

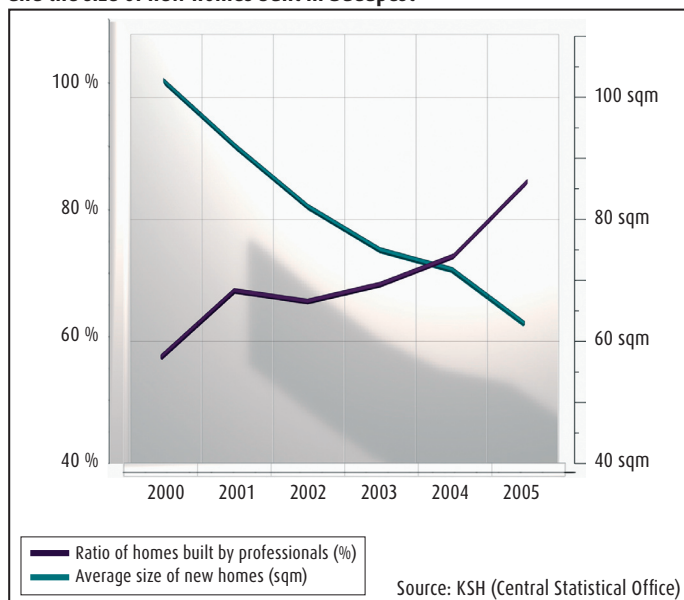
In the trends observed since already two years on the housing market, there was no break on the turn of 2005/2006. In terms of investors' activity, the duality of Budapest vs. country keeps persisting and on the offered market, the buyers clearly are in an advantageous position. With the acceleration of the competition of banks and investors, for the majority of the society, the purchase of a home is more and more a question of making up their mind.

### CONSTRUCTION VOLUME

According to the annual report of the Central Statistical Office, in 2005, countrywide 41,000 homes were granted final permit and the authorities issued 51,500 new construction permits. These figures are respectively 6.4 and 10.4% lower than the volumes in 2004. This means that, as new trend, now there was a reduction already in the number of the occupied homes as well. The deferred effect of the market buoyancy lasting until 2003 is over, that is, the large investments launched prior to 2004 were all built. The appetite for construction dropped primarily in the county capitals, where the number of new permits dropped by 31%. According to a statement of the National Office for Housing and Construction, on the other hand, due to the drop in VAT from January 2006, the application for the final permit might have been postponed to this year in the case of many properties completed last year, that is, the actual number of properties built last year could have been close to the 44,000 peak of 2004.

At any rate, the Budapest figures should be considered on their own, too. As opposed to the country-wide trends, in the capital city, the 12,303 homes occupied last year represented 21.2% more; the 15,247 construction permits issued were 7.6% more than a year earlier. Both in terms of the newly occupied homes and the newly issued permits, the share of Budapest is 30%. According to the Otthon Centrum's database, in 2006, a new record might be reached, while this year, it is expected that almost 13,000 condominium flats will be put into use. In a breakdown by counties, statistics show major variations. For instance, whilst the number of homes put in use dropped by 40% in Fejér County, in Heves, an almost identical increase took place. In the same way, almost 50% less new permits were issued in Tolna and Bács-Kiskun, while in Komárom-Esztergom, the volume increase was about 40%.

### Relationship between the share of construction by investors and the size of new homes built in Budapest



From the point of view of the construction forms, 2005 was the first year when more homes were built in new, multi-level, multi-owner buildings and subdivisions than in new family homes. The share of entrepreneurship-based home construction continued to increase in Budapest, to 84%. This ratio increased in the cities and towns as well, to 50 and 28%, respectively. No wonder that parallel to the expansion of the trading purpose, there is a further reduction in the average ground area of newly built homes. In Budapest, this was equal to 62.3 sqm (in 2004, it was 71!), while in the cities with county rights, this is 23 sqm larger. In the capital city, only every third of the newly built homes is larger than 60 sqm, while on a national average, their share is just the opposite.

### HOUSING POLICY, HOUSING SUBSIDIES, BANK FINANCING

Two years after the restrictions on lending in December 2003, the opportunities for home financing significantly widened and improved. The competition of banks continues to sharpen further, credit institutions offer increasingly advantageous conditions both in terms of the portion to be financed and in terms of interests and there is also general decrease in credit assessment time. And with the products of the lease market, having grown to a multi-player, ever expanding marketplace by early 2006 (where the most attractive feature is a zero per cent contribution of the lessee) new groups are added to the pattern of preferential financing. It might be safe to say that the purchase of a home already is a question of making up one's mind for a continuously expanding demand stratum.

