

Residential market has stabilized (at the bottom)



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We cannot expect property developers to, be it partially, cover hundreds of thousands arising from increased VAT from their own money. Already at time of crisis, developers were reluctant to grant discounts for new unsold buildings from the boom times (there are three thousand of them in Prague; around 250 and the same portion of new flats in various stages of construction in Brno, where they pulled emergency brake early enough). Burdened with pre-crisis (read as: unreasonably high) construction costs and closely monitored by financing banks, property developers find themselves in a price trap, especially when they are starting to compete with themselves by new, more cost-efficient flat projects. And in addition to this, comes the VAT increase although gradually and more gently than under the original government plans. Thus, let us consider as likely that soon we will have to pay extra for new housing.

Can the cause of the problem fix the problem?

How will the demand react in this situation? We do not need to speculate, we just need to remember the course of recent increase in reduced VAT rate from 5 % to 9 % (and later to 10 %). What happened in the new residential construction market? The demand (already overheated by low interests and accessible mortgages at the times of investment optimism, nurtured by the idea of perpetual economic boom) accelerated the growth even more. Everybody wanted to own housing still at lower VAT rates, builders hurried to complete construction before the decisive date, developers often rapidly tried to approve for use what was unapprovable, where under pressure, buyers risked purchase of unfinished flats unapproved for use in panic just to be able to pay the invoice with the original VAT rate.

The situation today is different, however. Recession sobering and investment hangover came after a boom party. Do we want to get over it by repeating the same scenario? Hard to say, although a certain analogy of above mentioned “hunt“ for lower VAT rate can be expected. Before the end of the year, it is not worth competing in projects which are not close to completion, however, the tax charades may help us from stocks of completed and unsold flats, mainly in Prague. And we will experience such competition more in projects under construction.

Only short-lived wins

So the first, short-term impact of gradual VAT increase on new housing still before its launch will be positive for the market: the buyers who have already made up their minds will speed up their purchases in the coming months and the hesitant buyers may decide. The demand will increase and the market will revive in two waves: before this year´s and next year´s New Year´s Eve. But it doesn´t look as good in the

mid-term. The demand, scared by the crisis and cautious, still hesitantly coming to life today, supported by lower interests and more accessible mortgages, will be pushed back into a defensive, especially when we can expect a rise in the price of mortgages this year. It will start by the here and there announced anti-inflation move of Czech National Bank in the form of 14-day repo rate increase - the basic interest rate in economy which is still at historic lows. In the long term, this means slowing down of expected new housing market recovery with all its negative impacts like unemployment in the construction industry and related fields.

Conflicting price pressures

Development of prices in new buildings will be affected by counter-influences. On one hand, there is a continuing excess of supply and the necessity to sell stocks of new flats (especially in Prague) which will keep the prices at the level lowered by the crisis (for example, at CZK 40,000 per sqm in best projects in Brno). On the other hand, inflation signals triggered (not only) by the change in VAT and supported by possible local "hungry" demand in the areas where flats under construction are missing, after selling new flat stock built at the time of the boom and subsequent construction freeze, at the time of crisis, and new property development is still merely in project preparation stage.

No major changes this and next year

In older (so-called "second-hand") flats, supply will be tempted to "catch up" price difference, which will increase prices of new buildings through VAT increase and will open "price scissors" (open at recession times) even more. This is an absolutely justified and especially healthy price drop of prefabricated flats in housing estates. We have witnessed similar price rise at the boom times when prices of new flats were growing and secondarily, prices of older, mainly prefabricated flats were also rising. Unlike those times, when demand exceeded supply and everything that came to the market was sold, often for unreasonable prices, the situation is totally opposite at the moment. Residential market has stabilized, however, at the bottom level (also in terms of prices) and the excess of supply over demand will surely keep it at the bottom this and maybe also next year. Therefore, we don't need to be afraid of irrational price jumps mainly in prefabricated houses.

Another question is, whether and what influence the VAT increase in new owner-occupied housing will have on rental housing market? Worsened affordability of owner-occupied housing has led to an increased interest in rental housing in the recent years. Further acceleration of increased demand (and resulting increased rental prices) is unlikely because the impacts of rent deregulation will act in the other direction on higher supply of rental flats and thus falling rent.

In any case, in conjunction with the estimated impact of "more expensive" VAT on new owner-occupied housing prices, we can expect growing demand for flat reconstruction in older brick houses as well as prefabricated housing estates. Whether it be with the help of New Panel scheme or without it. And this is surely good news, to conclude this topical issue.

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