



Residential property price developments in the first half 2006

Ing. Mikuláš Cár, PhD., National Bank of Slovakia

A combination of strong economic growth stimuli and a relatively stable political environment in the Central European Region is creating relatively good conditions for the real estate market in Slovakia. The arrival of foreign investors is substantially expanding the scope for construction of industrial real estate and is raising interest in high-quality administrative centres. The expected growth in economic performance and in citizens' purchasing power, together with easier access to mortgage and consumer loans, is supporting a further expansion in the network of commercial and recreational centres and the development of the residential property market.

The developing market and shifting real estate prices is affecting economic activity and aggregate demand in several ways. So, for example, the increase in real estate prices is raising expectations for income from real estate investments, which in turn is reflected in the construction of new buildings and higher demand in real estate-related sectors. Rising real estate prices can also have a significant effect on the investment decisions of companies facing difficulties in other sectors. Likewise, changes in the prices of houses and flats are affecting the financial behaviour of owner-occupiers and prospective buyers. The meeting of housing needs at a time of rising residential property prices is resulting in higher household expenditure and an increase in private consumption.

Because of the growing impact of changes in real estate prices on economic activity, aggregate demand and on overall price changes, and in order to ensure the problem-free repayment of real estate construction loans, there is increasing interest in the tracking and evaluation of real estate prices, not only from buyers and sellers, but also from intermediaries and commercial banks; this is also becoming an important factor in monetary policy. Indeed, experts examining the effect of declining real estate prices have found that although the bursting of a property-price bubble has so far happened infrequently, it can involve up to double the losses associated with the bursting of a share-price bubble.

EXPECTED SLOWDOWN IN RESIDENTIAL PROPERTY PRICE GROWTH IN THE EURO AREA

The ECB in cooperation with national banks has since 2001 been constructing an index of year-on-year changes in prices of houses and flats in the euro area, weighted by the share of each country's GDP in the overall GDP of the euro area (the construction of the average index of year-

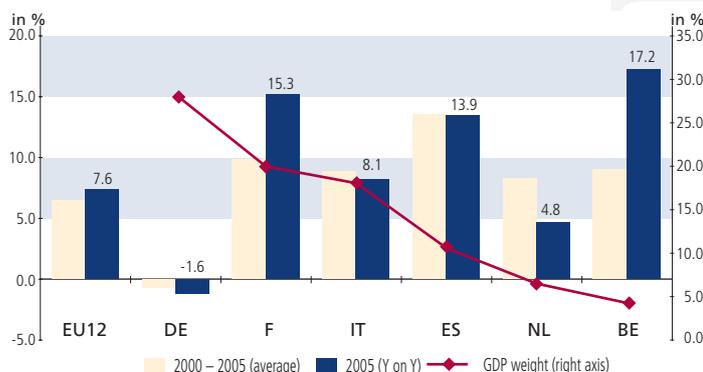
on-year changes in residential property prices for the euro area does not yet take into account data for the new Member States, nor residential property prices in Denmark, Sweden and the United Kingdom).

According to the ECB, average residential property prices in the euro area for 2005 increased by 7.6% year-on-year (compared to 7.2% for the previous year), representing a steeper rise than the average for the period since 2000 (6.7%). In the key euro area countries, year-on-year growth in real estate prices was relatively differentiated, as Chart 1 shows. In 2005, the sharpest year-on-year rise in residential property prices occurred in Belgium (up by 17.2%) and France (15.3%), while the prices in Germany continued to decline (by 1.6%). Residential property prices in Germany have been stagnating for the past ten years, and since Germany accounts for the highest share of euro area GDP (almost 30%), this has a significant effect on the value of the average index of house and apartment prices for the euro area.

The effect that the development of residential property prices is now having on the overall price level is only indirect. In fact, expenditure related to the private ownership of houses and flats is not directly included in the calculation of the harmonized index of consumer prices (HICP), yet the development of residential real estate prices is affecting the level of rents entered into the construction of the HICP. In this way, prices of houses and flats act indirectly as an inflationary or deflationary factor.

