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Residential Market Review

Commentaries and analyses by REAS

Central Europe in the spotlight - residential markets in CE 12 capitals

Investing on residential markets in the Central Europe region has become a permanent part of long-term global investment strategies of many players. Today Central European markets draw even more interest as due to the less developed mortgage sector they are less affected by the American crisis.

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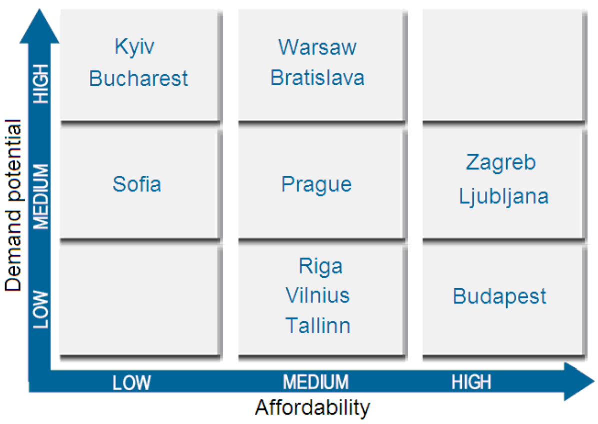
The approach to investigate capital cities as the first place of foreign investors to enter a market proved to be a worthy starting point for research on the Central European region. After initiating such research on ten capital cities in 2007, REAS and its strategic partner JLL have just completed this year's second edition, now including twelve capital cities.

The research area comprises the Central European core region made up by the four Visegrád countries with the capital cities of Warsaw, Prague, Bratislava and Budapest and the capitals of the Baltic states, Tallinn, Riga and Vilnius. Further the capitals of Romania and Bulgaria (Bucharest and Sofia) are included. These two countries have come into the spotlight of international investors since they entered the European Union on January 1, 2007. In addition to these nine recently-ascended EU countries, the residential market of the Ukrainian capital Kyiv is analyzed. Brand new added to the research are the capitals cities of Slovenia and Croatia, Ljubljana and Zagreb. These two countries are the first entities of the former Yugoslavia which established closer ties with the European Union, culminating in the accession of Slovenia in 2004 and its adoption of the euro in 2007 and Croatia holding a candidate country status.

The strong performance of the Central European residential markets was caused by the merger of two integral factors: an increased interest in global investing in real estate on the one hand and attractive local market prospects with strong demand patterns for housing and a high return potential on the other hand. Thus, Central European housing markets emerged on the global investment landscape. While the residential sector was traditionally understood as a long-term investment place, it was however suddenly flooded with capital from short-term speculative investors in search of fast money. This flood of capital led to an imbalance of supply and demand structures, resulting in tremendous price rises. As a consequence housing became less affordable for many households throughout the region, in spite of a huge need for housing.

While over the last five years investing in residential real estate has been treated almost like playing on the stock exchange, conditions for short-term investments worsened in some capital cities or even entirely disappeared in others. Now attitudes of investors will have to change towards long-term investment strategies. Given the different pricing and affordability levels in the CE capital cities, the question for these long-term investors is where the most sustainable demand is located. The following table attempts to summarize the different capital cities' demand potential, combining local economic and demographic factors influencing demand plus an assessment of foreign demand, and their affordability level.

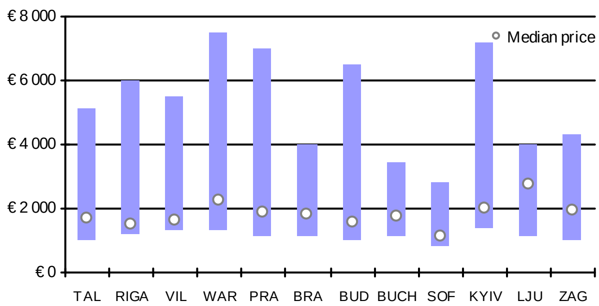
Residential Market Potential



As stated the residential markets of the CE capital cities are on the turn into markets for long-term players instead of short-term speculative investors. However, there is quite a difference in the advancement stage between the twelve cities. A look at the standing of each capital in the residential market cycle indicates that there are some capitals with already overpriced markets, whereas there are other cities in which developers have just started to adapt prices to actual levels of demand.

