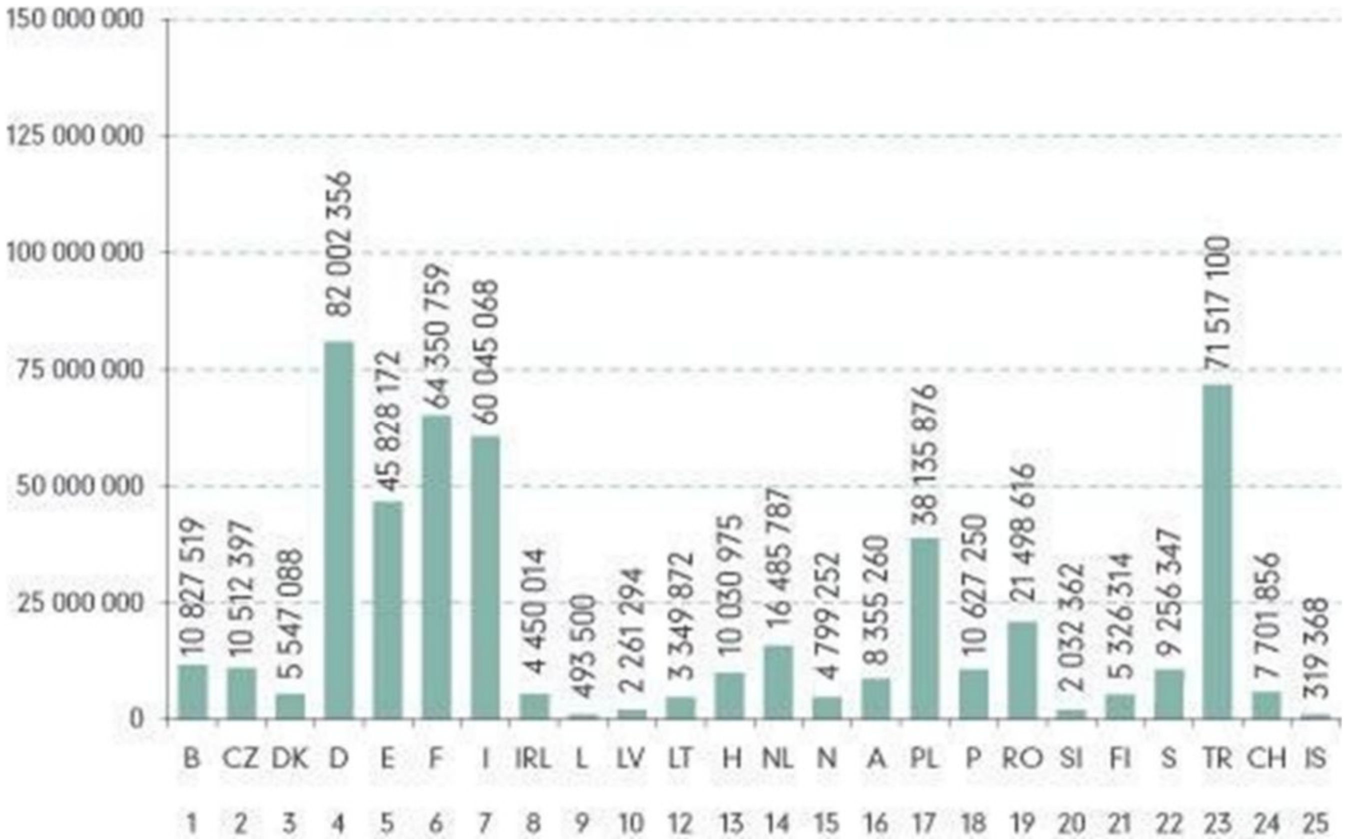
FIABCI

European real estate market: Challenges and opportunities

Contents

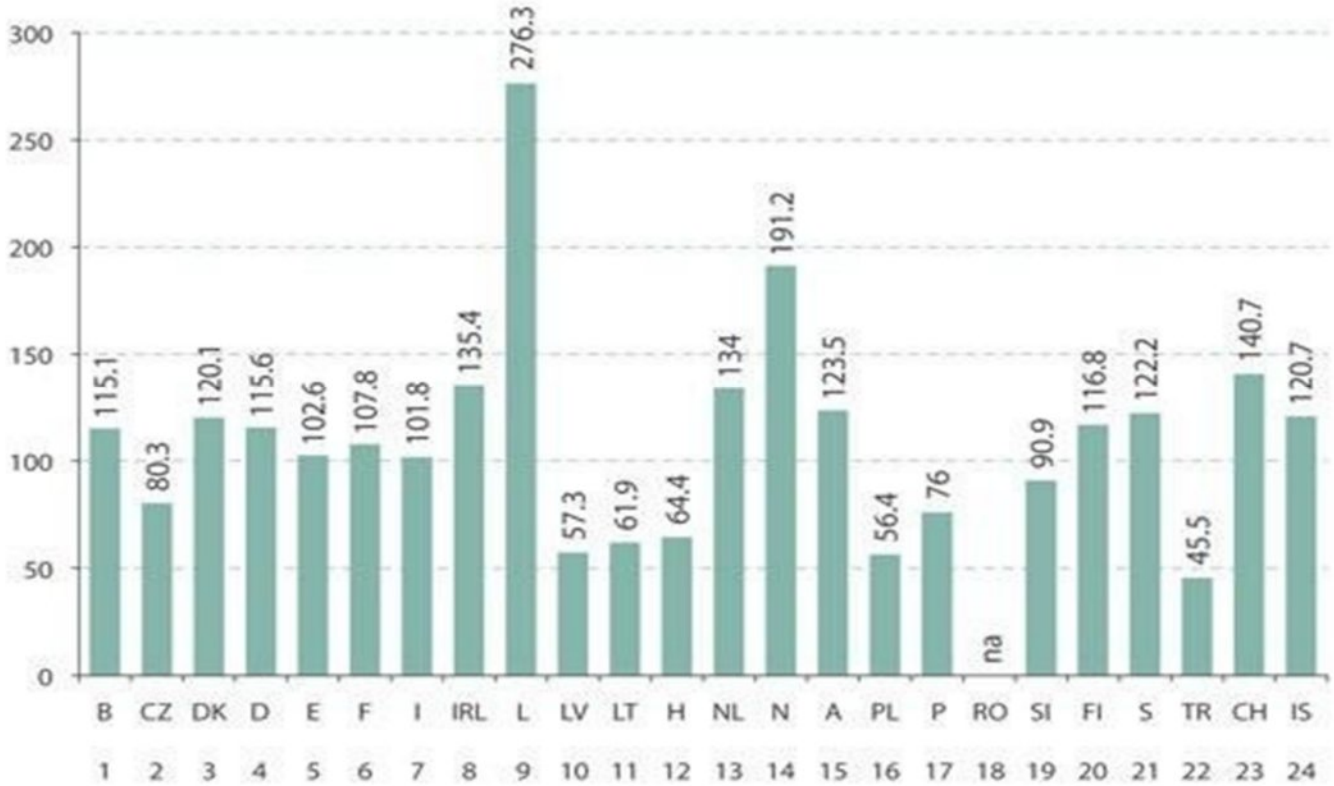
A problem foretold , 1997 - 2007

Total population: 457 Mio people



A problem foretold , 1997 - 2007

GDP/capita: average = 100



Home ownership is a major component of wealth in Europe.

Almost 70% of Europeans own their homes with a wide variation:
- just over 40% in Germany
- 60% in France
- 70% in Belgium
- nearly 90% in Hungary, Slovakia and Lithuania,

with the value of the primary residence representing more than 60% of household wealth in countries such as Finland, Germany, Italy, Sweden and the UK.

A problem foretold , 1997 - 2007

In the years 1997 to 2007 prices more than doubled in 11 of the EU 15 member states,

In Greece and France prices almost trebled. In Finland prices increased by 86%.

For prices in eight of these countries the rate of increase was greater in the second half of the period whilst

However in Germany prices declined slightly, in Austria they rose by 4% between 2002 and 2007, and in Portugal 9%.

House prices rose much faster than wages in most member states, with some exceptions

In France house prices more than doubled relative to average wages between 1997 and 2007, in Spain and the UK they rose by 85-86%, in Italy and Sweden by 70% and in Belgium, Denmark and the Netherlands by 60-62%.

However in Germany prices fell by -13% relative to wages and in Portugal by -2% over the same period, and -7% in Austria over the last five years of the period.

Mortgage debt relative to annual household income increased the same way.

Between 1998 and 2007 mortgage debt more than tripled in Ireland relative to household income. Spain – 250%; Denmark – 200%. Netherlands and UK - 80%.

In the new member states there was an even larger increase in borrowing – 300%. Mortgage debt reached a level of more than 80% of household income in Estonia and 60% in Latvia (increased by a factor 8). For the Czech Republic – 30%; in Hungary – 20%

Again Germany proved to be an exception with the amount of outstanding mortgage debt being slightly smaller in relation to household income in 2007 than in 1998, and 7% smaller than in 2002.