Residential property price developments attract daily interest from the banking sector, as well as from other entities (developers, owner-occupiers, buyers, intermediaries) and various research insti-

Chart 1 Residential property prices in selected euro area countries



Source: Eiglsperger, M.: Residential property price statistics for the euro area and selected EU countries. OECD-IMF workshop of Real Estate Price Index, Paris, November 2006.



tutions. According to analyses and estimates made by real estate experts, the decade of sharply rising residential property prices is slowly coming to an end. They point out that several European countries reported a slowdown in the growth of house and flat prices in 2006 and that the period of low interest rates in the euro area has passed, which may be expected to result in dampening of public demand for residential housing in certain countries (especially the United Kingdom, Ireland and Spain). But according to Liam Bailey, Head of Residential Research at the London-based consultancy Knight Frank, residential property prices may continue to rise gradually over the next two years in several European countries. This applies particularly to the new Member States, where the real estate market is still basically in its first stages.

In Spain, which has the highest rate of owner-occupiers in Western Europe (around 85%), it is estimated that the average house price increased by 12% in 2006 (compared to 15% in the previous year). The average house price in Madrid and Barcelona is fluctuating around EUR 446 000.

In France, house prices rose in the first half of 2006 by 9.4% (compared with 15.3% in the first half of 2005) and the average house price in Paris represents around EUR 345 180.

In the UK, which has one of the most vigorous residential property markets in Europe, the rise in house prices so far reported for 2006 is 5% (compared with 3% for the previous year). The average house price in the UK in September 2006 stood at GBP 168 460 (EUR 251 000). In London (host of the 2012 Olympic Games), house prices increased by 7.3% over the first nine months of 2006, for an average of GBP 259 646.

Europe's most stagnant and unvarying residential property market has in recent years been located in Germany, where a related fact is that to rent a house or flat there is more advantageous than to buy one. The average house price in Germany over the past 10 years has fluctuated around EUR 234 182. Real estate experts predict, however, that the average house price will have risen 7.8% by the end of 2010, because of demand outstripping supply in certain cities (Frankfurt, Düsseldorf and others). Another factor supporting a rise in German residential property prices is the increase in value added tax that came into force at the beginning of 2007, from 16% to 19%.

The residential property market is influenced to a considerable extent by the strength of regional economies, expectations for their medium-term trend development, and, in many cases, by persisting propensities to (non-)owner occupancy. It is, for example, typical in the UK that to buy a house is more advantageous than to rent one (fully 71% of houses and flats in the UK are in private ownership). In Germany, by contrast, the rate of owner-occupiers is only 43%, while in France it is around the EU average of 63%.

The UK has Europe's largest real estate mar-

ket. For example, of the more than EUR 143 billion invested in the European real estate business during the first nine months of 2006, the UK accounted for almost 36%, Germany over 22%, France over 11% and Sweden over 6%. As regards attractiveness to foreign capital, Germany is now the most sought-after location, scooping up fully 32% of foreign investments in European real estate for the first three quarters of 2006 (a figure of around EUR 64.2 billion). It was followed by the UK (almost 22%), France (14.1%), Sweden (6.7%) and Poland (5%).

The implementation of the four freedoms of the enlarged EU (the free movement of goods, services, persons and capital) has in practice increased the internationalization of the market in residential properties and is slowly but surely synchronizing residential property prices. This is seen, on the one hand, in the strong growth in residential property prices in the countries of Central and Eastern Europe (especially in the Baltic states and Bulgaria, as Chart 2 shows), and, on the other hand, in the gradual slowdown in residential property price growth in the old EU Member States. But although residential property prices in Central and Eastern Europe are rising sharply, they remain substantially lower than those in Western European countries.

A general problem in evaluating real estate prices, and especially in comparing them on a year-on-year basis, is the availability of the relevant official data. The data used are notable for the diversity of their sources (ministries, mortgage lenders, real estate agencies, land registry offices, and so on), the differential coverage of territory (the whole country, only larger urban centres, etc.), the lack of distinction between new and old real estate, the varying frequency at which surveys are carried out, etc. Although, in general, the indicator of year-on-year changes in residential property prices is gradually improving, it is still below the standard of other economic statistics and price indices for the euro area.

