

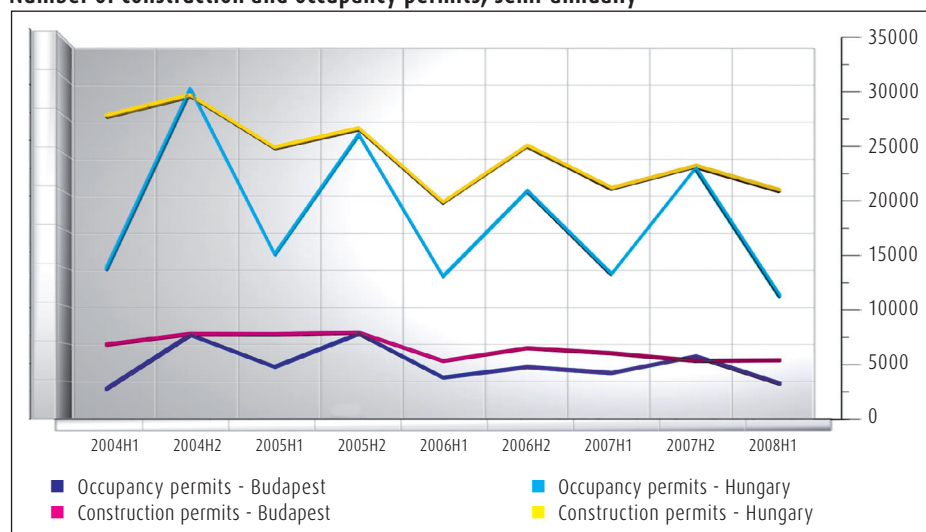
Several years of lows in the number of completed homes; for the first time since long years a decrease in the prices of plots even in areas that are highest in demand; foreign firms and buyers for investment purposes becoming more cautious; in addition, Hungarian buyers fell out – this is how the housing market can be characterised in the first half of 2008. When we look around across the European markets, we can consider ourselves almost lucky, because due to the cautious lending practices and the absence of a price bubble, we can sense only dumped effects of the credit crisis.

CONSTRUCTION VOLUME

According to data of the Central Statistical Office, in the first half of 2008, occupancy permits were granted to 11,100 homes and, nationwide, construction permits were issued for 20,900 new homes. To the figures of one year ago, this represents a decrease of 15.5% and 0.8%, respectively. An above-average expansion occurred in the capital city, where the number of new homes occupied (3080) was 24% less and the number of new applications for permits (5238) was 11% less than in the first half of 2007. In contrast to that, in the other cities, the number of construction permits issued increased by about 10%.

The larger portion of homes newly occupied in the first half of the year was built for private individuals for their own use, and almost half of the new homes were family houses. The proportion of home construction by entrepreneurs dropped to 44% countrywide and to 78% in Budapest. Accordingly, most of all, construction of small flats was reduced, while the proportion of homes above 60 sq m increased within the stock of new construction. The average ground area of new homes was 91 sq m, 5 sq m larger than in the same period of the previous year. In Budapest, the increase of home sizes was even more important: from 62 to 72 sq m.

Number of construction and occupancy permits, semi-annually



Source: Central Statistical Office

In terms of regions, the most unfavourable developments were observed in Budapest and in the average of villages, where home construction dropped by one quarter and one fifth, respectively. The Southern Great Plains represents the only region where, in these six months, there was an increase (of

almost 9%) in the number of newly occupied homes. In Southern Transdanubia, on the other hand, the drop in construction volume was close to 50%.

