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Trends in the European Residential Property Market in 2007

A Year of Change for the Residential Property Market?

The year 2007 was an interesting one for the property market in Europe. Clearly the property market is affected by external factors and economic and financial changes played a part in market developments, particularly global financial difficulties, resulting in some countries seeing an end to a period of steadily rising property prices. In other countries, prices continued to rise, so it is difficult to speak in terms of an overall European trend. The situation is further complicated by the fact that there remain fundamental structural differences between markets, even within the European Union. This overview is based mainly on information received from CEPI's member organizations throughout the European Union.

Looking back firstly at the year 2006, and the information which CEPI gathered for that year and published in its report for 2006, we can say that 2006 saw prices for houses and apartments increase in virtually all countries. The sole exception was Germany, which saw slight falls. The highest minimum and maximum sale prices per sq m in a capital city were recorded in Italy both for houses (2,400-11,000) and apartments (2,000-15,000), Rome being closely followed by Madrid and Dublin as the most expensive European capital city. The largest annual price increase from 2005 was recorded in Latvia (which saw a rise of 49% in the price of apartments and 30% in the price of houses). These rises reflected the intensive development of the property market in the Eastern European countries following their accession to the EU.

In June 2007 the European Central Bank (ECB), in its Financial Stability Review¹, commented on the risk that concern about the increased cost of credit protection associated with sub-prime securities could have an effect on the broader market for structured credit instruments. It also referred to a slowdown in net borrowing by the household sector since 2006 although levels continue to remain high, with signs of a moderation of house price inflation in a number of euro housing markets. It expressed the view that the risk of potentially disruptive property price declines in the future appears to be limited in the euro area as a whole, although there are continuing differences between individual Member States. However, concerns remain about the sustainability of unprecedented levels of mortgage-related leverage in those parts of the euro area where housing valuations appear stretched; levels of debt are high and where the majority of debt is financed at variable interest rates.

In addition 2007 saw rising oil prices, a strong euro and increases in the cost of credit due to the sub-prime crisis. These factors have combined with rises in retail interest rates and more stringent lending criteria to making investors nervous. By the end of the year these pressures were already being felt, although in certain countries more than others. We will seek to illustrate these changes by referring to specific countries.

A Correction in Certain Markets

Taking France as our first example, information reported by one of CEPI's member associations illustrates the practical impact of difficulties in the financial markets. In October of last year FNAIM observed that price increases were slowing in all sections of the market. In the third quarter of the year prices increased at a rate of +4.7% for the resale market (as opposed to +7.1% at the end of 2006) and at a rate of +1.6% for the private rental market (as opposed to +3.6% at the end of 2006)².

For the whole of the year, FNAIM recorded a rate of increase for France of 3.8% for existing properties, as opposed to 7.1% in 2006 and 10.4% in 2005, showing the rate of slowdown in price increases. The continued stability of the market depends on factors such as household morale in terms of finances, the risk of increased inflation, likely falls in purchase power and the possibility of continued problems in the financial markets. It is possible that 2008 will also see continued alternating price rises and falls³.

¹ ECB Financial Stability Review June 2007

² Fédération nationale de l'immobilier (FNAIM) "L'Observatoire des marchés de l'ancien" Octobre 2007.

³ FNAIM "L'Observatoire des marchés de l'ancien" Janvier 2008.

In the Netherlands NVM⁴ reports prices as rising at a rate of 1.2% for the last quarter of 2007, with an increase of 4.3% compared to the same period in 2006. In Denmark, according to information published by EDA⁵, the price index for single family homes rose steeply in 2006, but fell back in 2007. In Finland also (based on information from SKVL⁶), indications are that price increases started to fall towards the end of 2007, after steady increases and a high volume of transactions, with prices of houses and apartments estimated to be up by approximately 6% during the year 2007 compared to the previous year.

However, it is evident that other markets have seen more pronounced changes. Indeed 2007 has been reported by one of CEPI's Irish associations IAVI⁷ as being "the year the property market turned, and not just in Ireland. As in the US and UK tighter monetary policy conditions and growing concern about the extent of overvaluation in property markets caused a reduction in demand, particularly from investors. From the heady heights attained by the start of the year, average property prices in Ireland began to decline from February".