The Baltic capital cities give clear examples of currently overheated residential markets in which prices currently either stay in place or are even slightly declining. But also Kyiv, Warsaw and Zagreb have seen a clear cooling down in pricing dynamics over the last year resulting in a current price equilibrium. Prague, Budapest, Ljubljana and Bratislava are on their way to such a temporary price standstill but have not yet reached it. Bucharest experienced high price increases over the last year but has definitely already crossed the line to a decreasing rate of price rises, while Sofia gives the impression of still having room for price rises at a higher rate.

There are not only dramatic discrepancies in pricing between the twelve capital cities but also in the quality of the product. In markets where almost all housing projects brought to the market are almost immediately sold, many developers see no need to invest in quality. Until recently this used to be the typical situation on the region's residential markets and particularly concerned one-time investors. Yet, several long-term players also showed and still show difficulties to adopt construction, architecture and standards to a more mature level. Given the growing prices of land, construction materials and labor costs along with a labor force shortage due to the outflow of skilled workers to Western European countries, the developer's potential margins have narrowed, partly explaining the slow pace of housing quality adoption. However, with a growing awareness for quality factors and, hence, a higher selectiveness of potential home buyers, the region will become an arena for serious long-term developers and investors.



Gross prices of new apartments in EUR per sqm of usable area, 2007

"Residential Markets in Central European Capitals" report

Bratislava, Bucharest, Budapest, Kiev, Ljubljana, Prague, Riga, Sofia, Tallinn, Vilnius, Warsaw and Zagreb.

Comparative analyses and investment prospects

Download the full version from http://www.reas.pl/publications.html

The residential market in Krakow

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Consultant

Katarzyna Kuniewicz is currently writing her doctoral thesis in the Public Finance Faculty of the Catholic University of Lublin under the supervision of professor Zyta Gilowska. She gained experience in the area of co-operation with the public sector as consultant in numerous programs supporting the communes in the years 2000-2005.

Apartment prices in Krakow have grown at a higher rate than the average remuneration. In 4. quarter 2007 the average salary could buy mere 0.38 sqm of the average priced apartment.

With regard to the number and value of constructed developers' units, Krakow ranks second among the largest Polish agglomerations. In terms of the number of units delivered by 1,000 people in 2006, after seven years of Warsaw's preponderance, Krakow regained its first place with almost 9 units delivered per 1,000 people. With the number of inhabitants at almost 760 000 people, it is the second largest city in Poland

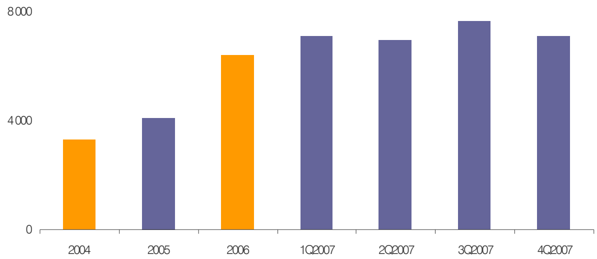
Krakow's demographics favorably affects the residential demand. Although the population within the city limits remains stable, it has grown at an increasing rate in the entire metropolitan area.

Moreover Krakow's economic situation is relatively advantageous for its inhabitants – the GDP per capita is by over a half higher there than the national average, the remunerations have grown gradually although they still remain much lower than in Warsaw, and the unemployment rate is among the lowest in Poland. Yet apartment prices in Krakow grow at a higher rate than the average remuneration. In Q4 2007 the average salary could buy mere 0.38 sqm of the average priced apartment, while in 2003 this affordability index amounted to 0.78.

The Krakow residential market has been subject to rapid development in the recent years. In the years 1997 - 2005 from 3,000 up to 4,500 apartments were delivered in Krakow yearly, while the output varied much from year to year. The year 2006 had brought about high-rate increase in the housing construction output that reached 6,600 units and thus outnumbered the record 2001 performance. This high growth rate was specific first and foremost to developer output ("for sale and rental" and housing cooperatives) although growth was observed also in other investor groups. The year 2006 was also yet another year of high-rate increase in the number of building permits issued.

The 2007 statistics show that this trend had prevailed. After three quarters of 2007, there were over 9,100 building permits issued, a result by 30% better than in the same period in the record breaking year 2006. A similar situation regards data on started constructions. In the three quarters of 2007 over 7,800 apartments were started, the highest result for that period since the year 2000. Therefore the statistics allow to predict a very high supply level.

