

Otthon Centrum

Residential Market Monitor 2008/2



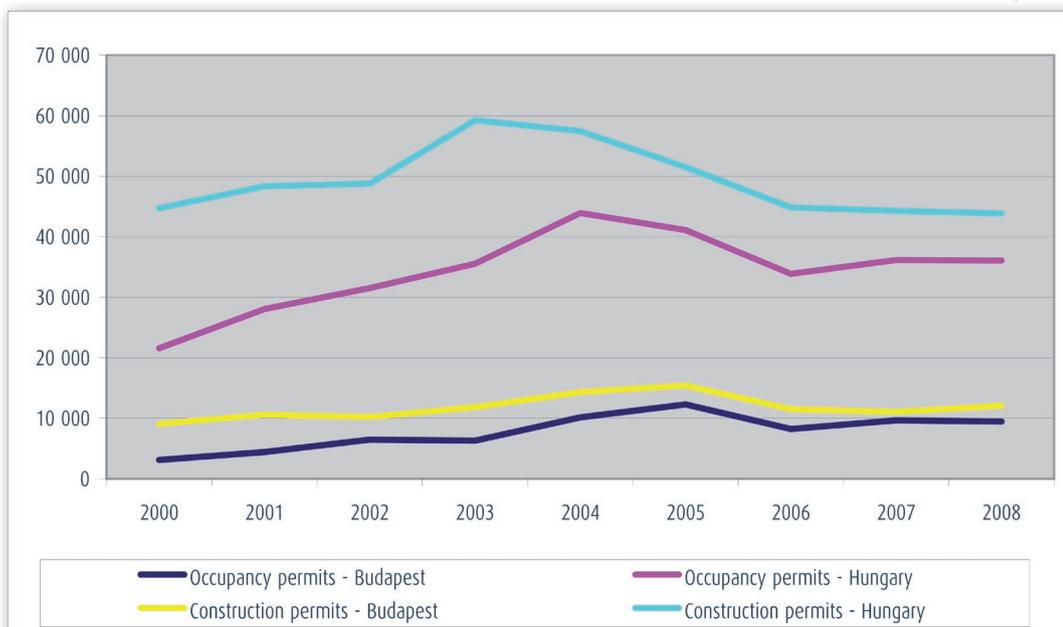
2008 shall be evaluated, by any means, as a year representing a turn of trend on the residential market. Sales started to get slow already from the beginning of the year and by October, the hope that the international financial crisis might keep off from the Hungarian market was gone. In the last two and a half months of the year, almost all articles on property topics dealt with crisis, directly or indirectly. Due to the austerity measures applied due to the economic depression and a drastic increase in redemption payments, we shall calculate with structural consequences that have an impact in the longer run.

CONSTRUCTION VOLUME

According to data of the Central Statistical Office, in 2008, similarly to the preceding year, occupancy permits were granted for 36,000 homes and construction permits were issued for almost 44,000 homes, which is 1% less than in 2007. The country-wide data for the year shows stagnation in home construction, but significant differences by areas and fluctuations during the year can be observed.

The number of new permits issued in Budapest and in the larger cities increased significantly last year as well (by 9 and 7%, respectively), and the number of newly occupied homes was 14% higher than in the preceding year. But in villages, there was a large drop in home construction, both in terms of permits (-15%) and completed projects (-10%). There were major fluctuations in data in the first three quarters of the year; in the last quarter, the number of completed projects decreased by 1%, in November and December the number of new permits decreased by 10%.

Number of construction and occupancy permits, annually



Source: Central Statistical Office

In 2008, more than half of the new homes were built by natural persons, mostly for their own use, whilst 47% of them were built by corporations, typically, for selling. In Budapest, the share of entrepreneurs was 81%, representing a slight decrease in a comparison with 2007. As to the construction modalities, for the whole of the country, residential parks lost from their importance; as to new residential property, most of the homes were built as family houses. Parallel to a reduction in the ratio

of investors' construction, there was a rise in the share of larger homes, and the average ground area of the new homes was 90 sqm for the whole of the country, close to 67 sqm in Budapest, i.e. the largest in the last 3 years.