The collection of internationally comparable data on residential property prices could be qualitatively supported by information from a Eurostat pilot project aimed primarily at verifying the feasibility of including expenditure related to owner-occupied housing (OOH) in the construction of the harmonized index of consumer prices in the EU Member States (the HICP-OOH pilot study). This project has been supported from the outset also by the ECB, and from the end of 2006 a representative of the ECB's statistics section will sit on the steering committee for the pilot project. An important secondary product of this project is the planned development of the harmonized index of residential property prices for the euro area. Work on this project has been progressing relatively slowly up to now – it began back in 2000 in five countries (Finland, Germany, Poland, Spain and the UK) and it expanded in 2006 to include a further seven countries (Cyprus, France, Greece, the Netherlands, Slova-



kia, Slovenia and Italy). The next stage was outlined at a working meeting held in Lisbon in November 2006. The following two meetings should address the potential scope for using hedonic methods in the construction of price indices (Slovenia, February 2007) and should discuss the final report (based on the national reports) and the final draft of the technical project for the actual collection of statistics on OOH-related expenditure and real property prices (Spain, June 2007).

RESIDENTIAL PROPERTY PRICES IN SLOVAKIA AFTER ANOTHER TEMPORARY DECLINE IN GROWTH

Since a decision on whether the Slovakia Statistical Office (ŠÚ SR) is officially to collect data on residential real estate prices in Slovakia will depend on the conclusions of the Eurostat pilot project, even year 2007 appears to offer no realistic prospect of these data being officially collected within the scope of national statistics.

The strong interest in mortgage loans is related to the increasing attention being paid, above all by commercial banks, to the acquisition of high-quality and adequately structured information on the development of residential property prices. A promising step towards this end is the initiative of court experts in the civil engineering field, who, in cooperation with the Institute of Court Expertise at the Faculty of Civil Engineering at the Slovak University of Technology in Bratislava, have produced a draft questionnaire for the processing of an information database on flats, houses and land, in order to meet the needs of experts. The creation of such a database with suitably structured data would be an excellent aid to all entities for whom reliable prices of residential property are an important tool in their day-to-day activities.

One of the potentially reliable and most accurate sources of data on residential property prices in Slovakia should be land registry offices and their departments for the registration of real estate rights. Until recently, however, when there was a tax on the transfer, disposition, or donation of real estate, it was usual to have dual prices – the official one and another one for the land registry office's documentation. Although the risk of dual prices has now been eliminated, cadastre doesn't record the prices of buildings and flats; this is despite the fact that they have the documents with which to do so – as also evaluation of real estate should be a component part of attachments to the draft of the entering to the real

estate cadastre. As far as land is concerned, the cadastre only records the prices of agricultural land, and then only from 15. April 2004 (the date of introduction of the last amendment to the cadastral legislative act). Making the appropriate fact about residential property prices from the real estate cadastre accessible requires some administrative and software solutions, but elaborating of price map of real estates is not among the priorities of the Geodesy, Cartography and Cadastre Authority of the Slovak Republic at present.

The NBS is seeking to overcome the lack of official data on residential property prices through a cooperation agreement with the National Association of Real Estate Offices of Slovakia (NARKS). The aim of the cooperation is to acquire the required data for each quarter since the beginning of 2005 (in addition to the said quarterly data, annual data since 2002 is also available). Although the NARKS database was created for a purpose other than that laid down by the ECB, it is for the time being one of the few available sources of data on residential property prices in Slovakia. What could also contribute to improving the quality of data is the new certification of real estate agents in the form of permits, not to mention the participation of NARKS in the pilot study of the new internet portal "Real Estate Price Map".

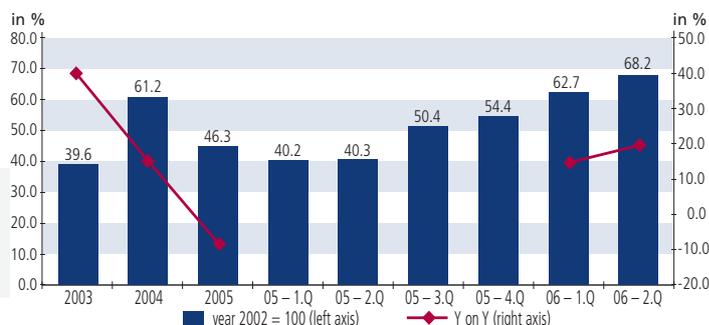
According to NBS calculations based on data from the NARKS database, residential property prices in 2003 and 2004 rose sharply in comparison with 2002 (by almost 40% and more than 61%, respectively). The significant increase in residential property prices in this period was clearly related to the expectation of a further rise in prices following Slovakia's accession to the EU. At the beginning of 2005, probably owing to a downturn in demand for residential property, the prices increased at a far slower pace, but in the second half of the year they began steadily to rise again. The average price per m² of residential property increased in 2005 by more than 46% in comparison with the average for the base year of 2002, which set against the previous year represented a slowdown in growth of almost 15 percentage points. As Chart 3 shows, prices of houses and flats compared with the 2002 base year average increased in the first two quarters of 2006 even more sharply (by almost 63% and more than 68%, respectively) than in 2004 (by more than 61%). By comparing the development in the average price per m² of residential real estate against the 2002 base year (SKK 17 832), it is possible to generalize that the first half of 2006 saw typically fast growth following an initial sharp

