

The housing supply remains inadequate, in terms of quantity as well as quality. Despite an acceleration in construction over the past few years, the demand-supply ratio is still unbalanced because of bureaucratic

Home, sweet home in the new Europe

ECONOMICS

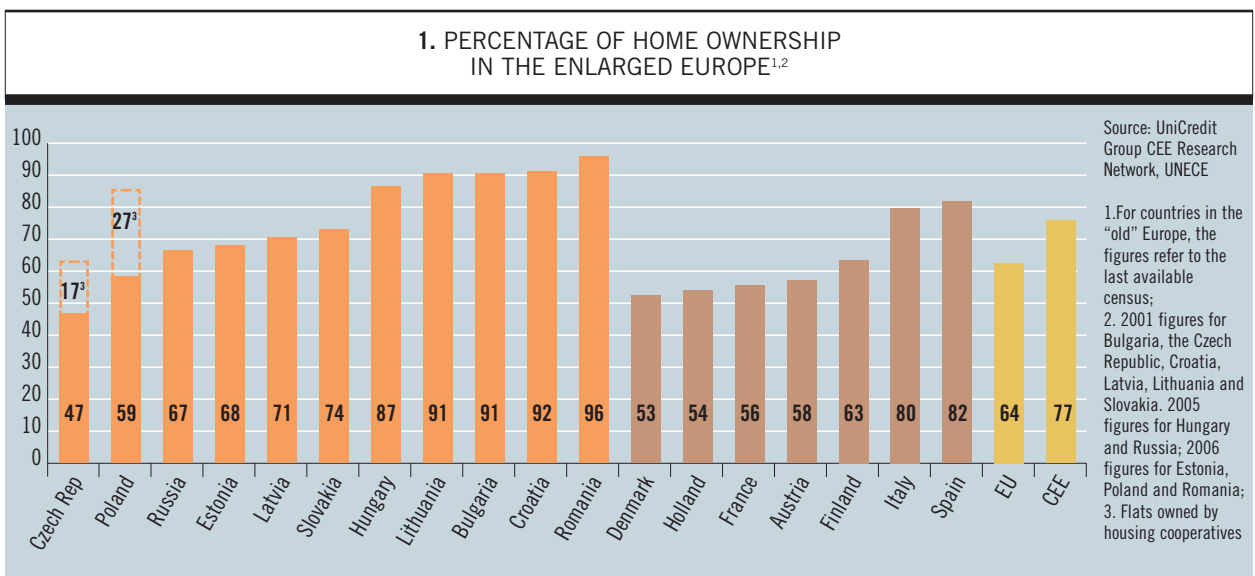
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delays, the lack of an efficient land registration system, few urban plans and scarce availability of land, especially in big cities. However, there are prospects for further growth

The housing market in the Central and Eastern European countries has undergone a significant transformation over the past decade, although there is still a quantitative and qualitative gap in the supply of new housing at the regional level. While the percentage of home ownership

is generally high as a result of the privatisation process in the region, housing quality still lags behind Western European standards.

In the majority of cases, existing housing date back to the planned economy, with about 70% of housing built between 1945 and 1990. Although these buildings are



relatively recent, they are often in less than optimal condition. The average surface area is about 63 square metres, compared to 87 square metres in the EU's mature Western markets. Houses in the old EU have 4.2 rooms on average, compared to only 2.8 rooms in Central and Eastern Europe.

