



AUDIT
OFFICE



REPUBLIC
OF CYPRUS

LEASING OF STATE FOREST LAND FOR THE ERECTION OF HOTEL UNITS IN AYIA NAPA

Executive Summary



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AUDITED ENTITY

Department of Forests

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Leasing of state forest land is governed by the Forestry Law 2012 (Law 25(I)/2012), which replaced the Forestry Law 1967 (Law 14/1967). According to the provisions of the Law and relevant Regulations, the Council of Ministers has the power to grant, lease and generally dispose state-land within state-forests.

On the basis of the above, the Republic of Cyprus signed, inter alia, in 1970, 1981 and 1982, five lease agreements of state forest land, for a time span of 99 years, for the erection of five hotel units (A, B, C, D and E), in Ayia Napa. The contracts, four of which were concluded within the framework of policy regime, in the post-1974 period, which included measures to reactivate the displaced hoteliers, were initially signed by the Ministry of Energy, Commerce and Industry and then managed by the Department of Forests (DF).

This performance audit, which also embodies elements of compliance audit, was carried out within the framework of the Auditor-General's responsibilities to perform audits with respect to the allocation of public funds in the most economical, efficient and effective way. The objective of the audit was to demonstrate the weaknesses of previous contracts in order to form recommendations to improve the existing legal framework.

In particular, in the context of auditing DF, our Office compared the different ways of calculating the rents paid by the foresaid hotel units and examined their reasonableness. The method of calculating the rent, which, as turned out in some cases, can be influenced, is outlined below:

For hotel unit A, based on the lease agreement, the rent was defined as a percentage of 3% on the gross takings for a period of 13 years from the commencement of the operation of its premises, of 6% for the next 12 years and of 12% until the expiration of the lease.

For the other four hotel units, B, C, D and E, based on the respective lease agreements, the initial rent was defined as a percentage of 3% calculated on the market value of the leased land, which was adjusted to 5% after the completion of ten years and since then was being adjusted every five years, either according to changes in the General Retail Price Index issued by the Government or according to the fluctuation of the approved hotel invoicing rate on accommodation and food services, pursuant to article 10 of the Hotels and Tourist Accommodation Laws 1969 to 1974, whichever is the highest. We note that, in order to calculate the fluctuation of the approved invoicing rate on accommodation and food services of each hotel unit, a relevant formula is used, based on the agreements.

The most significant audit findings, are summarised below:

- a.** In view of the fact that a period of 48 years has elapsed since the signing of the aforementioned contracts for the lease of state forest land and the fact that one of them has been sub-leased, while another had been sub-leased in the past for a period of approximately ten years, since this is permitted by the contracts, the purpose of the four lease agreements, i.e. as an incentive for the reactivation of displaced hoteliers, may have elapsed.

- b.** It became clear that the method in which rents are calculated, as defined in the contracts, may, now, cause a distortion in the tourism industry, since the lessors pay significantly lower rents than they would have paid if they had leased the land under current market conditions. In particular, we calculated the rent, which would have been paid, at a rate of 5% on the value of the property, as defined in the Immovable Property of the Republic (Disposal) Regulations of 1989, based on the market value as at 22.9.2020, which, according to the Department of Lands and Surveys (DLS), concerns land value based on their existing use and not their planning zone. In comparison with the

actual annual rents paid, the above calculation leads to significant differences, amounting up to €5.043.071, which is a cause for concern.

c. It became clear that, in the above mentioned four cases, lessors are able to influence the level of rents, which are calculated on the basis of accommodation and food services as declared to the Cyprus Tourism Organisation (CTO), to the extent that the rent is marginally close to the amount of it, as would have been calculated on the basis of the General Price Index.

