

# Residential Market Review

Commentaries and analyses by REAS



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# Fundamental Factors of Demand for Housing



Dr Władysław Brzeski, FRICS

## Partner

A real property economist with over 25-years' experience. Dr. Brzeski collaborates with international institutions (incl. The World Bank) in the area of real property, housing and urban development. He was an advisor to Deputy Prime Minister Leszek Balcerowicz and was Deputy Mayor of Kraków.

Fundamental factors do not determine instantaneous developments of demand and supply, however their role in medium and long periods is predominant.

The primary residential market in Poland features more and more evident stabilization, and sometimes even stagnation and reduction of newly built units' prices. This results in slowing down of trading, lower presales rates, higher rebates, and shrinking developer margins. These phenomena are quite unanimously described by attentive observers of the market using official statistics, data randomly collected from market players, and incidental observations.

However when further development scenarios are forecast, larger differences appear. This follows on one hand from different results of analyses of fundamental supply and demand factors, as well as from adopting different assumptions for future developments.

Multitude of these factors and their interactions make analyzing and forecasting the market highly complex. The more so that a significant part of market players' decisions and behaviors that largely affect the real estate market is not rational, as it is the case on capital markets. This article focuses on the fundamental factors of the primary residential market's demand side.

## Dwelling needs

The most important fundamental factors are dwelling needs, without which there'll be neither demand for housing, nor supply to satisfy it. There are also financial needs, mainly as investment in an apartment, which represents a portion of demand for housing from the primary market.

The dwelling needs are measured with quantitative indices of necessary floor area per person, apartment size per household, or number of units per one thousand inhabitants. These needs change with the population's age structure, income, and lifestyle and broadly meant cultural preferences. The key role in fundamental analysis is that of age and income dynamics, i.e. changes in their structures. Depending on level of detail, population is broken down into age groups with similar dwelling needs.

The "young singles" age group of 18-30 year olds (today perhaps even 35) needs mostly small and cheap flats located in easily accessible downtown areas of cities.

The "young families" group of 30/35 – 40/45 year olds as a rule needs larger flats that may accommodate small kids, who feel best on low floors and in yards or gardens. Therefore location-wise these are still inexpensive dwellings, often located in less expensive suburbs. The "mature families" group of 40/45 –55/60 year olds, more affluent and with adolescent children, typically needs an even larger floor area (numbers of rooms), which focuses its attention on more expensive and better located apartments in between suburbs and the downtown. And finally the "empty nesting" group in age over 55/60 returns to needs for dwelling in smaller apartments, yet well accessible (typically downtown-located) and with higher living comfort.

Therefore there is strong correlation between dwelling needs and age group. Small households in the "young singles" and "empty nesting" groups represent demand mainly for small flats but in good downtown locations, while large households of "young families" and "mature families" represent demand for large apartments but in urban and suburban locations. This correlation may be quantified and used in forecasting global dwelling needs based on demographic dynamics, which include also migration changes. Investors and their advisers do the same, albeit to a smaller scale of their respective markets.

This regularity, observed in countries with mature market economies, in Poland was largely disturbed under the communist regime, and therefore now it has not been yet fully relevant. However the primary residential market is a mechanism that enables and reinforces this correlation. Dwelling needs change not only "cyclically", but also "structurally" along with changing household sizes in line with the pan-European trend towards smaller households. This results on one hand from changes in lifestyles towards more individualistic (atomized) ones, as well as from growing affluence that enables such lifestyles in practice.

Quantitative analyses of dwelling needs' fundamental factors produce coefficients of the numbers of apartments for each age group. They also explore correlation between dwelling (ownership or tenancy) affordability

and household size, because in poorer times a tendency becomes evident to enlarge households (in order to share dwelling expenses), and a tendency to reduce them in times that are more affluent.

Dwelling needs are also determined based on analysis of households' current living conditions. Dwelling's mismatch in terms of its size, standard, location, or holding provides concerned households with a strong impulse to improve their housing conditions. After the period of Communist rule, when households were assigned to apartments and then "locked in" them for generations, we've inherited a high level of mismatch between households' dwelling needs and actual conditions. Therefore the market is lacking some housing products, and their supply may be realized by new development only. Supply adequacy analysis is therefore an indispensable element of demand forecasting and explains why some demand estimates are so high.