Table 1 Prices per m² of residential property in Slovakia since 2002 (in SKK)

| Year | 2002 | 2003 | 2004 | 2005 | 1.Q 05 | 2.Q 05 | 3.Q 05 | 4.Q 05 | 1.Q 06 | 2.Q 06 |
|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Flats | 18 132 | 24 538 | 28 072 | 25 720 | 24 565 | 24 526 | 26 463 | 27 326 | 28 860 | 29 948 |
| Houses | 17 532 | 25 264 | 29 420 | 27 568 | 26 819 | 27 139 | 28 069 | 28 245 | 29 538 | 30 147 |
| Total | 17 832 | 24 901 | 28 746 | 26 088 | 24 998 | 25 014 | 26 815 | 27 524 | 29 007 | 30 000 |

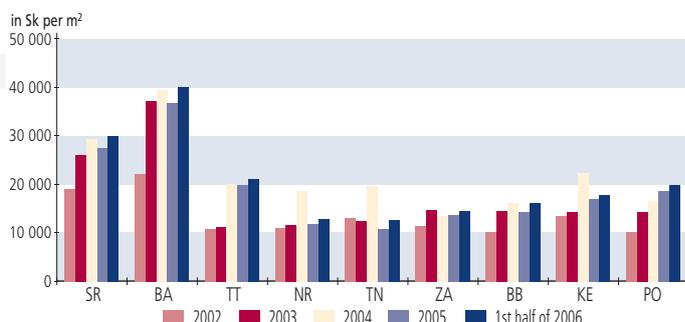


Chart 2 Changes in prices per m² of residential property in Slovakia since 2002



Source: NARKS and NBS calculations. Quarterly data are available only since 2005.

Chart 3 General development of residential property prices in Slovakia since 2002 according to region



Source: NARKS and NBS calculations.

increase (2003 and 2004) and a subsequent temporary slowdown (2005).

According to NBS calculations, the average price per m² of residential property in Slovakia in 2005 stood at around SKK 26 000, down by almost 10% in comparison with 2004. In the second quarter of 2006, the average price per m² of house and flats amounted to SKK 30 000. It was also because of the base effect that residential property prices in Slovakia rose year-on-year in the first two quarters of 2006, by 16% and almost 19.9% respectively.

The available data shows that the most frequently traded properties are three-bedroom flats. The average price per m² of one-bedroom to four-bedroom flats increased relatively sharply up to 2004, and then declined in 2005 (with one-bedroom and two-bedroom flats recording the steepest decreases of, respectively, 14% and almost 13%). By the first quarter of 2006, however, the prices of these flats (apart from one-bedroom flats) had exceeded their average prices in 2004 and they increased again in the second quarter of the year.

Prices of five-bedroom flats increased also in 2005 in comparison with 2004 and stagnated in the first half of 2006. As a share of transactions involving flats, however, five-bedroom flats account for little more than 1%. The average price

per m² of a one-bedroom flat in the first half of 2006 stood at SKK 31 197, representing an increase of almost 24% in comparison with the second half of 2005. An even steeper year-on-year increase was recorded by two-bedroom flats in the second half of 2006 (more than 26%). Prices of three-bedroom flats rose by almost 16% and four-bedroom flats by 17.5%. The average price per m² of all types of flats in the first half of 2006 amounted to SKK 29 404, for a rise of almost 20% in comparison with the second half of 2005.