Home construction continues to focus on the region of Central Hungary. In Pest County, the number of new homes occupied increased by one-fifth to the previous year, in Budapest, the number of newly issued permits increased by 9%. Hence, half of home construction in the country takes place in the region of Central Hungary, either in terms of new permits or completed homes. The number of newly occupied homes increased in all counties of the Southern Plains, by 12% as a regional average, and the increase was homogeneous also in Southern Transdanubia, but in this case a drop of 19% occurred. In terms of construction permits issued for new homes, the increase was 40% in Central Transdanubia, and the decline was 22% in the Northern Plains.

HOUSING POLICY, BANK FINANCING

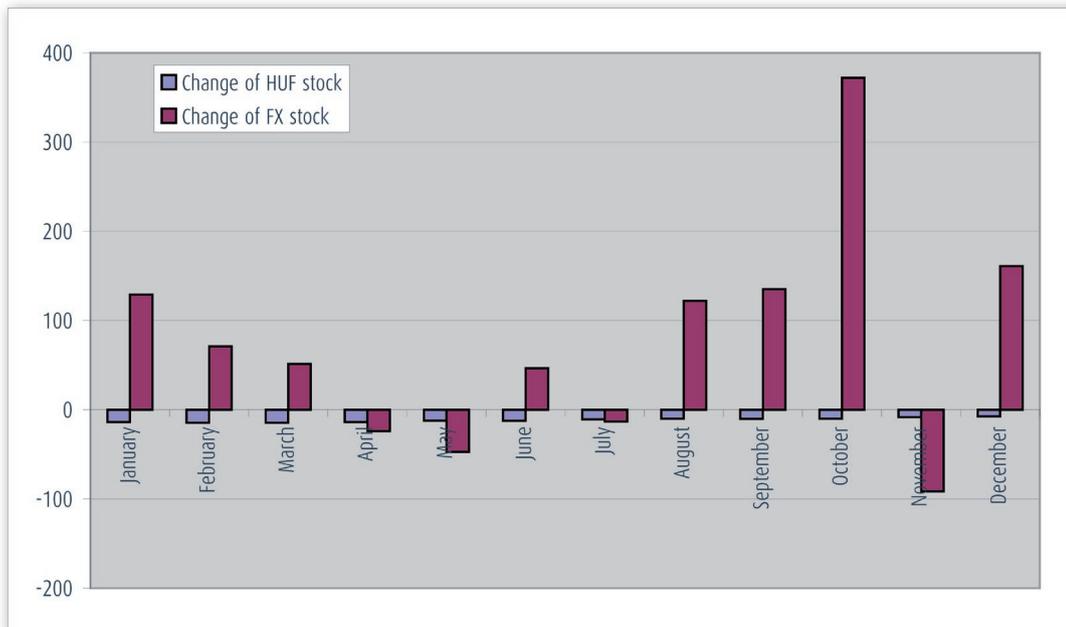
For the common man, the effects of the financial crisis can be sensed truly only from October 2008, but the processes that have led to this situation started already much earlier. The first troubles have shown themselves already last spring, even if only on the market of currencies and of government securities, at the beginning. In the last two months of the year, however, the devaluation caused by the crisis, a soaring of risk premiums, capital outflow and liquidity disturbances became increasingly manifest. In October, from one day to the other, several large banks stopped their lending based on Swiss francs. Later, upon a drastic increase in the central bank's base rate and news on the IMF loan facility, the market became somewhat reassured.

The forint's depreciation and high volatility were hard hits for the mortgage market, driven mainly by currency-based loans until now. In addition, already in September, one could sense that funding became somewhat more expensive, especially on the foreign exchange markets. With crisis spilling over to the interbank markets as well, in addition to the increase in costs, with CHF swaps drying out, the scarcity of funds also began to play a role.

