



Otthon Centrum

RESIDENTIAL MARKET MONITOR 2010/1

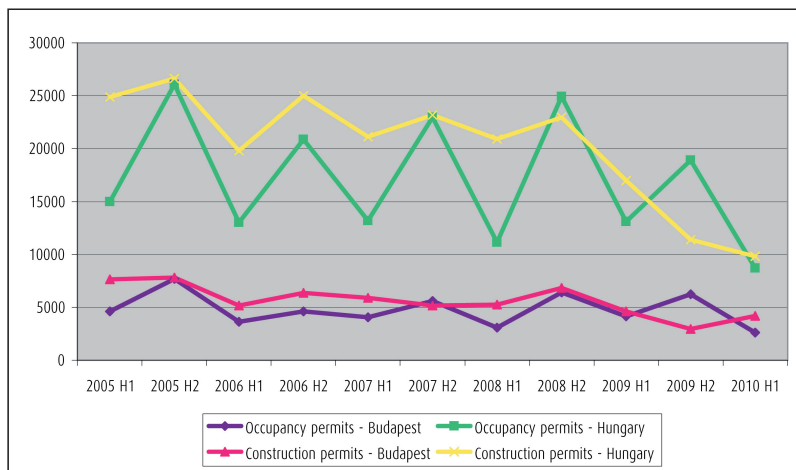
Even though there are several signs of a comeback from the nadir for the residential market and the segment starts strengthening again, its future performance and the re-creation of demand are largely dependent on the housing programme, planned by the new government for launch in 2011.

CONSTRUCTION VOLUME

According to data of the Central Statistical Office, in the first half of 2010, occupancy permits were granted to merely 9,000 homes and construction permits were issued for less than 10,000 new homes. The number of newly occupied homes is 34%, the number of new permits is 41% less than in the first half of 2009. Country-wide, acceleration is observed in the number of new permits: in the first quarter of 2010, the increase was 30%, in the second quarter, 50. The number of newly occupied homes (still increasing from 2008 to 2009) dropped by 26% in the first quarter of this year, by 41 per cent in the Q2. During the first six months of 2010, the number of newly occupied homes was approximately the same as the numbers observed in the early 2000s, prior to the pickup in construction. That is, the crisis is signalled not only by an increased weakening of building intentions, but also the data of newly occupied homes. Taking the above numbers as a basis, we estimate the number of delivered homes at about 20,000 this year, for the whole of the country.

The capital city remained the most important homebuilder, and even if the number of newly occupied homes decreased by 38 per cent in the first half of the year, its share, country-wide, is still 30 per cent (by the way, 55% of the new homes were built in the region of Central Hungary). Shares of the significant builders have been sinking at identical rates, therefore, similarly to the first half of 2009, households and corporate entities were represented in proportions fifty-fifty for the whole of the country, whilst only 14 municipality flats were built (0,2%). In Budapest, the share of construction by entrepreneurs increased minimally, to 79%.

Number of construction and occupancy permits, semiannually



Source: Central Statistical Office

An average drop of one-third in home construction is valid for most of the regions. The regions of Central Transdanubia and Northern Hungary show a dif-

ferent picture. In their case, the size of the decrease is merely one-fifth, but in the Great Plains region, the number of newly occupied homes has got halved. In a comparison with the same period of the previous year, the number of new permits dropped to almost one-third of the previous levels in Central and Western Transdanubia and in the Northern Great Plains. The number of construction permits issued in the capital city stagnated, due to an increase in the first quarter, at around 4,200, but in the second quarter, a 30 percent drop was observed.

In spite of a stagnation of entrepreneurs' construction shares and an increase therein in Budapest, the average ground area of homes built in the capital city increased by 5 sqm (to 71.5), and 3 sqm (to 92.3) for the whole of the country, in a comparison to the first half of 2009.

