

reas

on.point

March 2011

Residential Markets in Central European Capitals

Bratislava • Bucharest • Budapest • Kiev • Ljubljana • Prague
Riga • Sofia • Tallinn • Vilnius • Warsaw • Zagreb

The condition and course of development of the residential markets in the countries of Central and Eastern Europe differed greatly during 2010. The gap between attractive and less attractive markets is likely to widen in 2011.

In cooperation with

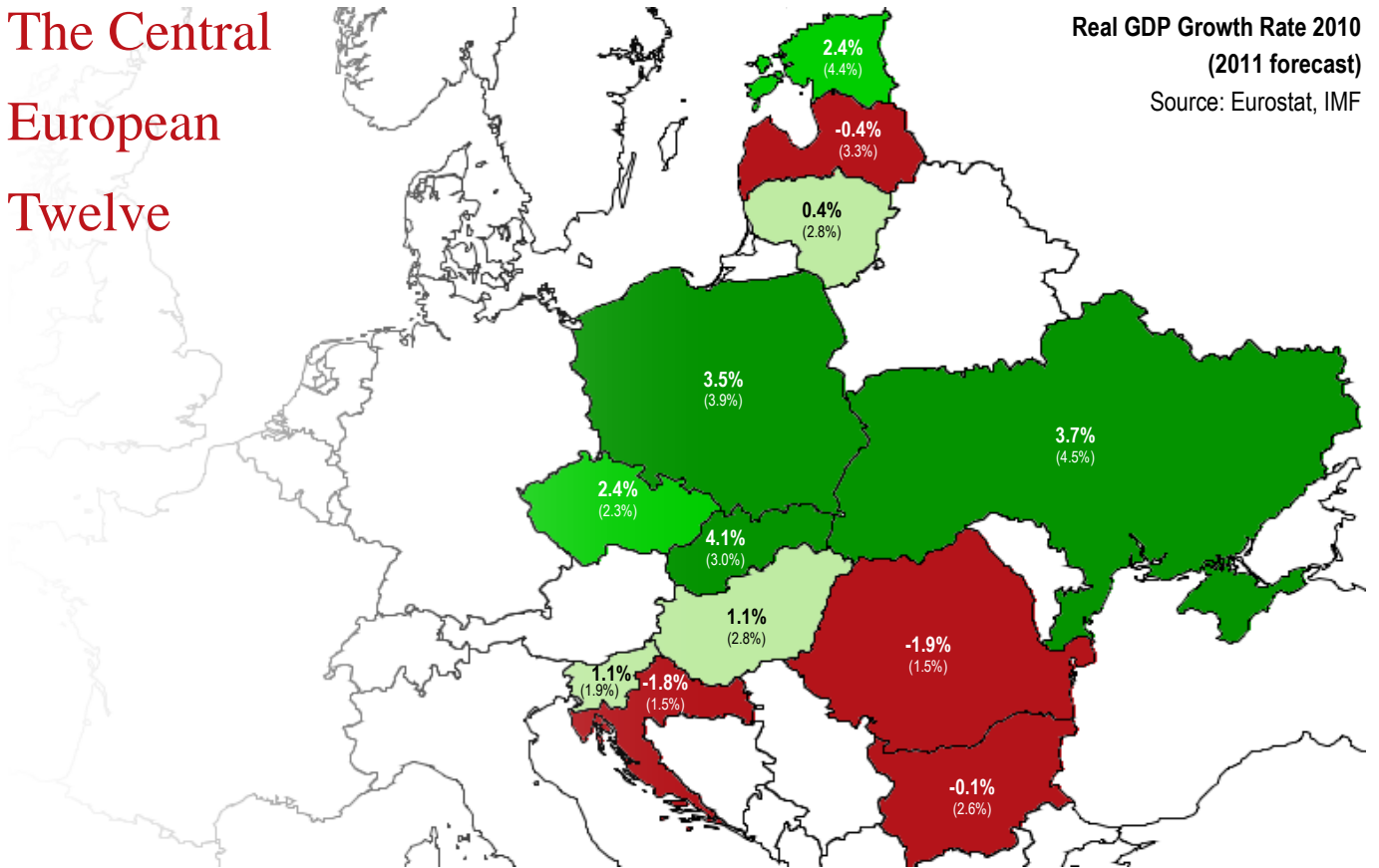


JONES LANG
LASALLE®

Real value in a changing world



The Central European Twelve



Central and Eastern Europe is no longer viewed as one uniform investment region. Investors and international developers focus on the better performing economies and residential markets with robust local demand. The gap between strong and less attractive markets may widen.