#### Financial needs

Besides dwelling needs, there are also financial/investment needs that in the recent period of the primary market's price stampede were important demand drivers. These needs motivate buyers of apartment for own dwelling as well as capital market players, for whom the real estate market is an alternative opportunity of investment for regular income, real capital protection (against inflation), and for opportunist capital yields. Growing savings of the Western world's aging population and profits of primary energy (oil, gas) suppliers have led in the recent years to capital flood of many emerging markets. Opportunistic capital has flown also to the primary residential market in Poland and at its relative shallowness it has greatly contributed to price rises.

Therefore further price dynamics on the market to a large extent depend on behavior of the opportunistic capital invested in new apartments. The capital's outflow to markets with higher dynamics of prices (such as Bulgaria, Romania, and Ukraine), or its return to the motherlands (e.g. to cover losses on those markets) will result in increased supply and more profound price adjustment. Different than relative stable dwelling needs, investor behavior driven by financial needs and oriented to short-term yield is hardly predictable. That's why forecasting demand on markets with a large share of opportunistic capital, also called speculative capital, is more complex and much more difficult.

#### Purchasing power

Needs alone generate no demand, because a purchasing power is needed to make demand effective. It consists of own funds (own contribution) and borrowed funds (mortgage loan), as well as own income necessary to cover dwelling expenses and to repay the debt. Purchasing power is unevenly distributed among social groups, age groups, and regions/localities. Own funds and income are relatively stable, they do not dramatically change overnight and as such they are easier to forecast, whereas borrowed funds are purchasing power's less stable component since rapid changes in loan interest rates immediately translate into loan amounts available to apartment buyers.

Recently in Poland it was just purchasing power's increase due to lower interest on mortgage loans that made the market experience a "quantum leap" to the orbit of much higher prices that could have been financed owing to lower credit cost, at common expectation of still growing incomes. At the same time the presently seen credit availability constraints and interest rate increases act as a negative leverage enforcing larger own contributions and with time reducing marketable prices. The loan leverage has lifted the market to a higher orbit in the recent years, but at the same time it introduced a significant uncertainty resulting in the demand's reduced stability.

Analyzing and forecasting the primary residential market's demand is more difficult due to presence of the demand's less stable and hence hardly predictable elements. These are first and foremost investment needs and mortgage loan availability. They have their sources in the capital market, the behavior of which is hardly predictable even by expert specialists. The recent worldwide upsets on this highly globalized market resulting in more expensive credit and limited liquidity, are now starting to evidently affect the housing demand by way of reducing the purchasing power. Luckily the Polish economy has not suffered much so far, but it may suffer more in a longer run.

Housing demand's stable factors are dwelling needs and households' own funds and incomes. These factors, dwelling needs and income in particular, are still strong in Poland and determine continued optimism of the market's players in the mid-term perspective, when the capital market's less advantageous and unstable fundamental factors will improve and reinforce the purchasing

## Residential Market in Warsaw



**Kazimierz Kirejczyk**  
President and co-founder of REAS

One of the the leading Polish experts on residential market. Member of the Global Real Estate Institute and Urban Land Institute; Co-founder of European Property Institute.

In the Warsaw residential market, we are witnessing a two-fold increase of offer – after 1st quarter 2008, on the there were 13 500 new apartments on offer, compared to 6 500 from last year.

According to official statistics, the population of Warsaw is approximately 1.7 million, yet in reality, there are several hundred thousand more people more living within the city limits, who are not officially registered. Compared to other European capitals, Warsaw is populated by the lowest percentage of the country's population (below 5%), while for large and medium size countries the percentage usually falls between 8 and 12%. This allows to assume that in the nearest decade the population of the city and in particular the population of the metropolitan area will rise significantly – which means good perspectives for the residential market.

Economic situation of Warsaw residents is very good, still the consumers' attitudes are strongly affected by the global situation and concerns regarding the growth of inflation and reduced pace of the economic development. This has its impact on the mortgage market. Like in other large cities, both the number of mortgages made in the fourth quarter of 2007 and their average value decreased as compared to previous quarters. It can be hardly explained solely by the increase of interest rates, since salaries over the last twelve months have been increasing very quickly, almost entirely setting off higher debt service.

Approximately 3,500 units were launched on the market in the first quarter of 2008 - a clearly lower figure than in the previous quarter. The number of units exposed on the market at the end of the quarter was similar to that of the previous quarter and amounted to approximately 13,500 units. A year earlier, in the first quarter of 2007, there were some 6,300 units offered for sale.