In the fourth quarter of 2007 new units constructed by developers and housing cooperatives were clearly concentrated in the central part of the city – in Śródmieście, the central part of Podgórze abutting Śródmieście, in parts of Krowodrza adjacent to Śródmieście and Nowa Huta. Traditionally, western and eastern locations of the city are not popular among developers. Projects with the highest prices are developed in Śródmieście (in Stare Miasto, Łobzów and Grzegórzki) and, on a lower scale, in areas of Krowodrza and Zwierzyniec being natural extensions of downtown developments; single projects priced above 9,000 PLN/sqm were also listed in the north-east part of Dębniki. Projects with average prices up to 8,000 PLN per sqm are constructed mainly on the city outskirts. They are the most popular products in Podgórze (a large concentration of such units is located in the north-west quarter of Zakopiańska and Zawiła Streets) and in the districts of Prądnik Czerwony and Prądnik Biały.



Average apartment prices in Krakow; 2004-2007

In 2006 the housing market value doubled, caused both by a large price increase (at one point in time prices in Krakow exceeded the level of Warsaw prices) and the delivery of a few luxury projects. In 2007 the value of the market is growing with similar dynamics, exceeding for the first time 2.5 billion PLN and in 2008 it will exceed 3 billion PLN.

Lofts for connoisseurs

One of the Polish residential market's maturity symptoms is the growing diversity of its offer. Now those in search for an original design and unique interior may choose from a number of options – including loft dwelling .

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He also graduated from Postgraduate College of Property Surveying, Real Estate Agency and Management at the Faculty of Real Estate Agency.

Loft today stands for upscale-standard housing premises in a post-industrial building. Facilities that are converted into residence include, but by far are not limited to, former manufacturing halls, old streetcar or bus depots, mills, and water towers. Residential development of former industrial facilities exposes the developer to a specific risk and expense. The developer must consider monument conservation-related constraints. Not all available engineering solutions are feasible because of architecture-specific and regulatory material and structural constraints. Moreover some elements are not standard, such as windows for instance, and must be made customized. Loft conversion may also require a custom interior design, which adds to finishing costs. Therefore converting a former industrial facility often costs more than building a new house, which translates into the final product pricing. That is why loft is an exquisite offering targeted at buyers with incomes above average.

The dwelling's uniqueness makes loft so attractive and hip. Originally lofts provided cheap housing to artists who needed space for residence and atelier. Premises such as - for instance - attics in industrial buildings, spacious and undivided, fit the purpose perfectly and conveniently accommodated them both. What loft is about is large and open space and old walls. Such projects stand out with their specific "feeling". Buildings converted to housing are often one hundred and more years old.

In Poland one of the most spectacular, and commercially successful, loft conversion projects is U Scheiblera in Lodz. At first the apartments were sold at 3,600 - 3,800 PLN/sqm gross prices, today they sell at 7,000 - 7,900 PLN/sqm. The project's successful promotion has made loft accommodation fashionable in Poland, from which other projects benefited. Loft apartments are now on offer in Gliwice at W Spichlerzu and Stara Piekarnia; in Żyrardów at Lofty Le Girarda and Stara Przędzalnia; in Warsaw at Lofty Fabryka PZO, in Poznań at Lofty Osiedle Ułańskie, in Łódź at U Scheiblera, and in Bydgoszcz at Arkada Park. In a large portion of Poland's thirty biggest cities such projects are either already under way or planned.

„U Scheiblera" Factory, Łódź

However demand for such premises is limited, for various reasons. Open undivided space is not good for everyone, and what is valuable for an artist in need of a workshop may be discomforting for a family with kids. Furthermore, such projects are priced way above the city's average. For instance: while in the fourth quarter of 2007 an average apartment was priced on the primary market in Warsaw at 8,500 PLN/sqm, the Fabryka PZO lofts were offered at 13,400 – 14,000 PLN/sqm gross price, i.e. 60% higher. That is why loft is a product for special customers from an upscale market segment.

Also supply of former industrial facilities convertible to residence is very limited. Suitable post-industrial buildings are scarce in bigger cities. In view of their limited supply further increases may be expected in lofts' prices, since they will be in-demand by customers looking for unique and original dwellings.