2010 presented a greatly varied picture in the condition of the regional residential markets. Likewise the economic performance of the national economies differed to a great extent, from strong growth over stabilization to protracted contraction. The banking sectors also faced distinct situations: while in some countries the banking sector was a supporting factor for the economy and real estate markets, in other countries both were negatively affected precisely due to the turbulence of banks. Investors remained selective and made careful decisions on the geography of their activities. Equally, developers selected their development projects with caution. Investments and new construction activities occurred in those markets where effective demand by homebuyers continued or resumed. These dimensions are apparently highly interlinked and impacted in distinctive ways on individual residential markets.

Poland demonstrated the most robust residential market performance, while it simultaneously continued to have strong economic growth. The housing market of the Czech Republic followed closely behind, whereas activity concentrated on Prague. Slovakia noted the largest growth in GDP within CEE, though the residential sector did not show any substantial movement. In contrast, the level of demand for apartments started to improve in the Baltic States, while the economic recovery happened at a slower pace. In Slovenia it is the weak banking sector that is hampering growth. The Hungarian economy started to improve in terms of GDP, while housing demand remained low. Ukraine's economy experienced an even faster growth, yet the residential market is still in deep crisis. Bulgaria, Romania and Croatia all recorded shrinking GDP rates in 2010 and a standstill in housing.

2010 Market Review

Despite the fact that the condition of each country was quite particular, the countries of Central and Eastern Europe observed an economic revival in 2010. Slovakia, Ukraine and Poland recorded the highest GDP growth rates followed by Estonia and the Czech Republic. Hungary, Slovenia and Lithuania also noted positive growth. However, it should be borne in mind that all countries that noted GDP growth in 2010 were not able to entirely counterbalance the level of decline recorded in 2009, except for Poland which did not fall into recession. In spite of a continued decrease last year, improvements were also recorded in the economies of Romania, Croatia, Latvia and Bulgaria. Albeit unevenly, the region began to recover from the downturn in 2009.

Another common feature was the application of austerity measures by national governments, due to the situation in public sector debt and budgetary deficits. In the case of Romania, Latvia, Ukraine and Hungary, international bailouts comprised another reason. This ambiguity of being on the upswing and uncertainty with respect to the impact of austerity measures dominated a good part of the discussion on the market's development. In fact, applied or planned tax increases, freezing of public sector wages, labour market reforms and revisions to the pension system have already produced impacts on housing demand. Nevertheless, in 2010 it was mainly developments in the banking sector which influenced housing markets.

In terms of mortgage lending, most markets have seen an increase in the activity of banks compared to 2009, with interest rates at a long-time low and reduced margins. However, bank's criteria for issuing loans to prospective homebuyers remained conservative. Furthermore, households were not willing to make a commitment for the next 30 years in all countries, in light of labour market uncertainties and unclear price trends of residential property. In terms of construction loans, banks have changed their focus in lending activities to the disfavour of real estate financing. Banks remain risk averse and cautiously monitor developments on the housing market. This is partly caused by the number of non-performing loan portfolios that banks have to manage. Banks' attitude towards handling troublesome credits impacted negatively on the sale of investment plots and problematic projects. Sellers were usually asking for much higher prices than potential buyers were willing to pay.

There was little in common in the relation of supply and demand between the markets in the region in 2010. While for instance Warsaw recorded approximately 10,600 sales of apartments and even more new supply, Bucharest evidenced a near standstill in transactions and a very limited level of new supply. Development trends differed greatly from market to market, as shall be described in the individual commentaries on the following pages.

2011 Market Outlook

From the perspective of developers and investors in residential property in CEE, the key challenges in the near future will comprise:

- the development of spending power and confidence levels of potential homebuyers;
- the impact of austerity measures on housing demand;
- tougher regulations in mortgage lending via Basel III, a rising share of non-performing loans and increasing interest rates;
- Changing focus in banks' lending activities to the disfavour of financing real estate developments;
- the course of the consolidation process of the developer's market, since economic failure of companies and distressed projects can put stress on the sector as a whole;
- uncertainty about banks' policies regarding financially unsustainable projects, as banks may finally lose patience.

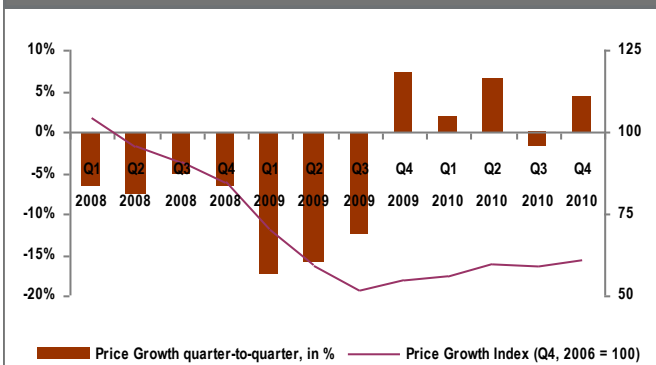
A widespread recovery is not likely to occur across CEE this year. Instead there may well be a growing gap between the development of attractive markets and market segments on the one hand and less attractive ones on the other hand.