HOUSING POLICY, BANK FINANCING

Both in the property business and among home buyers, perceptible expectations preceded the parliamentary elections in April. Even though an unrealistic dumping of promises, characteristic for previous votings, did not emerge this time, and the government party having obtained a two-thirds majority also made it clear already at the beginning of the year that any measures to ease access to housing could be counted on only from 2011, the general climate is that of expectations and the "housing issue" was one of the main topics until now this year, in particular, from the point of view of assistance to borrowers in trouble.

A decision with negative effect for retail lending – already restricted in two steps, in March and June, by the lowering of the loan-to-value ratio and the regulation of credit assessment – came in the same month of June, when the government banned currency-based mortgages, in the framework of its first package of measures. Even though nowadays, more than two-thirds of transactions are realised without a new borrowing, and the share of forint loans within new loans reached 70% already in the first half of the year, taking out euro loans, with lower installments represents a solution for many. Their being squeezed out is another major loss for the slowly recovering residential market.

According to our proposal, until a more significant of the prime rates, the budget could carry in the next two years, a small interest rate subsidy for forint loans, for a short period of time, and the effect thereof would be very beneficial for the residential market. In the same manner, borrowing costs could be reduced by a cut in the sourcing costs of banks, with a revitalisation of the secondary market of mortgage letters, as well as permission for commercial banks to issue mortgage letters.

At the same time, in connection with the situation of banks (and indirectly, the real estate market) the main problem is how the bank tax, introduced in July and planned at 200 billion forints this year and in the coming year, would affect the readiness of banks to lend, and how much of the extra burden they would devolve to borrowers, through the borrowing costs.

In the second quarter of the year, a thirty per cent was the increase in the number of debtors with currency loans who did not default yet, but fail to pay

their installments since more than 60 days. And by now, the number of customers with debts overdue since more than 90 days is about 100,000, whilst because of the consistently strong Swiss franc and euro, this number is likely to increase further. On the whole, at least 500,000 persons may be concerned already now by the danger of default.

In the light of statistics, it is no surprise that during the last six months, most of the professional ideas and government steps were aimed at providing help to borrowers in trouble. Within that framework, already a June package of proposals included the set-up of the National Asset Management Company, to take over the homes of defaulted borrowers. Otthon Centrum submitted already in the spring of 2009 a proposal suggesting this type of assistance to defaulted homebuyers, therefore, we welcome the set-up of such an organisation, even if a detailed concept of the latter's operation has been promised by the government only for this autumn. Although the extension of the eviction moratorium until mid-April 2011 helps to avoid the coming of homes behind the defaulted loans to the market en masse, an umpteenth extension of this moratorium may hold the risk of creating a false illusion in borrowers regarding the effects of their default, and a lengthy search for solutions may also menace the stability of the banking system.

That said, the government party is about to submit this autumn to the Parliament an eight-points package of measures, in order to protect housing loan debtors. This package of laws would prohibit any unilateral modifications of contracts or voluntary increase of interest rates for banks and credit institutions; on the basis of the proposal of the Hungarian Financial Supervisory Authority, the use of medium rates of banks would become compulsory in the case of retail currency loans; upon the customer's request, early redemption would be free; also upon request, the term of the loan could be automatically extended by 5 years; the banks could not demand more from the debtor than the value of the property's market value; and in the case of lasting insolvency, the application of penalty interests or other extra costs would be prohibited. These rules would not apply to properties owned by business associations or second/third properties owned.

According to general opinion, for currency loan debtors, the best antidote for any worrisome weakening of the forint would be the conversion of such loans. Significant savings could be achieved if our Swiss franc loan is converted into a loan with more favourable terms – but conversions shall follow strict criteria. Among others, banks evaluate the property used as collateral, may prescribe a minimum of certifiable income and customers shall have no late payment exceeding 30 days in their past. According to experts, at the same time, a debtor in Swiss franc who would switch to forint now, would realise the exchange loss, for the whole of the loan. Another argument against conversion into forints is the accession of Hungary to the monetary union, because after that, the euro will be the Hungarian legal tender, therefore, forint loans lose their present advantage. A solution for reducing monthly installment payments therefore can be to convert our Swiss franc loan into a euro loan, with a more favourable scheme. Doing so, we can make savings in monthly installments, but one shall not forget that the exchange rate risk can be diminished that way, without getting rid of it completely.

