



## Residential Market Report

1<sup>st</sup> Half 2008

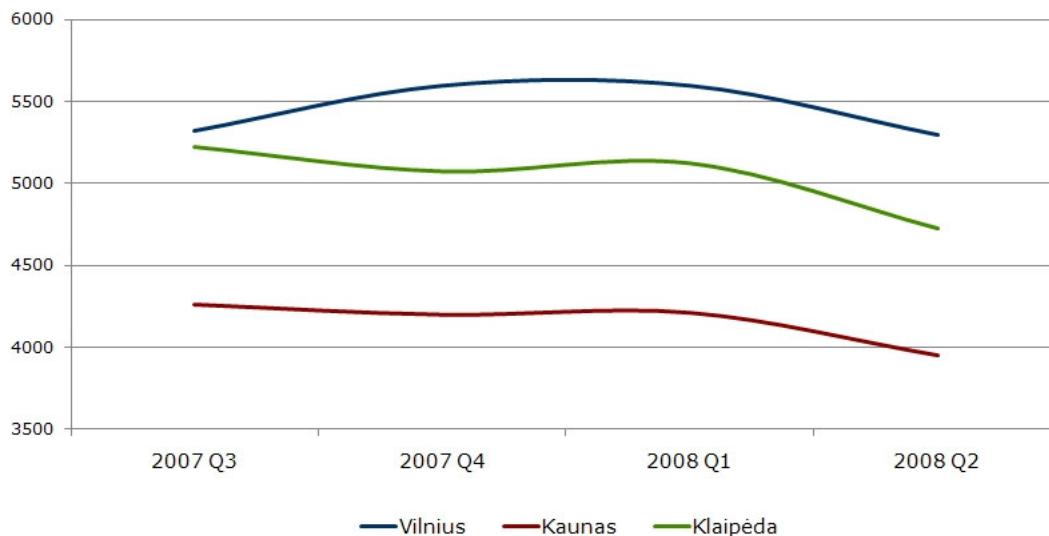
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REAL ESTATE ADVISORS

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A review of the results of the 1<sup>st</sup> Half 2008 enables us to state that the market in Lithuania has entered a new stage: a fast rise in prices and overly optimistic expectations from the majority of market players have been replaced by falling real estate prices with pessimism setting in.

Over the first six months of the year, prices for residential property in all the major cities have gone down. During this period, in Vilnius they fell on average by 9 percent, in Kaunas - by 10 percent, and in Klaipėda - by 12 percent. The fall in prices mostly affected larger apartments (three or more rooms) located in older apartment buildings, as well as the segment of apartments classed as "luxury" which sell for 10,000 litas or more per square metre. Smaller and economy class apartments are still in demand and liquid. The land plot market faces the largest liquidity problem: since the beginning of the year, prices for the majority of land plots for sale (in particular land plots for agricultural use, yet potentially allocated for residential and commercial property) have gone down by between 20 and 40 percent. Only smaller plots of land for residential use complete with infrastructure are in demand. The liquidity of land plots without infrastructure, and without change of use, is expected to decline even more in future. These plots can only be saved from decline in value by the installation of infrastructure (engineering communications, access, internal roads).

**Average prices in residential districts, LTL/m<sup>2</sup>  
(old construction 3 room apartments)**



What causes such dramatic changes in the market? The following are the main factors determining the drop in demand for residential properties:

- a) High and growing mortgage interest rates and rampant inflation. Growing inflation means that an individual who is earning the same amount of income as before (say, a year ago) cannot allocate the same amount of income for purchasing a home; whereas growing interest rates mean that an individual can borrow a smaller amount for purchasing a home, than that allocated for paying back the mortgage.