HOUSING POLICY, BANK FINANCING

From the 1st of January 2008, upon purchase of residential property, the home acquisition allowance (that is, the tax allowance for the amount invested into a new home, out of the proceeds from a sold home) is no longer applicable. At the same time, income from the sale of a home would become taxable only in the case of its sale within five years (until the end of 2007, this term was 15 years), but this tax could be reduced or even remitted by the authority, on an equitable basis. Due to the changes in the regulations, it makes sense to take into account, already at the time of a purchase, that in the case of a future sale, 25% of the income becomes payable. This is even more important when the property was bought at a good price and a major appreciation is expected within five years. In the case of a purchase for investment purposes, from a taxation point of view, it makes sense to wait with the sale until the end of that five-year period. According to our experiences, buyers did pay attention to this issue already in the first months of the year; at the same time, in the case of purchases for own use, this amendment does not seem to have a major impact on the decisions of the property owners.

From the 30th of June, the application area of the home construction allowance (social benefit) has been expanded and again, for families with two or more children, it became applicable to the utilisation of attics and to the building of an additional level (in cases where no new home is to be built). In addition, the contract about such advance shall include consent of the young couple that the Treasury is entitled to verify the fulfilment of this condition.

According to the data of the National Bank of Hungary, in the twelve months ending in June, there was a slow but steady decrease in the stock of forint-denominated housing loans: by mid-year, their quantity was just a little above 1600 billion forints, representing a good 130 billion decrease in a comparison with the previous year. As a consequence of a melting down in the stock of forint loans, last February, loans denominated in foreign currencies became dominant also in the case of housing loans, and their share in June already reached 51.3 per cent.

A significant increase takes place in the readiness of credit institutions regarding risk assumption. The main goal is to increase their market shares, even at the price of higher credit risks. One of the most recent and most important developments in the banks' innovation is the emergence of yen-based loans. An indication for the popularity of this new product is that within new housing loan contracts, its share already reached 10%.

In the first half of the year, there were no indications of any spillover effects of the international crisis on mortgage markets in Hungary. A certain protection therefrom is provided, for instance, by the fact that in our country, the loan value amounts to maximum 60-70% of the mortgage value. In addition to that, according to data of the National Bank of Hungary, the total stock of household borrowings to GDP is only 28 per cent, compared to 55 per cent in

the Euro zone. At the same time, due to the longer term and higher interest rates, last year, in a comparison with western countries, debt service within household income already represented 13%, on average. Also, a risk originates from the fact that an increasing portion of the mortgage-backed loans, with property as collateral, are general purpose loans, where redemption carries a higher uncertainty.

According to data of Otthon Centrum's Credit Center, in the case of housing loans, average term increased to 20 years by now. And the average loan amount was 8.2 million forints in the first half of the year – above market average. According to information available to the company, nowadays almost 7000 credit brokers operate in Hungary, and the number of individual entrepreneurs in this segment shall be at least at this level. At the same time, some consolidation is also observed on the market: the smaller intermediaries are dropping out or getting subordinated to companies operating large networks.

According to a survey of Otthon Centrum, carried out in the summer of 2008, with a country-wide sample of 4000 persons, 55% of those who purchased a home in the last twelve months and of those who intend to do so in the coming year made use / are certain to make use of a loan for the home purchase; one quarter of them would borrow not from a bank, directly, but from a credit broker. It is noteworthy that people in Budapest are far more averse to borrowing than people in the countryside, but the hypothesis based on age characteristics seems to be proven: younger age groups use / would use loans for home purchases in a far more significant proportion than older people.

An increasing number of people recognise that they can redeem their previously granted loans at more favourable conditions. Those people for instance, who are repaying now their loans granted in the period of the housing market boom prior to 2003, with market-based, two-digit interest rates, shall absolutely contact a credit broker. Refinancing may imply savings of even tens of thousand forints per month.

In March, it was decided that no uniform property tax, based on computed values, shall be introduced from 2009. From next year, local municipalities will be allowed to charge taxes on the basis of ground area or adjusted market value. Therefore, for the time being, guesses about the eventual effects of a new-type property tax became unsubstantiated.

