Cyprus lie along areas within sight of military guard posts or other military installations. This may negatively affect the desirability of neighbourhoods,⁹ as a result of a feeling of insecurity for inhabitants (and especially possible foreign home-buyers), and thus limits the value of properties in such areas. Combined with the ongoing removal of landmines, and assuming that these posts, and other undesirable installations resulting

⁶ Noë and Watson (2005), p. 3.

⁷ Zentelis (2001), p. 93.

⁸ In the case of *Apostolides v. Orams*, the Nicosia District Court ordered in November 2004 that the British couple David and Linda Orams had to destroy the house they had constructed on a property belonging to Greek Cypriot Meletis Apostolides, located in the Lapithos by Keryneia, and issued an arrest warrant against Linda Orams (<http://www.moi.gov.cy/moi/pio/pio.nsf>). However, an attempt to enforce the judgment in the UK using EU law failed at the High Court of England and Wales in September 2006. Leave to appeal was allowed (http://www.timesonline.co.uk/article/0,,200-2348969_1,00.html).

⁹ Galster (2005).

from the current political situation, would be among the first to be removed, this would probably have a significant positive impact on the prices of properties in such areas. In addition, semi-collapsed buildings within the currently UN-controlled Buffer Zone may be repaired, increasing the desirability of adjacent areas.

Convergence of Incomes

One of the most important positive price factors is the impact on demand of the apparent convergence of the incomes in the North with the incomes in the South. While Lordos (2004a) outlines a scenario under which demand would remain unchanged,¹⁰ his approach lacks this element of dynamism. According to Zentelis (2001), an increase in the standard of living as a result of higher incomes could lead to increased demand for additional space or higher quality urban space.¹¹ In addition, Platis and Orphanides (2005) have indicated that the increase in per capita disposable income of Greek Cypriots between 1997 and 2002 probably contributed to higher demand for more or higher quality housing in the South.¹² As seen in Section 5 above, GNP per capita in the North has already risen by 82% in nominal terms, in four years, despite *de facto* barriers to international trade, tourism and investment. Following a solution, further and rapid rises in GNP should be expected, acting as positive pressure on prices.

Convergence of Economies

Theory also points to the process of macroeconomic convergence accelerating, owing to the above-mentioned legal certainty, physical security and the opening up of the economy of the North. Ports and airports would be opened to direct international traffic; businesses would enjoy improved access to credit from the more developed banking system in the South, and possibly from banks in the North too. Commercial lending rates for businesses in the North would probably fall too, since at present they are based on much higher Turkish lira rates, rather than Cyprus pound rates (or euro rates from 2008). As of October 2006, the main lending rate of the Central Bank of Turkey was 22.5%, compared with an equivalent rate of 4.5% set by the Central Bank of Cyprus and 3% set by the European Central Bank, which is due to be the main reference rate for Cyprus assuming it adopts the euro on schedule in January 2008. Assisted mortgages as provided for in Annan V, investment in accommodation for the re-housed, and potential foreign aid and foreign investment would also provide a basis for strong economic growth. The macroeconomic convergence would act as a strong catalyst towards faster convergence in the property markets as well.

¹⁰ Lordos (2004a) p. 7.

¹¹ Zentelis (2001), p. 93.

¹² Platis and Orphanides (2005), p. 23. For further background see Holmans (1994) and Milesi-Ferretti and Kodres (2004).

The Wealth Effect of Compensation

The wealth effect for all Cypriots created by the restitution to around half of Greek Cypriot refugees of all of their property (allowing it to be sold or used as collateral for loans), part-restitution and compensation rights for the remaining half of Greek Cypriot refugees, and part-restitution and compensation rights for around half of all Turkish Cypriots, would act as an upward pressure mechanism on property prices. Compensated Greek Cypriot owners may, as seems to have occurred during the stock market boom of 1999,¹³ use their increased purchasing power to make speculative purchases.

Market Reaction to Price Falls

Since land supply is inelastic in the long term,¹⁴ even if there were a sudden fall in prices, under normal market (and political) circumstances, potential sellers would adopt a wait-and-see approach in such cases, until prices rise again. As Hajispyrou and Pashardes (2003) indicated,¹⁵ in cases where land prices do fall, this is often short-lived, as speculators move in to snap up the bargains, thus pushing up demand and prices again. This is particularly the case with land held by individuals, rather than property developers – we estimate that only 10–15% of the land to be reinstated would be developed within the first 3–4 years. In addition, as noted by Ball (2005),¹⁶ during downturns in the prices of housing units, new purchasers enter who would otherwise have been priced out of the market, and drive up demand. Thus, under normal political conditions, one could assume that the market reaction of price falls would have a stabilizing impact on prices.

Relocation of Turkish Cypriots

Part of the population in the North would be relocated from the areas of territorial adjustment within the Turkish Cypriot state. Celik et al. (2003) have indicated that a significant number of Turkish Cypriots (about 68,000) would be relocated. This would create demand for the alternative accommodation that, under Annan V, must be made

¹³ Platis and Orphanides (2005) explain possible effects of wealth due to increased share prices on house prices in the South in 1999, during the stock exchange bubble that probably continued long after the stock exchange started to decline, since the property market was regarded as a safe haven for investors in an environment of limited investment opportunities and options (pp. 42–44).

¹⁴ ECB (2003) has indicated that land prices appreciated in a number of European countries faster than house prices and that house prices appreciated faster than construction costs. This can be explained by the inelastic land supply in the longer term.

¹⁵ Hajispyrou and Pashardes (2003), pp. 81–82. The authors refer to speculative purchases of agricultural land between 1974 and the early 1980s to take advantage of expected changes in zoning, which led to a sharp increase in the prices of such land.

¹⁶ Ball (2005), p. 14.

available to them to purchase (through use of compensation bonds, ‘property appreciation certificates’, personal funds or loans). This will of course increase the demand for land.

Planning Authorities’ Behaviour and Intervention

Another crucial factor is the influence of the planning authorities in approving applications to develop reinstated or newly purchased land (much of which is still largely undeveloped in the North). If we can assume, as above, that the increase in land supply resembles the effects of political decisions regarding zoning, then we can also consider the possibilities for interventions through zoning by the authorities. Land planning can contribute to the maximisation of values via rational land allocation to productive sectors, urbanisation and optimisation of land use.

Fiscal Incentives for Property Ownership

Also, specially designed fiscal incentives can allow the authorities actively to influence both demand and supply for housing and land. This would in turn permit the state authorities to prevent property prices from falling by encouraging property ownership, which could help the Property Board in its task of disposing of the properties in its holdings.¹⁷

Property Exchanges

Demand in the Turkish Cypriot state could increase as a result of the indirect property exchanges (what we earlier called quasi-exchange of properties). Reinstated Turkish Cypriot owners (totalling 142 thousand skales/donums) might want to benefit from the gap in property values between the Greek Cypriot and the Turkish Cypriot constituent states by exchanging their property in the South for compensation and using the proceeds to exploit opportunities in a market of probably rapidly increasing prices in the North. We estimate that this could affect 142 thousand skales/donums. The sales in the South would have a relatively small impact on prices in that area, since the affected property represents only 3% of the total area of the Greek Cypriot state. However, it would have a bigger impact on prices in the North, because of the latter’s smaller size and the lower purchasing power of Turkish Cypriots.