Provisional conclusion

These factors boosted demand but proved unsustainable. When the bubble in the housing market burst:

- The construction industry partly collapsed (unemployment rate in Spain well over 20%)
- Pressure increased on the ability of many households to repay mortgages
- Falling house prices and difficulties in obtaining loans made it harder to make deals
- Some Eastern European countries faced a particular problem in that much of the increase in lending was denominated in foreign currencies
- The extent to which borrowers were able to benefit from falling interest rates varied due to reluctance on the part of lenders to pass on the full reduction

We do perceive similar trends in the US. Does it mean that the European and American markets are similar?

What are the main differences between the EU and US market?

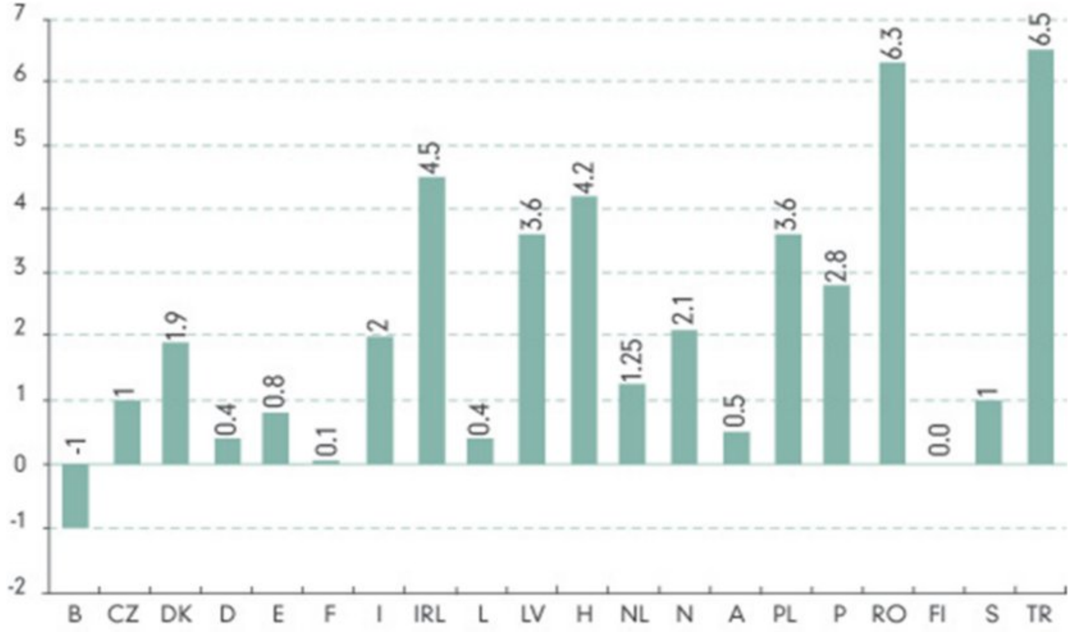
1. Supply is more constrained in Europe, due to the greater availability of land in the US
2. The mortgage market in the US is more developed leading to a more immediate response to access to borrowing
3. The situation regarding interest rates in Europe is more diverse, with countries including Spain and Italy having variable rates as opposed to the long-term rates normally applied in the US
4. The cyclical correlation between house prices and mortgage debt is much higher in the US than in Europe, with a particularly low correlation in Germany
5. Housing wealth in Europe forms a larger share of GDP than in the US, with housing being the main form of wealth for many European households and land values being generally higher

We do perceive parallel trends within European countries.
Does it mean that the EU represents one market?

What do the fundamentals indicate?

inflation rate,
purchasing power,
duration of loans
percentage of loans in relation to the property value

Inflation rate (%)*



Historically, one can see that the Real Estate sector faces a crisis when the effective interest rate is higher than 6%. Below 4%, it offers a real leverage effect which, the last 10 years, has provided for an increase both in prices and market activity.