Whilst the year 2008 will be commemorated because of the credit crisis that exploded in October on the market of lending, the balance of the first ten months of the year is clearly positive. The year 2008 was, due to such significant increase, favourable for the intermediaries as well; the role of credit agents continued to increase; certain experts say that half of the banks' loan assets are attributable to credit agents.

In 2008, the stock of forint-based residential loans decreased permanently, but the rate of such decrease was smaller and smaller, on a monthly basis. Last year, currency-based loans already dominated not only in the case of newly granted loans, but acquired an overwhelming position also within the total stock of residential loans. This increase started to grow with full speed in August, because in the first half of the year, the effects of stock increases and decreases mutually weakened each other to a considerable extent. (Within that, changes in the exchange rates also played a role, because the National Bank of Hungary registers the stock of currency loans in forints!)

Monthly changes in the stock of retail residential loans in 2008 (HUF bln)



Source: National Bank of Hungary (NBH)

The October events can be clearly followed on the diagram. One of the reasons for the significant jump in the stock represented the news on changes in the terms of lending in foreign currencies. Customers wishing to obtain such loans submitted their applications earlier, in order to get loans with the “preferential” terms still in effect. Still, the leap of the currency-denominated stock in October was due not only to the “last minute” borrowings, but also, the continuous weakening of the forint also implied a higher loan stock. The drop in November was already attributable to the increased strictness of currency-denominated lending and the lack of funds, and it could not be compensated by the somewhat improved exchange rate that continued to be weak. In the background of the increase in stock for December, in addition to the exchange rates, we find a certain recovery of the lending in foreign currencies. During the last month of the year, the share of currency loans within total retail loan stock was about 67%.

For the total stock of retail loans denominated in currencies, from late summer (when NBH first announced the monthly amount of revaluation) to the end of January, the additional burden of the debtors, payable because of a weakening of the forint could amount to 1500 billion forints. At the same time, customers penalized by a drastic increase in their loan burdens were soon faced with the problem that an early redemption or conversion into a forint loan, offered by the banks, was not a solution for them, because in the first case, the exchange rate is manifestly not favourable and in the latter case, the high forint interest rates represent a serious hindrance. Taking account of that, debtors in trouble could only opt for an extension of the loan’s maturity. Moreover, by the end of the year, after a period of Swiss franc dominance, euro loans became more attractive.

With regard to weight of this problem and the wide range of people concerned, the plan of a “emergency package” from the government has been outlined, already a few weeks after the explosion of the crisis. The point is that with a property market in depression because of unavoidable impairment losses in the collaterals behind the mortgage loans, an increase of the redemption payments to such an extent may make questionable the solvency of customers who earlier never had major late payment issues.

From the year 2009, several amendments were made in financing and taxation:

- From 2009, up to a value limit of one hundred thousand forints, the price of home improvement and upgrade can be deducted from the base of the personal income tax, if the gross annual income of that person is below HUF 3.4 million. This new rule applies to wide strata of the population, but unfortunately, because of the low limit amount and the related small size of the tax reduction, it would hardly have an effect on whitening the economy.
- A lowering of the inheritance duty applies only to direct descendants/ascendants and it means the lifting of such duties, up to the level of

twenty million forints of inherited values. Even until now, one of the ways to avoid the payment of this duty was to conclude, within the family, sale and purchase or donation contracts for the properties in question. But so we can expect a decrease in the number of registered transactions, and that will not necessarily indicate an actual slowdown on the market.

- With its decision in mid-December, the Court of Constitution repealed the currently applied regulations for the luxury tax introduced in 2006. By the same, the possibility of value-based property taxation was also eliminated (according to the initial plans, this was intended for application from 2009 onwards, as an option), as this tax was to be calculated under a method similar to the luxury tax. That is, the introduction of this form of property taxation, considered the most equitable by many, cannot take place for the time being.