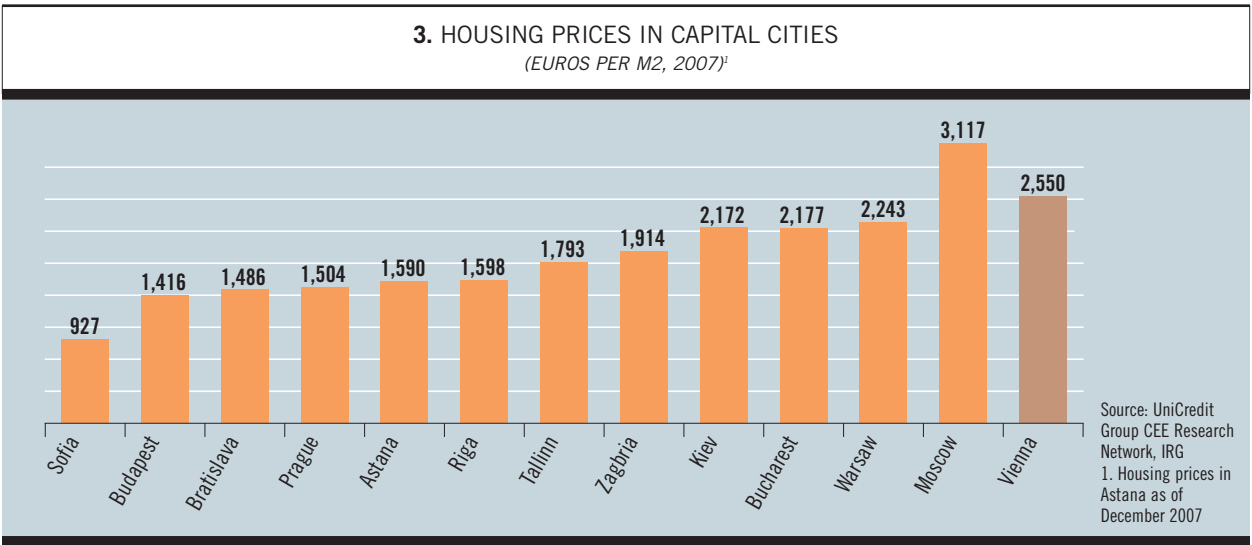
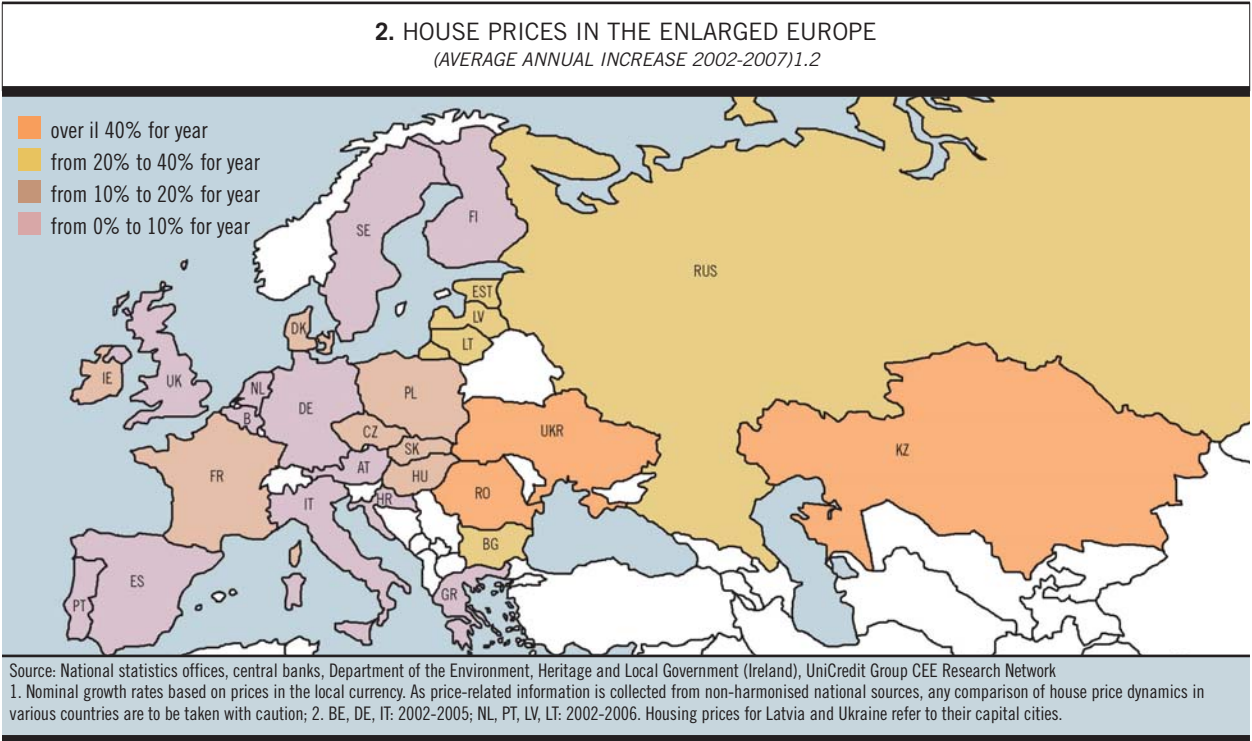
The housing supply is inadequate not only in terms of quality but also in terms of quantity. Despite significant acceleration in construction over the past few years, the supply of new housing is still not large enough to satisfy the demand. In this context it is worth emphasising that bureaucratic delays in obtaining building permits, the lack of an efficient land registration system and, in some cases, the lack of urban plans and the scarce availability of reasonably priced land, especially in big cities, are major obstacles to a larger supply of new housing.