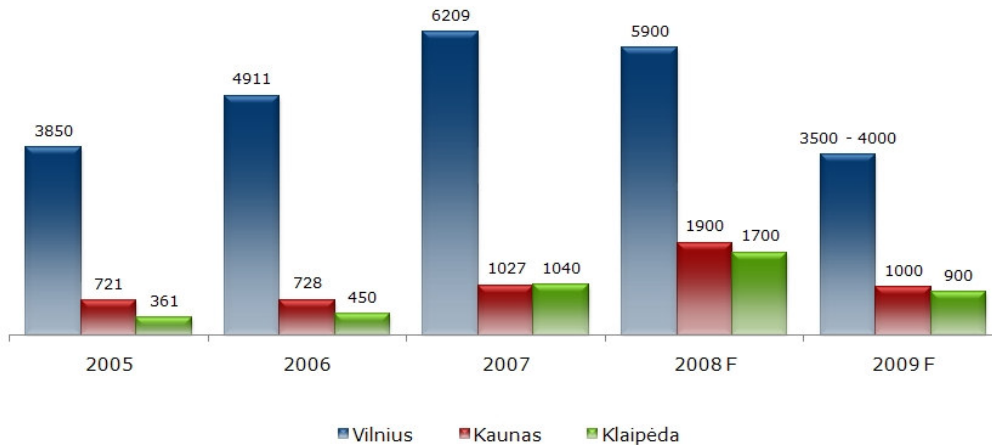
Therefore, it is possible to state that the purchasing power of the majority of potential buyers is currently in decline.

- b) A survey of customers carried out by Ober-Haus in March this year showed that nearly half of potential buyers do not resolve to acquire residential property (even if their income allows them), because they are fearful of a fall in prices in the near future, and are also aware of the fact that any property purchased may depreciate in value after some time, i.e., cost less than it was purchased for.
- c) Optimistic expectations are further undermined by reports in the mass media about new troubles of real estate development and construction companies, a global fall in prices, and grim forecasts of local and international professionals with respect to both the real estate market and Lithuanian economics.

To summarise the prevailing mood in the market - it is possible to assert that the market has been seized by a light depression and is currently waiting an upturn in activity. Buyers are currently focused on spending money on summer activities and holidays, and sellers are looking forward to autumn when, as is customary after summer, the market becomes more activate.

Poor results of real estate development companies and falling prices determine the more cautious attitude of banks towards financing new projects. Currently in Lithuania, hardly any loans are being granted for purchasing plots of land. A much smaller proportion of loans is being granted for construction; furthermore, advance sales are being requested. For builders, who over the past years have enjoyed particularly favourable conditions for bank loans, this situation has come as an unpleasant surprise. The majority of real estate development companies were not prepared for this and are currently experiencing various problems related to financing of completion of projects and development of new projects. A large proportion of planned projects (in particular, the construction of apartment buildings) will be stopped, or will not even begin. As a result, according to data available to Ober-Haus, instead of 6,000 apartments planned in Vilnius in 2009, at best 3,500–4,000 apartments will be built. In Kaunas, 1,000 apartments are planned to be built, and in Klaipėda - around 900 apartments - nearly half the figure for 2008. It is difficult to predict the number of newly built apartments offered for 2010, but the number may decline further. Rapidly growing real estate prices and favourable project financing conditions, which were available a few years ago, attracted both smaller construction and investment companies, and companies that had little to do with the real property sector; yet in the near future the group of real property development players may considerably decline: new participants are not expected and smaller companies that performed risky investment policies may have to terminate their activities (at least in the real estate segment).

### The number of apartments built and scheduled to be build



It may be said that the market is currently undergoing essential changes that will have a negative impact on some market players, as well as positive aspects:

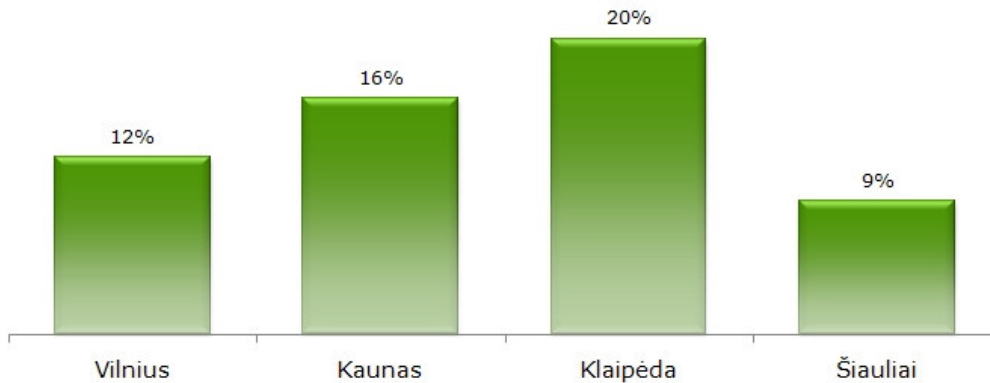
- The residential property market is no longer the "sellers' market", but it has become the "buyers' market". Even though sellers are not happy about the situation, conditions in the market are currently dictated by buyers. Solvent buyers are now particularly valued in the market and it is now a better time than ever to negotiate the best residential property prices with sellers.
- Almost no property speculators remain on the market. Even though their impact on the surge of prices in previous years was overestimated (the resale of apartments was far from the main factor that caused an increase in prices in 2003–2007), their activities did reduce opportunities for "real" buyers to select their preferred residential property. During the price boom, potential residential property buyers had to "compete" not only with other buyers, but also with canny resellers, in order to reserve or acquire appealing residential properties. Therefore, the majority of apartments (particularly the more appealing ones) were purchased before construction of the building had even started - relying on drawings and models. More lucrative selection opportunities have opened up for potential buyers - they can now choose residential properties in ready constructed buildings.
- The reduction in demand means that builders and sellers in the secondary market have come to realise that there will be no more opportunities to sell any kind of property for any set price. The buyer's needs are now of utmost importance. Thus, it is likely that real estate development companies will pay more attention to the needs of their customers and will sell real properties which appeal to the market. Yet, it is necessary to acknowledge that the main demand of the majority of potential buyers is the small final price paid for the property. It seems that in the near future smaller sized residential properties built at lower