MARKET OF THE NEWLY BUILT HOMES

Under the impact of the financial crisis spilling over to Hungary, banks not only applied substantially stricter norms for their financing on the retail side, but they also became more cautious about their financing property projects. In our country, all this was coupled with an unfavourable environment of the real economy that determines the fundamentals for property market, where in development activities a fall occurred that was not seen since a long time.

In the situation that developed under the impact of the crisis, power relations have suddenly changed. Given that the whole of the market is now driven by demand, buyers found themselves in bargaining positions that were not seen earlier. In addition, already by the end of last year, effects unfolded that might shape the whole of the market even in the long run. After 4-5 years, another clear shift can be observed for instance towards small flats. Also, an increase took place in the share of cash buyers who are looking for opportunities on the property market to avoid the rising risks of bank deposits. At the same time, quite a number of people postpone their purchases and this has an enlivening effect on the market of rented homes. We may continue to consider small flats to be the most secure investments and to be the easiest to sell or rent out. These effects were particularly manifest in the completed or close-to-delivery projects, where an evident end-of-year turnover was generated by this new group of buyers.

In a comparison with that, in early January, a wait-and-see position was typical for the market; clients were waiting for things to develop. This year, a stronger bargaining also started, from the buyer side. Many home buyers became pushy from seeing bargain opportunities reported by the press – and often exaggerated, too. They kept making attempts at several places, in several rounds, to trim down prices, with more or less success. At any rate, demand and transactions are now much “healthier” than in the first weeks, months after the crisis struck. Those who did wait until early January, reappeared again and – after a relatively long decision making, but having thoroughly studied technical, legal and financial issues – they do buy the larger homes, as planned earlier, but with terms that are sensibly better. Keywords like worthiness and quality were present for buyers earlier as well, but now the investor’s reliability, capital strength and bank references gained an importance, never seen before.

The signing of contracts takes place several weeks later than previously, and some of the transactions are very difficult to close. The reason thereof is more cautiousness and preliminary checks of loan applications. Earlier, in the period when loans were easy to obtain, this was not a major issue, but now buyers tend to run these rounds even before a registration contract to the value of 500,000 forints.

For cash buyers, the VAT changes planned for this summer will have no implications in respect of investments already completed. A problem arising from price increases may occur in those ongoing development projects, where the final contract can be made only after the VAT amendment or where the final invoicing and payment will become due only after that. At any rate, the VAT increase also became a factor of the bargain.

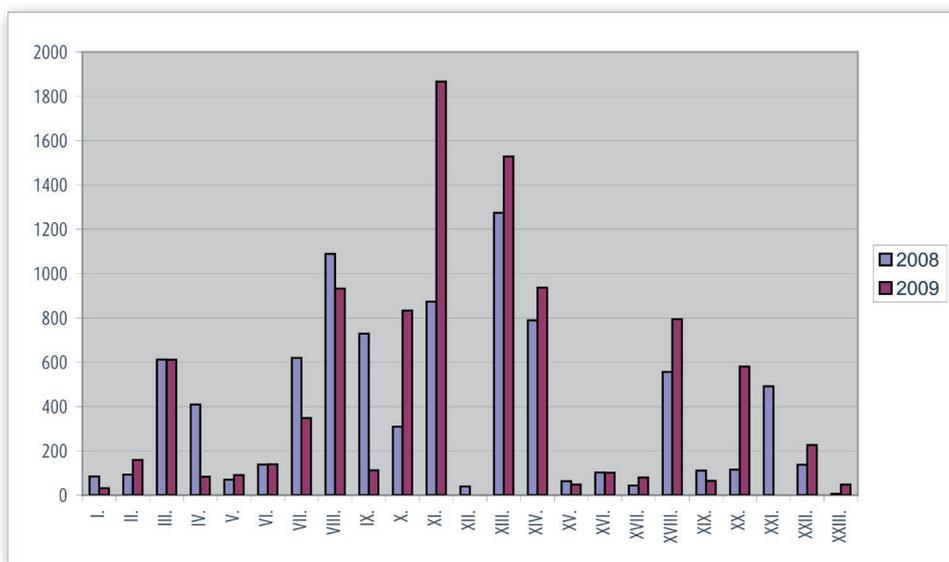
The static character of the supply side is an important limitation for the tools applicable by the developers in a depression. Here, it is simply impossible to make immediate decisions, neither in terms of the numbers of units or the layout of the homes. Due to demand pressure, therefore, different sales campaigns, promotions remain available, as well as open price reductions. In this latter case, however, suspicions might arise if the investor is easily ready to reduce prices to a large extent. On the one hand, this might make questionable the product's saleability, and on the other hand, a drastic drop in revenues may endanger the project's implementation.