This correction for 2007 was demonstrated by significant falls in activity. After a prolonged house price boom average national house prices in Ireland⁸ fell by -1.1% in November and - 5.9% in the twelve months to November 2007, a year which saw rises in interest rates and anxiety about employment, with younger and more indebted borrowers being particularly vulnerable.

According to IAVI, a sharp decline in new home completions in Ireland was noted in 2007, as builders responded to slow demand, with residential prices in Ireland at the end of the year being close to those applicable at the end of 2005. Changes were made to the property transfer tax (stamp duty) regime in Ireland in the December National Budget, bringing substantial reductions to many home buyers.

There was a strong increase in residential rents in 2007 (between 10 and 12 per cent per annum in Dublin) which does indicate a strong latent demand for property, and gives rise to hopes that the worst is over. For 2008 a fall in residential capital values is forecast for Dublin of - 4.1% and an increase in residential rents of 4%. Most expect an improvement in the market in the major urban areas as from the middle of the year, with the more pessimistic view being taken by some that the market may not recover until the end of 2008⁹.

In the United Kingdom concerns have also been expressed about a slowdown in the market. The final quarter of 2007 saw house price growth slowing to an average rate of 6.9% for the country as a whole and to an annual rate of 12.8% in London from 16.5% in the third quarter¹⁰. The Financial Services Authority has warned of difficult conditions likely for the market in the United Kingdom in 2008, due in particular to the number of borrowers coming to the end of the term of fixed rate mortgages and having to face large increases in the cost of their borrowing.

In Spain also there were signs of a slowdown, with a lower volume of sales and a flattening of prices. After years of substantial price increases the year 2007 saw an annual rate of growth of 5.3% at the end of the third quarter¹¹. By the end of 2007 the first price falls were being recorded, a decrease of 2% in Barcelona and 0.3% in Madrid¹². The indications are that subsequent figures are likely to show stronger falls in the level of prices.

The years 2001-2006 saw an increase in real estate activity in Spain with strong investment in real estate projects. For example, in 2003 450,000 new homes were constructed in Spain (compared to 800,000 new homes constructed in the USA in 2003). There was very high international demand and interest rates were low.

⁴ Nederlandse Vereniging van Makelaars in onroerende Goederen en Vastgoeddeskundigen (NVM).

⁵ Ejendomsforeningen Danmark (EDA).

⁶ Suomen Kiinteistönvälittäjäliito- Finlands Fastighetsmäklareförbund ry

⁷ The Property Valuer published by Irish Auctioneers and Valuers Institute (IAVI) Volume 26-No 6-Annual Property Survey 2007-January 2008

⁸ Permanent tsb/ESRI House Price Index November 2007.

⁹ IAVI idem.

¹⁰ figures reported by the Nationwide Building Society January 2008

¹¹ Knight Frank Global House Price Index Q3 2007.

¹² Idealista.com real estate news summary December 2007.

Following this period of strong market activity the year 2007 has been described as an "annus horribilis for Spanish real estate companies", with demand decreasing, higher interest rates and stricter lending criteria imposed by banks following the sub-prime crisis in the USA. In 2007, 40,000 real estate companies closed, more than 14,000 million euros was lost on the stock exchange and Spanish real estate companies burdened with high levels of debt to banks were forced to sell assets. However, as the market has slowed in Spain there has been an increase in international investment by Spanish developers and buyers.¹³

It would seem that in Spain the impact of a slowdown in the property market is more pronounced because of the large number of second homes in the country, with the second homes market being more likely to suffer in a downturn. The property market in Spain is also a very large one with more impact on the economy of the country as a whole than seen in some other countries.

In Germany property purchase prices continued to fall, but at a reduced rate. Shortage of supply may be having an impact. In November 2007 the number of building permits for apartments fell to 118,000, a reduction of 32% on the same period the previous year. The number of newly completed housing units fell to 225,000 (from 248,000 in 2006 and 600,000 in 1995), the lowest level since the end of World War 1¹⁴.