Warsaw and Prague will certainly be amongst the most attractive markets. Being the region's largest market by far, the Polish capital showed a resilient residential market performance in 2010 and is expected to remain the most interesting market in 2011 and beyond. In addition, a few large cities in Poland, including Krakow, Wroclaw, Gdansk and Poznan, showed a strong rebound in 2010 and are likely to continue to expand this year. Prague, the major market in the Czech Republic, will almost certainly maintain its gateway position to the region and will therefore continue to attract domestic and foreign capital investments in residential property.

Worthwhile investments and development opportunities can also be found in Bratislava. Currently the market is not functioning properly due to the fact that most apartments in the market offer are not adjusted to local demand—here, further price correction is needed. Yet, new supply has the chance to design a better offer both quality and price-wise. In any event, prices for land plots will need to drop off. Recent developments in Tallinn, Riga and Vilnius also indicate opportunities for developers and investors, though it will be a wise choice to be selective in investment decisions.

One must be even more diligent and careful when considering an investment in the remaining residential markets. The more mature markets of Budapest, Ljubljana and Zagreb should generally be less risky but, at the same time, there will be fewer bargains. Bucharest and Sofia may potentially offer interesting deals but the markets are not expected to recover entirely during 2011. Kiev and other large Ukrainian cities remain interesting in a mid-term perspective.

Figure 1: Residential Price Growth in Tallinn, 2008—2010

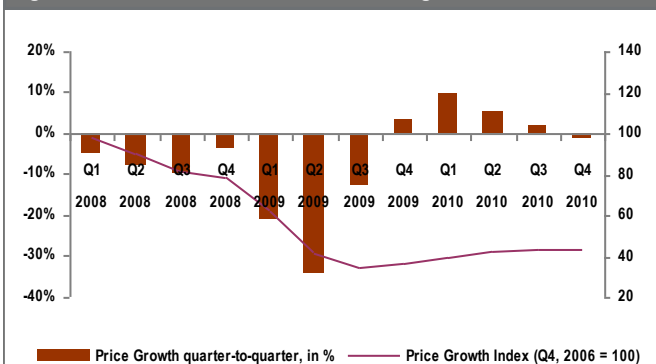


Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Estonia, Tallinn

During 2010 a rise in demand was noted on the residential market of Tallinn, compared to the previous year. Growth could be observed both in the number of sales and in the total value of transactions. Demand focused foremost on lower priced market segments. In certain segments buyers even faced difficulties finding an offer. Following the encouraging sales trend, developers started to gradually increase the level of prices. A moderate rise in development activity has been noted as well. Despite the visible improvement, the market is still far from the results of its boom period when the number of transactions were twice the size of those in 2010 and prices were twice as high.

Figure 2: Residential Price Growth in Riga, 2008—2010

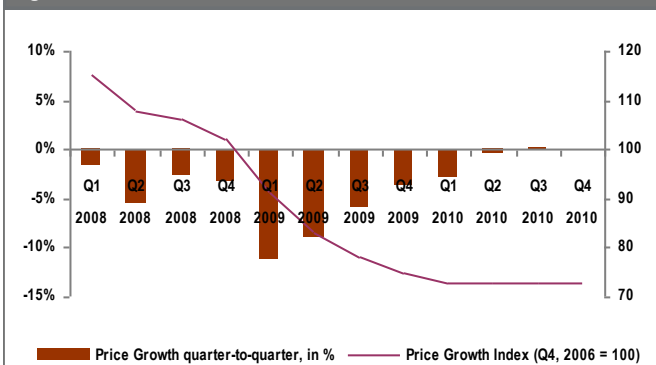


Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Latvia, Riga

Likewise to the situation in Tallinn, Latvia’s capital city has seen prices moderately grow since the end of 2009. Demand was on the rise, too. Nevertheless, the scale of the recovery is still modest—the average price level is more than 50% lower than in Q1 2008. The current upturn can be attributed to increased interest in mortgage lending, both from a buyers’ and banks’ perspective. Local households regained confidence in investing in residential property, purchasing to eventually satisfy their housing needs. As well banks view homes as an attractive investment again. Investments in apartments are scarce, though. Development activity has not returned to a significant scale, yet.

