FHB House Price Index analysis of 2011 and House Price Prognosis for 2012

FHB House Price Index 2011.

A further moderate decline in house prices was recorded in 2011

According to the figures in FHB House Price Index of 2011, **a slight drop of 1.9%** (in real terms 5.5%) **was recorded** in house prices **compared to the previous year** (Chart 1).

In producing the latest index, we relied on FHB's market information and observations as well as all data processed by the National Tax and Customs Administration until December 2011. Based on the new figures, no revision of the previous values of the Index was necessary.

FHB House Price Index values in 2011:

2011 quarter 1	2011 quarter 2	2011 quarter 3	**2011 quarter 4**
174,7	172,4	170,6	**170,8**

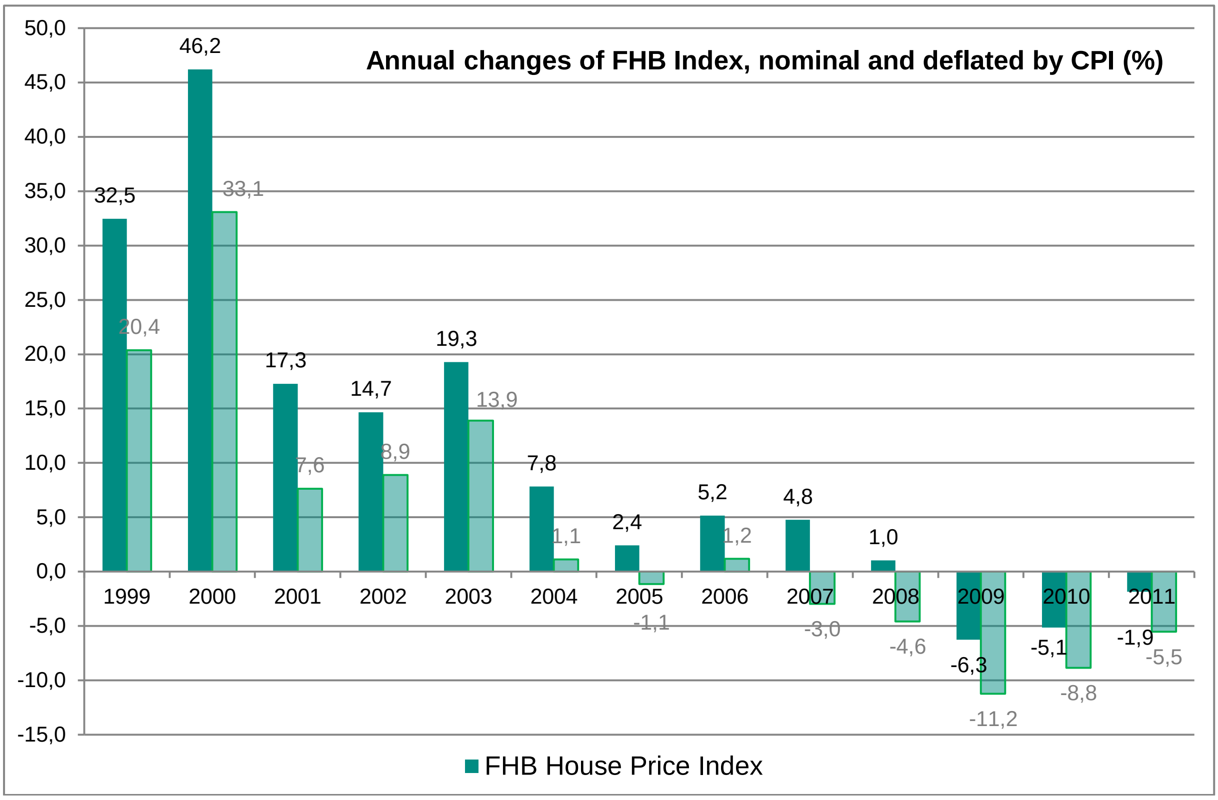

Chart 1. Annual changes of FHB House Price Index (Source: FHB)

The **decrease in the price level of houses** has **slowed down** over the last two years: compared to the second half of 2009, over a 2-year period a drop of only 3.3% could be recorded; however, **in the second half of 2011 house prices declined** with a **further** 1.6% **compared to the first half of the same year.** (For the total time series of FHB Index see Chart 2)