MARKET OF THE NEWLY BUILT HOMES

In a comparison with last year, the year 2008 had a more restricted beginning on the market of newly built homes. Seasonality, a usual feature earlier, is about to disappear, and in sales, large fluctuations are possible from one month to the other; this year, for instance, April brought some outstanding results. Even if demand remains at a constant level, buyers take a longer time and are more careful about actual purchases. These imponderables made investors more cautious, too, as in their case, a precipitate price increase or campaign may result in significant losses. In order to prevent a too fast sale of homes within campaigns, i.e. a reduction in profits, the period of such campaigns tends to be shorter nowadays. At the beginning of the year, the average price increase was 3-5% in the case of new residential projects, and for the whole of the year, we can calculate with an increase close to inflation.

In general, it is true that the dynamics of sales, the monthly number of units sold depends on the project's life cycle. Prior to delivery, about 80 per cent of the homes are sold to their owners, at the same time, there are differences between the two market segments. For homes offered at higher prices per square meter, it is typical that the sales figures are the best in the months prior to their completion, when the building is already accessible for physical inspection. In the case of lower-priced homes, where usually

a preliminary sale takes place or advantageous payment schemes are used, normally a major boost appears in sales at the time of the project's launch.

Buyers tend to be more and more specific about their ideas and, parallel to that, there is an increasing need for comprehensive services in the framework of the sale (including consultation on financing, technical and interior decoration issues). Usually, the financing of a new home becomes more complicated with the involvement of an existing home and an existing loan in the background, where a complex administration usually makes more complicated the purchase of the new property as well.

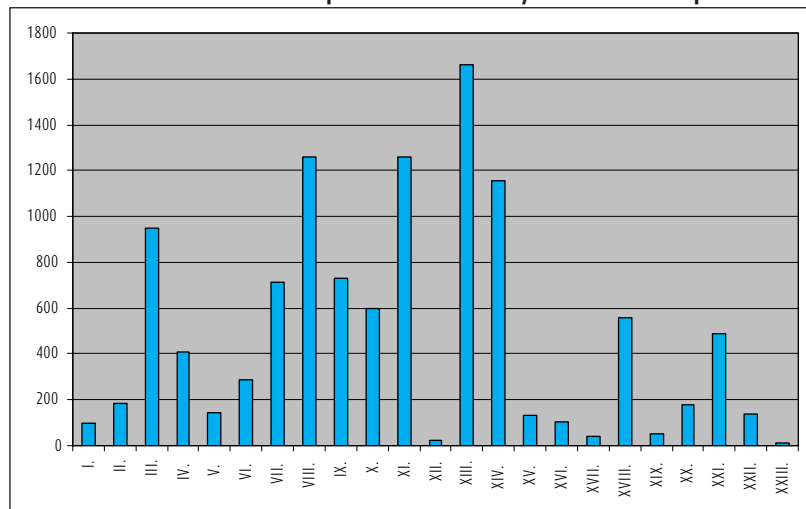
Due to the growing scarcity of downtown plots and an unbelievable increase in their prices, buildings to be refurbished or whole blocks of these became popular with investors. Even though the refurbishment of whole blocks, the organisation thereof and the preparations take a huge amount of time and money, this also provides for developers an ideal opportunity to enter the market with a mixed-function building complex. With such projects, they are in a position to diminish their risks and have an opportunity to build spectacular buildings, with the rehabilitation of a large area.

Another fashionable area for developers represent the two sides of the Danube, offering individual options. In Districts IX and XI, there are 4-5 ongoing development projects, with volumes of several thousand units in each. The popularity of green areas is continuous and here, a good number of plots suitable for residential construction remained available. On the whole, homes of 45-65 square meters, with good proportions, efficient layout and proper orientation are the most favoured ones for buyers.