Similarly, non-reinstated Greek Cypriot owners could probably seek to exchange their compensation bonds and ‘property appreciation certificates’ against Turkish Cypriot property offered for sale by the Property Board in the Greek Cypriot state. As outlined in Section 3, we estimated that this would total 284 thousand skales/donums.

¹⁷ See Muellbauer (2004), Poterba (1984, 1991).

Conclusions

As explained above, the addition of new *de facto* supply to the market has to be set against the fact that it occurs over a period of several years; that a slow release of property would in all likelihood be supported by the behaviour of the authorities; and that its impact on prices in the South (or North) would be limited mainly to those properties that cannot compete based on locational characteristics. Most importantly, however, no analysis of the impact of the provisions of the Annan Plan on property prices is complete without a full assessment of the dynamic factors that would come into play as a result of the reunification of the island: the large positive impact on prices of legal certainty and physical security; the convergence of incomes that has already occurred even under conditions of restricted investment; and the impact of the wealth effect. Barring deeply unstable political conditions, the conditions should exist for a rapid rise of property prices in the North and a continued steady rise of property prices in the South.

RECENT ACTUAL PROPERTY PRICE BEHAVIOUR NORTH AND SOUTH

PROPERTY MARKETS ON THE ISLAND already appear to have been influenced by recent political developments. From our analysis, it seems that the easing of restrictions on movement through the demarcation line that has been enjoyed since April 2003, combined, perhaps, with the failure to reunite the island, has affected external demand in both markets. This is significant because the period we examine (January 2003 to June 2006) is the first period for decades in which these two property markets have related even indirectly to each other. Foreign second homebuyers appear to have been initially attracted to the North – probably by lower prices as we will see in this section. At the same time, foreign demand for second homes in the South was weaker in 2004 than in the previous year.¹ Although, other factors may also be at play, such as an increase in prices in the South and weaker demand in the primary UK market, there does appear to have been some shift of external demand from the South to the North during the period under review.

Recent Property Price Trends

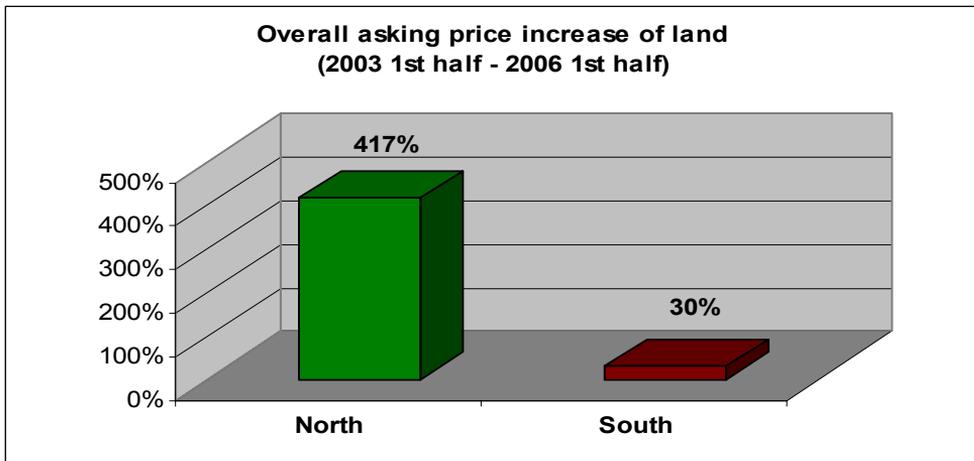
After collecting and processing the data on asking prices² for properties (see Appendix III) for the period January 2003 to June 2006, we concluded that property prices increased in both, the North and the South during the period under examination, albeit much faster in the North than in the South.

According to our analysis, land prices in the North rose by 417% between the first half of 2003 and the first half of 2006. The land-price appreciation rate was 118% up to the first half of 2004, but from the second half of 2004 until the first half of 2005 there was a marked slowdown: it decelerated by 25%. However, in the second half of 2005 and the first half of 2006, there was a clear increase of 114% and 131% respectively. Meanwhile, house prices in the North during the examination period increased by a total of 46%. However, the house appreciation rate decelerated from

¹ Platis and Orphanides (2005), p. 57.

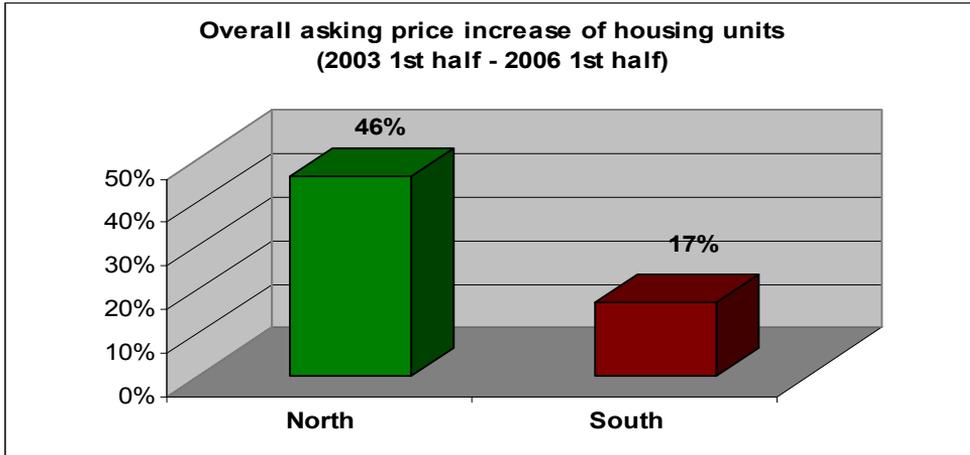
² Asking prices are not identical with transaction prices. They contain a certain upwards bias related to negotiating tactics. See, for example, Platis and Nerouppos (2004, 2005).

Figure 2: Asking price increase of land



Source: S. Platis Economic Research

Figure 3: Asking price increase of housing units



Source: S. Platis Economic Research

34% in the first half of 2004 to 2% in the first half of 2005. In the second half of 2005 house prices decreased by 1%, but in the first half of 2006 there was a noticeable acceleration of 10%.