For example, we mention that the annual rent of the hotel unit C, as calculated on the basis of the revised accommodation and food service prices, currently amounts to €139.737 (from €311.914) and is by €172.177 lower than that in the previous period, i.e. decreased by 55%, at a time of a significant increase in the performance of Cyprus tourism industry.

d. In addition, according to data submitted by the CTO, we observed that, in calculating the average accommodation and food service price on a per day per person basis, the DF took into account the average price of a double room. This price would vary significantly upwards if the average single room price was taken into account in the above calculation. Therefore, there may be an issue of incorrect implementation of the provisions of the contract to the benefit of the lessors.

e. By comparing data across hotel units B, C, D and E, we observed that regarding hotel unit D the rent increased over time, the only one classified as three-star and having the highest rent price per sq.m., while hotel units C and E, which are classified as four-star, pay the lowest rent per sq.m.

f. The Commissioner for State Aid Control (CSAC), under his letter dated 6.6.2018, addressed to the DLS, pointed out the need to examine whether the current rents and right of use fees of state immovable property used for tourist purposes correspond to market rents.

g. We also pointed out that, according to the Immovable Property (Tenure, Registration and Valuation) (Amendment) (No. 4) Law 83(I)/2010), «if the property will be used for the erection of main tourism premises, the rent amounts to an annual percentage of 5% calculated on the value of the property».

h. In view of the fact that, in order to amend the terms of the aforementioned contracts, the consent of both parties is required and the fact that, in all likelihood, the hotel units would not accept an adjustment of the rent on the basis of the market value, since this would entail a significant increase in the rent, we would have expected the DF to consider the potential to terminate the contracts, before renewing them for another 33 years on the same terms, which, prove to be unfair for the Republic.

In conclusion, while we recognise the legal impediments which may render it very difficult, if not impossible, to adjust rents to market values, it is still clear that the terms of the above leases, as they stand today, do not ensure the disposal of state forest land in the most economical and efficient way.

We recall the weak system of the disposal of Turkish/Cypriot properties, which was in force until 2018 and has recently been replaced by a procedure, which provides for the publication of all available Turkish/Cypriot properties regarding the granting of dwellings for permanent housing, agricultural and livestock land plots and premises for professional use.

Similarly, we consider that leasing state-land directly to specific natural or legal persons, in particular for commercial purposes (such as, for example, the lease of state forest land for erecting hotels and the recent leases of state-land and state forest land for the purpose of erecting photovoltaic parks, the erection of a private university and a livestock unit) by no means satisfies the principles of transparency, equal treatment and non-discrimination.

Based on the above, we have drawn significant conclusions and provided recommendations on how to effectively manage state forest land, as outlined below:

- ◆ In order to secure public interest, state forest land should be managed in accordance with the principles of good administration, transparency and equal treatment . This requires that, especially in cases of land leases of large developments (i.e hotels, industrial units, universities, etc.), an open, transparent and competitive procedure is followed to secure its disposal in the most economic, efficient and effective manner. In every case, the disposal of state-land should be managed in a transparent manner. For the calculation of the minimum acceptable rent, the method set out in Law 83(I)/2010 (i.e., in the case of hotel units, 5% of the market value of the land) could have been used provided that it will be amended accordingly.

- ◆ long-term agreements between the State and private bodies, particularly when they include clauses which are impossible to amend without the consent of the lessee, entrap the Republic in unfair solutions which do not serve the public interest. Probably, the original purpose of the leases, through the years, became obsolete.

In general, the duration of a lease agreement should be proportionate to the investment, in order to allow sufficient amortization time, but not longer. The existing Forestry (Disposal of State Forest Land) Regulations (RAA 134/2012) has set a time limit of 15 years for cases of lease of state-land for agricultural or livestock purposes, but no limit has been set for tourism or industrial purposes. Although this allows a flexibility to the Council of Ministers, it should not be used without a predetermined policy, which should be related to the type of the development, on the basis of a study carried out by the Ministry of Finance. There should be no renewal clause in the agreement.

- ◆ Methods of calculating rent in a way that allows lessors to influence the level of amount of rent should not be adopted.

The audit findings and recommendations were communicated by letter to the DF for taking all reparatory actions.