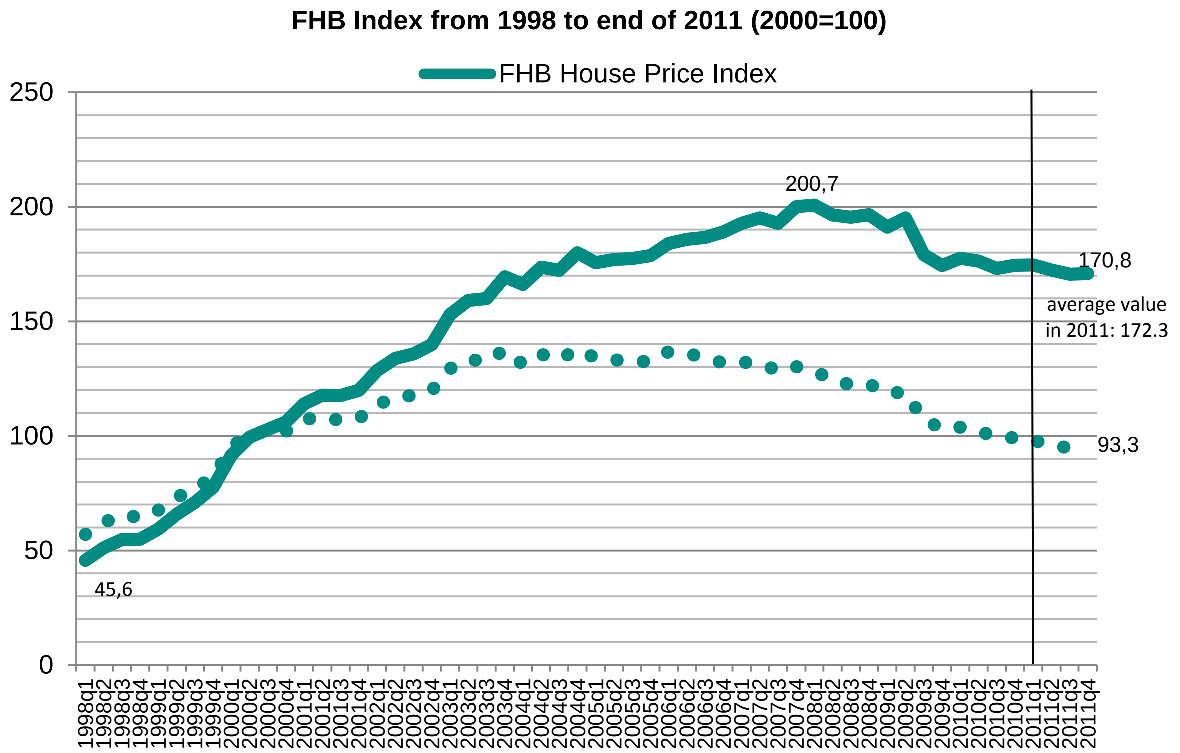

Chart 2. The FHB House Price Index (Source: FHB)

Analysis of FHB House Price Prognosis for 2011

Unexpected circumstances, especially final repayments at non-market rate* caused prices to drop in the second half of the year

The FHB House Price Prognosis published at the beginning of last year forecast a nominal increase of 2 % expecting house prices to rise in the second half of the year. In our prognosis for last year we counted with the fact that **the decline of the supply side and the imposed restrictions (regulation of foreclosures) would support the price decreasing effect generated by the demand side's weakness, therefore, limiting the drop in prices**. During the year, however, prospects for recovery deteriorated continuously (*Charts 3a and 3b*) strongly affecting the demand and expectations, therefore, **during the year** we **modified out forecast to stagnant.**

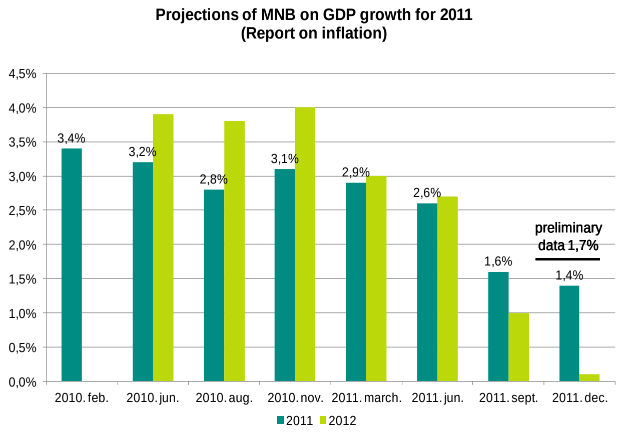

Chart 3a. Projections of the National Bank of Hungary (MNB) for economic growth in 2011 (Source: MNB Report on inflation)