The home creation programme of the New Széchenyi Plan published in August outlines the highlights of the new government's housing policy. Given that the domestic stock of homes have lags that are less quantitative, but rather qualitative, the government's strategy is aimed primarily at the solution of structural problems. The planned measures are oriented towards a modernisation of the existing stock, on the basis of energy conservation and efficiency, the construction of energy efficient homes, as well as a major expansion of the rented homes.

In respect of housing subsidies, one of the main goals is to act in harmony with the subsidisation of having children. In addition, the government places great emphasis on quality and the legality of construction, as well as self-provision. Therefore, building societies shall play an important role. The 'Swallownest

Programme', ensuring a first home for young couples shall be also relaunched. But these measures are planned to be introduced gradually. The provisions and the key figures indicate a very ambitious programme: from 2011, renovation of 100,000 homes per year (150-200,000 later on); the number of new homes shall increase to 40-50,000 per year; in the framework of a pilot project, construction of 300-500 rentable homes per year, later 1,000 p.a.; a "housing" budget representing 1.5% of the GDP.

In the opinion of Otthon Centrum Credit Centre, due to the stricter terms of financial intermediary services, the market of credit brokerage may see significant changes and shrink to about one-third of the previous size. In addition, one cannot exclude that for customers, services may become more expensive. The point is that from October, independent credit brokers can work only if they obtained a permit of the financial supervisory authority. In the new act on credit institutions, the new rules applicable to credit brokers were already included on liability insurance, remuneration, as well as training and examination requirements.

MARKET OF THE NEWLY BUILT HOMES

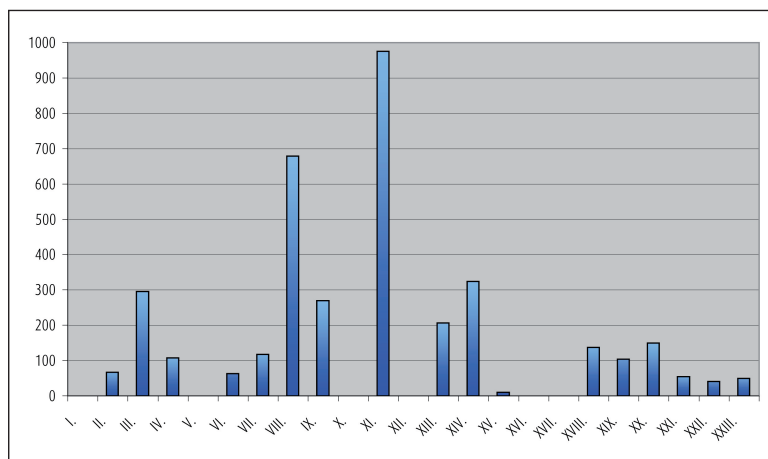
Even though some improvement took place in 2010 regarding quantitative problems (low sales figures and accumulated unsold stocks) of the market of new homes, the sector is still clearly characterised by stagnation, and any noticeable shift, due to a recovery of demand, can be expected next year only.

According to our survey, in the first half of 2010, about one thousand newly built homes were sold in Budapest, in condominium houses. For the first half of 2009, when due to the VAT increase applied from July brought a spectacular increase in demand during the spring, the same figure was 1090. And the negative effect of the VAT increase was shown, in a spectacular way, by the 520 homes sold in the second half. A reason for hope for the whole of this year is that without any purchases brought forward, in a "normal" market environment, this year has shown almost the same market absorption like last year, so far.

Another development that can be considered a positive yield of the crisis is that number of delivered but unsold homes decreased from 3,800 early this year to 3,400 in the capital city. This is based on the lack of resupply, on the one hand, and the fact that a decisive majority of the demand is focussed on delivered or almost-completed homes. Nevertheless, a signal for the difficult situation of investors is that in the capital city, sales of several investment projects, already under construction, were stopped. This is the main reason why the unsold stock under construction decreased from 3,000 in January to 1,900 by the end of the first-half. That is, by mid-year, those who were looking for a new property in Budapest could select from 5,300 homes. Every fifth thereof were from District XIII, whilst the share of District XI is 15%, the shares of Districts III, VIII and XIV 7-9%. At the same time, the lowest stocks are in Districts I, XII and XV.

