

# Real estate shares: it started and will end with properties

Author: Martina Martinovičová | Published: 26.05.2009

The shares of real estate companies were the first to be affected by the oncoming financial crisis and will be the last to feel its departure. This year, their prices at the Prague Stock Exchange cannot be therefore expected to develop in a manner that would make them an attractive choice for reasonable investors - the crisis is not over yet. Some analysts even project another slide in the share rates by up to 50% and even predict their departure from the main exchange market in Prague. The latter mostly applies to ECM shares - in their case, the volume of trades on average hardly reaches CZK 2 million a day, which is one of the conditions for the PX index base. These visions may be too catastrophic, but at any rate real estate shares can expect a brighter future no sooner than next year. And the development of their rates will indicate that the financial crisis is bidding us farewell.

## Bear market

Today, the shares of property development companies are not attractive for investors. The sector is affected by the crisis and works with a large volume of credits - the biggest problem these days. "Real estate companies were hit by the ongoing crisis head-on. In the last four months of 2008 and the first two months of this year, they recorded huge decreases in shares. The prices of some companies in this sector reached single-digit percentage values compared to their annual maximum prices," says Josef Stoužil, of Capital Partners. The current growth trend will incite, according to him, a downward correction of the rates. "This large growth is not adequate to the current economic situation," Stoužil says.

Two issues in the real estate sector are traded in Prague - the shares of Orco and ECM Real Estate. Their development over the last year basically copies the development of shares in the same sector in the US. Year-on-year, Orco plummeted from over CZK 1,400 to the current approximately CZK 200 per share and ECM from over CZK 800 to under CZK 450, and had even seen a price lower than CZK 200. "We can expect that the development of real estate shares will be heading in the same direction as elsewhere. The domestic exchange for Orco's shares is Paris, which largely influences the share rates here. A distinct negative for both share titles is their very low liquidity. Any larger purchase or cancellation of a larger investor's position may rock the share rate without any fundamental reason," Stoužil comments.

## No sooner than in mid-2010

What is the expected development on the stock exchanges in Europe and the USA, which have the biggest influence on the Prague scene? For example in its latest analysis, the analytical team of the securities trader Atlantik FK describes the current growth on the equity market as a "short-term growth against the backdrop of a generally declining market trend" and points out that this is not the beginning of a new "bull-like" share rate development. Rather pessimistically, the analysis expects, taking into account the continuing and spreading recession in most sectors, the bottom to be reached in the first half of next year, and even later in real estates and finance. "The biggest banks and financial institutions are probably through the worst, as regards the scope of accounting losses. However, they are still to feel the negative effects associated with the revaluation of toxic assets and nationalizations, and also reduced dividends and profit dilution. The problems of the US economy are still serious and a further increase in the unemployment rate has to be expected, just like a decrease of consumer demand and further drop in real estate prices," says Milan Vaniček, of Atlantik FK. The current bear market in the USA has lasted for one and a half years, which is a very short period of time, according to him, compared to previous recessions,

when it took two to four years to overcome the downward trend.

“The most important thing for the investors is to realize that we are ahead of a huge deflation pressure, which will occur in most developed countries. We expect that this development will continue because the unemployment rate is climbing and the banking system has to depreciate its loan portfolios,” says David Karlsbol, Saxo Bank’s Senior Economist. He argues that changes will come when the indexes of new purchase orders start increasing. “It is particularly important if the bank reserves, i.e. a part of the money reserve accumulated in commercial banks, are used for something. If they are, it would bring about a turnaround. However, we would be surprised because credit activities in the banking system are usually restricted at least for two years during a recession,” he adds.

### **Key factor: US mortgage market**

It all started with problems on the US mortgage market; it is therefore important for the stock exchanges what is happening and will happen there. The condition of the mortgage market is important from several points of view - it influences the situation on the market of residential properties and the financial situation of households, as well as the conditions in the financial sector. The economists unanimously expect further growth of property prices, decline in household spending and very slow recovery after the recession in the USA.

In their latest projection, the analysts of Česká spořitelna focused on the development of the availability of mortgages on the availability of houses on the US market (these are different things, i.e. if an interested person theoretically has the means to buy a house, the bank may not always provide him with a mortgage). The interest rates are at a record-low level now. “The Fed is doing everything possible to push the mortgage rates down, help the real estate market and prevent further aggravation of the situation in mortgage securities,” says Luboš Mokráš, of Česká spořitelna. According to him, however, the declining rates have a larger impact on the refinancing of mortgages than on an increase in the interest in mortgages to buy houses. Why? Although the prices of houses are going down, just like the costs of mortgage, which should be positive, the situation is hampered by the aggravating situation on the labour market. “So far, the higher availability of houses has not reflected in the interest in their purchase so far. There are probably two reasons: some potential buyers are waiting for another decline, and some for economic stabilization - to minimize the risk that they would not be able to repay the mortgage in case of loss of work,” Mokráš thinks.

Due to the low rates, there is a huge wave of mortgage refinancing in the USA at present. It means lower costs of repayment, i.e. lower financial burden for households, which releases resources for other expenditures. For financial institutions that own instruments related to mortgages, it means that thanks to the refinancing there is much more cash coming in today. “It should mean that the market in mortgage instruments will clean up at least to some extent and will be clearer, which should help stabilize the financial sector,” Mokráš adds. The calming of the financial sector, the alleviation of the bank’s current fears of risk and lack of willingness to lend money should subsequently support the stabilization of the whole real estate market.

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