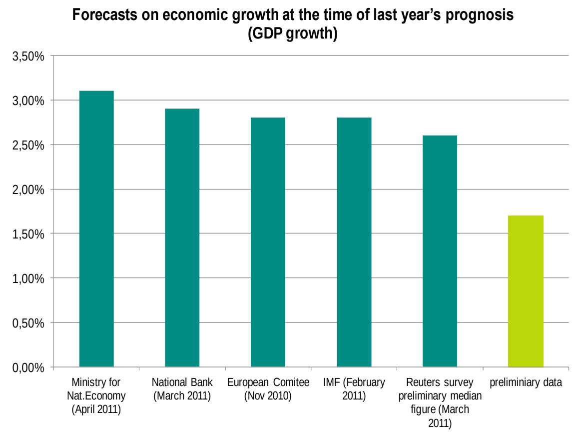

Chart 3b. Value of major macroeconomic forecasts at the time of our prognosis for last year (Source: organizations indicated in the chart)

However, as a result of the less favourable (than expected) economic growth as well as the effects of final repayments at non-market rate on the housing market, a decrease in prices materialized instead of

an increase anticipated for the second half of the year. During the final repayments at non-market rate, the public partially spent their accumulated savings (including savings set aside to purchase housing units) on the repayment of loans and according to the concurrent experience of market players, sellers were prepared to accept lower prices for their real estate due to the stipulated deadline.

Final repayment at non-market rate: repayment of FX mortgage loans at a preferred, non-market rate. Highly debated regulatory measure of the Hungarian state that enabled mortgage borrowers to repay their FX loans at non-market rate.

To sum up, due to the even more unfavourable macroeconomic and financial environment as well as the effects of final repayments at non-market rate, the level of house prices last year **fell behind our previous expectations**.

Housing market trends in 2011

Housing market turnover still at a 10-year low

According to our forecast, **turnover on the housing market stagnated at a low level** (*Chart 4*). The number of transactions shows a 10-year low, the market has been waiting for a turn in hibernation for three years. Without the increase in turnover due to the final repayments at non-market price, we would be very likely to record the minimum value of the last three years. Based on the information acquired so far, **the 92 thousand transactions expected for 2011** is barely a third of the peak value recorded in 2003.

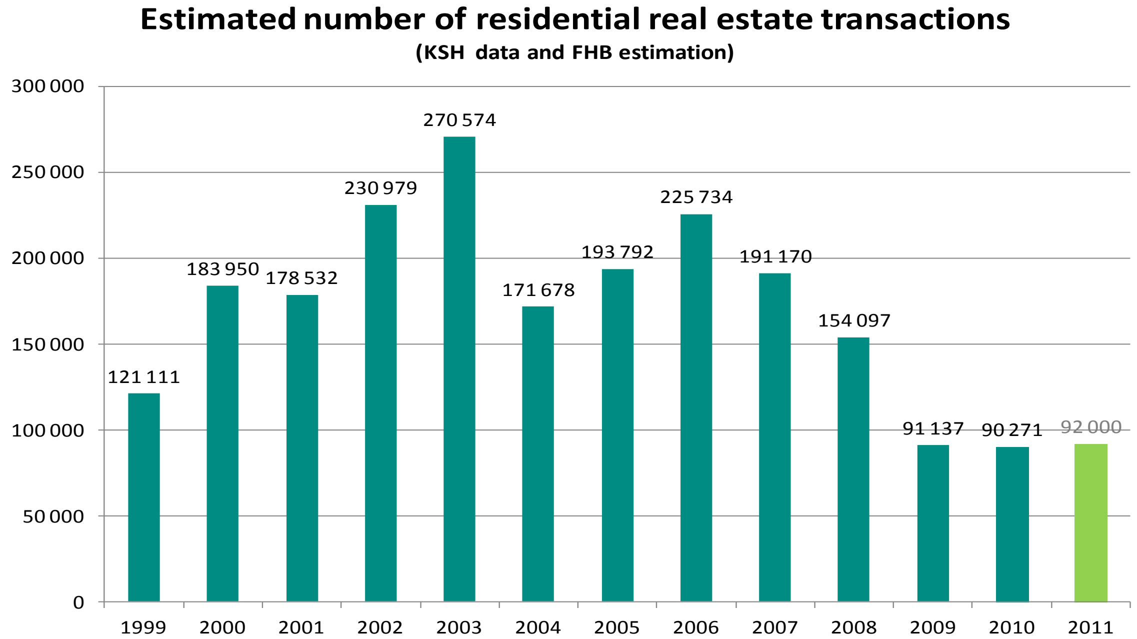

Chart 4. Estimated number of residential real estate transactions (Source: KSH and FHB estimates)