(*) : Eurostat

Purchasing power

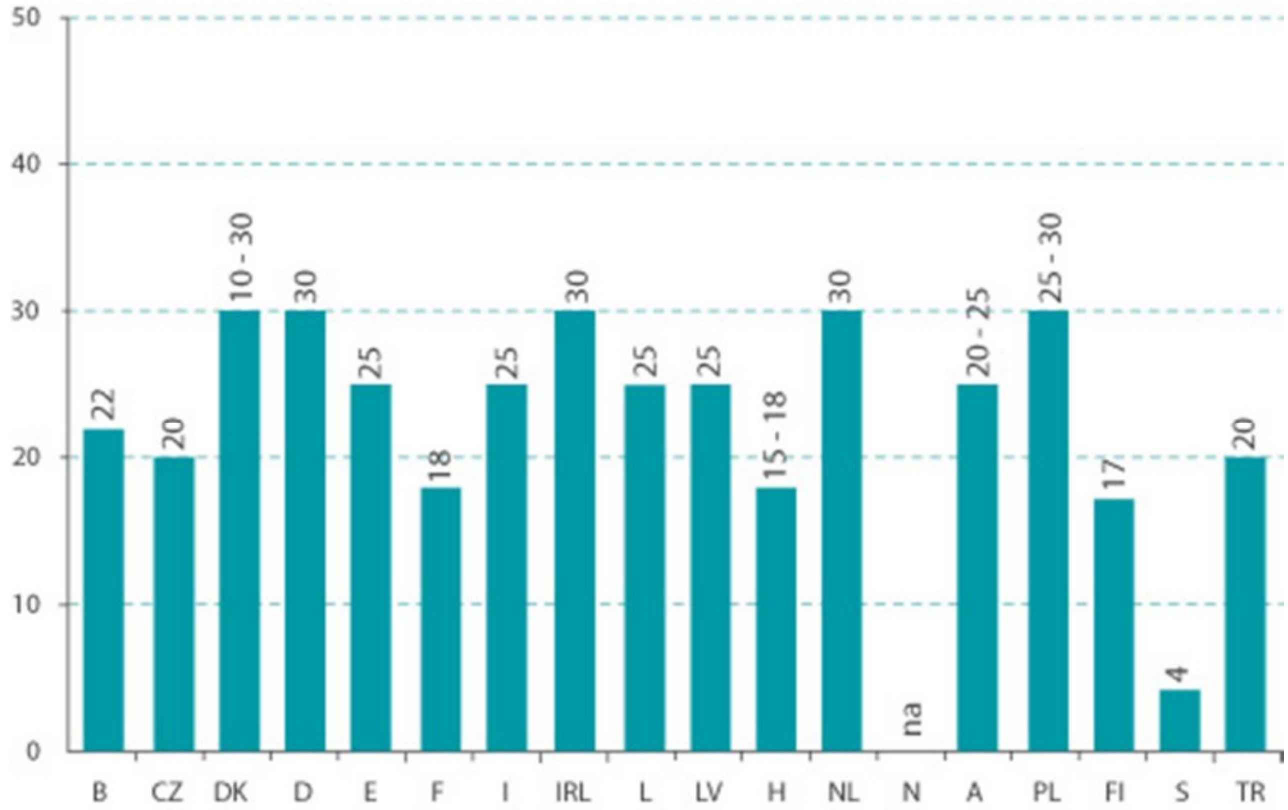
Table 1: Volume indices per capita 2006-2008, EU27=100

	Gross domestic product			Actual individual consumption		
	2006	2007	2008	2006	2007	2008
Luxembourg	272	275	276	153	147	148
Ireland	145	148	135	110	112	109
Netherlands	131	132	134	117	119	119
Austria	124	123	123	116	113	112
Denmark	124	121	120	112	113	112
Sweden	121	123	120	111	113	111
Finland	115	118	117	103	106	107
United Kingdom	120	117	116	133	131	129
Germany	116	116	116	115	113	113
Belgium	118	116	115	107	105	106
France	109	108	108	113	113	113
Spain	105	105	103	100	100	98
Italy	104	103	102	101	101	100
Cyprus	91	94	96	91	98	105
Greece	93	93	94	102	102	103
Slovenia	88	89	91	78	80	82
Czech Republic	77	80	80	69	71	71
Malta	77	76	76	78	76	78
Portugal	76	76	76	82	80	82
Slovakia	63	68	72	60	65	68
Estonia	65	69	67	61	65	63
Hungary	63	63	64	63	61	62
Lithuania	55	59	62	61	66	69
Latvia	52	56	57	56	61	61
Poland	52	54	56	55	59	62
Romania	38	42	47	42	45	49
Bulgaria	36	38	41	39	41	44
Croatia	57	60	63	55	58	60
Turkey	44	45	46	46	46	47
Former Yugoslav Republic of Macedonia	29	31	33	34	36	38
Norway	184	179	191	128	131	131
Switzerland	136	141	141	117	120	120
Iceland	123	121	121	131	133	121
Montenegro	36	40	43	38	50	54
Serbia	33	34	36	39	40	43
Bosnia and Herzegovina	27	29	31	34	36	37
Albania	23	23	26	26	28	30