Figure 3: Residential Price Growth in Vilnius, 2008—2010

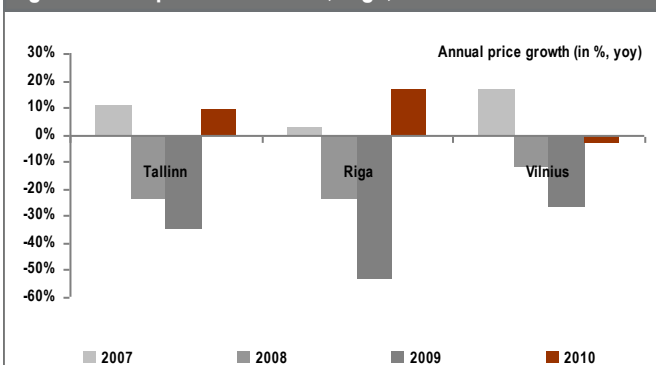


Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Lithuania, Vilnius

While the price development of its Baltic peers was somewhat similar, Vilnius’ housing market followed a quite different track. Property prices continued to fall until mid-2010 and only stabilized during the last two quarters of the year. At the same time, effective demand somewhat improved over the course of the year, visible in a growing number of transactions. Inexpensive apartments in residential neighbourhoods were most desirable, indicating that local households were responsible for the lion’s share in demand. The market remains a buyer’s market. The offer of apartments is still ample, including a large share of completed, yet unsold units. Thus, developers keep new supply limited.

Figure 4: Comparison—Tallinn, Riga, Vilnius



Source: REAS

Tallinn, Riga, Vilnius

After the shock of two year’s of economic decline and a downward price spiral, the Baltic States witnessed a slight recovery. Estonia, which entered the euro zone in 2011, was doing particularly well, while Lithuania’s economy stabilized and Latvia started to recover following the bailout. Still, the effect of previous double-digit GDP contractions, high unemployment, austerity measures and budget fixing were evident across the three countries. Although the economy was stagnant in many sectors, the housing industry has slowly picked up in the three capitals, whereas the level of improvement is higher in Tallinn and Riga than in Vilnius. The banking sectors also improved, thus supporting growth.

Poland, Warsaw

Warsaw remained one of the most stable housing markets within CEE. During 2010 the average price of all units offered for sale on the market increased by 2%, whereas the average price for apartments in projects newly launched to the offer during 2010 was lower. This meant that in general developers adjusted their new projects to the changed market conditions. Prices proved attractive enough to draw decent interest by homebuyers, as sales of more than 10,000 units were noted year-on-year, while the number of ready, yet unsold units remained stable. As a result, developers were confident enough to introduce more units in new residential projects to the market than were sold during the year.

Czech Republic, Prague

Prague is also recognized as a reasonably stable housing market. Even though the average asking price decreased by 2% in 2010, there was a positive price trend recorded in the second half of the year that we continue to observe into Q1 2011. The level of sales on the primary market improved during 2010 compared to the previous year, declared by most large developers and real estate agencies. Although the number of units newly introduced to the market was lower than the number of apartments sold, developers were surprisingly active regarding new developments in H2 2010. Yet, the share of ready, yet unsold units in the market offer might be a reason for concern as well as a possible change in VAT.

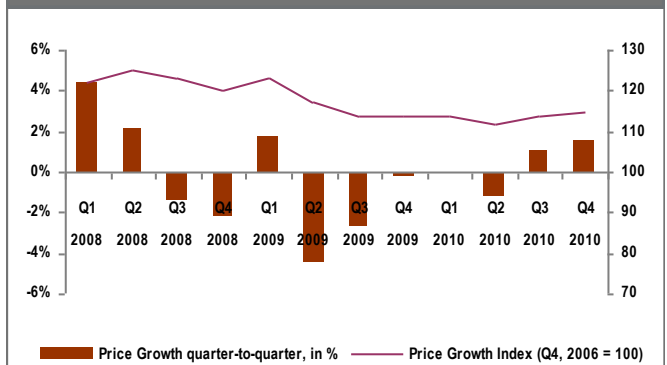
Slovakia, Bratislava

Bratislava's residential market is stabilizing, though it is still suffering from an oversupply of apartments introduced during the boom period. These are to a great extent units which are poorly adjusted to the current demand structure, in terms of size, layout and pricing. Additionally, prices remained fairly firm during 2010, as the sales pace was noticeably low in this market segment. Developers concentrated on selling what they had, while they only launched a few new projects. If banks continue to demand a minimum of 30-40% of equity and a similar level of pre-sales, this tendency is likely to continue. A price correction of units from previous years is probable during 2011, while new supply should be better adjusted.