Households' income and the high price of loans are still strong constraints on the demand side of the housing market

The **rate of employment** and **income of households** on the demand side of the housing market **still presents a strong constraint regarding the increase of housing market transactions.** Based on our experiences we can say that a simultaneous increase in the rate of employment in several segments and geographical locations might draw a more optimistic picture for investment prospects of households (purchasing or building housing units). Thanks to the community service schemes, the rate of employment showed a small, fragile increase in the first half of 2011 (*Chart 5*). It is also promising that the competitive sector moderately contributed to the growth in the rate of employment but the future dynamics of the growth is highly questionable due to the deterioration of the expectations regarding the economic upturn. Real income of households has slightly risen this year due to the changes in taxation and wages (*Chart 6*) but this moderate increase will not loosen up the constraints.

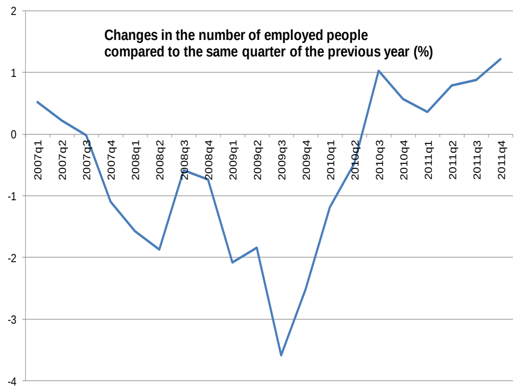

Chart 5. Changes in the number of employed people
(Source: KSH)

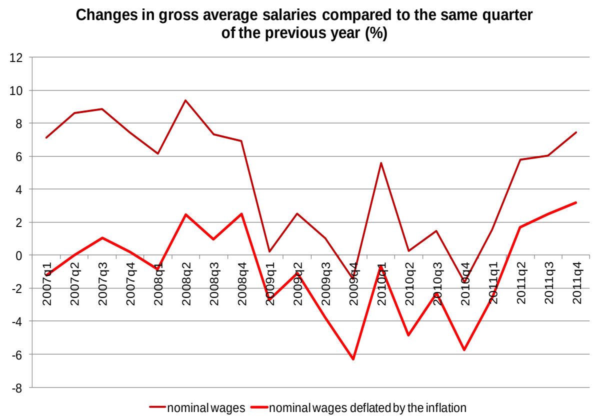

Chart 6. Changes in gross average salaries
(Source: KSH)

A significant decline in the demand of households is caused by the shrinking of savings spent on final repayments at non-market rate but originally set aside for housing investments in the long run and **the rising interest rates of housing loans at the end of 2011 and the beginning of 2012** (*Chart 7*), the reason for which being the **higher HUF yield** as well as – in accordance with the findings of MNB's survey on lending – the **decrease in the banks' willingness to take risks**.