The hit product remains foreign currency based housing loan, within that, the interests of a loan denominated in Swiss francs are the most advantageous. Its competitive edge persists even after a stronger weakening of the forint, having occurred in March 2006. In accordance with that, about 80% of the loans placed are market rate loans, denominated in Swiss francs. The remaining 20% are mostly loans with state-subsidised preferential interests, more favourable in the case of newly built homes, due to the size of the borrowing. According to NBH data of early 2006, out of the housing loan stock of 2300 bln HUF of the households with over one year to maturity, loans denominated in Swiss franc represent 457 billion, while six years ago, these represented merely half a billion forints.

According to the experiences of the Otthon Centrum Credit Center, the average size of the loans disbursed shows an upward trend: towards above 8 million HUF in the case of second-hand homes, while in the case of newly built ones, to a level exceeding 9 million HUF. The preferred maturity continues to be 20 years.

Market competition and, in particular, lease loans, available at a minimum level of own contribution compel the banks more and more to seduce borrowers with schemes implying low initial installments. Subject to income, for newly built homes, loans with actually 0% own contribution came to the market. It is to be noted, however, that it depends not only on the banks, but the seller (investor) can also impose a certain downpayment upon the contract's conclusion. To sum it up, a customer reported a minimum wage level, who is not included in the BAR list (bad debt records) can obtain a housing loan without major problems, but with a couple of millions of own contribution, this may mean a routine transaction.

Like in previous years, at the end of 2005 – beginning of 2006 there was again a government decision that might have a significant influence on the willingness of the households to buy homes: namely the reduction of the upper rate of the value added tax from 25 to 20%, with effect from

January 2006. In the last quarter of the previous year, investors and sellers had all the reasons to be concerned that buyers might postpone their purchases, in a hope for lowering prices from January.

It became quickly common knowledge that for installments paid last year, a 25% VAT applied, but for installments due in 2006 – if vesting also occurs in 2006 – VAT is only 20%; and the developers tried to offer the homes with low downpayments, accordingly. In addition to that, the buyers could obtain an even safer guarantee to apply a reduced VAT rate, with the application of a deposit at a lawyer, of a blocked account, even for the whole of the amount. In spite of all that, the buoyant turnover of the first month of the year 2006 at Otthon Centrum has shown that, even though the 4% price drop was not an automatic one, the developers applied the lower rates rather in the form of allowances, there must have been a large number of people who postponed their purchases of a new home for this year.

The VAT reduction applicable to the housing market was on the agenda in another case as well, in February 2006. Namely, subsequent to an EU decision, a possibility emerged to shrink the VAT on social purpose home construction and on the labour costs' portion of home refurbishments even to the most preferential rate, 5%. On the basis of an agreement of the parties on the principles, the government made a decision already in March to apply a reduced VAT rate to home refurbishments and a similar draft was prepared also for social purpose housing.

As to the elections, the related uncertainties did not present themselves on the demand side of the housing market during the first three months of 2006. The point is that the two large parties did not present (or presented only late) a markedly different programme on this subject what could have made home buyers sit out. On top of the preferential VAT rate already mentioned, the programmes only included an endeavour to make the existing assistance forms more attractive, to improve the situation on the home rent market (construction programme, assistance to rentals) and, with particular emphasis, a more resolute assistance to the refurbishment of the existing homes (not only blocks of flats).

In 2006, a new type of tax was also introduced, in the form of luxury tax on high-value properties. According to that, the owners of homes, houses and holiday houses with a value of more than 100 million HUF shall pay the equivalent of 0.5% of the portion exceeding 100 million, per year. It is estimated that the new law applies to 11,000 properties and from the tax on these the budget revenue might amount to 1.1 billion forints.