The rental market in Germany saw increases averaging 1% from the beginning of the year, although there were large differences between the smaller towns and larger cities such as Essen which saw increases of up to 10%. Hamburg, Berlin and Leipzig saw increases of 4%. Increases were higher for older dwellings probably due largely to the difficulty of obtaining building permits, with Munich being the most expensive city. On an annual basis purchase prices of one family and terraced houses saw a decrease on average of -1% for the country as a whole. However the market seems stable, with a slight decrease in prices in some cities but slight increases in most. In Germany purchase prices seem to be at the levels of 1997, having seen large increases prior to then, with consolidation since. Fiscal incentives for home ownership (although not investment) have given rise to comment that now may be a good time to buy.¹⁵

The markets in Central and Eastern European countries continued to see a lot of activity, having attracted a lot of property investment activity in recent years. In particular Bulgaria saw the largest price increases, an annual increase of 30.6% to the third quarter of 2007¹⁶. These increases were fuelled by a lack of supply, particularly of modern apartments, and increased investment. The global credit crunch appears to have had little impact on this market. Indeed Bulgaria was described as the world's strongest property market in 2007 with an estimated turnover of 11.36 billion euro, an increase of 2.36 billion euro over the previous year¹⁷.

In addition it seems likely that there will prove to have been price rises in Romania, following its accession to the EU on 1 January 2007. Authoritative figures are not yet available to substantiate this. However experience tells us that the years prior to accession have seen accelerating prices.

Latvia has experienced large price raises (as demonstrated by the figures for 2006 previously mentioned) but the market slowed in 2007 and prices of apartments even fell by 2% in October 2007, prices being 6% higher than October 2006¹⁸. Subsequent figures are likely to indicate stronger falls.

Slovakia is another country which saw important developments in its residential property market for 2007. In the medium term, residential properties have seen a growth rate of 8-10%. Since 2001, the market has been in the process of catching up. It is striking that in 2007 a third of all construction work in Slovakia was designated for residential property. The country has experienced a dynamic market due to an influx of capital and investment, although the liquidity of the clients commissioning works is in issue. Strong demand is an important element

¹³ Planner Read presentation for the SIMA08 Madrid International Real Estate Exhibition.

¹⁴ Dr. Zitelmann PB GMBH German Real Estate News 25/07.

¹⁵ Immobilienverband Deutschland IVD Bundesverband der Immobilienberater, Makler, Verwalter und Sachverständigen e.V. Wohn-Preisspiegel 2007/2008.

¹⁶ Knight Frank idem

¹⁷ British property investment company Obelisk quoted in the Sofia Echo 01 February 2008.

¹⁸ according to the Latio price index.

together with bank conditions for borrowing, availability of projects (particularly in Bratislava and the industrial areas) together with the introduction of the euro and attractive prices. In 2007 14,000 units were completed, 20,500 units were commenced and 54,000 under construction.

This strong demand is likely to be due to a deficit of units, Slovakia having had a total of 310 units for each 1000 inhabitants (as against an EU average of 400). In the first six months of 2007, prices increased between 10-50%, depending on the region. Prices were at a level of 1,500 per square metre on average in Bratislava and 900 to 1,200 outside Bratislava, for new constructions. In terms of lending criteria, banks in Slovakia offer mortgages of up to 120% of the value of the property. The second homes market in Slovakia is an attractive one with increased interest in investment. This point also applies to other countries in the region, with interest in the purchase of second homes shifting further eastwards.¹⁹

2007 also saw price growth slowing in the Polish market with prices stabilizing. Particular factors which may affect the market there include an "anti-speculation" tax as from the beginning of 2007, at the rate of 19% of a property's increase in value if sold within five years of its original purchase. Another significant tax change is the ending of tax relief that avoided the proceeds of sale of apartments being taxed if the proceeds were invested in another apartment or construction of a house. High prices mean that affordability is now an issue in a more competitive market. However, in Warsaw, in spite of high levels of construction demand for apartments remains high, although prices have been rising at a decreasing rate. Investment buyers have grown more cautious after a period of strong speculative activity. Krakow is Poland's largest residential market, where demand continues to outstrip supply, due to the poor quality of existing housing stock and a relatively strong economic situation. Increases in the output of housing construction are likely to bring further development of the residential market.