Listing prices in the segment of regular units in the first quarter of 2008 almost reached 9,000 PLN/sqm. However, the increment in the course of the last quarter is so insignificant that listing price levels can be described as stabilized. Over the last twelve months (Q1 2007-Q2 2008) prices went up by about 5%, although the average price of units delivered to the market in the first quarter of 2008 was by about 15% higher than that from the first quarter of 2007.

The sale on the Warsaw housing market continues to be relatively high. At the end of the first quarter 2008 there were only approximately 400 units available for purchase in completed projects, which is about 2% of the number of units planned by developers for delivery in 2008. At that point in time 87% of units planned for completion in the first half of 2008 were sold and 70% of those planned for the second half. The pace in the first quarter of 2008 was moderate: the total number of units sold is estimated at approximately 3,500. However, it was much better than in the third quarter 2007 and slightly better than in the fourth quarter 2007.

Despite the outflow of speculative buyers, the sale rate in subsequent quarters should not be reduced and is even expected to increase at the yearend. In such case the annual sale could be estimated at approximately 15,000-16,000 units. Unless developers take a decision to postpone starts of some projects in the pipeline, forecasted supply expressed in terms of number of units listed for sale in the course of the whole year can be estimated at 22,000-24,000 units. It can be also projected that the number of completed yet unsold units will reach the level of 10-15% of the annual output and will continue to grow in 2009.

The next 24 months may be rather difficult for Warsaw developers: supply will remain at an exceptionally high level, interest rate are more likely to rise than to fall, prices will stabilize and profitability of the development activity will decrease. The most secure projects are those easy to be flexibly phased, targeted to a wide range of clients, in particular to a growing group of middle class households with stable income and equity tied up in their smaller dwelling. Another type of secure investments are high quality, cozy apartment-type projects in good locations which are still in short supply on the market. The most risky projects will be residential towers with high development costs and accordingly high prices, targeted mainly to investment buyers.

# Global Impacts on Poland's Residential Market



**Maximilian Mendel**  
Consultant

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In an era of globalization and increasing cross-border investment activities, Poland's residential market was not only able to attract foreign capital flows but also became considerably prone to external market events.

Nowadays Polish newspaper articles on residential markets are often headed with catchwords such as housing bubble, market correction, stagnation or even crisis. In light of global events like the US mortgage crisis and downturns of European housing markets in the UK, Ireland and Spain, it seems fair to discuss the impact of global crises on the local market.

As a consequence of the globalization process, global capital is in permanent search for investment opportunities, among which property markets proved profitable options. The growing appetite for real estate also includes a considerable part of interest in residential markets. Besides global playgrounds like China, Brazil or the Arabian Peninsula, the housing markets of Central Europe have attracted much attention on the old continent. With the latest EU accessions in 2004 and 2007, investments in the region became a less risky choice, while these markets at the same time promised high initial rewards due to low price levels. Poland as the largest market with a high level of backlog demand for housing was one of the main destinations for investors.

In the boom years between 2005 and 2006 until well into the first half of 2007, many investors — individual and corporate investors, funds and development companies alike — made easy profits on Poland's residential market. Though the price bonanza had already lost in pace in the course of 2006, numerous developers were still able to gain considerable yields, especially when cheap land purchases had previously been made. The simultaneous start of the US mortgage crisis in late 2006 was therefore of lesser concern for these developers and also for many short-term investors. Then the US mortgage crisis eventually turned into a worldwide financial crisis, followed by serious market downturns in Ireland, Spain and the UK. Nevertheless there was not any sign for lowered demand or loosing willingness of developers to invest in the Polish residential market, yet. When in the third quarter of 2007 apartment sales came to a near standstill on Poland's main urban markets, more than a few developers, investors, experts and journalists still seemed to be taken by surprise. Although, as will be revealed, rather domestic factors impacted on the drop of sales, the global financial crisis was made scapegoat by many, and at least partly justifiably so.

The main reason for the falling sales level was made by a combination of two factors: on the one hand a sudden

oversupply of new apartments on the market and on the other hand a limited effective demand. Due to a larger choice, potential buyers felt they were not any longer forced to react quickly to get an apartment. In addition, rumors about price corrections came up and households held back their purchase decision. Demand was then further limited, since falling, stable or even only slightly growing prices proved a disincentive for speculative investors who nearly disappeared from the market. But the limited demand side also had its roots in the global crisis.