Asking prices in the South also increased during the period in question, but at a slower pace compared to the North. Land prices rose by 30% between the first half of 2003 and the first half of 2006. The land price appreciation rate was 11% up to the first half of 2004, but in the second half of 2004 it decelerated to 2%. In the next two

half terms of the year 2005, it increased by 3% and 4% respectively. In the first half of 2006, it rose substantially by 11%. House prices in the South increased during the whole period under investigation by 17%, but with negligible deceleration: they rose by 5% year on year in the first half of 2004 and 4% in the second half of 2004. In the whole of 2005 there was no significant change, but in the first half of 2006 there was an increase of 8%.

Table 4: Property price growth North and South

Property price growth (%)	Jan–June 2003/Jan–June 2006
<i>Land</i>	
North	417%
South	30%
<i>Housing units</i>	
North	46%
South	17%

Source: S. Platis Economic Research

Weakening Demand Under Part of the Period Under Review

Both markets witnessed a slowdown or decline of asking prices in the middle of the period under review, according to our analysis. In the North, asking prices of land increased at a strong pace up to the second half of 2004, when in the first half of 2005 an asking price decline of 9% compared with the previous period was witnessed (see Figure 4). Asking prices for housing units rose in double digits up to the first half of 2004, but then remained stable (0% growth) in the second half of 2004, rose in the first half of 2005, and then declined in the second half of 2005 (–1%). Conversely, in the first half of 2006, both land and housing asking prices of the North presented a notable increase.

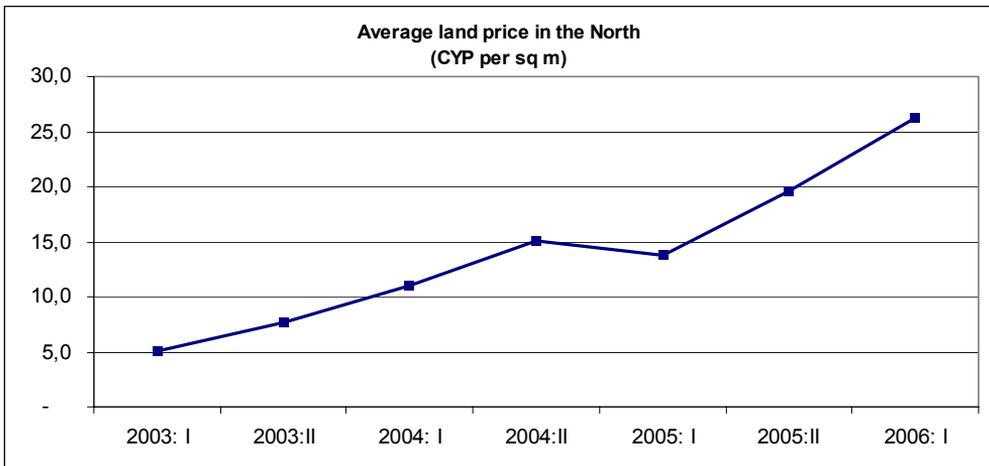
There are two likely explanations for the downward trend in the first half of 2005. First, as mentioned in the regional analysis below, demand for housing units in the North appears to have been driven by expectations of a solution and the desire to be housed in areas that would form part of the Turkish Cypriot state. This could explain a decline in prices of housing units in the second half of 2004 (compared with the previous period), after the referendums in April of that year that did not result in a solution to the Cyprus problem. Second, apparent weakening of demand for land from the first half of 2005 is probably explained by the *Apostolides v. Orams* case, in which a Greek Cypriot owner lodged a court case in the Nicosia district court against a British couple that had built on his land. On 9 November 2004, the court ruled that the Orams must demolish the house and return the land to its pre-1974 state. This appears

to have reduced external demand for property significantly, albeit only for a short period.

The fact that this downturn lasted for only a short period could be explained by four factors. First, per capita incomes in the North continued to rise at a very fast pace. As discussed above, rising incomes normally have a positive impact on prices. Second, the administration in the North has issued a number of decrees in the past year to restrict development in certain areas. Restriction of supply in some areas could have pushed up prices in other areas. Third, it is possible that the announcement in December 2005 that Cherie Booth QC, wife of the UK prime minister, would be defending the Orams may have reduced fears in the UK that the Orams might have to demolish their home. Fourth, there is the possibility that foreign demand for local residencies and investment in the area has increased.

Our data analysis also showed a weakening of demand in the South for part of the period under review. Although prices continued to rise, the rate of increase of both land and housing asking prices declined in each half-year period, when compared with the previous half-year period – except from the first half of 2006, after which asking prices increased. This is probably a reaction to weakening external demand, notably from the UK. However, it is interesting to note that property prices continued to increase during 2003, when the solution scenario and the prospect of an increase in supply was still open, and only showed fluctuations thereafter.

Figure 4: Average land prices in the North



Source: S. Platis Economic Research

Table 5: Price change compared with the previous period

% change on previous period	South	North
<i>Land</i>		
2003 H2	6%	53%
2004 H1	4%	43%
2004 H2	2%	36%
2005 H1	2%	-9%
2005 H2	3%	42%
2006 H1	10%	34%
<i>Housing units</i>		
2003 H2	4%	11%
2004 H1	2%	22%
2004 H2	4%	0%
2005 H1	0%	2%
2005 H2	0%	-1%
2006 H1	7%	7%

Source: S. Platis Economic Research

Legal Uncertainty Penalty

The ‘Orams effect’, albeit shortlived, underlines the sensitivity of property demand to legal uncertainty. Moreover, we found that impact of the uncertain legal basis for property possession in the North is not limited to external demand but also affects prices of property traded among Turkish Cypriots.³ Property not owned by Turkish Cypriots prior to 1974 is traded at lower price levels depending on the basis of the claim (some deeds issued reflect property abandoned in the South that is owned by Turkish Cypriot refugees). In fact, we found that the ‘legal uncertainty penalty’ limits the values of properties granted to settlers at 35% to 45% of the values of original Turkish Cypriot properties.⁴

Convergence of Prices

Despite the above-mentioned weakening of demand, prices in the two property markets began to converge in the period under review. Land prices in the North as a proportion of those in the South rose from 9.1% in the first half of 2003 to 35.9% in the first half of 2006. The trend of housing unit prices was also in the same direction: prices of housing units as a proportion of those in the South rose from 37% to 46% in the same period.

³ In many cases, property adverts in newspapers mention not only the characteristics of the property but also the type of the title deed, which reflects the level of legal certainty. This has been confirmed by Turkish Cypriot professionals in the real estate sector in private interviews.

⁴ This figure is based on answers obtained in the context of interviewing Turkish Cypriot professionals in the area of real estate.