According to our preliminary, interim data, this year the expected number of condominium flats delivered in Budapest shall be below 4,000 and that, after 8,300 last year, forecasts a decreased of about 50%. Also in terms of family houses, we do not expect a drop smaller than that. Most of the homes, almost one thousand, shall be completed in District XI; this shall be followed by District VIII, with 700 homes. About 300 new properties will be built in Districts III, IX and XIV, whilst in District XIII, previously permanently in the top 3, barely 200. As opposed to that, in six districts, we have no knowledge of condominium flats at all.

The number of condominium homes planned for completion in 2010 in Budapest districts



Source: Otthon Centrum; on the basis of data provided by investors and distributors
Note: As at July 2010.

Market absorption, that is, the number of new homes sold is of course closely related to the volume of offer. Therefore, in the first half of this year, most of the flats were sold in Districts XIII, XI, XIV and IX, respectively. Any summing up is difficult, however, due to the fact that in a comparison with the pre-crisis period, there are spectacularly more buyers who withdraw from contracting, after a preliminary contract and so, homes already recorded as sold ones return to the offered stock.

While we can evaluate the absorption of unsold stock as a positive trend from the point of view of market balance, this occurs due to the lack of confidence of buyers to starting projects, the high construction risks of investors and a squeeze in credit possibilities in general. Taking into consideration that more than 40% of the historical cost of a new home flows bank to the state treasury through taxes, contributions and the savings made due to less social and unemployment costs because of increased employment, a vitalization of demand is a clear objective. Therefore, in order to accelerate a recovery of the market of new homes, we believe that in addition to the already disclosed elements of the new government's home creation programme, certain further measures would be welcome to improve the positions of homebuyers and homebuilders, such as:

- A moderation of the new homes' 25% VAT burden, even to 5%. EU regulations provide a possibility for that.
- In the case of companies meeting certain criteria in the construction industry (e.g. 100 employees, free from overdue debt, training commitments, etc.), blue collar workers employed could be granted a Start „Builder” card for 2-3 years, when they shall pay lower public charges only.
- Construction companies could get involved in the public works programme, implemented as part of the social reform, mainly via employment of unskilled labour.
- Even though a rationalisation of rules applicable to levies was started already last year, there is still potential for instance in restoring for new homes the limit of exemption from duties to HUF 30 million.

MARKET OF SECOND-HAND HOMES

After a strong start of the first quarter of this year, a slowdown was observed on the residential market this spring, turning into stagnation. At the same time, on the basis of sales experience in the first half of the year, we maintain our forecast prepared at the beginning of the year, according to which in 2010, after a strong one-third drop of the market on the whole last year, we expect a minimum increase, of a few percents on the residential market.

The decrease in demand during the previous two years of the crisis had a differentiated effect on the submarkets. A fall below average (at about

20%) was observed in the Buda districts, where the clientele is less affected by a squeeze in borrowing possibilities and in the agglomeration area on the Buda side, as well as certain towns in the country. From a territorial point of view, differences in the fall of turnover figures was primarily linked to the general economic situation, the solvency and savings of people on the lookout for homes, the readiness of banks to lend and the property stocks.