Warsaw, Prague, Bratislava

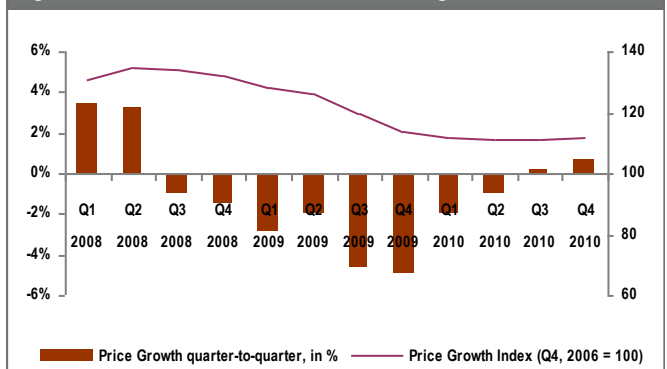
The economic prospect in the three countries looks positive, particularly as the German economy improves. In terms of housing markets, Warsaw and Prague were presumably the best performers in the region over the past year. Both noticed a visible improvement in sales compared to 2009, while at the same time prices remained stable. Although some developers might still face difficulties, the housing industry as a whole experienced a revival from the downturn. The high level of confidence even led to the return of a larger number of new projects in both cities. The largest problem is the large offer, i.e. level of competition, including a large share of old stock. This problem hampered a faster recovery in Bratislava.

Figure 5: Residential Price Growth in Warsaw, 2008—2010



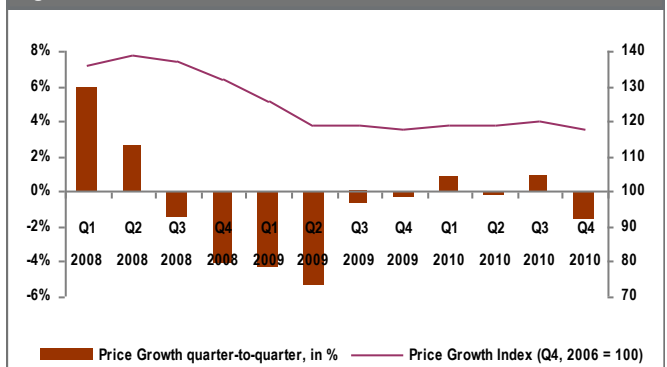
Source: REAS, growth rates calculated based on asking prices in PLN per sq. m.

Figure 6: Residential Price Growth in Prague, 2008—2010



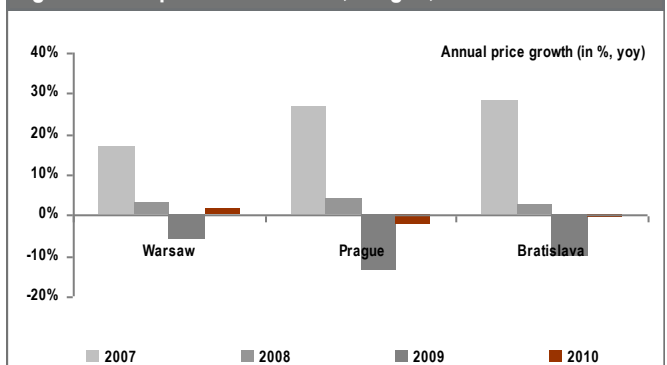
Source: REAS, growth rates calculated based on asking prices in CZK per sq. m.

Figure 7: Residential Price Growth in Bratislava, 2008—2010



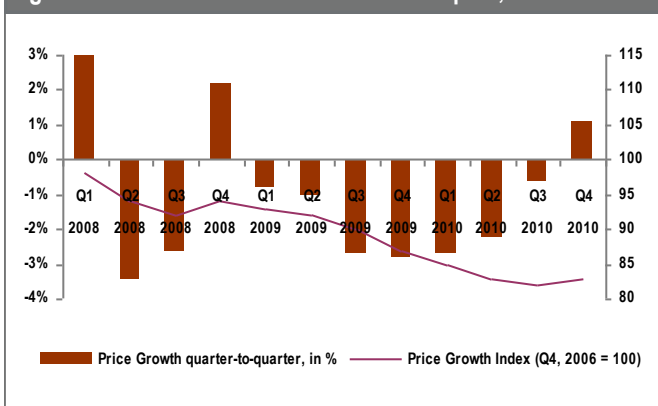
Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Figure 8: Comparison—Warsaw, Prague, Bratislava