Table 6: Property prices in the North compared with the South

	South CYP per m ²	North CYP per m ²	North as % of South
<i>Land</i>			
2003 H1	55.90	5.07	9.1%
2003 H2	59.44	7.75	13.0%
2004 H1	61.89	11.05	17.9%
2004 H2	63.02	15.04	23.9%
2005 H1	64.39	13.76	21.4%
2005 H2	66.55	19.54	29.4%
2006 H1	72.88	26.18	35.9%
Overall	63.44	14.06	21.51%
<i>Housing units</i>			
2003 H1	910.07	336.96	37.0%
2003 H2	942.37	372.71	39.5%
2004 H1	956.72	452.74	47.3%
2004 H2	995.17	451.88	45.4%
2005 H1	996.72	459.93	46.1%
2005 H2	997.85	456.90	45.8%
2006 H1	1,067.53	490.55	46.0%
Overall	980.92	431.67	43.87%

Source: S. Platis Economic Research

Property Price Increases in the North by Region

A further finding of our analysis was that property price increases varied from region to region across Cyprus, both in the North and in the South. In the North, the fastest increase in land prices was observed in the urban and suburban areas of Kyrenia. This region may be regarded as the tourist resort of the North. Comparing the first half of 2003 with the first half of 2006, we found that asking prices for land appreciated by 705%. Land in and around North Nicosia appreciated by 505%. This was followed by the rural areas of Kyrenia and the northern coast, where land appreciated by 502%. Land in the Famagusta area and neighbouring coastal villages, including Bogazi and Trikomo, appreciated at a comparably much slower rate of 241%. House prices also received a strong boost in the above-mentioned areas according to our analysis, though not as strong as the boost in the case of land prices. Moreover, in the area stretching from Famagusta to Bogazi and Trikomo, where land prices did not increase as sharply, house prices showed higher increase. House prices appear to have increased most sharply in the area of North Nicosia, followed by Famagusta, Trikomo, Bogazi, and Kyrenia and suburbs, while in rural areas of Kyrenia and the northern coastal region the increase was weaker.

Table 7: Price increases in the North by region

2006 H1 compared with 2003 H1	Land	Housing units
Kyrenia, suburban areas	705%	97%
North Nicosia	505%	204%
Kyrenia rural areas/northern coast ^a	502%	45%
Famagusta, Trikomo, Bogazi	241%	141%
<i>Total</i>	<i>417%</i>	<i>46%</i>

Source: S. Platis Economic Research

^a Excluding Karpasia Peninsula & Morphou

Reasons for Regional Differentiation

While the increased external demand may have been the main driving force for the property-price appreciation in some areas at least, an additional determinant may also be seen in the prospect of a solution. This was considered as a likely scenario in 2003, and may have encouraged persons residing in areas subject to territorial adjustment (that is, areas that would form part of the Greek Cypriot state) to buy property elsewhere, namely in the territory that would form the Turkish Cypriot state.⁵

Convergence of Incomes

Finally, as seen in Section 5, our examination of this brief period has shown that the convergence of property prices, even in an environment of legal uncertainty, occurred at a time when incomes were also converging. While the ratio of land and housing prices in the North to those in the South came down by 26.8 and 9 percentage points respectively, the ratio in the case of per capita income fell by 15.9 percentage points between 2002 and 2005.

Conclusions

From our data analysis, we can conclude that property prices on both sides of the ceasefire line seem to have been affected by interrelating factors triggered by developments in the Cyprus problem. The partial relaxation of restrictions on movement through the demarcation line from April 2003 allowed a portion of external demand for second homes to flow from the South to the North. While this development seems to have triggered an initial price rally in the property market in the

⁵ While the data sample for properties located in areas that would have been affected by a territorial adjustment was small, it does allow the conclusion that both land and housing asking prices are at significantly lower levels compared to property prices elsewhere.

North, it appears to have contributed to a stabilisation of property prices in the South during the period under review.

Our analysis also underpins the importance noted in the literature of the impact of legal certainty on property markets. As the prospect of an end to the Cyprus problem and related property ownership issues grew, so too did property prices in the North. As the prospect of a solution faded and legal risks for occupants of Greek Cypriot-titled land were highlighted by developments, prices in the North eased downward. In addition, the very prospect of territorial adjustment appears to have resulted in an internal shifting of demand in other areas within the future Turkish Cypriot state. This trend does not seem to have been reversed even after the rejection of the Annan Plan by the Greek Cypriot community. Indeed, anecdotal evidence suggests that the recent plans announced by the Turkish Cypriot administration to offer Greek Cypriot refugees compensation or restitution have had another negative impact on the market in the North.

We may therefore assume that a settlement of the Cyprus problem that created conditions for legal certainty of property ownership would eliminate the legal uncertainty penalty immediately, resulting in a narrowing of the differential between land prices in the North and land prices in the South by around 8 percentage points according to our estimates. At the same time, as also underlined in the literature, locational characteristics play an important role: with prices of property in areas with certain attractive locational characteristics less affected by uncertainty than the overall market.

Developments in the Cyprus problem also seem to have affected the property market in the South, but in different ways. They led to a weakened demand for second homes, which appears to have negatively affected property prices, although the acceleration of economic growth in 2004 and 2005 seems to have acted as a cushion, allowing property prices to continue to rise, albeit at a slower rate. In the first half of 2006, the property prices presented a high increasing rate.

Finally, the twin convergence of property prices and incomes occurred while the Cyprus problem was still unresolved. We may therefore assume that a probable settlement may enhance growth in both the South and the North, leading to a higher pace of convergence for both the economy and property markets.

TESTING THE VIABILITY OF THE PROPERTY BOARD

OUR ANALYSIS OF THE PROPERTY MARKETS in the North and South today allows us to test the viability of the Property Board under four different scenarios of property price-growth in the North, taking actual price levels and proportions as one of our points of reference. The pace of price-growth in the North is *the* determining variable for two reasons. First, as seen in Section 3, the largest proportion of the property to be reinstated, exchanged, rented, leased or sold belongs to Greek Cypriots and lies on the North. Second, the market price at which such property is sold will be the primary source of the Property Board's income. The pace at which property held by the Property Board appreciates will therefore determine to what extent its income meets its financial obligations, and therefore will ultimately determine the viability of the Property Board.

Although it is quite possible that conditions would be more favourable, we have taken note of the widespread scepticism about the impact of the Annan Plan and been extremely cautious in our assumptions. As detailed in full below, this caution extends to the calculation of 'current values'; the amount paid out in bonds; the annual coupon (interest rate) paid on compensation bonds by the Property Board; the market value of property held by the Property Board in Year 1; the amount of property sold each year by the Property Board; the income it would earn from rentals; the growth rates of property prices in the North under each scenario; and the exclusion of the initial CYP 100 million that would be financed by the federal government.

Calculation of 'Current Value'

As outlined in detail in Section 4, unlike other studies, our calculation of 'current value' takes into account, as dictated by the Annan Plan, the events of both 1963–64 and 1974. This leaves a total 'current value' of titles held by the Property Board after Property Exchanges of CYP 4.5 billion (rounded up) in 2005.

Calculation of Property Board Liabilities

It is worth noting that the amount to be paid in compensation bonds was significantly reduced in Annan V from what it originally was in Annan II and III. This is because, in Annan V, one-third of the property remaining after territorial adjustment was entitled to full reinstatement instead of only around one-tenth as was the case in the previous versions of the Plan. Moreover, only one-third of what finally remained non-reinstated would be paid in the form of compensation bonds.