According to data from the NARKS database, there is a substantial disparity in prices per m² of residential property between Bratislava Region and the other regions of Slovakia, as Chart 4 shows. In Bratislava Region, the average price per m² of residential property stood at almost SKK 40 000 in the first half of 2006, whereas, for example, in Trenčín Region it was less than SKK 14 000.

The dominant weight of Bratislava and its environs in the Slovak real estate market is taken into account when calculating the average price per m² of residential property in Slovakia as a whole. That came to SKK 29 503 in the first half of 2006, representing around 75% of the residential property price in Bratislava Region. Yet while the average residential property price in Bratislava and its environs was almost 35% higher than the Slovakia-wide average, the corresponding price in other regions was far below the national average. Trnava Region reported an average price per m² of residential property at around 72% of the national average, Prešov Region reported around 63%, Košice Region 57%, Žilina Region and Banská Bystrica Region just over 50%, Nitra Region around 47%, and Trenčín Region around 45%.

It may be expected that the development of average residential property prices in Slovakia will in coming years depend on the prices set for houses and flats by developers in Bratislava and its environs. If they rise, even the prospective buyer of a medium-range flat will face having to pay more.

Based on the available data on residential property price developments, it can be established that the average price in Slovakia of a house or flat with an area of 150 m² is fluctuating around SKK 4.5 million (approximately EUR 125 000). By making a general comparison between the previously mentioned prices of residential property in old EU Member States with the most developed real estate markets (and assuming that the average prices of residential property are around 70% of their prices in large urban centres), it may be said in very simplified terms that average residential property prices in Slovakia do not even come to half of the average residential property prices in the old EU Member States. This fact serves as the basis for speculation that residential property prices in Slovakia will continue to rise steadily over coming years.



CONCLUSION

The significant internationalization of the residential property market in the enlarged EU is reflected, on the one hand, in the strong growth in residential property prices in the countries of Central and Eastern Europe and, on the other hand, in the gradual slowdown in the growth of residential property prices in the old EU countries. Since the public's average demand for real estate is being maintained by heavy migration across Europe, these prices cannot be expected to decline within the short term.

The current residential property market is typified by substantial regional differences. Most transactions and the highest prices of residential property are recorded in industrial centres and their surrounding areas. With demand for residential property now greatly exceeding supply, certain properties in the real-estate market may be overvalued on a non-objective basis, which could in turn pose problems for their future marketability.

According to the available data, residential property prices in Slovakia rose sharply in the run-up to EU accession (in 2003 and 2004). In 2005, prices of houses and flats in Slovakia declined year-on-year by around 10%. They began to pick up again in the second half of that year, and then in the first two quarters of 2006, the prices of houses and flats in comparison with 2002 rose even more sharply than they did in 2004.

Since average residential property prices in Slovakia amount to only around half of the average residential property prices in old EU countries, there is room to speculate that these prices in Slovakia will continue to record steady growth in coming years.

Given that the expanding residential property market will also be related to a potentially substantial movement in the prices of such properties, appropriate attention will need to be paid to improving the quality of data sources, which is a key condition for the acquisition of high-quality information on the effects of residential property price developments on both the overall price level and on financial stability within the society.

Bibliography:

1. Baláž, V.: Ceny nehnuteľností sú globálne prepojené (Real estate prices are globally interconnected), in SME – Financie, 18 October 2006, p. 22.
2. Čár, M.: Monitoring Residential Property Prices in Slovakia, in Biatic 1/2006.
3. Eiglsperger, M.: Residential property price statistics for the euro area and selected EU countries, OECD-IMF workshop of Real Estate Price Index, Paris, November 2006.
4. Farmer, F.: Staré verzus nové byty: do čoho je lepšie investovať peniaze? (Old flats versus new – which are the better investment?), in Trend špeciál – reality, October 2006.
5. Kilbinger, S. S.: House-price growth is easing in most of Europe, in The Wall Street Journal, 25 October 2006, p. 32.
6. Kubička, O.: Návrh databázy všeobecnej hodnoty nehnuteľností (Proposal for a database of the general value of real estate), in Almanach znalca 2/2006.
7. Makaronidis, A.-Hayes, K.: Owner-occupied housing for the HICP, OECD-IMF workshop of Real Estate Price Index, Paris, November 2006.
8. www.knightfrank.com

A

I

B