Overall Central Europe continued to see strong construction output of dwellings in 2007. Demographic factors also play a part with major cities tending to lose population (in accordance with the trend in most of Europe). Prices in the cities in this area have tended to be pushed up by speculative demand, some from foreign investors. It is anticipated that the post-accession price growth period of 3-5 years will be followed by a period similar in length but characterised by higher supply and price stagnation. The mortgage market is also developing in these countries, leading to a great deal of potential. It is expected that the most dramatic changes in the long term are expected to take place in the Balkan states and Ukraine, with development slowing in the other countries. Due to economic and political changes these markets are still taking shape²⁰.

Structural Differences between Markets

What then was the trend for 2007? It was a year of changes in the property market but those changes were more pronounced in some countries than in others. There has been a general slowdown in the growth of residential property prices, but with certain exceptions. Economic, financial and political factors play a role and some European markets appear to be at a different stage in their development. There still remain important differences between markets, in spite of the increasing availability of cross-border funds and products and the expanding second homes market. For example there are differences in the rate of home ownership. In 2003 the ECB put the share of owner-occupied housing in the European Union as varying between 39% in Germany and 85% in Spain, with an average of 61%.

Taking Italy as an example²¹, which has a high rate of home-ownership (nearly 70% in 2003, and above the European Union average); there are several features which distinguish the market in Italy from that in other countries. The age at which Italians buy their first home is much higher than elsewhere, so that by the age of 30, in the Anglo-Saxon countries the home-ownership rate is around 40-50%, but only 15-25% in Italy. According to the ECB (2003), mortgage debt in Italy in 2001 averaged only 10% of GDP, compared to an EU average of 39% and 60% in the UK. Also, mortgages in Italy are for shorter terms, typically 10-15 years. The fact that foreclosure is difficult affects the development of the Italian mortgage market, with it taking on average 48 months to

¹⁹ WKO Austrian Chamber of Commerce, Building News for the Republic of Slovakia October 2007.

²⁰ based on information supplied by REAS

²¹ see European Central Bank Working Paper Series No 857/January 2008 "Housing and Equity Wealth Effects of Italian Households")

foreclose a mortgage in Italy, compared to less than 5 months in the United Kingdom. However the market is strengthened by the facts that there are tax advantages to home ownership (as in many other countries) combined with a highly regulated rental market which reduces the supply of rental property.

Differences in Regulation within Europe

There remain important differences in the legal formalities required in purchasing property between European countries, with large differences in transaction costs. There are wide disparities in levels of regulation across the EU ²², with different regulatory models. These different regulatory systems are exemplified by the Latin notary systems found in the majority of continental European countries with fixed fees, the deregulated Dutch notary system with negotiable fees, the lawyer system found in the UK and Ireland, the Czech Republic and Slovakia (and to an extent Austria) with negotiable fees, and the Scandinavian licensed real estate agent system with negotiable fees. Each of these different regulatory systems has its own characteristics which affect the cost and timescale of transactions, with variation in legal fees between different countries.

Whilst there are certain trends in the European property market and clear changes in some national markets it remains difficult to give an accurate comparison of the market in different countries. Data is obtained from different sources using different methodology which vary in reliability. Although there are a variety of sources available these are not always authoritative. Given the importance of the property market to the European economy it would be useful to have accurate references and comparable data at a European and national level.

What is striking is that, in spite of a few European legislative initiatives, the Member States still largely define their own terms and conditions as to access to their respective real estate markets. Notably, half of EU Member States do not regulate, or no longer regulate, real estate professionals, as if liberalization of the market equals deregulation. CEPI is convinced that trying to realize a European market also means providing common rules which impose minimum, but essential requirements. At least in this way we can work towards more transparency for those seeking to understand the European property market.

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²² Centre of European Law and Politics University of Bremen, study COMP/2006/D3/003 "Summary of the comparative legal and economic study into the EU conveyancing services market"