Under the provisions of Annan V (see Section 1), in areas that were outside territorial adjustment, the Property Board was to reinstate to dispossessed owners one-third (3/9ths) of their properties and pay compensation for the remaining two-thirds (6/9ths) as follows.

- One-third of the remaining two-thirds ($1/3 \times 2/3 = 2/9$ ths) to be paid in the form of interest-bearing compensation bonds. According to our calculations in Section 4, these amounts to one-third of CYP 4.5 billion, which is CYP 1.5 billion.
- Two-thirds of the remaining two-thirds ($2/3 \times 2/3 = 4/9$ ths) to be paid in the form of dividend-paying ‘property appreciation certificates’. After the above-mentioned upward adjustment of bonds, this results in CYP 3 billion. The dividends are linked to Property Board profits; therefore, if the Board makes no profits, it pays no dividends. The total liability of the Property Board is reflected only in the CYP 1.5 billion worth of bonds.

Calculating Property Board Assets

Since the Property Board will sell titles at market value (the price a buyer is willing to pay), its assets over the years would be determined by two factors:

- The market value of property prices today.
- The growth in market values during the period in which it would sell titles.

The Market Value of Property Prices Today

Here again we make a cautious assumption. Since most of the Property Board’s holdings will be in the North, and since most of the property in the North is undeveloped, we take as a proxy today’s value of land in the North as a proportion of the value of land in the South as calculated by our analysis (see Section 7). We found that land values in the North were 20% of land values in the South. We therefore assume that, in the first year, the market value of the property in the North will be only 20% of the ‘current values’ used to calculate compensation. It should be noted that this is an extremely prudent assumption. If we simply multiplied the market value of

land in the North today by the amount of property that the Property Board is likely to sell, the Property Board's assets would exceed its liabilities by a factor of four.

The Growth in Market Values

According to our findings, land prices in the North have risen by 172% in the past two years. We assume that this is unsustainable over a long period and set the four price-growth scenarios as follows.

- **Scenario 1.** We assume that prices in what would be the Turkish Cypriot state increase on average at a rate of less than 9% a year for 30 years (only 5% on average after Year 10).
- **Scenario 2.** We assume that property prices in the Turkish Cypriot state rise on average yearly by 11% for the first 25 years (5% on average after Year 15).
- **Scenario 3.** We assume that property prices in the Turkish Cypriot state rise on average about 16% a year for the first 15 years and 10% on average for the entire 35-year period.
- **Scenario 4.** We assume that property prices in the Turkish Cypriot state rise by about 24% annually on average for the first ten years and 5% for the remainder.

Other Prudent Assumptions

We also make a number of other prudent assumptions.

- The annual coupon (interest rate) paid on compensation bonds by the Property Board is 10%, compared with the current coupon of 4.75% on Republic of Cyprus ten-year bonds.
- The Property Board sells only 3% of its holdings each year. It will be a large player in the market, and a faster rate of sale raises the risk of 'flooding the market'.
- We also exclude income from any rentals in our analysis.
- We exclude the initial CYP 100 million that would be financed by the federal government.

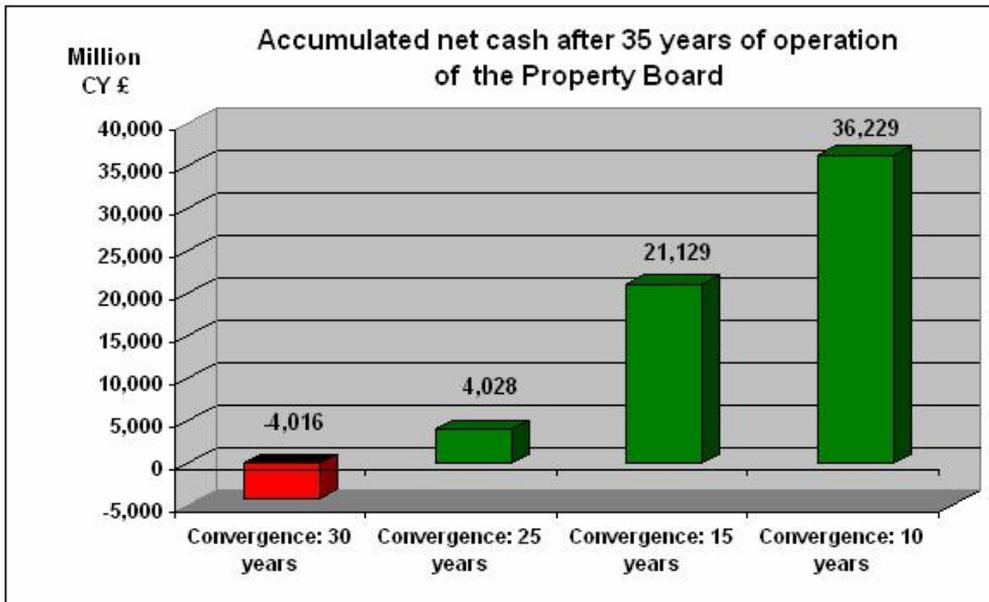
Results of the Viability Test

- **Scenario 1.** In this case, the Property Board accumulates a total debt of CYP 3.7 billion by Year 25. In fact in Year 25, the loan-to-value ratio of the Board exceeds 80%, making it impossible to obtain any non-government-backed

financing, given international banking practice. Therefore, under this scenario, the Property Board becomes insolvent in 25 years.

- **Scenario 2.** In this case, after 35 years the Property Board accumulates a total net cash of around CYP 4 billion available for distribution to the holders of ‘property appreciation certificates’. The maximum loan-to-value ratio is 50%, making it possible to borrow money and finance its operations, by using the property available as collateral. However, taking into account the cost of money, this represents a net present value loss of CYP 61 million.
- **Scenario 3.** In this case, after 35 years, the Property Board accumulates a total net cash of around CYP 21 billion, available for distribution to the holders of ‘property appreciation certificates’. This reflects a net present value of almost CYP 1.7 billion.
- **Scenario 4.** In this case, the Property Board accumulates in 35 years a total net cash of CYP 36.2 billion available for distribution, reflecting a net present value of CYP 3.3 billion.