REAS News

Dr. Władysław Brzeski granted the fellowship of Royal Institution of Chartered Surveyors

Dr. Władysław Jan Brzeski, REAS partner, was granted fellowship of the Royal Institution of Chartered Surveyors (FRICS) awarded to experts in the area of real estate valuations.

RICS is one of the most respected organizations of professionals in the world, gathering people professionally active in the domain of the real estate market. The institution has been operating for 134 years in Great Britain, but professionals with RICS title are working all over the globe. The membership of RICS is estimated at 140,000 people active in 146 countries. RISC Poland was launched in 1991.

The fellowship of RICS is awarded to 5 percent of the most respected real estate specialists in the world. They are leaders in their professions, people actively working to develop and promote the real estate market globally.

REAS presentation during the international fairs MIPIM 2008 in Cannes

During this year's edition of MIPIM, the largest real estate and investment fairs in the world, REAS will launch the second edition of the report „Residential Markets in Central European Capitals", prepared in co-operation with Jones Lang LaSalle. The report presents the investment potential of twelve capital cities of Central European countries.

The presentation conducted by Kazimierz Kirejczyk will take place on March 12th at 10.00 a.m. in Hotel Majestic, 10 Boulevard de la La Croisette, Cannes.

New edition of REAS reports on residential markets

New edition of REAS reports on residential markets of the largest Polish cities, including the data from the 4 quarter of 2007, is already available. In REAS reports, you will find thorough analyses of the situation on residential markets in Warsaw, Krakow, Łódź, Poznań, the Tri-City and Wrocław, including the economic, demographic and urban-planning premises of their development.

We encourage you to download the reports' summary from http://www.reas.pl/reports_cities.html

To receive additional information, contact Paulina Starzyńska, e-mail: paulina.starzynska@reas.pl, tel. 22 380 21 04

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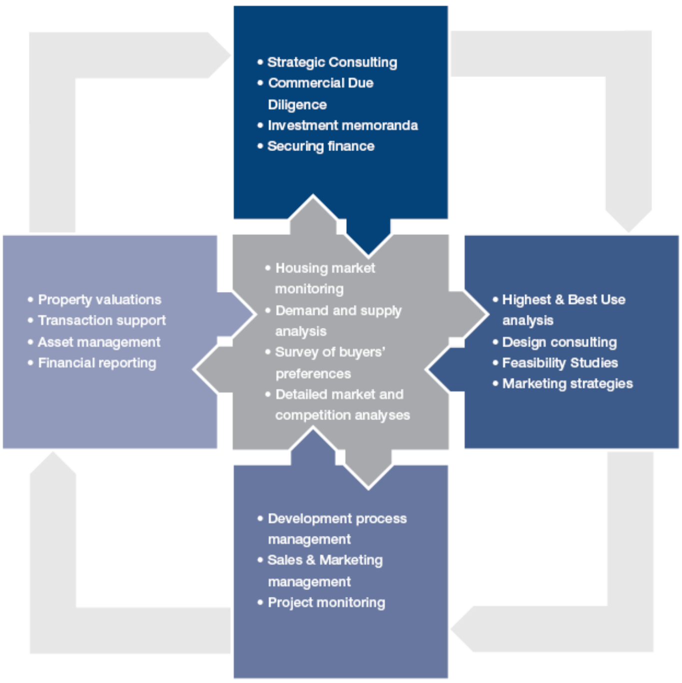

REAS is an expert advisor in the planning and development of housing projects in Poland and Romania.

REAS staff are the leading Polish specialists in market research, design, housing project management, project financing, marketing and sales, as well as urban and housing development. REAS partners, as advisors to the World Bank and the Government of Poland, have played an active role in Polish housing sector reforms in the early 1990's.

Since 1997, REAS has been advising developers, investment funds, banks, local governments and other institutions active on the Polish housing market. From the beginning, REAS has set the standard for investment services and is an invaluable source of comprehensive information concerning the residential market in Poland. Independence and objectivity, combined with extensive knowledge and long-term experience, allow REAS to effectively support its clients at every stage of a housing project.

REAS is strategic partner to Jones Lang LaSalle, the leading global real estate services provider.

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