Investors were concerned by the spectacular squeeze in project financing and the significant tone down in demand to different extent. The most difficult situation arose for those who just started the construction, but only about 25% of the homes were sold and / or those who basically focussed on price-sensitive buyers. As they were not in a position to stop the construction, they saw themselves in a situation of forced sale, offering their units at lower prices, by giving up an important portion of their profits. At the same time, those who already were in an advanced construction phase and, even more importantly, where a higher portion of the homes was already sold, may be able to weather the spill-over of the crisis with relatively no problems, especially if their product is an attractive and competitive one. And to construction projects close to completion, the confidence of clients is also larger.

Whatever the crisis may still mean, a large portion of the homes from good projects will be absorbed by the market. For the buyers, emphasis is not necessarily on cheapness, but rather the possibility to purchase in the present situation good products, at affordable prices. A good price/value ratio provokes interest from potential buyers in a difficult period as well. An increased need for smaller sizes may persist in the longer run, because buyers are trying to minimise their borrowings. On the other hand, for this reason, the real premium category, designed for foreigners who performed splendidly until the crisis, but suddenly disappeared now, may fade away to the background.

In all areas of the property market, affected by the financial and economic crisis, one shall expect selection; the recent period's market cleaning effect shall persist in 2009: developers with inadequate financial background may withdraw from the market or terminate their businesses, and a similar process may be expected on the side of property agencies as well, with the drop-out of non-competitive businesses, whilst due to increasing uncertainties among buyers, the share of professional property intermediation services may grow and, within that, the role of large networks could strengthen.

Condominium houses delivered in 2008 and planned for delivery in 2009, in Budapest by districts



Source: Otthon Centrum; on the basis of data provided by investors and distributors
Note: as at February 2009.

According to a full-scale survey of Otthon Centrum, dating from February 2009, in the framework of projects, most of which have been already launched, this year 9600 units would be delivered in condominium houses in the capital city. It may be a surprising fact that this figure is two thousand higher than the volume built by entrepreneurs in 2008, for sale. At the same time, it is a multi-year experience that about one-third of the implementations planned at the beginning of the year typically are carried forward to the following year, and this can become even stronger this year, due to the crisis. According to our estimates, the built volume might reduce by about 30%. Supply, responding to

the effects of the crisis only with some delay, may drop next year even more, and that – together with the absorption of the 1900 units already delivered but unsold – may even result in a deficit on the market of new homes that shall be operating hopefully already in normal ways by that time.

From 2009, two novelties are introduced with the purpose of a quality improvement in homes built:

- A document called 'green card' or 'home label' shall show how efficient energy consumption in that particular property is. This provision enters into force from January 1, 2009 for new homes, while in the case of second-hand homes this takes place only three years later. Presumably, this certificate will not have a sensible effect on the market for the time being, as it may cause a major reshuffle rather on the market of homes from owners, later. At present, for buyers of new homes the main criterion is the price of that home, while all other considerations follow only after that.
- This is the year when the first homes built in line with the construction specifications modified in September will be delivered. The regulation has been tightened up on several sections of the National Territorial Development and Construction Requirements. From the point of view of saleability, such changes are positive and provide for higher-quality homes. Still, compliance with the amendments implies additional costs for developers and so, logically, it would result in a price increase, but it is questionable whether this can materialise.