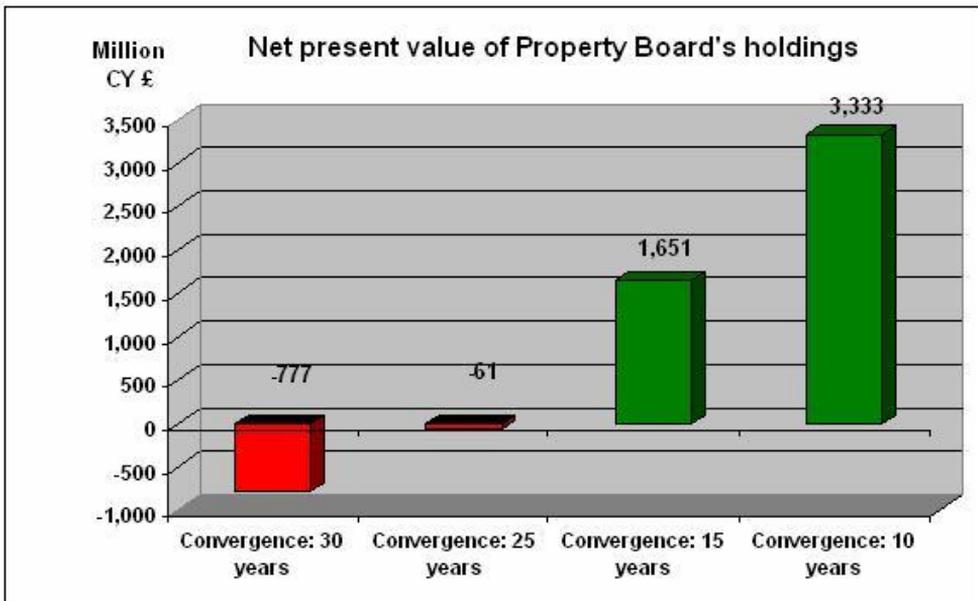
Figure 5: Accumulated net cash of the Property Board



Conclusions

While it is quite possible that there would be a localised negative shock on property prices in the South following restitution, the viability of the Property Board will finally be determined by the growth rate of prices in the North, where most of the Property Board's assets would lie, as well as by the starting point, that is the ratio of assets (market values) to liabilities (bonds calculated at 'current value'). Even allowing for a very low ratio of assets to liabilities (1:5) from the first day, high interest payments and much slower property price growth than theory suggests, we found that only under the first scenario – which assumes extremely low price growth for more than two decades – would the Property Board be unable to fulfil its financial obligations (without any intervention by the authorities). Under normal market and stable political conditions, therefore, we find that the Property Board would be profitable.

Figure 6 Net present value of Property Board holdings



OVERALL CONCLUSIONS

BASED ON THE CONVERGENCE LITERATURE and on recent economic performance of the real estate markets in Cyprus, we can conclude that a reunification of Cyprus would benefit the economies of both communities by leading to an accelerated investment-driven growth, despite the presence of restrictions in the economic process. With the right policy mix facilitating growth, including clarification of property issues, the process of convergence could lead the economy in the North to high catch-up rates, offering the South opportunity to increase its pace of convergence with the more developed EU economies.

The addition of new *de facto* supply to the market has to be set against the fact that it occurs over a period a several years; that a slow release of property would in all likelihood be supported by the behaviour of the authorities; and that its impact on prices in the South (or North) would be limited mainly to those properties that cannot compete based on locational characteristics. Most importantly, no analysis of the impact of the provisions of the Annan Plan on property prices is complete without a full assessment of the dynamic factors that would come into play as a result of the reunification of the island: the large positive impact on prices of legal certainty and physical security; the convergence of incomes that has already occurred even under conditions of restricted investment; and the impact of the wealth effect. Barring deeply unstable political conditions, the conditions should exist for a rapid rise of property prices in the North and a continued steady rise of property prices in the South.

While it is quite possible that there would be a localised negative shock on property prices in the South following property restitution, the viability of the Property Board will finally be determined by the growth rate of prices in the North, where most of the Property Board's assets would lie, as well as by the starting point: the ratio of assets (market values) to liabilities (bonds calculated at 'current value'). Even allowing for a very low ratio of assets to liabilities (1:5) from the first day, high interest payments and much slower property price growth than theory suggests, we found that only under the first scenario – one of extremely low price growth for more than two decades – would the Property Board be unable to fulfil its financial obligations (without any intervention by the authorities). Under normal market and stable political conditions, therefore, we find that the Property Board would be profitable.

Finally, although a full assessment of the Annan Plan on the whole economy is beyond the scope of this report, it is worth noting, as we have seen, that economies can grow, incomes rise and property prices increase even when an administration is

running a large budget deficit, as in the North today; when the banking system is of uncertain viability; and when the economy is subject to restrictions on trade and investment. The economic conditions that would prevail under Annan V were by no means ideal, but our overall conclusion is that they would not prevent the property regime from being viable or even highly profitable.

THE PROPERTY PROVISIONS OF ANNAN V

Territorial Adjustment

THE AREAS SUBJECT TO TERRITORIAL ADJUSTMENT – currently under Turkish administration – that will be handed over to the Greek Cypriot Constituent State cover the whole of the UN-controlled ‘buffer zone’, a large portion of the Morphou region, Famagusta, a significant portion of the Mesaoria region and large portion of the Tillyria. Further, the village of Kormakiti will also be given to the Greek Cypriot Constituent State. The exact territorial adjustment procedure that would begin no later than 104 days after the treaty came into force and would be completed 3.5 years later, is divided in six phases as follows:¹

- **Phase 1:** Handover to the Greek Cypriot State no later than 104 days after the day of entry into force of the Foundation Agreement. Phase 1 includes UNFICYP relinquishing authority over the Buffer Zone and the handover of Famagusta and Kokkina.
- **Phase 2:** Handover to the Greek Cypriot State no later than six months after the day of entry into force of the Foundation Agreement of the areas of Achna and Petra.
- **Phase 3:** Handover to the Greek Cypriot State no later than one year and three months after the day of entry into force of the Foundation Agreement, with enhanced United Nations supervision in the last three months of the areas of Loutros/Gallini and Tymbou.
- **Phase 4:** Handover to the Greek Cypriot State no later than two years and six months after the day of entry into force of the Foundation Agreement, with enhanced United Nations supervision in the last six months of the areas of South Famagusta, Kalopsida/Acheritou, Lysi/Kontea, Avlona and Lymnitis/Soli.

¹ The Annan Plan V contains an unchanged version of the map included in various versions of the plan according to Alvaro de Soto’s address speech at the ‘High Level Preparatory Donor’s Conference to Support the Comprehensive Settlement of the Cyprus Problem’ in Brussels on 15 April 2004.