Source: REAS

Figure 9: Residential Price Growth in Budapest, 2008—2010

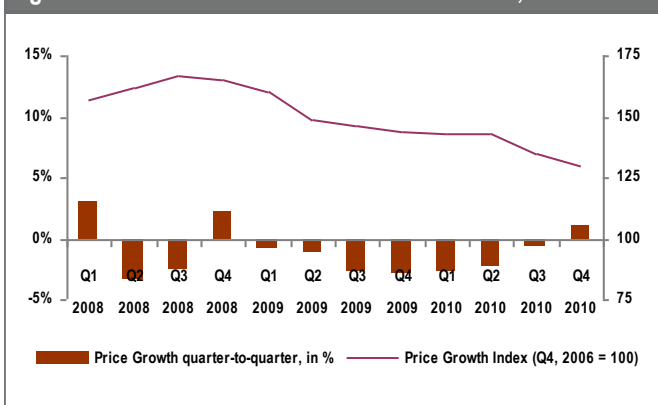


Source: REAS, growth rates calculated based on asking prices in HUF per sq. m.

Hungary, Budapest

In terms of housing demand, 2010 has been extremely weak for Budapest’s market. The willingness of households to buy apartments on the primary market was low, as the real value of a property was simply uncertain. The average asking price level continued to fall during the first three quarters of the year, while the trend reversed in Q4 2010, though the price growth was rather symbolic. Uncertainty regarding the exchange rate’s development still impacts on the sector, as most loans were denominated in foreign currencies, particularly the Swiss franc. The unclear direction of the housing market, a weak banking sector and a lack of financing has also led to dwindling numbers of new developments.

Figure 10: Residential Price Growth in Bucharest, 2008—2010

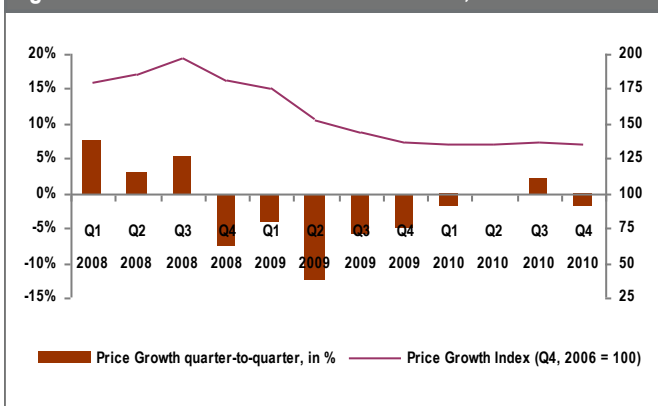


Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Romania, Bucharest

Romania’s largest market has not shown much progress during 2010. The existing market offer is basically difficult to sell both due to its price level and due to its structure. Primarily, most units are too large. In order to go ahead, developers would need to discount apartments substantially from the current price level, despite the fact that the average price continued to decline by almost 10% in 2010. Starting new, price-wise adjusted projects could be competitive on the market. The extension of the First Home program into 2011 presents another opportunity for a newly designed market offer. Past investments, however, keep developers busy and there is little interest by new players to enter the market.

Figure 11: Residential Price Growth in Sofia, 2008—2010

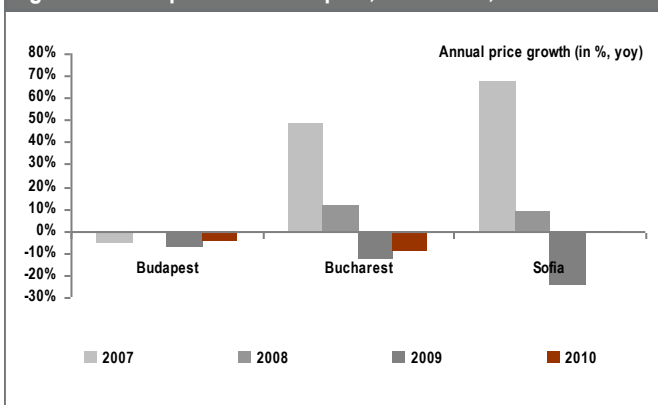


Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Bulgaria, Sofia

During 2010 the primary Bulgarian residential market continued to deteriorate. In Sofia the number of transactions dropped by 5-10% year-on-year. Construction activity of new housing projects was insignificant. The number of building permits issued decreased drastically. Then again prices only noticed a marginal decline in 2010. Yet, given the hefty drop in the previous year, the average price level returned to mid-2007 levels on the whole, i.e. the moment in time just before the local price boom had started. It is likely that the downward spiral will eventually end in 2011. However, a sudden rise in sales is not expected, as apartments presently available for sale do not match homebuyers’ demand.