## MARKET OF THE NEWLY BUILT HOMES

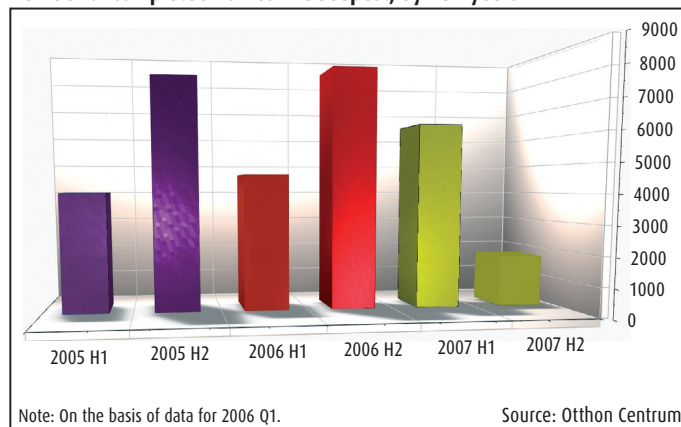
As already mentioned earlier, the VAT reduction introduced from January 1, 2006 did not involve a general decrease in the prices of the newly built homes. An unusually buoyant turnover in the first three months of the year shows, on the other hand, that there were many who postponed their purchases to this year, partially for this reason. Moreover, it seems that seasonal effects on the market of newly built homes are declining. The permanently available, abundant supply on the market, on the one hand and the campaigns and allowances in all segments keep demand at fairly constant levels. At the same time, as new investment projects are launched in an increasing number, there might occur spectacular drops in respect of individual projects or companies.

On an average, we can realistically calculate with the sale of 3-4 homes per months in a project and that, as an outcome of the constantly widening supply, means that the levels of a few years ago became halved. And in addition to that, a natural phenomenon is that 15-20% of the homes are sold only after the final completion of the building. The rise in the sales usually is spectacular after the start of the sales action and at dates close to the completion. Even though regularly newspaper articles report about 8-10,000 unsold homes in the capital city, according to our detailed and unique market survey, this is an exaggerated magnitude. According to our regularly updated database containing more than 500 active investment projects in Budapest (i.e. the ones for sale), covering the whole of the supply side, at

the end of March 2006, there were only 1600 occupiable (i.e. completed) homes on the market in the capital city. This figure is likely to increase until the end of the year, because the home construction activity keeps increasing, as witnessed by the planned completions.

According to our sales data, in terms of market absorption (ratio of the homes sold within the stock of completed homes), District 7, 9, 10, 13, 15, 16 and 18 perform well, above 90%. Parallel to that, in certain districts, due to the low number of projects and with small numbers of homes in each, the performance of individual projects might have a decisive impact.

### Number of completed homes in Budapest, by half years



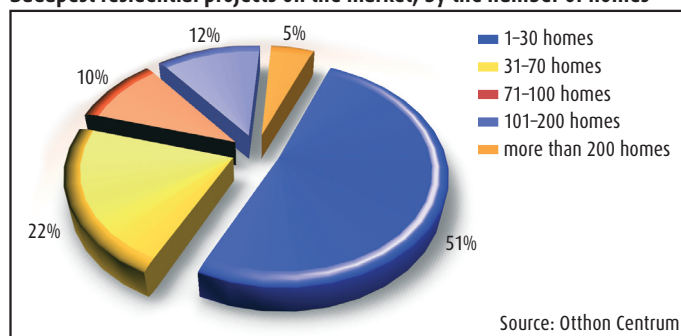
Due to an offered market, flexibility towards the buyers and the role of often tailor-made terms is increasing in importance. A relaxation of the payment terms, freedom in the choice of the bank, the possibility to obtain a lease loan is applied in an increasing number of the projects, to widen the potential clientele. Even if newspaper articles often deal with quality problems of the newly built homes, an increasing number of the investors and contractors realise that only maintenance of the quality level and its further improvement can be the path to be followed.

On the investors' side, however, a clear increase is observed in costs. The main reasons for that are the rising land prices and construction costs – including a 'whitening' of the labour relations – and the increasing marketing and sales costs. This latter is typically at 4-5%, but in the case of an investment project targeted at foreigners and applying special marketing tools this ratio might well go up to 8-10% within investment costs. The shrinking of the developers' margins is especially spectacular on the mass market. In spite of all that, the forwarding of the additional costs to buyers is usually not a solution.

