

# HOUSING MARKETS IN CENTRAL AND EASTERN EUROPE

**Petr Zemčík, Ph.D.**

# Syllabus

- Teacher <http://home.cerge-ei.cz/petrz/>
- Course description
- Text
- Grading
- Prerequisites
- Outline

# Real Estate Price Indexes in Central and Eastern Europe

Year	Bulgaria	Czech R.	Estonia	Hungary	Latvia	Poland	Slovakia
1997			42				
1998			50				
1999			50				
2000	87		51				
2001	89	78	68	88			
2002	89	84	89	90	98		72
2003	100	100	100	100	100	100	100
2004	148	116	128	109	108	378	115
2005	202	119	167	110	137	530	104
2006	231	130	254	109	271	429	121
2007	298	173	280	111		974	150
2008	373	220	259	112			

# Why real estate decisions are different?

- High value
- Long economic life
- Debt financing
- High transaction costs

# Example

- Apartment “3+kk”, 70 m<sup>2</sup>, garage, Českomoravská
- 2005: 3.6mil Kc (incl. 5% VAT)+0.4mil Kc furniture, etc. (mortgage 2.6mil Kc)
- 2009: 4.95mil Kc – [0.1mil Kc real estate agent]-[0.15mil Kc sales tax]=4.7mil Kc (mortgage balance 2.4mil Kc)

# Shilling, Ch.1

- Real estate and the economy:
  - Land ownership and use
  - Real estate as wealth/asset, employment, and a commodity
- Real property characteristics
  - Physical, institutional, economic
  - Market

# Real estate and the economy

- Real estate = A field of study, a business activity, a financial asset
- Land ownership and land use:
  - USA-2.3 bil. Acres (1 acre= $64^2$  m<sup>2</sup>= $209^2$  feet<sup>2</sup>)
  - 39.1% public, 60.9% private
  - Only 2% urban use

# Real estate as an asset

- Tangible assets

Non-real estate (durables, equipment) 29%

Real-estate 71%

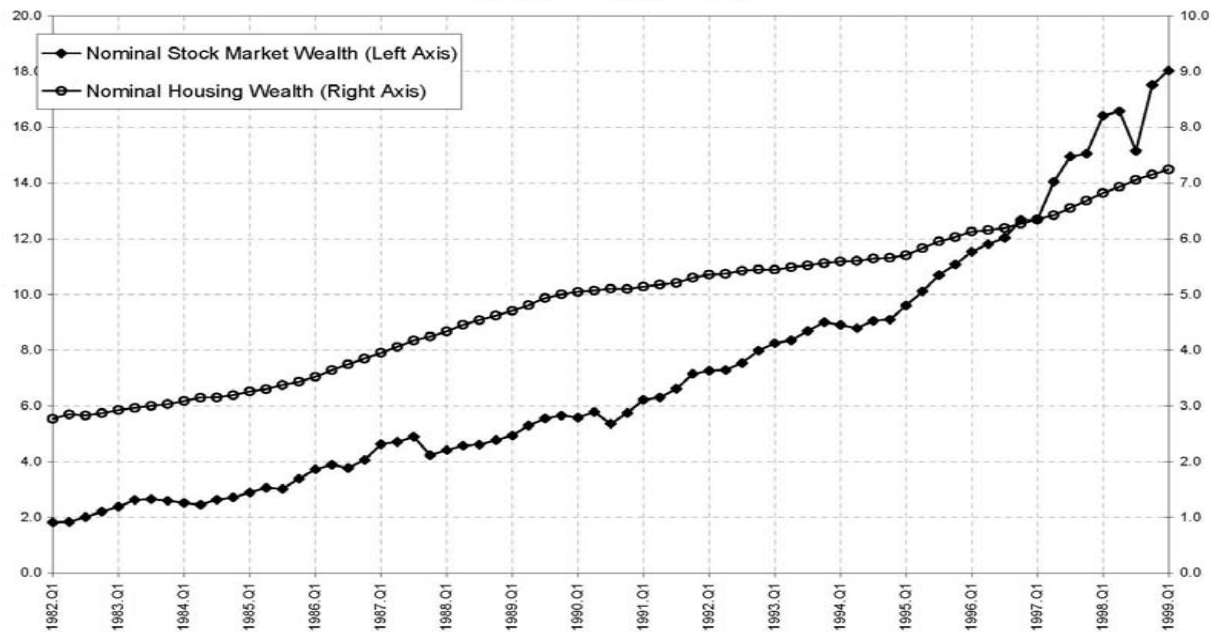
- non-residential 16%

- Residential 56%



# Real estate as a financial asset

Figure 1  
US Stock Market and Owner-Occupied Housing Wealth  
(Trillions of Current Dollars)