MARKET OF SECOND-HAND HOMES

Last October, lending based on CHF, the most favourable borrowing at that time, was terminated by banks within a matter of days, and a drastic increase was implemented, uniformly, to residential loans. Let's take an example: In September, a young couple could safely plan to buy a 60 sqm home (in addition to their own contribution, we calculate, as an example, with a 10-million forint loan, based on Swiss francs, 20 years to maturity and a redemption of about 75,000 HUF per month), but by the end of the year, they probably gave up this idea, with redemption payments of 110,000 HUF per month on euro denominated loans, qualifying as the most favourable ones at that time. Therefore, they either bought a different home for a few millions less and one room smaller, or they postponed their purchase.

Due to the difficulties with borrowings for the clients and due to postponed purchases, at the same time, the market of rented homes may liven up. Because of the more austere borrowing terms, many people might be compelled to opt for renting, whilst more cautious, creditworthy people also might prefer to wait with borrowing at deteriorating terms and rent temporarily a home (and if experiences are favourable, they might apply this solution for a longer period). Therefore, general disapproval of renting a home, considered at present usually to be a forced solution, may perhaps be reduced, but there are not too many chances for a whitening of the rental market (conclusion of a contract, tax paid on revenues) in the present economic situation.

The narrowing of borrowing possibilities caused a slowdown in demand, but because of the ailing capital markets, a portion of investors turned their attention to real property, therefore, diminishing demand was partially set off by property purchases for investment purposes. In the last two months of 2008, three kinds of buyer groups were present on a market that squeezed to about half of its size in

the same period of 2007: cash buyers who regrouped their savings from stock market and other financial investments to real estate; those persons who had already initiated their transaction during the year and held an already signed sale and purchase contract (and eventually a loan contract); and those who are forced to move and cannot postpone the purchase.

Even though changes in demand for housing do not occur from one day to the other and the squeeze in residential borrowing are bound to have consequences in the longer term, our forecast projecting a decrease in demand for homes has been confirmed partially already by the transaction data for November-December 2008. For a comparison, we used the same period of 2007 and the first ten months of the year 2008.

Average second-hand home prices ('000 HUF/sqm)

	Nov-Dec 2007	Jan-Oct 2008	Nov-Dec 2008
Countrywide			
Prefab block flat	181	183	177
Brick condo flat	268	260	260
Family house*	183	171	160
Budapest			
Prefab block flat	197	203	196
Brick condo flat	312	301	293
Family house*	270	245	221

Source: Otthon Centrum, transaction database
*Including terraced and semi-detached houses

In the last two months of the year, in a comparison with the first ten months, the sqm prices of purchased homes decreased in all categories and all areas; it was only the countrywide average of the brick-built homes, where no change took place last year. And a continuous price decrease was to be observed already from the end of 2007. At the same time, for new homes, an opposite process unfolded: according to our data, in November-December 2008, the prices we recorded were 1-5% higher than in the first ten months of the year, in each category.

Prices of prefab block-built flats are characterised by a relatively small scope, because in this segment, supply consists of very similar units. Still, homes with energy improvements and supplied with separate meters are increasingly in demand, and that can be observed in their prices as well. Diversification is the highest in the category of family houses, where due to the higher-than-average prices, response to changes in demand are more sensitive.

In our analysis, we also examined the average size of residential properties sold by owners. On this basis, the size of residential properties purchased in the period of the crisis is either the same or larger than in the previous period of the year or in the last two months of 2007. On the whole, the significant decrease in unit prices and the slight increase in average size resulted in a decrease of the purchase prices of homes in the examined period. Family houses represent an exception, where a large increase in size led to an increase in overall prices.

For the time being, buyers do not give up their intentions in terms of size under the impact of the crisis, they rather prefer less expensive properties. (Those who sense the most the toughening of lending and who could really buy only a smaller home, prefer to wait with their purchase.) They can do so by quality trade-off, that is, the price of the homes becomes more important than their actual state. Another explanation may be that there is an improvement in the buyers' position in the framework of the price bargain. The drastic squeeze of the market tends to compel sellers to accept more significant price cuts.