Figure 12: Comparison—Budapest, Bucharest, Sofia



Source: REAS

Budapest, Bucharest, Sofia

The economies of Bulgaria and Romania are recovering slowly, after being seriously hit by the crisis. GDP growth will be hampered in the coming years. On the positive side, both countries indicate fewer threats with their national budgets and debt figures in the public sector than elsewhere within CEE. The rebound to growth of above 1% of Hungary’s economy was primarily export-led, while internal demand continued to be weak. Investments in the housing sector of the three countries are considered to be riskier when compared to Poland or the Czech Republic. Demand for apartments is still weak in Budapest and even weaker in Bucharest and Sofia. Prices fell further in 2010 and are likely to continue to fall.

Ukraine, Kiev

The housing market of Kiev has not yet picked up from the downturn, though the macro-economic recovery should be able to assist in improving the situation in the mid-term. The average price level decreased by around 10% throughout 2010 and it is likely that the falling price tendency is to prolong into 2011. A growth in demand of local households is hindered by limited access to mortgage loans, the relatively high level of unemployment and the uncertainty as to when the downward price spiral will end. Foreign investors have not been active on the market, neither as homebuyers nor in the residential construction sector, due to obstacles in obtaining building permits and a high level of corruption.

Slovenia, Ljubljana

The residential market of Ljubljana was brought to a standstill in H2 2010 by the weak performance of the country's banking sector. The three largest Slovenian banks reported losses in 2010 and, thus, virtually halted lending activities. This situation has to a large extent been caused by an increase of bad loans and it is likely that banks will have to further set aside cash reserves for loans in arrears into 2011. In addition, developers were, and are still not willing to invest in new residential projects due to a lack of demand. At the same time, prices did not move too much, noting only a minimal decline during the year. This might partly be explained by the market's size and the wait-and-see policy of developers.

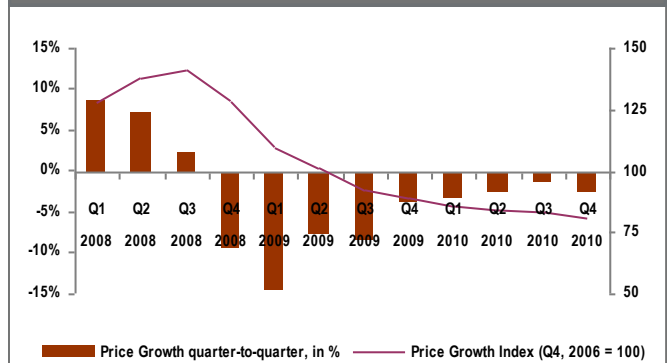
Croatia, Zagreb

Although the situation of the residential market in Zagreb is less severe than the one in the Adriatic Coast region, a continuation of low demand levels and falling prices have also been noted in the Croatian capital during 2010. A decline in residential construction has also been observed. The average asking price has therefore declined for the third year in a row, whereas the level of decline varied between different market segments. With slightly rising prices over the last months of 2010, a reversal in price trend may occur, though the change will rather be characterized by stabilization than by fast price growth in 2011. Most developers will be able to hold their position, though no major expansion can be expected.

Kiev, Ljubljana, Zagreb

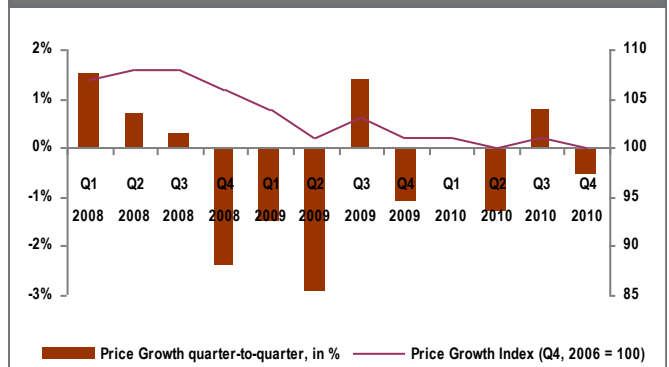
Being formerly relatively stable markets, the housing markets of the Slovenian and Croatian capitals experienced a major drawback in 2009 which continued throughout 2010. The major problem lies in the lack of demand, while price drops have so far been small, though continuous over the last 2 to 3 years. To a certain extent, the cause of the low transaction level in both cities can be found in the weak national economic performances and difficulties in the banking sectors. In contrast, the situation of the Ukrainian economy greatly improved in 2010. Still, the crisis on Kiev's residential market protracted, with prices falling further. Investors and developers left the market, leaving construction to semi-public entities.