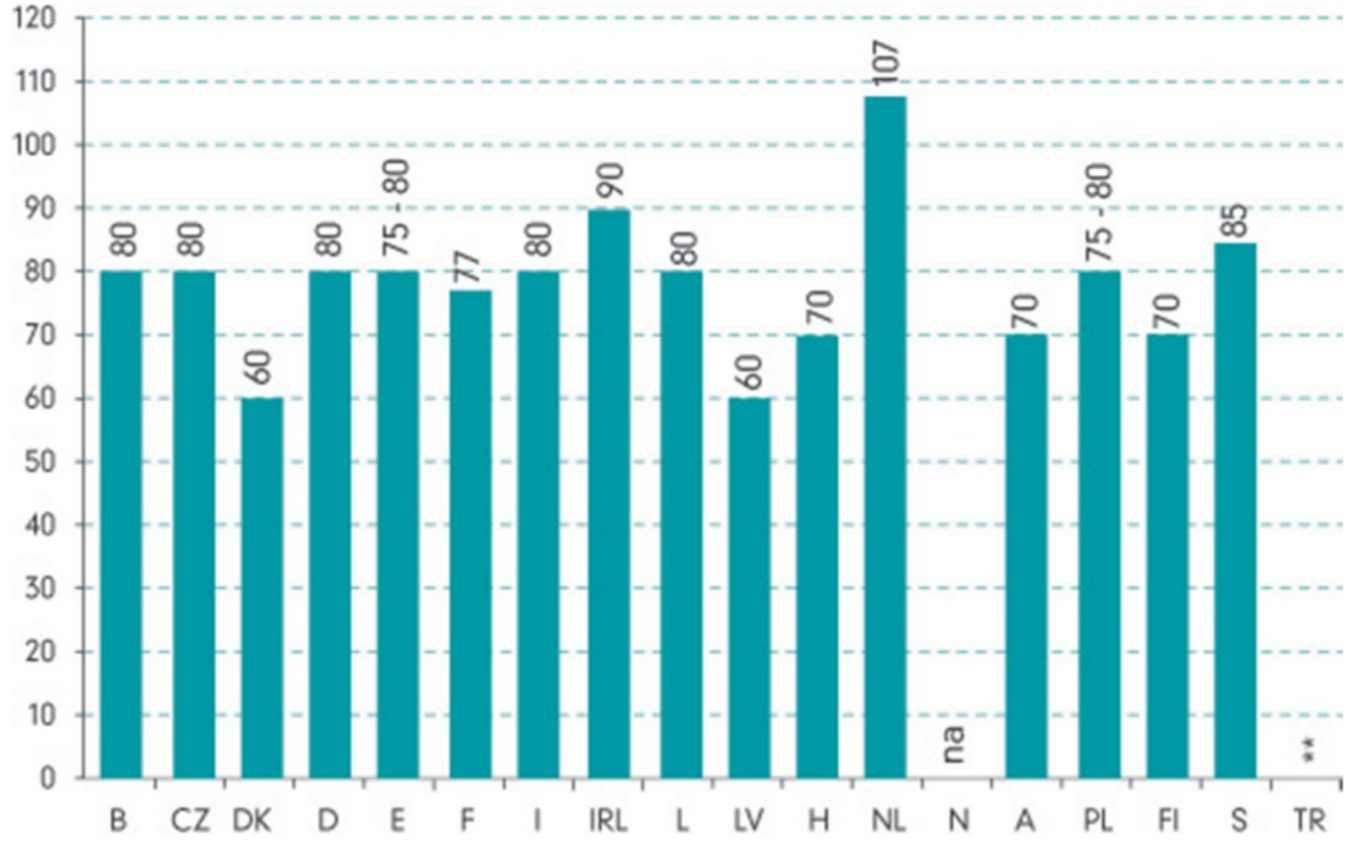
Source: Eurostat (prc_ppp_ind)

The EU: one RE market?

Average duration of loan (years)



Average % of the loan in relation
to the value of the property purchase



Provisional conclusion

Combination of inflation rate, purchasing power, duration of loans and percentage of loans in relation to the property value provides an interesting scoreboard in that it informs about people's ***financial capacity to afford dwellings over time***.