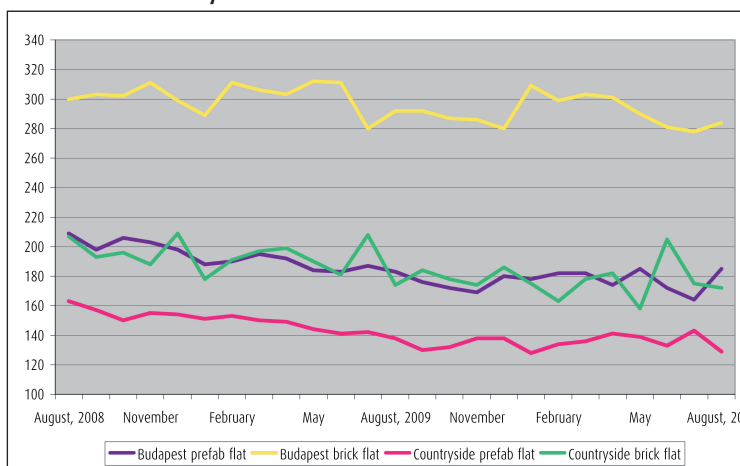
Not only the volume of demand dropped significantly, but there was also a major change in the proportions financing schemes for homebuyers who remained on the market. Whilst in 2008, the ratio of those who purchased homes by using their collateral under an existing loan or fully in cash was at around 30% for the whole of the country (with 50% in the Buda districts and 5-10% in the less developed cities and towns), this year, their ratio went up to 70%. Regional differences remained valid; in Districts II and XII and at Lake Balaton, cash buyers represent 90%, but for instance in the eastern Pest agglomeration, they represent only 45-50%. The difference comes from the ratio of buyers

with investment intentions, the buyers mix, on the one hand, and the risk rating of the town, village or area, on the other, this latter having implications on access to loan facilities.

Homebuyers lowered their requirements according to several parameters: smaller size, ground area, number of rooms, lower prices, other types (terraced houses became acceptable, instead of detached family houses) or neglect of other requirements (e.g. one bathroom, instead of several). The impairment of the least crisis-proof properties ranged between 10 and 35%, depending on their areas, during the last two years. Most of all, prefabricated blockhouses lost from their values, primarily because of the obsolete engineering appliances, isolation and due to district heating. Less resistance to the crisis, in general, is observed in the case of flats with large size, in a poor neighbourhood, poor condition, or poor internal layout. A decrease in value can also come from a special market situation, where in a specific, concentrated area, such as a prefabricated housing estate in a town of the countryside, the offer increases from homes purchased earlier mostly with a minimum of own funds and the owners, suffering from redemption difficulties, would like to get rid of them now, lowering the prices, by the same.

The table shows, on the basis of Otthon Centrum's monthly transactions, the average prices in the past two years, in different categories. Due to different events influencing the residential market and the characteristics of the database, if we would use a trendline instead of a curve showing frequently hectic moves, we would obtain a clear downward trend, in each case. When averaging monthly moves, we obtain figures showing that the month-on-month average changes were between -0.2% and -0.9% in the investigated period; with the smallest figures (about 5% in two years) in the case of brick-built flats in Budapest and the highest ones (in excess of 20%) observed in the case of prefabricated block houses in the countryside.

Monthly average prices of homes in condominium houses sold (HUF '000/sqm) in the last two years



Source: Otthon Centrum sales

The most crisis-proof properties maintained their 2008 price levels at nominal. It is typical that in a city environment, the smaller flats, close to downtown proved to be the best investments, and a separate category is represented by rarities, with limited offer. These include, for instance, plots with good locations, high-level family houses, as well as new or novel properties, considered as rarity in a given area. On the whole, we can say that for those who purchase homes for investment purposes and for those who have been waiting for the most favourable price level, it does not make sense any more to delay their search for homes.

Still, by now it became typical that people purchase residential properties for a home, and not for investment purposes. This means that they commit themselves to a certain flat or house, not only for a few years, but for several decades, together with all advantages and disadvantages thereof. More and more people recognise the importance of a serious, thorough investigation of the selected property, prior to the purchase. Parallel to the benefit from an increase in the value due to refurbishment, the feeling of the property, its comfort and its quality shall be also taken into consideration, even if these can be improved with different kinds of refurbishments – where an increasing emphasis exists, on the basis of the government's housing strategy, for support.

In a comparison with the first year of the crisis, this year, there is no clear reduction in rental fees. Especially in the less expensive categories, the increase in demand, due to delaying the purchase of a home (and the borrowing), put on the brakes for a further drop of prices. In the larger cities with universities and the frequented Budapest districts, rental fees dropped by a maximum of 5-10% to last year, but in many cases, they remained at 2009 levels. In the same manner, the bargain potential also decreased. The basis thereof is that advertisers reacted to the market conditions and they indicate prices that are closer to reality, in a comparison with last year. In addition, the competition created by the abundant offer also forces the owners to apply restrained pricing.