Figure 13: Residential Price Growth in Kiev, 2008—2010



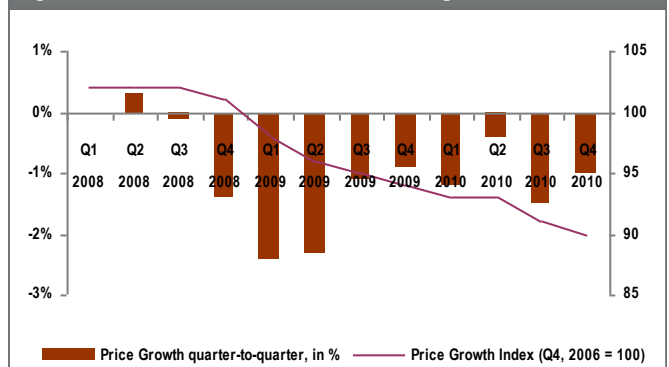
Source: REAS, growth rates calculated based on asking prices in USD per sq. m.

Figure 14: Residential Price Growth in Ljubljana, 2008—2010



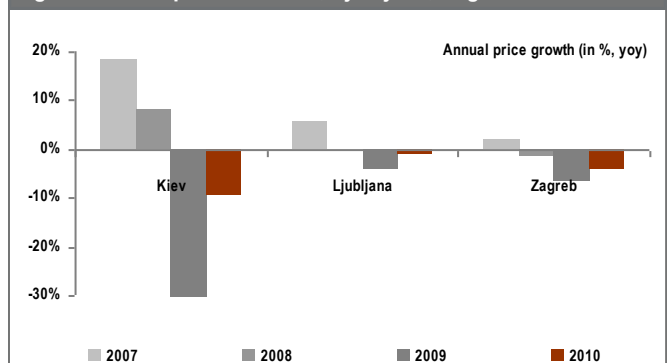
Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Figure 15: Residential Price Growth in Zagreb, 2008—2010



Source: REAS, growth rates calculated based on asking prices in Euro per sq. m.

Figure 16: Comparison—Kiev, Ljubljana, Zagreb



Source: REAS

The report has been prepared by REAS in cooperation with Jones Lang LaSalle

About Jones Lang LaSalle

Jones Lang LaSalle (NYSE:JLL) is a financial and professional services firm specializing in real estate. The firm offers integrated services delivered by expert teams worldwide to clients seeking increased value by owning, occupying or investing in real estate. With 2009 global revenue of \$2.5 billion, Jones Lang LaSalle serves clients in 60 countries from 750 locations worldwide, including 180 corporate offices. The firm is an industry leader in property and corporate facility management services, with a portfolio of approximately 130 million square metres worldwide. LaSalle Investment Management, the company's investment management business, is one of the world's largest and most diverse in real estate with more than \$40 billion of assets under management. For further information, please visit our Web site, www.joneslanglasalle.com.

About REAS

REAS is an expert advisor in the planning and development of housing projects in Central Europe. REAS consultants are the leading specialists in market research, urban and housing development, design, development management, project financing, marketing and sale of residential projects. REAS partners, as advisors to the World Bank and the Government of Poland, have played an active role in the Polish housing sector reforms. Independence and objectivity, combined with extensive knowledge and long-term experience, allow REAS to support its clients at every stage of a housing project. Since 1997, REAS has been advising developers, investment funds, banks, local governments and other institutions in their operations in the residential market in Poland. As result of a strategic partnership, Jones Lang LaSalle and REAS offer integrated services in commercial and residential real estate in Poland, Romania, Hungary, Czech Republic and Slovakia. Since 2007 REAS offers full range of its services in other Central European countries. For further information, please visit our Web site, www.reas.pl.

Contacts:

Pawel Szejter

Partner, Head of Advisory
R E A S | Residential Advisors
Warsaw
+ 48 22 380 21 00
pawel.szejter@reas.pl

Maximilian Mendel

Director, CEE Research & Advisory
R E A S | Residential Advisors
Warsaw
+ 48 22 380 21 18
maximilian.mendel@reas.pl

Kevin Turpin

Head of Research Central & Eastern Europe
Jones Lang LaSalle
Prague
+ 420 227 043 131
kevin.turpin@eu.jll.com

Residential Markets in Central European Capitals • March 2011

OnPoint reports include quarterly and annual highlights of real estate activity, performance and specialised surveys and forecasts that uncover emerging trends.

www.reas.pl

www.joneslanglasalle.com

Information on supply, demand and pricing was derived from own research and regional expertise. If not otherwise declared, prices refer to the average asking price per sq. m. of new apartments.

COPYRIGHT © REAS Sp. z o.o. 2011. All rights reserved, except where noted otherwise. No part of this publication may be reproduced or transmitted in any form or by any means without prior written consent of REAS. It is based on material that we believe to be reliable. Whilst every effort has been made to ensure its accuracy, we cannot offer any warranty that it contains no factual errors. We would like to be told of any such errors in order to correct them.