costs will be on offer in the market in order to satisfy the needs of buyers' looking for the most appealing price. Of course, very high quality residential properties which are now of fairly limited choice will be offered to the more well-off part of the population. Therefore it is likely that new projects will take two different directions: reduction of costs and construction of small budget residential properties (the majority of new projects), and improvement of quality of construction and architectural solutions of buildings offered to buyers who are able to purchase more expensive properties.

- Worsening real estate project financing conditions and a reduction in demand should cause an increase in competition among real estate development companies, and survival of the most professional companies with the largest financial capacities. This should enable cleansing of the market of "fly by night" companies seeking quick profit during the market boom at the expense of quality. On the one hand, this is a positive factor, because when less reliable companies abandon the market, customer trust in real estate development companies and new construction should grow. On the other hand, after termination of activities or bankruptcy of some development and construction companies, guaranteed maintenance of apartments and houses purchased from such companies will remain unclear.
- Increasing offers of reductions for newly built properties in the primary market should be a signal to buyers that even though this summer, in comparison to previous years, the choice is still varied, it will obviously decline in the long run (particularly in the primary market) because the scale of construction is getting smaller and more and more sellers in the secondary market, who do not receive the required sales amounts, opt for lease of apartments.
- The apartment lease segment, compared to the sales market, is very active. While sales prices over the first six months of this year in major cities of Lithuania have gone down by 5-15 percent, so the apartment lease process over the same period has gone up by 10-20 percent. The active apartment lease market and the price rise in the market show that the demand for apartments is still in place in Lithuania - some potential residential property buyers simply postpone their plans to purchase a home and live in a leased apartment instead. At a suitable moment, such lessees will join the group of buyers of residential property.

**Average rents changes 2007 Q2 - 2008 Q2  
(2-3 room apartments)**



- It is also very important to note that over 90 percent of residential property fund in Lithuania includes apartments in old apartment buildings constructed more than 10 years ago, the majority of which require major renovation. The coming cold season will further reveal problems of inefficiency of residential properties in these older buildings. Increasing heating prices and expected expenses for renovation of buildings should increase buyers' interest in newly built properties. Decreasing offers for properties in newly built buildings and the poor quality of properties in old buildings may determine a much wider price gap between new and old properties in the near future and, perhaps, even cause a deficit in newly built residential properties, which, as a result, will reduce choice opportunities for buyers. The current situation is favourable for people willing to sell their old apartments (while the difference in price between newly built and old properties is small) and purchase newly built apartments. This is particularly true, as sellers of newly built residential properties have more room for negotiation regarding price reductions.

To sum up, current and expected changes both in Lithuanian economics and the real estate market, offer a good basis for potential buyers to assess their real possibilities and needs; sellers should realistically consider their expectations; and real estate developers should listen to the buyers' needs and plan their projects and company activities more accurately. The real estate market, like any other segment of the economy, functions in a cycle: a rise in the market is followed by a fall and *vice versa*. Yet it is important to consider the law that has been proved throughout the history of economics, which states that in the long term real property will only become more expensive.

*If you wish to receive any additional information about development of the real estate market in Lithuania, Latvia, Estonia, Poland, and Ukraine; or you would like to order a special report on the part of the market relevant to you or the market of the project in progress, please contact UAB Ober-Haus real estate market analysts.*

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