The 2011 performance of the residential market largely depends on the new government's housing programme and its effect on the market turnover. If demand starts lowering again, it may result in falling prices, debtors with payment problems "getting stuck", increase of risk costs for the banking system, as well as a drop in the economic performance of the property industry. An important impetus for demand may be the reduction of personal income tax, promised for next year. From freely available monies remaining in the households (part of which could be "converted" into the redemption of housing loans), more cash can head towards the residential market. The reduction in PIT and a growth path of the economy would have positive implications for confidence in the future and for consumer climate, which are outstandingly important drivers for the residential market.

MARKET OF CONSTRUCTION / DEVELOPMENT PLOTS

On the market of development plots, the wait-and-see position is still dominant. At the same time, sellers (unless they are forced to sell) are waiting for a recovery of the market and, by the same, an increase in prices, and buyers keep delaying their purchases, in the hope of further price reductions. In the presence of these two pricing concepts, there are barely any transactions on the market of plots. In the offer, there are an increasing number of properties coming from liquidations. Banks, as long as possible, have confidence in selling by the owners, but finally, properties that are still considered too expensive by the buyers, end up with the banks or liquidators.

Another hindrance for a rise in demand is that developers have plenty of reserve areas, therefore any search for new plots shall be prompted by a specific – and rare – development idea. A typical reaction in crisis is a reduction in project size, and so, also for residential development, plots suitable for small condominium houses are in demand. The premium areas rank relatively higher in demand. The main reason for that is that there was no drastic reduction in the borrowing possibilities of those who are looking for homes here (mainly in Buda) or they are cash buyers, a priori. For the same reason, the market of plots for family houses operates with the least disturbances in the green areas of Buda and the fall of prices was also the smallest here, because the owners are rarely in a situation of forced sale.

As opposed to that, the market of development plots practically came to a standstill in downtown Pest. The price expectations of buyers and sellers are the most distant here, too. Perhaps some minimum demand is generated by end-users, with the intention to build office space, company HQ, but in the absence of free plots, this takes place increasingly frequently with the refurbishment of existing buildings. The challenge for office developers is the refurbishment, in accordance with modern requirements, of historical buildings in inner Buda, which represent a large potential, because demand is relatively important there, but there are no free plots.

The market situation makes still difficult to determine the actual plot values. In certain areas (e.g. mass market) there is no sale and purchase at all, or the benchmark price is significantly different from the market price level, therefore, prices in the table are sometimes only "theoretical".

Typical prices of plots suitable for condominium development in Budapest

Area	Net plot price projected on net saleable sqm of residential area (HUF)
Inner portions of Districts I, II and XII ¹	70-140.000
Districts VI and VII, within the limits of Nagykörút	70-90.000
Districts VI and VII, outside the limits of Nagykörút ²	45-65.000
Former brownfield zone of district XI	20-35.000
Rehabilitation area of District IX	30-45.000
The Angyalföld portion of District XIII	25-40.000
District XIV	30-60.000
District VIII ³	15-40.000
District X	10-15.000

Source: Otthon Centrum

¹ The higher price is typical for District I.

² Excluding Andrásy út.

³ The higher price is typical for the Palota-quarter.

At present, there are only few active foreign investors in the Budapest market. Investors from Western Europe are almost completely gone, therefore, in the last 2-3 years, companies from the Far East and the Arab countries represent the majority. They are mostly looking for plots suitable for the development of commercial and industrial facilities. For this type of properties, however, the high yield expectations of the buyers represent a difficulty for sale and purchase.

Both residential developers and players in commercial development have high expectations to the new government. As long as no specific, attractive programmes are published for stimulating demand and investments, the whole of the market is in a wait-and-see position.

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Upon request, we also prepare structured reports on the property market; please contact us at:



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