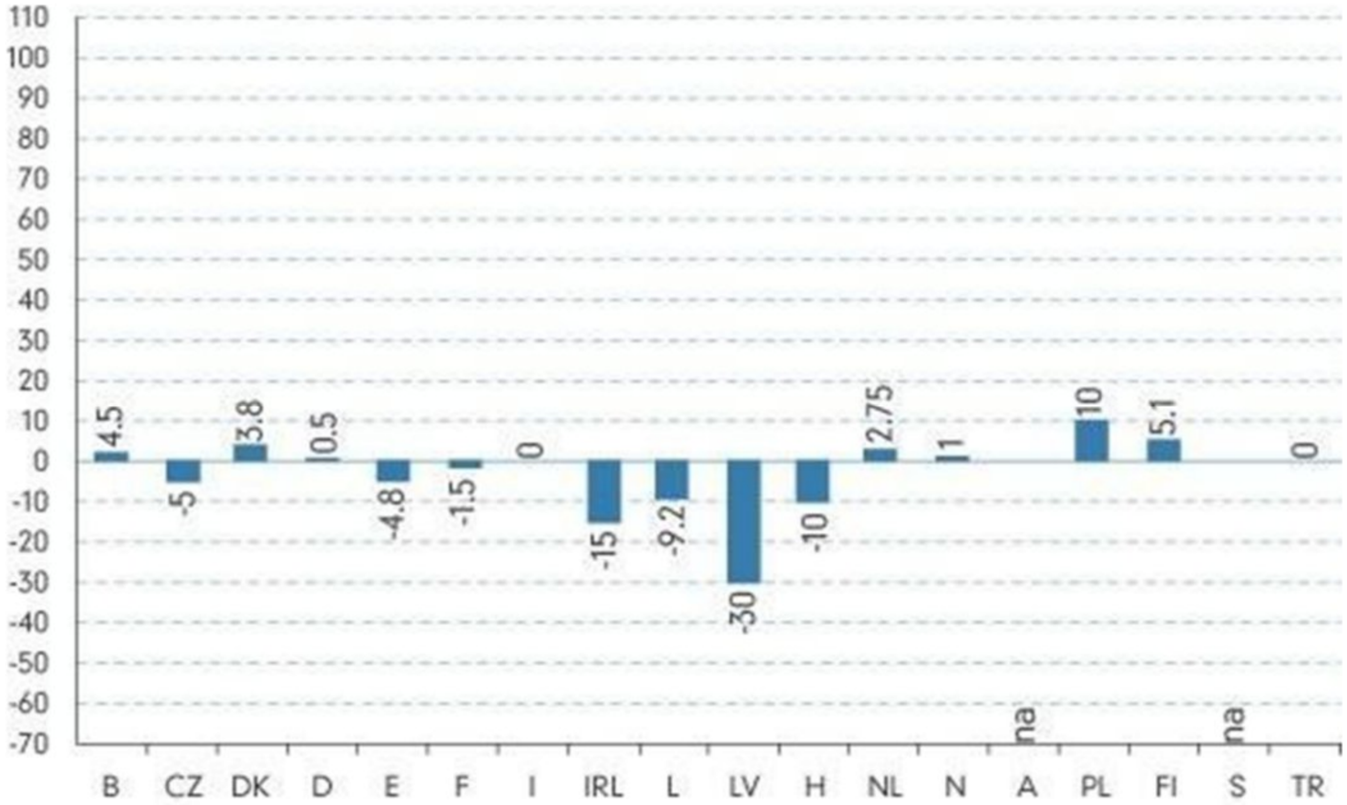
For Belgium, this combination provides a figure of 5,18 over the last 25 years, while price increase of dwellings rated 5,31 over a same period (1983-2007). As a conclusion, it is assumed that the capacity of Belgians to buy dwellings remained equal over time.
For countries throughout Europe, the results prove most variable.

<u>We may therefore expect that real estate markets differ from each other and react in very different ways to the current financial and economic downturn</u>.

Is this confirmed by trends and figures since 2008?

1. Sale prices: trends

Percentage change in sale prices for houses since 2007



1. Scandinavia

The housing markets in Scandinavia came to a standstill in autumn 2008.
Nevertheless, prices went up again in 2009!

FINLAND
On annual basis: -1.5% price decrease, 4.1% increase of rents
During quarter 4 : +3.5% price increases over the country;
+9% in the cities

SWEDEN
Yearly increase of 7% for a one or two dwelling buildings
Some local price decreases during the year

NORWAY
House prices increased by 1% over the year, apartments by 3%
House prices increased by 29% since 2005
Rents increased by 1% for houses, and 1.5 for apartments

DENMARK
was an exception in Scandinavia with a fall in house prices of -7.5% and apartments -5.7%. Rental prices increased by 3.6%. Denmark was one of the first countries to experience problems in both its banking sector and housing market in 2008

2. Baltic States

The Baltic States, just a few miles away from Scandinavia, suffered strong recession and saw prices fall steeply in 2009, in part reflecting the unsustainable and very high level of borrowing after recent entry into the EU

ESTONIA
Price decrease of over 20%, rents going down 35%
Fall in sales volume of over 50%

LATVIA
Price falls of 30% for houses and 40% for apartments
Rents fell by 35% for houses and up to 60% for apartments
Building permits reduced to 40% of 2006 figures
25% of estate agents ceased operations in 2009

LITHUANIA
Up to 2007, much of the demand caused by the growth in the economy was channeled into property with a great deal of foreign investment, so that foreign debt had increased above 125% of GDP. As a consequence: RE collapsed, GDP declined by 18% in 2009

3. South East Europe

South eastern European countries are also newcomers within the European Union.
They had benefited from huge foreign investments and EU structural support which resulted in sharp price increases, although the economic and financial environment remained fragile.