# Real estate as employment

Year	Real est. empl.	Total empl.	%
1940	2,517,155	44,888,083	5.61
1970	5,003,049	77,308,792	6.47
1998	7,248,000	124,762,000	5.80

# Real estate as a commodity

- Suppliers and modifiers of space – subdividers, builders, and developers
- Owners of space – equity, lenders
- Users of space – owners or tenants
- Government regulators

# Real property characteristics

- Physical – Immobility, indestructability (of land), heterogeneity
- Institutional – law, public regulation, local and regional custom, associations and organizations (NAR, NAHB, ULI)
- Economic – location, scarcity, interdependence (with close property), durability

# Classes of property traded

- Residential – houses, apartments
- Commercial – stores, office buildings, hotels, etc.
- Industrial – factories, warehouses, etc.
- Rural – farm and land
- Special purpose – churches, colleges, etc.
- Public – highways, post offices, etc.

# Market characteristics

- Localized competition
- Stratified demand – a specific purpose
- Confidential transactions
- Relatively uninformed participants
- Supply fixed in the short run
- Macroeconomic determinants

# Lux: Public housing policies

- Theoretical framework
- Public authority as an understanding paternalist
- The role of local governments in EU countries
- Local government and a housing survey

# Theoretical framework

- Economic perspective
- Social perspective
- Public housing policies



# Economic perspective

- Housing service – heterogenous, multidimensional good (location, quality, space), tenure (to rent vs to own)
- Durable good – consumption & investment
- Spatially fixed good
- Transaction costs
- Externalities

# Social perspective

- UN declaration on human rights in 1948: The right to housing is a social right in addition to political and civil rights.
- Housing policy guidelines, EEC 1992: this right is unenforcable and non-claimable.
- UN Council for human rights: The right to 'adequate housing'

# Housing as a merit good

- A merit good is a good, for which the society believes that its consumption is inherently desirable and must be supported (housing, education)
- Merit goods vs. public goods

# Financial affordability of housing

- A certain standard of housing for a price or a rent that does not represent an unreasonable burden as judged by the government
- Measures: rent-to-income, price-to-rent, etc.

# Price-to-rent, 273 US MSA

---

	P/r>22.5	P/r>20	P/r<13	P/r<12
1986	10	13	70	64
1987	11	17	72	65
1988	12	19	71	64
1989	11	20	70	64
1990	13	18	70	63
1991	12	14	71	63
1992	10	14	70	63
1993	11	12	68	61
1994	10	12	71	54
1995	10	14	67	47
1996	10	12	67	47
1997	10	13	65	48
1998	11	16	61	44
1999	12	18	58	41
2000	14	22	54	38
2001	18	23	47	32
2002	19	25	47	30
2003	21	26	44	28
2004	24	32	36	20
2005	33	48	32	23
2006	40	52	26	22

---

# Objectives of housing policy

- Eliminate market failures (efficiency) – the government as a rational economist
- Redistribute housing consumption (equity) - the government as an understanding paternalist – a concept of a welfare state needed.

# Housing policy instruments

- Income tested cash allowance (demand side subsidy) – more efficient, politically less feasible.
- Lowering the cost of housing – rent control, social housing (supply side subsidy)
- Tax relief and interest subsidies (demand side subsidy)

# Ex. Social housing in UK

Housing policy	1979/1980	1996/1997
Social housing	61%	20%
Housing allowances	11%	58%
Tax relief	28%	22%



# A shift from social housing

- the need to reduce the budgeted deficit
- a crisis of the welfare state concept – the government is not a provider any more
- ownership politically preferred to renting
- high costs of social housing

# Social housing allocation policies in EU

- Centrally defined criteria – Luxembourg, Germany, France, Italy
- Regional allocation policies within loosely defined rules – UK, Ireland
- Partnership agreements between municipalities and housing associations – the Netherlands

# Housing policies in Central and Eastern Europe - questionnaire

- Transfer of responsibilities to municipalities together with the transfer of dwellings.
- Central legislation on non-targeted rent regulation.
- Decentralized allocation rules, setting rents, and the use of privatization income.

# Economist 5/31/2003: House of cards

- Stock market bubble vs. property bubble
- Property business – around 15% of GDP
- Housing: 40-50% of total wealth in Europe and in Australia, 30% in the US.
- Mid 1990s-2002: real property prices up 50% in Australia, UK, Ireland, the Netherlands, Spain, and Sweden. 30% in the US.

# Betting the house

- Ex. UK, 1992-2002, stock returns -40% vs. property returns +55%
- Favorable tax treatment – tax relief for mortgage payments, tax credit for first time buyers
- Fundamental analysis (rents)
- Irrational exuberance

# Vicious cycles

- Rising real estate prices=> growth
  - wealth effect, consumer spending
  - borrowing against property
  - effect on banks
- House price bust -8% relative to a GDP trend growth, share price bust only -4%
- 2003: Predicted cooling property markets