By the way, with the purchase of a well-selected new home, one can obtain multiple returns. On the one hand, from the very beginning of the construction works, up to the one-and-a-half-two years to the completion of the project, the value of a home increases by 10-15% on average, but in the areas highest in demand, the increase might be even 40%. Parallel to that, if we rent out that home, from the rentals, we can get back 5% of its value each year. A third factor is the general upward trend in property prices. This is quite difficult to translate into figures, but according to our estimate, in ten years, the value of Hungarian homes might be more than doubled. On the whole, however, residential property, as a yielding property, requires nowadays a longer-term investment approach.

On the basis of processing our database covering condominium house projects in Budapest, almost 11,200 homes shall be completed this year. (As always, we shall take note that in our experience, at about half of the projects there are delays of a few months as compared to the first published delivery date, therefore, about 25-30% of this quantity of homes shall be completed in 2009 only.) In 12 districts, there will be an increase in the number of homes to the year 2007, in 11 districts, a decrease is expected.

Homes in condominium houses planned for delivery in 2008 in Budapest



Source: Otthon Centrum

Note: as at July 2008.

From among the districts where at least one hundred homes are built every year, the increase is almost threefold in District III, more than twofold in Districts IV and VIII, and it is above 50% in Districts VII and XVIII. As opposed to that the decrease is 25% or more in Districts II, VI, IX, XIII, XVI and XXII.

The number of completed, but unsold homes decreased from two thousand units early this year to 1830 units by the time of our June survey. This quantity exceeds two hundred units in Districts VIII and XIII, is between one hundred and two hundred in Districts II, IV, X, XI, XIV and XVIII. In terms of units to be completed in 2008, the unsold stock exceeds 30% in Districts I, II, IV, VI, X, XII, XVII and XXII. This ratio (so unsold stock / new completions in 2008) is 16% for the whole of Budapest.

A government regulation published in July, to enter into force on the 12th of September, while partially confirming established practice, applies considerable rigour to several points of the National Territorial Development and Construction Requirements. The main elements are:

- » A residential building shall be at a distance of at least 50 meters from national roads and at least 250 meters from motorways.
- » In the new homes, at least one of the rooms shall be 17 square meter in size, and American kitchen or dining corner shall not be included in the calculation thereof.
- » The size of the smallest room shall be at least 8 sq m.
- » The regulation formulates a minimum requirement regarding the availability of sunshine.
- » If the number of rooms exceeds two, in addition to the bathroom a separate toilet shall be built, and that cannot have a door to the same airspace with the dining room or kitchen.
- » In the future, air conditioners can be placed on facades only under a cover.
- » Car garages shall be of a size of at least 2.7*5 meters.
- » From 2013 onwards, in a building with more than six homes, covered garages shall be built.
- » For each home, a bicycle storage area shall be built.
- » In areas used by handicapped persons as well, the thresholds shall not be higher than 20 millimetres and doors shall be at least 90 centimetres wide.
- » In houses with a total height of at least 10 meters (i.e. by now, already three-level buildings), the installation of an elevator is mandatory; in houses with a total height of more than 13.65 meters, a goods lift shall be also installed.

The amendments targeted at a quality improvement of new homes are basically due to the compelling force of market needs. The same applies to the institutionalisation of energy certificates, to be obtained for a portion of homes from 2009. At the same time, the increased rigour of construction rules shall imply an increase in implementation costs, and the investors are likely to forward these costs in the housing prices.

MARKET OF SECOND-HAND HOMES

On the market of second-hand homes, after a quiet beginning, the second quarter brought a spectacular drop. At an annual level, we expect in 2008 a 5-10% decline in demand. An indication of a drop in willingness to sell and buy is included in our survey in the summer of 2008, at a country level, with 4000 interviewees, according to which merely 2.7% of the interviewees plan the purchase of a home in the following one year (in 2007, this proportion was 9.3%), while for sale, it is 3.2% (this was 7% a year earlier). The price of homes at central locations, with good layout, attractive for investment may increase in real terms as well, at the same time, the prices of homes in block houses, with a large ground area, built in the seventies, not renovated in line with energy considerations may even drop by 7-8%.