A few figures provide an overview of the situation. There are about 413 houses per thousand people in the region, well below the Western European average of 472, while the supply of new houses reached an average of nearly 3 homes per thousand people in Central and Eastern Europe in the past three years, compared to 7.4 new homes in Western Europe. The acceleration in the building sector over the past few years has largely been concentrated in capital cities and the main urban areas, with an increasing number of holiday homes in coastal areas, as in Bulgaria and Croatia, or winter resorts in the mountains, as in the Czech Republic. In terms of demand, an increasingly stable macroeconomic framework and the resulting rapid growth in overall income and wealth that has been observed over the past few years, together with easier access to credit fuelled by the strong growth of the mortgage market, have provided significant drivers for improved living conditions. However, increased demand for housing has been accompanied by a progressive deterioration in people's investment capacity, especially for lower income groups. As a result, in many countries in the region, the demand for the purchase of new homes is still mainly linked to the emerging middle class and the wealthier segments of the population.



The growing influx of foreign capital, which mainly flows to the capital cities and the holiday home segment, has given the demand for housing a major boost. Property speculation and the boom in the market for second homes appear to be particularly strong demand drivers. While precise figures regarding the overall number of transactions involving foreign investors are not readily available, a few estimates suggest that it is quite high. In

Romania, for example, foreign buyers are estimated to account for around 40% of the overall demand for housing. Similarly, around 40% of the overall demand in Moscow's housing market is estimated to be investment-related. Another fast-growing category of home buyers is expatriate workers, who have invested a significant portion of their savings in the domestic housing market over the past decade (remittances by Romanian and



Bulgarian expatriates amounted to approximately €5 bn and €1.3 bn respectively at the end of last year). Strong demand combined with the qualitative and quantitative gap in supply has led to a considerable rise in housing prices, thereby raising concern about a possible risk of overvaluation. It is worth emphasising that the privatisation process contributed significantly to raising prices, with flats sold at substantially below-

market prices, leading to strong misalignment with macroeconomic fundamentals.

There was an especially significant increase in house prices in Romania, Bulgaria and the Baltic countries in the run-up to EU membership (with annual real growth rates ranging from 23% to 43%), a strong acceleration over previous years. In the second group of countries (Poland, Croatia, Slovakia, the Czech Republic and Russia), house prices grew at a moderate rate of 6% to 22% from 2004 to 2007, with a more noticeable slowdown in Hungary as a result of the recent adjustment of supply. The most marked increases were seen in former Soviet countries such as Ukraine and Kazakhstan, where housing prices in

_Sustained demand for housing continues throughout Central and Eastern Europe; this is one reason why prices keep rising in countries such as Romania, Bulgaria and the Baltic region



some sectors were up to ten times higher at the end of last year than at the beginning of the millennium. Generally speaking, the highest increases are to be seen in big cities and the coastal areas, with housing prices in the Eastern European capitals equalling those of the main European cities even though average household income levels are far lower. Despite strong growth over the past decade, we still believe that housing prices in the region are compatible with a balanced market, although trends away from this balance have been seen in certain segments.

The residential property market in the region still offers the prospect of significant growth opportunities, although the current macroeconomic is less favourable as a result of the international financial crisis. Economic growth is still high but the repricing of risk at the international level could stem capital inflows into the region and lead to some credit tightening, two factors that could negatively impact the dynamics of the property sector.

All in all, despite a less favourable international scenario and a few imbalances, the qualitative and quantitative gap in supply combined with unsatisfied structural demand are long-term market drivers. The results of one of our recent surveys of a representative sample of households in the region shows that about 2 of 10 households plan to buy a new house in the coming years, mainly to live in (see box for details). There are obviously some areas to monitor: these include holiday homes in Bulgaria and some imbalances in capital cities such as Bucharest. The bursting of the property bubble in Kazakhstan could be yet another warning signal.

Life in Central and Eastern Europe today

The first, fundamental step towards a complete and exhaustive analysis of the property market in the region is to highlight and study its potential, especially in terms of demand. To this end, a detailed market study was undertaken to examine the current living conditions and expectations of citizens of 12 Central and Eastern European countries (Russia, Ukraine, Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Croatia, Bosnia Herzegovina and Serbia) and estimate future growth for the housing market as well as the credit market, since the two are closely linked. A representative sample of at least 1,000 people over 15 years of age and living in the major urban areas was interviewed in each country. The study essentially had two distinct but closely related objectives. The first was to identify people's current living standards, the level of demand for new housing and its main components so as to obtain an extremely detailed overview of the main characteristics of the region's housing market and its future growth. The second focused on analysing the main financing methods that households use to buy property so as to draw significant conclusions regarding future opportunities for the growth of the mortgage market in the region.