Our survey shows that in more than half of the projects in the capital city, there are no more than 30 homes. At the same time, within the homes under construction, a similar portion (54%) represents the ones in projects of more than 100 homes. While in 2005, there were 22 residential projects in Budapest with more than one hundred homes each, this year 36 such projects are expected.

New development areas, next to the brownfield zones – outskirts, downtown and Danube quay – are gaining more and more weight. The favourite development areas remain District 6, 7, 8, 9, 13 and 14, but some new dis-

### Budapest residential projects on the market, by the number of homes



tricts were also added to the 'mental map' of the buyers, such as District 4, 15, 16, 17, 19 and 22. As to the market in the countryside, the present, relatively dull activity of the investors is likely to bear a temporary character only. Several larger-size residential projects are under preparation or in construction, for instance in Debrecen, Miskolc, Eger, Győr.

Instead of studios, the 1 room + 2 half rooms represent the hit product, already since 2-3 years. This, however, does not necessarily imply an increase in the size of the residential properties. According to our survey, in Budapest, 26% of the buyers, in cities of the countryside, 17% are looking for newly built homes up to 40 sqm.

A differentiation between the mass market and the premium category is more and more perceptible, both in terms of prices and of the timing of their sales. The price gap is opening, and in the upper category, by the end of 2006 even a price of 2 million HUF per sqm will not be exceptional, at the same time, the performance of this sector is largely dependent on the 'appetite' of the foreign buyers. This category shall, of course, play a marginal role in the residential turnover – almost exclusively in Budapest. In the framework of the 'Fészekrakó' ('Nesting') programme, a price limit of 15 million HUF applies in Budapest, where 59% of the homebuyers are looking for homes at those prices, while in the country the limit is 12 million and 48% of the homebuyers are interested in properties at those price levels.

In addition to the buyers, there are more and more companies from Western Europe – Spain, the Netherlands, Italy and France – coming to the market of Budapest as developers. They launch residential projects typically after an in-depth market assessment, after preparations lasting up to several years. An indication for the Spanish companies' different approach is that they see a large potential in the building of whole boroughs, in non-typical residential areas.

## MARKET OF SECOND-HAND HOMES

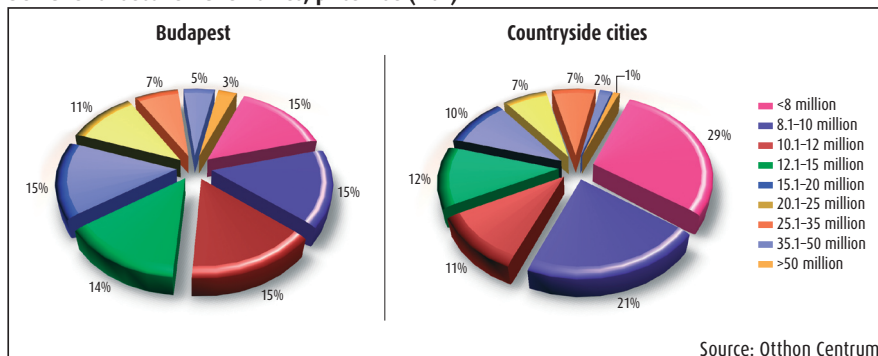
According to preliminary information from the Duties Office, in 2005 there were about 52,000 transactions of residential properties in Budapest, corresponding roughly to the level of 2000 and representing a reduction of 16% to 2004. Even within that, the number of the contracts dropped most of all in the medium category. The fact that the prices of newly built mass market homes tend to stagnate, in some cases, they decline, exercises an increasing price pressure onto the market of the second-hand homes. Our assessment revealed that the prices of second-hand and newly built homes come closest in the high prestige, garden suburbs (the difference is merely 5-15% for instance, in District 2/A and 14).

On this offered market, buyers are in a favourable bargain position since years and this trend shall continue. The significant offer and the non-competitive prices keep lengthening the time required for the sale of homes. According to a survey of Otthon Centrum in early 2006, only 56% of the sellers can sell their residential properties within a year, but in an increasing proportion, that takes place with the involvement of property expert companies. The participation of such firms in the transactions is particularly high in the downtown areas, representing the bulk of the supply on the market.