On the basis of our database containing several thousand transactions for the first half of 2008, the following average prices can be established for the market of second-hand residential property, by size and type, for the whole of the country:

Average home price, from owners (thHUF/sq m)

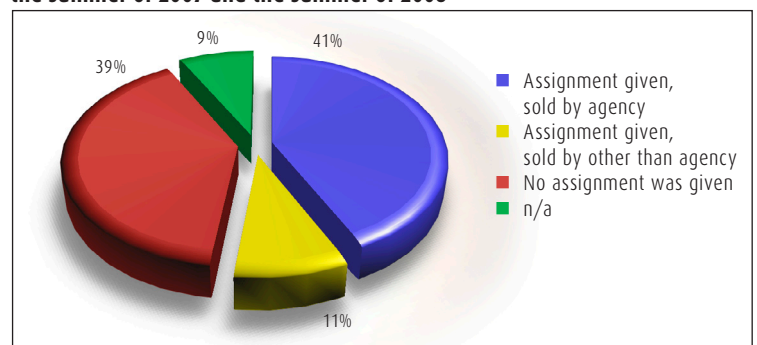
	Brick flat	Block of flats	Family house
Buda	645	222	389
Pest	386	204	264
County capitals	458	156	182
Other	338	163	172
Country, total	358	188	197

Source: Otthon Centrum

Due to a combination of abundant supply and the tough competition of investors, banks and vendors, consumer protection is increasingly important in the property business. Competition of the networks takes place not only in terms of the number of offices and homes sold, but also in the training of consultants, a precondition for proper customer service.

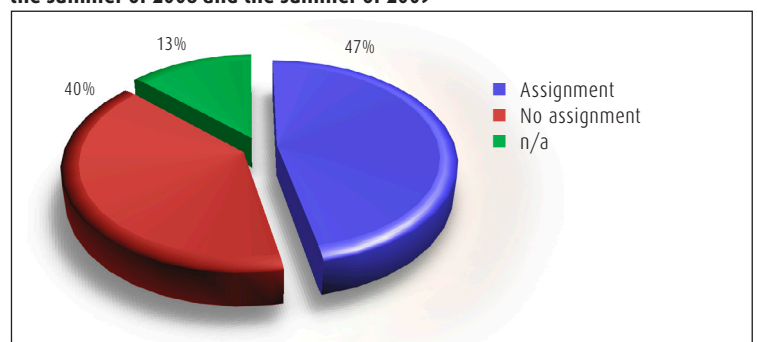
According to our survey, with regard to homes sold during the last year, 52% of the owners assigned a property agency and 41% of the homes were sold by those firms. As compared to the average performance, efficiency of property agencies organised into networks is typically higher than the one of small firms with a single office. As to transactions planned for the upcoming year, the preliminary indication of a 47% share of agencies is a decrease only seemingly, as this share is expected to be surely higher. As a matter of fact, the typical market behaviour is that the owners first try to sell their homes, but after several weeks of unsuccessful attempts, an agent is contacted. It is interesting that property firms are more accepted in the countryside, but probably market characteristics, rather than human factors represent the reason behind.

The role of agencies in property sales between the summer of 2007 and the summer of 2008



Source: Otthon Centrum

The role of agencies in property sales planned between the summer of 2008 and the summer of 2009



Source: Otthon Centrum

According to the experiences of Otthon Centrum International Client Services, the foreign client base of the Budapest residential market was strongly reduced and restructured, at the same time. The number of Spanish and Irish investors, who represented up to 80% of total buyers, went down substantially by now. There is still interest from them, but the number of transactions is smaller and the decision-making time is longer now. Nowadays, investors are far more informed; they purchase not on the base of a prospectus, but verify the characteristics of the property, its marketability on-site. The neighbourhoods of universities, high-traffic areas are popular, as well as refurbishable used property. Foreigners typically buy homes with one living room and two bedrooms. In addition to the presence of Spanish and English investors, South African, Norwegian, Iranian, Belgian, French, Italian and Russian investors also joined, who typically allocate 60-400 thousand Euros for such investments.