There was no immediate mortgage crisis in Poland, simply because subprime or similar mortgage products for higher-risk borrowers were not existing. Yet, both the credit crunch and the specific problems on European markets had its side effects on Poland's residential sector. The foremost spin-off of the mortgage crisis in Poland was based on a new strictness of banks to issue credits, both to homebuyers and developers. Worse conditions and restricted access to loans for households contributed to a large degree to the reduced demand, which let sales levels fall from Q3 2007 onwards. Moreover, higher restrictions to get mortgage credits is presenting a growing problem for developers to finance new investments. Particularly small development companies, who need financial backing by banks, will be most affected and may be forced to withdraw from the market.

Another impact of global events on the local market is represented by the problems chiefly Spanish and Irish developers are facing. Due to the crisis on their home markets, some developers from the two countries will need to sell their Polish investments in order to save the mother company at home — if not too late already, as the first spectacular bankruptcy of a large Spanish developer with property in Poland has recently shown. Also several Spanish and Irish developers will have troubles to develop profitable projects, since many land purchases were overpriced, based on unrealistic, steady price growth assumptions.

Summarizing, global capital is intrinsically tied to Poland's housing market be it in form of banks, foreign developers, local developers with overseas capital, international funds, or investors. However, the players keep changing as are the ways of investments due to transformations on both the local and global level.

## REAS News

### REAS at Central Europe Meeting Point

REAS was a Program Partner of the third edition of the Central Europe Meeting Point Conference held in Warsaw on 22-24 April in Warsaw. REAS was one of the entities invited to develop the program and its members of staff presided over four out of a dozen sessions of the Conference.

Joanna Iwanowska led a session dedicated to the Bulgarian real estate market. Władysław Brzeski presented REAS research of residential markets in twelve capital cities of Central European countries.

Paweł Szejter delivered a presentation about perspectives of the development of residential markets in Polish towns populated by 100,000 – 500,000 people and later headed a panel discussion with participation of representatives from the towns of Szczecin, Rzeszów and Katowice.

Kazimierz Kirejczyk presented the most dynamically growing areas of Warsaw. The attendees of the Conference could see some of them with their own eyes during a sightseeing tour in Warsaw.

### New edition of REAS reports on Polish residential markets

The new edition of REAS quarterly reports, presenting residential markets of Warsaw, Krakow, Łódz, Poznań, Wrocław and TriCity in 1Q 2008, will be available May 12th.

For the first time reports include analysis of changes in sales pace and the number of flats being in offer in subsequent quarters of 2007 and 1Q 2008.

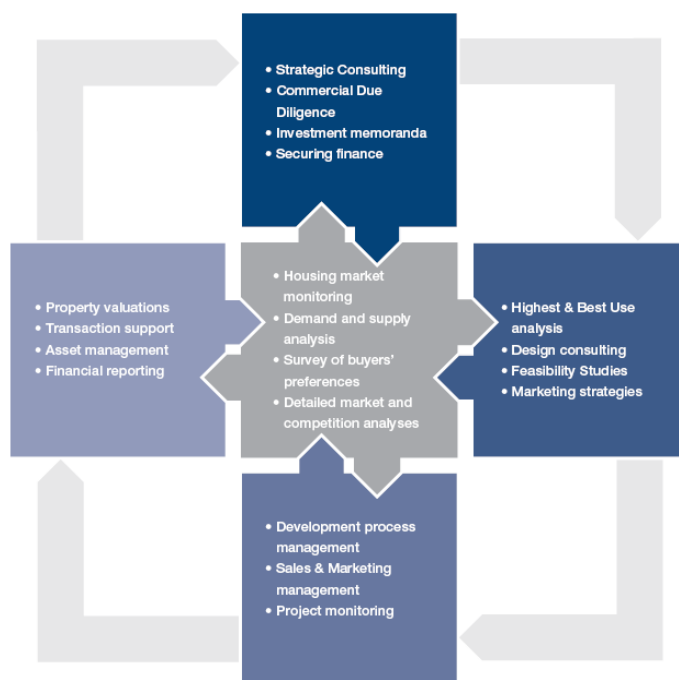
More information on reports at [http://www.reas.pl/reports\\_cities.html](http://www.reas.pl/reports_cities.html).

### REAS supports a Business Mixer in Bucharest

REAS and Jones Lang LaSalle sponsored the first „Drinks Before Home” Business Mixer, organized in Bucharest by Roberts Publishing, April 17th.

It was the inauguration of meetings aiming to bring together the participants of the local real estate market. The meeting was attended by 80 representatives of companies active in the Romanian real estate market, including: developers, banks, brokers, investment funds and advisory companies.

## Informacje o firmie REAS



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.