The number of foreign buyers seems getting stabilised in the capital city, while at Lake Balaton there is a decline in the number of transactions carried out by them. Thus, according to data from the Ministry of Internal Affairs, Budapest, with a 31% share in 2005, outpaced the region of Lake Balaton in terms of the dynamism of foreigners. Countrywide, Dutch buyers make the most important group, in addition to that, the traditional dominance of Austrians, Germans and Swiss buyers remained. A prominent phenomenon is that the share of Irish buyers increased to 13% from an almost zero level a few years ago. The Irish, as opposed to British, purchase homes almost exclusively in Budapest. Here, the 705 Irish and 234 British buyers

represented last year half of all transactions with foreigners. It is important to note, however, that the official data record only purchases of private individuals. In the case of transactions via companies, we can only make estimates. According to these, the number of foreigners having bought residential properties in Budapest can be about five thousand in 2005. Even

## Demand for second-hand homes, pricewise (HUF)



though buyers from Western Europe, coming to the market primarily for the purpose of making investments give preference to the inner city of Pest, a spectacular development is a widening of the area where they are ready to buy (such as Angyalföld – District 13 and Józsefváros – District 8).

In a comparison of Budapest and the cities in the countryside, there are some well visible differences in terms of needs and opportunities. While in the countryside, half of the buyers are looking for homes below 10 million HUF, in the capital city this ratio is 30% (on the Buda side, merely 8%). In the countryside, usually, buyers search for somewhat larger homes. There are significant differences also with regard to the other preferences: whilst in Budapest, after 'price', 'number of rooms' and 'good neighborhood', the selection criterium of 'transport' ranks fourth, in the countryside, criteria like 'on which floor' and 'general condition of the property' still precede it in importance.

Even though since last August, the government assists the owners and local government to raise funds for own contributions to the refurbishment of block flats with a loan framework of 20 billion forints, available at preferential conditions, under the name 'Panel Plusz' ('Block Plusz'), it cannot be expected within the foreseeable future that the stock of block of flats, representing about one-fifth of the residential properties becomes a desirable target for home seekers. Homes in refurbished, upgraded buildings become more attractive, but for a more significant upswing in turnover, a rehabilitation of the residential area would be also required.

## THE MARKET OF RENTED HOMES

No significant change occurred on the market of rented homes since early 2005. The relatively scarce demand, appearing most of all in the category of about 100,000 HUF, can be further reduced by an increase observed in home leases, as this scheme is an advantageous alternative for renting homes mainly for the higher-income people with no savings. There are some well definable groups in demand, by areas, and on this basis, we can speak about different partial markets.

Except for the category of 20-30,000 forints that can be considered a minimum, on the Pest side, demand is the strongest for homes of monthly rentals of 40-55,000 HUF/month. Therefore, singles and couples can make a selection among adequate homes, but these are not located in the most preferred areas. The majority of block of flats and of the offer of the cities in the countryside (mostly cities with universities) also belong to this category. At higher price levels, in the range of 80-100,000 HUF, homes for rent are in demand in the central portion of downtown Pest, with good access to public transport (underground or tramway), by foreign students. Primarily, they are looking for newly built or refurbished homes, with complete furniture. Young couples are looking for homes with the same parameters, typically, with garage.

Even though not in the same numbers like a decade ago, but high-position employees at local representative office of foreign companies represent a permanent demand in the category of 120-180,000 HUF/month. The area within Nagykörút, even its District 8 portion, covers well the location meeting their needs. The typical renting period is one year.

On the Buda side, it is easier to find a tenant for the newly built homes. For separate houses, on the other hand, there is no large demand. It is difficult to rent out above 80,000 forints a two-room property built earlier and located in a good place; at the same time, for newly built properties, the rental might be even the double of that. This is about the price limit above which the owners are ready to assign an agency to arrange the lease.

## THE MARKET OF BUILDING / DEVELOPMENT PLOTS

Since the boost of the mass market of residential property five-six years ago, the segment of the property market with the most reliable performance is the market of land parcels suitable for the construction of condominium houses. Here, a 10% price increase was observed also last year, a rate higher than the average for the whole of the housing market. This is true in spite of the fact that the expected return of 25% in terms of capital employed dropped to 20% by now, approaching the levels in Western Europe.