Although home ownership is high, 2 of 10 households plan to buy a new house in the next ten years or more. One of the main results to emerge from the study is that, despite the high percentage of home ownership (around two-thirds of respondents own a home in which they live on a regular basis), potential demand remains high, with around 2 of 10 households planning to buy a new house or flat in the next ten years or more. The percentage of Romanians (25% of respondents), Croats (24%) and Slovenians (23%) expressing their intention to buy was particularly high. This result is easily explained if we consider, as mentioned earlier, that quality standards in current housing, most of it a legacy of the Communist era, are largely inferior to Western standards in terms of size as well as the lack of basic services such as running water and electricity. The desire to improve living conditions in a wider context of strong income growth and achieve living standards comparable to Western Europe is therefore one of the main components of the demand for new housing. The obvious consequence is that, in the majority of cases, the reason for buying a new house is to use it as the main residence and live in it (88% of respondents). Buying property for investment purposes is a motivation in only a few countries where there is strong demand from abroad, notably Bulgaria and Croatia (7% and 8% respectively), especially in the coastal areas, and Romania (6%), particularly in the capital, Bucharest.

It should be pointed out demand is principally driven by young

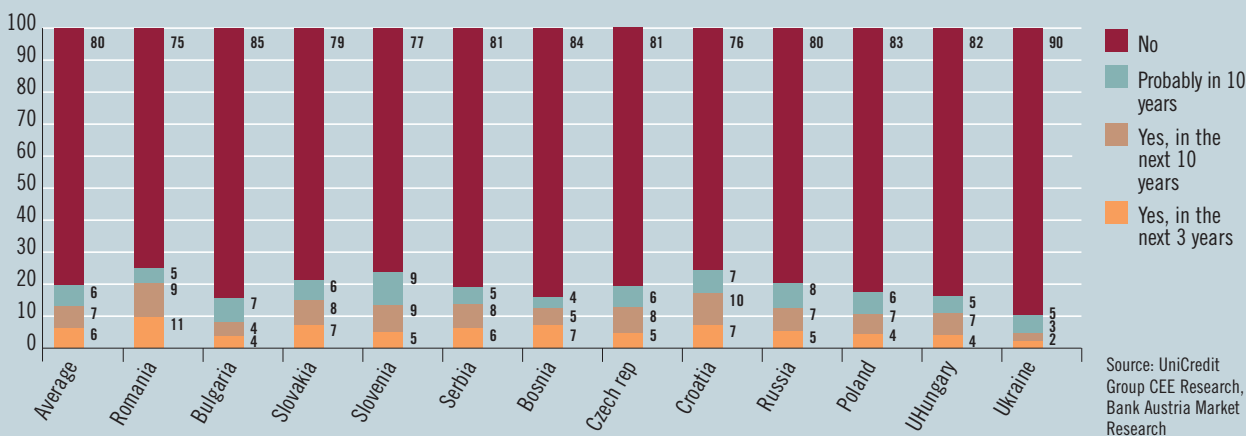
people and higher-income households. Considering that these economies are still experiencing strong growth, this is practically a foregone conclusion and the underlying reasons are easily intuited.

Bank loans are still the main financing method used to buy a house. Shifting the focus to an analysis of the main financing methods used to buy a new house, the study shows that bank loans still play a leading role (cited by 62% of respondents on average), followed by savings, with a reasonably hefty 34% of responses. As regards bank loans, Slovenian, Croatian and Hungarian households have the highest percentage of borrowers (over 70% in each country), while fewer households take out a bank loan in Poland (58%), Bosnia (57%), Russia (59%) and Ukraine (33%).

Considering that access to both financing methods is easiest for the wealthier sections of the population and the young (who are driven by a strong personal ambition to improve their lifestyle as they climb higher up the career ladder), an analysis of these results could lead to further considerations regarding the level of access to finance.

The desire to buy a new house and access to a wider range of financing methods are clearly very strongly linked to individual household wealth and the country's overall growth level. In this regard, Czech, Slovakian, Slovenian and Hungarian households (the four wealthiest countries in the region) have more financing options – from 1.4 to 1.6. – than households in the other Central and Eastern European countries (especially Russia and Bosnia, where the figure is just over 1.0).

4. INTENTION TO BUY A NEW HOUSE OR FLAT



5. PLAN TO FINANCE THE PURCHASE OF A NEW HOUSE