BULGARIA
28 of the largest cities and towns in Bulgaria saw values decline by around -28%
At the end of the year prices continued to fall

ROMANIA
Faced an important stock of completed and unsold units
Average price falls of over 20% despite depreciation of the currency (not yet Euro)

1. Central Europe

Germany, Austria and Switzerland are known to represent very stable RE markets. Poland, Slovakia and the Czech republic appear to have reacted relatively well to the crisis. Hungary performed badly and represents an exception.

GERMANY

Has a history of long and gradual declines in prices since 1995, a low level of mortgage debt
and the continued existence of a large rental sector
Almost no financial speculation in the residential RE sector

POLAND

Large fall in volume of transactions
Only the most affluent 10% of Polish households meet the underwriting lending criteria
Nevertheless, moderate price falls: -3.5% for houses; -8% for apartments; rents went up 12%
The fall in the value of the zloty made prices attractive for foreign investors

HUNGARY

Had already experienced severe economic problems in previous years
Lot of apartments remaining unsold in spite of fall in number of new constructions
Interest rates charged on mortgages were high

1. Western Europe

Western European countries have been moderately affected, although with two substantial exceptions being Ireland and Spain

FRANCE
Sales prices went down 5.6% for houses and 4.2 for apartments
Prices comparable to 2005 / Prices stabilized during last quarter
Number of transactions started to increase again

SPAIN
In 2006 more housing units were under construction in Spain than in Germany, France, Italy and the UK combined; the construction sector had become unsustainable at 13% of employment and 9% of GDP in residential investment
Therefore, a large inventory of unsold stock and heavy impact on global economy
Prices fall up to 30% (no detailed official figures available); half of professionals ceased activity

IRELAND
Ireland has seen a fall in the number of lending institutions active in the market, resulting in a lack of availability of finance
End 2009 property prices were about 40% off their 2006 peak,
Rental market noticed falls of about 20%
Ongoing falls during quarter 4

1. Provisional conclusion

European markets have developed very differently
during the financial and economic crisis.

Some countries are doing well and see increasing demand
and increasing prices.

Other countries are suffering from the downturn
and start recovering.

However it is notable that there remain structural differences
between the markets.

Econometric models and estimates do not mirror reality;
reality does not mirror equilibrium prices

Europe remains a continent with strong regional variations
and differences within national borders.

Elements of a reasonable forecast

Best forecasts are most difficult to make, because indicators do not clearly and unanimously point in one direction and because national economic environments strongly differ

Countries that went through a serious economic downturn, such as the Baltic countries, the South Eastern European countries as well as Spain and Ireland will certainly remain fragile for some more time

Western and Central European as well as Scandinavian markets experienced moderate falls of business and prices.

What can we learn from the limited number of data that are available from these countries for 2010-2011?

1. A general trend to stabilization

Finland:

- **Amount of sales at 2007 level**
- **Sale prices 15% above 2007 level**
- **Time needed to sell at 2007 level**

France:

- **House prices up 1.2% since lowest point in 2009**
- **Apartment prices up 4% since lowest point in 2009**
- **700.000 transactions expected for 2010, same level as 2009**
- **Time is perceived as OK to sell**

United Kingdom:

- **Available stock volumes have risen steadily throughout 2010**
- **The average achieved sale price hit 95% of the average asking price in September**
- **September recorded a 3% price increase in the prime market over past year**
- **Prices fall again in the last months ; the residential market is weakening**

Sweden:

Sweden's economic fundamentals differ from most other developed countries due to the absence of housing bubbles, an intact banking system and strong government finances - which generate good growth prospects.

The economic performance has been in line with several developing countries in Asia and Latin America, with a **GDP growth of 6.9%** in the third quarter of 2010 compared to the same quarter of 2009.

The Swedish transaction volumes more than **tripled in 2010** due to strong fundamentals and an increased opportunity to obtain financing.

Property prices are expected to **keep on increasing in 2011-2012** as the economic recovery continues.

Poland:

Poland has proven to be resilient to the current economic downturn. With GDP growth in 2010-2011 forecast to reach 3.9 - 4% per annum, the Polish economy remains relatively strong. However, the economic slowdown in 2009 did affect the real estate market in 2010.

CB Richard Ellis's 2010 report shows that Poland is the **second most attractive retail destination** in the region after Germany.

After a period of a general slowdown in the real estate investment market, the first half of 2010 saw a substantial recovery.

The increased interest in the Polish market was fueled by positive economic indicators such as **growing forecasts of GDP - up to 3%** in 2010, **falling unemployment** (below 12%), **increasing foreign direct investments** (over €6 million in the first half of the year) as well as **improving private consumption**. The stability of the economy attracted foreign capital to invest in real estate.