Demand is the highest for the areas of District 5, 6, 7, 8 and 13 that are the closest to the centre of the city. Developers from the West, coming from an increasing number of nations (Israeli, Irish and Spanish, lately French, Austrian and Dutch), representing about three-quarters of the demand, consider this area to have the greatest potential, based on experiences in their own metropolitan cities. As with the shrinking of the offer in the part within the limits of Nagykörút, interest is increasing also for land further away from the centre, this appears also in a fast rise of the prices. In the absence of empty land parcels, in District 5, refurbishment opportunities are increasingly attractive for capital-rich investors. The ask price of such buildings is, after a significant rise, in the range of 250-300,000 forints today. Taking account of the one million forints price achievable per square meter, even so, this is a development possibility offering return.

In the same way, there is an increasing demand for development opportunities in the mid-Józsefváros (District 8), thanks to the visible progress of the city redevelopment project at 'Corvin sétány' ('Corvin Promenade'). The construction of the first condominium house is expected to start in the second half of 2006. In this area, land prices increased by 60-70% in a year, and with the upswing in demand, land owners waiting for years to bring their plots to the market also appear on the supply side.

Developers' activities continue to be restricted in District 3, that is, developers can calculate with unsatisfied demand in that area. Interest is continuous for the internal portions of District 1 and 2, that is, there is no surprise about a fast increase in the prices (up to 150-160,000 HUF, projected to the square meter of the homes).

It is worthwhile to note that the Irish and especially the Spanish investors follow a different strategy, as compared to the usual approach. It is understandable that they have no interest in the suburb areas, and one can observe in the last one-two years that they strive to create products in the

higher categories. Recent purchases by Spanish companies, resulting in the acquisition of huge development areas (the northern part of the Csepel Island, District 9, District 13) let us assume that their business idea is to create separate urban areas, and not necessarily constructions on bomb-sites.

In the areas of mass residential construction projects of recent years (mid-Ferencváros - District 9, Angyalföld - District 13, Zugló - District 14, Kelenföld-Albertfalva - District 11) the market's self-regulation process started, that is, demand declined, resulting in a stagnation or slight increase in land prices. Due to the large projects about to complete here (for instance, in District 13), however, it might be worthwhile to buy land now, in an expectation of another upswing.

The outer districts of Pest usually are not attractive for foreign investors (an exception might be the portion of District 18 closer to the centre), therefore, the few larger investment projects in process there are related to Hungarian companies. Here, the theoretical limit is a land price of 30,000 forints, below that, the purchase of a larger, integrated area might already represent an advantageous position for development. In this case, the investment can become profitable already at prices of 260-270,000 forints per sqm of the homes.

### Typical prices of plots suitable for condominium development

Area	Net plot price projected on net saleable sqm of residential area (HUF)	Price trend in a comparison to the previous half-year
Inner portions of Districts 1, 2 and 12	100-150,000	↑↑
Districts 6 and 7, within the limits of Nagykörút	100-140,000	↑↑
Districts 6 and 7, outside the limits of Nagykörút	70-100,000	↑↑
Former brownfield zone of District 11	35-45,000	-
Rehabilitation area in District 9	40-60,000	-
The Angyalföld portion of District 13	40-50,000	↑
District 14	40-80,000	↑
Rehabilitation area in District 8	40-55,000	↑↑
District 10	20-30,000	↑

Source: Otthon Centrum

Instead of a price increase, a gradual decline can be observed on the market of higher-value properties with family houses. For an upswing of the turnover, however, a further cut is required. Prices maintained at high levels significantly withhold demand for the time being. The price is determined by the individual location and characteristics of the land, as well as by the possibilities for allowed construction (such as a permit to build a condominium house). On the other hand, proximity of the inner city may mean a significant factor in pricing upwards. (For instance, the average square meter price in District 2/A jumps to a double of that level in the case of Pasarét - inner District 2.)

A start-up is observed in the Sasad and Hosszúrét parts of District 11. In this latter area, on the outskirts of Budapest and Budaörs, one of the last integrated areas on the Buda side is being parceled out at present. In the zone L6, a very large number of smaller condominium development projects are going on at Sashegy and, due to the favourable experience with sales, a square meter price of 60-80,000 forints proves to be competitive. In District 12, the strict provisions in terms of construction permits and prices representing a record level within the capital city act as barriers for an increase in the turnover, while in several districts of the city, land parcels might be simply too large (above 1000 sqm).

The above analysis is our regular residential market summary report, in an abbreviated format. Upon request, we also prepare structured reports; please contact us at:



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