- **Phase 5:** Handover to the Greek Cypriot State no later than three years after the day of entry into force of the Foundation Agreement, with enhanced United Nations supervision in the last six months of the areas of Famagusta, Mia Milia, Gerolakkos, and Zodhia.
- **Phase 6:** Handover to the Greek Cypriot State no later than three years and six months after the day of entry into force of the Foundation Agreement, of the areas of Xero, Assia, Pyrga, Prastio, Kormakiti and the greater region of Morphou including the areas of Myrtou, Kontemenos, Skylloura, and Agia Marina.²

Annan Plan V, Foundation Agreement, Main Articles, Article 10, Property

1. The claims of persons who were dispossessed of their properties by events prior to entry into force of this Agreement shall be resolved in a comprehensive manner in accordance with international law, respect for the individual rights of dispossessed owners and current users, and the principle of bizonality.
2. In areas subject to territorial adjustment, properties shall be reinstated to dispossessed owners.
3. In areas not subject to territorial adjustment, the arrangements for the exercise of property rights, by way of reinstatement or compensation, shall have the following basic features:
 - a. Dispossessed owners who opt for compensation, as well as institutions, shall receive full and effective compensation for their property on the basis of value at the time of dispossession adjusted to reflect appreciation of property values in comparable locations. Compensation shall be paid in the form of guaranteed bonds and appreciation certificates;
 - b. All other dispossessed owners have the right to reinstatement of one third of the value and one-third of the area of their total property ownership, and to receive full and effective compensation for the remaining two-thirds. However, they have the right to reinstatement of a dwelling they have built, or in which they lived for at least ten years, and up to one skala/donum of adjacent land, even if this is more than one-third of the total value and area of their properties;
 - c. Dispossessed owners may choose any of their properties for reinstatement, except for properties that have been exchanged by a current user or bought by a significant improver in accordance with the scheme. A dispossessed owner whose property cannot be reinstated, or who voluntarily defers to a current user, has the right to another property of equal size and value in the same municipality or

² Annan Plan V, Foundation Agreement, Annex VI, Territorial Arrangements, pp. 74–94.

- village. S/he may also sell his/her entitlement to another dispossessed owner from the same place, who may aggregate it with his/her own entitlement;
- d. Current users, being persons who have possession of properties of dispossessed owners as a result of an administrative decision, may apply for and shall receive title, if they agree in exchange to renounce their title to a property, of similar value and in the other constituent state, of which they were dispossessed;
- e. Persons who own significant improvements to properties may apply for and shall receive title to such properties provided they pay for the value of the property in its original state; and
- f. Current users who are Cypriot citizens and are required to vacate property to be reinstated shall not be required to do so until adequate alternative accommodation has been made available.
4. Property claims shall be received and administered by an independent, impartial Property Board, governed by an equal number of members from each constituent state, as well as non-Cypriot members. The Property Board shall be organized into branches in accordance with sound economic practice. No direct dealings between individuals shall be necessary.

The Powers of the Property Board³

The Property Board shall have the power to:

- a. Receive and rule on claims for *affected property*;
- b. Decide any question or dispute before it regarding claims, entitlements of *dispossessed owners*, *current users* or owners of improvements, allegations of sale under duress, *property* valuation, right of first refusal or title to or other rights in respect of *affected property*;
- c. Decide in individual cases on, and set and revise scales and values for the purposes of calculating compensation for *affected property* and improvements; rent, sale and purchase amounts; entitlements to *alternative accommodation* and other amounts under these provisions;
- d. Demand and receive prompt, full and unhindered access to any and all records, archives, databases or other information regarding *property* in Cyprus, and to any and all *property* in Cyprus for the purpose of inspection, valuation and assessment related to its tasks and operation, and to receive copies or extracts of information, without fee, tax or other charge;

³ Annan Plan V, Foundation Agreement, Annex VII, Attachment 2, Article 3, pp. 112–113.

- e. Order or procure the registration of interests in *affected property* or correction of entries in the relevant Land Titles Register or other records, based on entitlements under these provisions or other applicable law;
- f. Refer any question arising in respect of an *affected property* to another competent court or authority, as appropriate and for finalisation or any interim or other ruling;
- g. Order the suspension of any proceeding in any court or other authority, or any physical alterations (other than minor or emergency maintenance) with respect to *affected property*;
- h. Order or procure the completion of any steps as required to transfer interests in *affected property* or, where necessary, partition *affected property*, under these provisions or other applicable law;
- i. Issue legally binding orders to competent federal or constituent state bodies as required to implement its decisions;
- j. Acquire and deal with *affected property* in a responsible manner under these provisions, including the administration and disposal of *affected property* transferred to it or coming under its control;
- k. Facilitate the provision and allocation of *alternative accommodation*;
- l. Assist persons, upon their request, in the lease of *affected property*;
- m. Collect damages from and issue fines against any persons found responsible for damaging or destroying *affected property*;
- n. Administer and/or supervise a preferential loans scheme under these provisions and coordinate with the Central Bank and the federal government on any possibly needed regulations or provisions regarding implementation of the scheme, including mortgage default and enforcement mechanisms;
- o. Adopt such rules, regulations, procedures, forms and other instruments as required for the performance of its functions;
- p. Consult and seek recommendations from qualified experts to assist in the performance of its functions, including experts in valuation, economics, law, property markets, quantity and land surveying, registration, mapping and others; and
- q. Perform other tasks, including those which may be assigned to it by the federal government or either constituent state, or which are incidental or related to the performance of its functions.

GLOSSARY OF ANNAN PLAN TERMS

In Annex VII of the Annan Plan V and its attachments, the following terms are defined as:

Affected property: immovable *property* in Cyprus which the owner, being a natural or legal person, left or of which s/he lost use and control as a consequence of intercommunal strife, military action or the unresolved division of the island between December 1963 and entry into force of the Foundation Agreement, and which has not since been reinstated to the owner (or his/her heir, personal representative or successor in title), and over which s/he has not regained use and control. *Affected property* shall not include any *property* which was voluntarily sold, transferred or otherwise permanently disposed of by the owner, to a natural or legal person who was able to gain effective control over the *property*, or for which compensation due to compulsory acquisition has been accepted. The onus of proof of any such voluntary transfer or lawful expropriation shall lie with the transferee or his/her successor in title. In the absence of evidence to the contrary for the individual case in question, dispossession shall be presumed to have been unlawful and/or involuntary. People who are successors in title of *dispossessed owners* and have not been able to gain effective control over the relevant *affected property* shall be treated in the same manner as the *dispossessed owners* themselves would be.

Alternative accommodation: residential housing for people affected by the return and *reinstatement* of owners, who satisfy eligibility requirements. Such accommodation shall at least be of a level which is comfortable by reasonable modern standards (including being connected to public utilities where available, such as water and electricity); provides a reasonable ratio of living space for the number of household members which it must accommodate; is no less than 70 square metres for a household of up to two persons, 100 square metres for three persons, 120 square metres for four to five persons and 140 square metres for larger households; and, where practicable, is comparable to the residence which the recipient is vacating or which s/he possessed prior to his/her displacement (up to a maximum standard to be defined in regulations of the Property Board).

Current user: a person who has been granted a form of right to use or occupy *property* by an authority under a legal or administrative process established to deal with *property* belonging to *dispossessed owners*, or any member of his/her family who

has a derivative right to use or occupy such *property*, or his/her heir or successor in title. The definition does not include any person who occupies or uses a *property* without any legal, administrative or formal basis, nor any person using or occupying *property* under a lease contract from a private person, nor any military force, body or authority.