Polish market, continues to be dominated by foreign investment.

While in the first three quarters of 2009 the market saw the **transactions of assets** totaling only €81 million, since the beginning of 2010, the volume has **increased up to nearly €431 million**.

Turkey:

The Turkish property markets continue to perform well as the country moves forward beyond the global downturn, emerging as a strong and dynamic global contender. There are considerable long-term opportunities for international investors with strong consumer demand driving the engine of growth and prosperity. Projections are positive, and the real estate market is expected to steadily become more sophisticated. Consumers account for 75 million people, so residential and retail sectors are particularly attractive.

GDP growth is widely expected to continue in 2011, with projections varying from 3.6-5%. According to the IMF, the **GDP per capita will continue its upward trend**, reaching approximately €11,745 by 2015. This represents a **30% increase** compared with 2009.

Turkey's population places the country as the **second most populated in Europe** after Germany, and approximately 65% of the Turkish population is aged below 40.

All of this points to continuing growth in the real estate markets Evidence of this comes from the 'Jones Lang LaSalle 2010 Global Commercial Real Estate Transparency Index' in which Turkey was the **'Best Improver'** since 2008 across 83 countries covered.

The strength of the economic recovery has resulted in record auto sales, growth in mortgage loans and restored consumer confidence. The volume of **mortgage loans increased by 38% in 2010** compared with 2009, reaching €30 billion. Merrill Lynch predicts that mortgage loans will **grow an additional 30% in 2011**.

Most attractive places for investment

On example of:

- Brasil
- Vietnam
- USA (Miami, Florida)

Most attractive places for investment: Brazil

Two major international sporting events are propelling RE investment in Brazil. The hosting of the **2014 Soccer World Cup** and the **2016 Olympics** has attracted investors to the emerging regional powerhouse.

The right to host major international sporting events serves as monuments to Lula's achievements and economic success. Brazil is the first South American country to host the Summer Olympics. On the other hand, the last time that the Soccer World Cup was hosted by a South American country was in 1978 by Argentina.

Massive benefits from the games include an **injection of $51 billion until 2027** and the creation of 120,000 jobs annually until 2016, according to studies by Sao Paolo business schools for the Ministry of Sports.

The government plans to provide **$11 billion of investments**.

Most attractive places for investment: Brazil

Brazil's economy was not able to avoid recession in 2009 but contraction was minimal at -0.7%. Economic recovery is expected to resume in 2010 with a GDP growth of 3.5%.

Home ownership is at 75%, with only about 14% of the 42 million housing stock rented. But around 85%o of all homeowners live in low quality, self-built, single-room housing units.

Lula's pro-market reforms have greatly helped expand Brazil's mortgage market. The first big break was the government's approval of fiduciary alienation, whereby the buyer becomes the owner of the property only after it has been fully paid. The bank or lending institution holds ownership of property, while the loan is being repaid.

- Loan terms have lengthened to 30 years, from 10 to 12 years.
- Interest rates on housing loans offered by banks have fallen to 13% to 14%, from around 16% in 2005.
- Government-owned housing institutions now offer loans at 12% interest, payable over 30 years.

Most attractive places for investment: Brazil

Why Real Estate in Brazil?

Brazil maintained a relatively healthy position throughout the global economic downturn and emerged out of recession much quicker than most developed countries.

The International Monetary Fund (IMF) have predicted **GDP to grow by 4.5 percent** in 2011 (also expecting the economies of the U.S.A, the U.K, Germany, France and Japan to average at 2.5 percent);

Most attractive places for investment: Vietnam

Vietnam is enticing more and more international investors lately and, in a recent survey by the Association of Foreign Investors in Real Estate (AFIRE), Vietnam ranked **fourth in the world in the emerging global RE markets category**.

The results showed that Brazil, China and India dominate the emerging real estate markets for investment, but Vietnam, unranked in 2010, jumped straight into the world top five, taking fourth position. Among the emerging markets, Brazil took first place from China in second, which ranked top in 2010. India came in third, Vietnam fourth and Mexico ranked fifth, losing last year's position to Vietnam.

Russia, which has been amongst the top five emerging real estate markets for the last two years, dropped to tenth place.

Vietnam continues to appear attractive to foreign investors and its economy has **recovered well from the global recession**. Other factors enticing overseas investors to Vietnam are its **strong economic growth**, **fast rate of urbanization** and the **growth of its new middle class**.

Most attractive places for investment: US (Miami)

- 65% of foreign investment
- Average RE deals by foreigners: $ 220 000
- 2010 prices at the level of 1981

Sources

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EC, DG Economic and Financial Affairs
RICS
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