From the point of view of investors, the forecast of future price trends gives a reason for confidence. At present, we see that in the countries that are our competitors in this respect, where either a price bubble emerged or such danger exists (e.g. Romania, Bulgaria, Poland, Slovakia), prices already started to decrease or reached a level close to the maximum. The same is true, of course, for Spain, Great Britain, Ireland and the USA as well. As opposed to that, in our country no such bubble was formed, so there is room for an increase in residential prices, which basically means getting closer to the West-European average, in the longer run. According to our analysis, for the forecast of a more than twofold price increase within the next ten years, in addition to the lack of a price bubble, the following factors are decisive. Only briefly:

- » The credit crisis will avoid our country.
- » Improvement of economic performance.
- » Decreasing bank interests.
- » Continued competition in banking.
- » For the time being, the ratio of housing loans/GDP is low.
- » Accession to the Euro zone.
- » Increase in real income.
- » Decrease in unemployment.
- » Improving quality of the homes.
- » Changes in the number and structure of households.
- » High proportion of residences owned, which, according to examples is in correlation with the fast price increase.
- » Increasing developer costs.

A trendline of several years was broken in the first half of 2008, when all over the city, the increase in the prices of plots suitable for condominium houses came to a halt. Still, whilst prices were stagnating in the premium areas of the Buda side (Districts I, II, XII) and in the popular Districts IX, XIII and XIV, in downtown Pest (Districts VI, VII) and in the rehabilitation zone of Józsefváros (District VIII), a 30-40% drop was observed.

Typical prices of plots suitable for condominium development

Area	Net plot price projected on net saleable sq m of residential area (HUF)	Price trend in a comparison to the previous half-year
Inner portions of Districts I, II and XII	160-220,000	-
Districts VI and VII, within the limits of Nagykörút	125-200,000	↓↓
Districts VI and VII, outside the limits of Nagykörút	80-130,000	↓
Former brownfield zone of District XI	30-60,000	↓
Rehabilitation area in District IX	60-80,000	-
The Angyalföld portion of District XIII	50-65,000	-
District XIV	45-90,000	-
Rehabilitation area in District VIII	25-60,000	↓↓
District X	20-30,000	↓

Source: Otthon Centrum

In downtown areas, the reason was a drastic drop in demand of foreigners for housing, while in Districts VIII and X, construction is no longer profitable due to the increment of construction costs, significantly exceeding the increase in housing prices; as a result, less investor buy land. Another change is that instead of implementing projects with 200-400 homes, as preferred until now, larger companies are looking for plots suitable for the construction of 100-150 homes.

Due to the collapse of the property market in Spain and as a result of the bankruptcy wave affecting the property-related firms, this year, there was a spectacular decrease in the activities of Spanish developers, and they rather tend to appear as sellers on the market. An interesting development is a widening of the crisis on the mortgage market: parallel to a narrowing of the investor presence highly diversified in terms of nationalities earlier (with the coming of Spanish, Portuguese, French, Italian, German companies), Israeli companies became more active. And the Italian enterprises, in spite of their small number, usually arrive to our country with very serious intentions.

The development focus of the coming years may be the portion of the Danube side southwards from the Lágymányosi bridge and next to the Soroksár arm of the Danube, where on both sides of the river, several projects are under preparation, for the construction of about fifteen thousand homes, office buildings, as well as leisure and commercial facilities. The developments shall be similar to the projects unfolded in the northern area, in District XIII, only the sizes shall be larger.

September 2008

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

Otthon Centrum, Research Division

Tel.: (+36 1) 487 3321 | Fax: (+36 1) 487 3333

valko.david@oc.hu | www.oc.hu