Our sales database largely supports this latter theory; the only segment where bargaining positions did not improve was the one of family houses, where it was rather stagnating or a slight decrease was observed. The following table shows price decreases of properties sold in the given periods, calculating with the differences between the input price at the time of inclusion into the Otthon Centrum database and the selling price, after adjustment for extremities.

Average extent of bargain (in %) in the case of second-hand residential property

	Jan-Oct 2008	Nov-Dec 2008
Countrywide		
Prefab block flat	3,5	4,8
Brick condo flat	5,1	5,6
Family house*	7,2	6,8
Budapest		
Prefab block flat	3,2	5,2
Brick condo flat	4,7	5,4
Family house*	6,7	6,2

Source: Otthon Centrum, transaction database
*Including terraced and semi-detached houses

That said, the impact of the crisis can be summarised in a way that buyers who are creditworthy or have sufficient savings are in a favourable position, because sellers who are unable to pay their redemption instalments and, in a more general way, those who respond to unfavourable market news, are ready to

accept more important discounts. And this is a decisive parameter in the present situation, where the price became the crucial criterion for searches. At the same time, if we would like to make the transaction process shorter, it makes sense to contact large property agency networks. Making use of their market knowledge and comparative property database, we can easily avoid a situation where we can sell our property only after a long period of advertising and, finally, at a price which is far below value and where, as a buyer, we have good chances to make our selection from among homes with realistically determined prices.

MARKET OF CONSTRUCTION / DEVELOPMENT PLOTS

Prior to the culmination of the crisis, the market of development plots was sensibly down, for about one year and a half. Even though until mid-2008, there was a relatively vivid and solvent demand for plots available for construction, during the year, only a few large-volume transactions were realised. Owners (whether we pick owners of development properties or investment-purpose properties) presumably did not expect that the subprime crisis that started in the USA could have a serious effect on our country as well. The more so, some people expected a price increase. As opposed to that, the buyer side was active in searching opportunities, but definitely not at the price levels visualised on the seller side. Speculators operating with high leverage were quick to disappear from the market and, due to reasons detailed above there was a decline in the activity level of property developers as well. Therefore, it came to a stalemate situation on the plots market too, where demand and supply are unable to meet. In practical terms this means that the demand side is represented by a limited number of capital-rich buyers, who would be ready to make purchases at price levels well below the pre-crisis prices, but until October 2008, the majority of sellers refused to accept this.

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 I, II and XII	120-200.000	↓
Districts VI and VII, within the limits of Nagykörút	90-120.000	↓↓
Districts VI and VII, outside the limits of Nagykörút	65-90.000	↓↓
Former brownfield zone of district XI	25-45.000	↓
Rehabilitation area of District IX	40-60.000	↓↓
The Angyalföld portion of District XIII	35-50.000	↓
District XIV	40-70.000	↓
Rehabilitation area of District VIII	15-45.000	↓↓
District X	10-20.000	↓↓↓

Source: Otthon Centrum

Still, since October, there was a fundamental change in the economic environment, and finally this forced certain changes to emerge on the selling side of the plots market. A clear indication thereof is that sellers are finally ready for a correction, i.e. in terms of offered prices (because buyers refuse to accept these as well, for the time being). The levels of offered prices dropped roughly to the price level of late 2005. On this basis, a price drop of about 20% became evident already by the end of the year, but due to the freeze of the market, it is impossible to tell as yet, what the actual effect of the price drop may be.

Overall, the reason for market immobility is total uncertainty and risk avoidance – at present, this is what holds in check the whole of the property sector. There was an in-depth change in the fundamentals of the property market, as well as the marketing of the projects in the last two months of the year, and at present, a complete redefinition of the market and a reconsideration of previous operation models is in process, which makes difficult the development of a new pricing on each submarket. Due to the fact that the value of any development plot basically depends on the value of the property development project that can be associated with it, the emergence of the new price levels and so, a realistic determination of the plot values may take place only after a reshaping of the business plans.

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



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