Current value: value of a *property* at time of dispossession, plus an adjustment to reflect appreciation based among other things on increase in average sale prices of *properties* in Cyprus in comparable locations in the intervening period up to the date of entry into force of the Foundation Agreement. The *current value* of *property* shall be assessed as at the date of entry into force of the Foundation Agreement. This value shall bear interest, at the same rate as interest on medium-term government bonds, from the date of entry into force of the Foundation Agreement until compensation bonds and property appreciation certificates are issued.

Dispossessed owner: a natural or legal person who, at the time of dispossession, held a legal interest in the *affected property* as owner or part owner, his/her legal heir, personal representative or successor in title, including by gift.

Institutions: entities other than natural persons, including privately or publicly-owned or controlled bodies, such as public or private trusts, religious institutions; military forces and companies (other than sole corporations).

Market rent: the amount of rent which could be charged for a *property* on the open market, based on an assessment of *market rents* paid for comparable *properties* in comparable locations at the time of assessment.

Market value: the amount for which a *property* could be sold on the open market, based on an assessment of purchase prices or amounts paid for comparable properties in comparable locations at the time of assessment.

Original state: the state or condition of affected property at the time of dispossession of the dispossessed owner, not including improvements subsequently made by any party, assessed at current value.

Property: immovable property, being land and fixtures attached to land (or an ownership interest or undivided share in such a property).

Property eligible for reinstatement: any affected property for which title has not been given to:

- a. a current user in exchange for his/her affected property in the other constituent state (in accordance with Article 12 of the main provisions);
- b. a subsequent purchaser from such a current user (in accordance with Article 13 of the main provisions); or

c. the owner of a significant improvement in exchange for payment of the current value of the property without the improvement (in accordance with Article 14 of the main provisions);

and which is not owned by institutions nor used for military or public benefit purposes (Articles 9, 10 and 11 of the main provisions respectively).

Reinstatement: restitution through the award of legal and physical possession to the dispossessed owner, so as to enable him/her to exercise effective control over the property from which s/he was dispossessed, including use for his/her own purposes.

Reinstatement entitlement: The reinstatement entitlement is one third of the land area and one third of the current value of the property (whichever first applies) of the aggregated affected property of a dispossessed owner, who is not an institution.

Religious site: a mosque, church, chapel, cemetery, monastery, shrine, tomb or other place of worship. In exceptional cases, where living quarters, contiguous gardens or other land and buildings owned by the Church or Evkaf form an inseparable unit with the religious site, such property up to a maximum of 2 donums/skales shall be considered part of the religious site.

Significant improvement: an improvement (including any new construction on vacant land) to an affected property, which was made between the time of dispossession and 31 December 2002, or based on a building certificate (proof of engineering approval for construction) issued prior to 31 December 2002, or any later improvement which has been deemed admissible for this purpose pursuant to regulations of the Property Board and of which the market value is greater than the value of the affected property in its original state. If the property was damaged after the time of dispossession but during the events of 1963 to 1974, the market value of the improvement shall be compared to the value of the property in its state at the time the improvement was made. For the purposes of determining the ownership of the improvement, it shall not be considered as having attached to the land; the owner of the improvement is the natural or legal person who paid for the improvement or his/her heir, personal representative or successor in title. The burden of proof concerning the value, ownership and date of construction of any improvement lies on the owner of the improvement.

Sufficient financial means: income (taxable or otherwise) of more than X (X being the amount required to meet mortgage payments) or wealth of more than Y (Y being the amount required to purchase the currently used property or alternative accommodation). Entitlements and interests in affected property shall be taken into account for the purposes of calculating wealth. The Property Board shall determine the amounts of X and Y and revise the amounts annually, based on market figures and expert input.

Use for own purposes: use and enjoyment of affected property by a person, his/her family member, employee or representative (other than a tenant) through regular personal use (not necessarily as a permanent residence). Use for own purposes shall not include selling, renting, transferring by gift or otherwise disposing of an interest in affected property.

Vacant: not used or occupied by a current user or any member of his/her family or successor in title who has a derivative right to use or occupy such property.

METHODOLOGY FOR COLLECTION OF REAL ESTATE DATA

PERHAPS ONE OF THE MOST IMPORTANT PARTS of our research work relates to the use of the unique database of property prices, which includes both houses and land from both the North and the South. This enables us to draw, for the first time, fact-based empirical conclusions on property price trends on both sides of the ceasefire line and to base our assessment of the property provisions of Annan V on the real dynamics of the relevant property markets.

The real estate database includes asking-price data on housing units and land for 2003, 2004, 2005 and the first half of 2006. We collected data on asking prices, rather than transaction (sales) prices obtained from land-registry records, for two reasons. First, asking prices provide a much more up-to-date picture of the property market than any information available from land registries, where there is a long time-lag between the transaction taking place and its appearance in the land-registry records. Second, land-registry data can be problematic from a methodological point of view, given the practice of some sales prices being under-reported for tax purposes.

For real estate prices in the South, we collected data from the database of BuySell Cyprus Real Estate, the largest real-estate-related company that specializes in advertising property in the South. BuySell Cyprus Real Estate granted us limited access to two large databases (the biggest on the island) on asking prices: one for housing units, containing over 7,000 entries, and one for land, containing around 1,700 entries. For real estate prices in the North, we gathered over 1,000 advertisements for housing units and just under 300 advertisements for land, published in newspapers in the North: *Kibris*, *Afrika*, and *Cyprus Today*. In order to collect a representative sample, the search for both North and South covered seven six-month periods between January 2003 and June 2006.¹

Kibris is the largest Turkish Cypriot newspaper in terms of circulation, while *Afrika* was selected because it hosts free-of-charge advertisements in special sections submitted by private persons. The fact that the advertisements are free of charge means that it is able to attract a large number of submissions. This made possible the collection of data from a rather large sample, despite the relatively small size of the property market in the North. *Cyprus Today*, a weekly English-language newspaper,

¹ Data in the North was compiled by Ms Özlem Yöncü, university economic graduate student.

was also selected because it attracts a considerable number of advertisements for villas and other housing units in tourist areas.

After cleaning the data to exclude significant outliers, repeat advertisements and other anomalies such as lack of full descriptive information regarding the property, the final sample was condensed to a total of 1,619 land entries and 6,215 housing entries for the property market in the South and 203 land entries and 507 housing entries for the property market in the North.

Further, for the purposes of verifying the results of our data analysis and obtaining a further insight in the real estate market in the North, we carried out interviews with Turkish Cypriot real-estate professionals, assisted by Dr Ayla Gurel. The interviewees who answered questions submitted to them in the form of a questionnaire were:

- Mr Zeyneli Uzunoglu, Royal Estate
- Mr Fevrzi Ozersay, Mimar
- Mr Cemil Tamcelik, Buy and Sell
- Mr Serden Hoca, Hoca Emlak

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