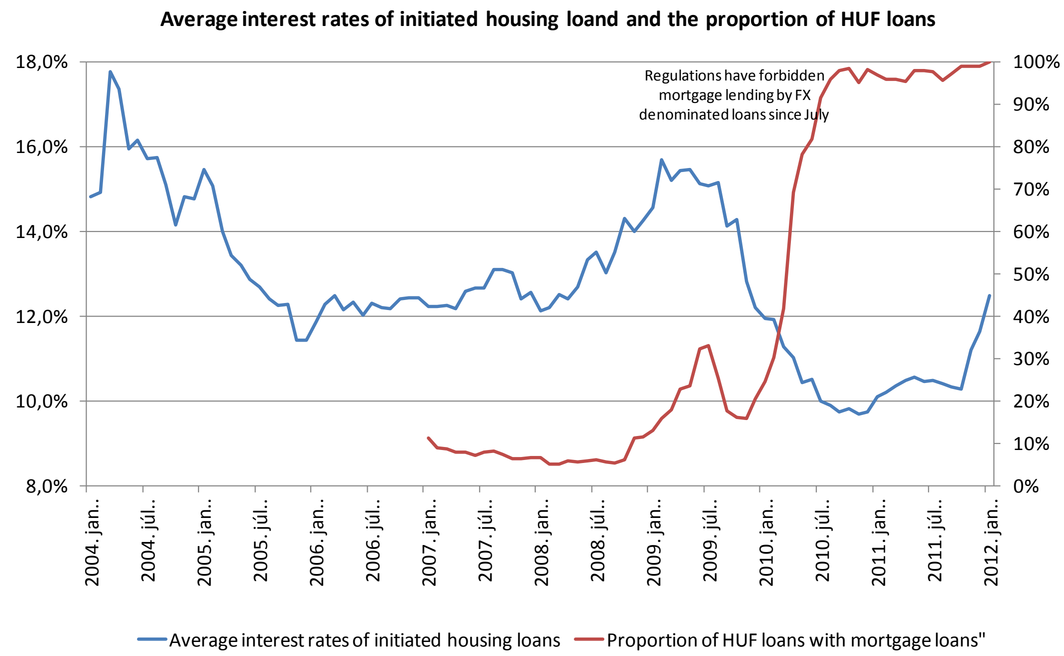

Chart 7. Characteristics of initiated housing loans (Source: MNB)

The final repayments at non-market rate also hit the shrinking credit market in the first part of the year

As a result of the introduction of **final repayments at non-market rate, unprecedented events** happened **in the market of retail mortgage loans**. Although there are no final data regarding the exact number of clients involved in the final repayments or on the assets functioning as a resource for the final repayments as the financial transactions are ongoing till the end of February, it is worth evaluating the situation based on the figures at the end of January. According to the information provided by PSzÁF till the end of January 2012 (*Table 1*), the household sector repaid loans in a value of 1074 billion HUF by depositing 776 billion HUF. Just to illustrate the order of magnitude this amount equals with 10 % of the retail turnover last year. Of all the repayments a sum of only 207 billion HUF was financed from newly initiated loans.

	pcs	at market rate of exchange (million HUF)	at non-market rate of exchange (million HUF)
October 2011	29 427	174 766	130 565
November 2011	25 136	164 181	117 792
December 2011	39 774	303 167	219 690
January 2012	47 639	431 595	307 952
total	141 976	1 073 709	775 999

Table 1. Figures on final repayments till the end of January (Source: PSzÁF)

Primarily due to final repayments at non-market rate, **the stock of FX mortgage loans shrank by 1017 billion HUF, to 4286 billion HUF** by the end of January 2012. At the same time the stock of HUF mortgage loans rose by 259 billion HUF to 2044 billion HUF (*Chart 8*).

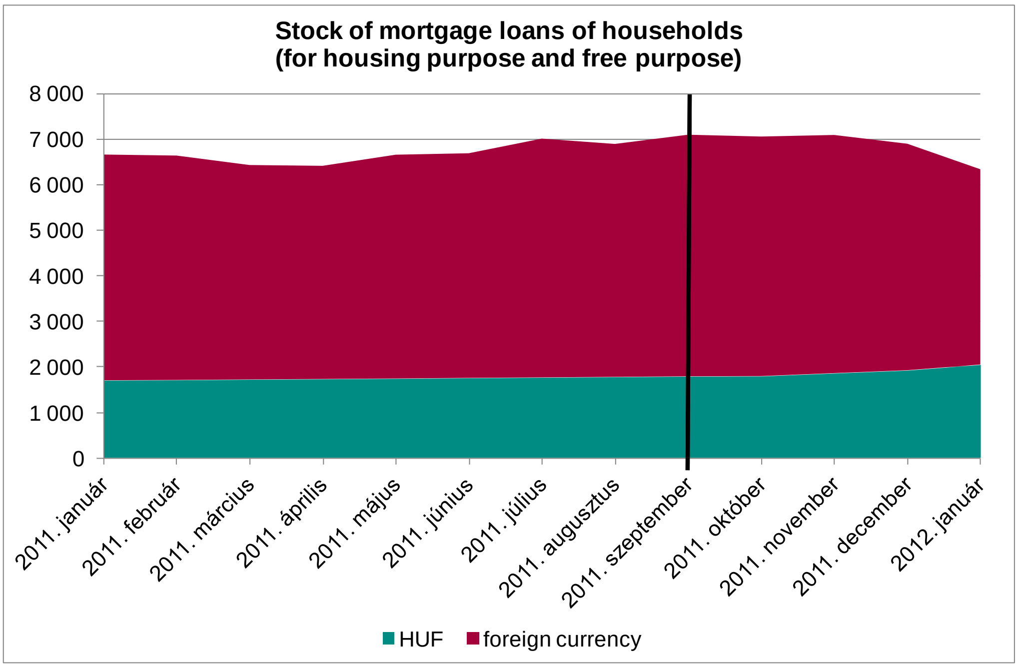

Chart 8. Stock of mortgage loans of households (Source: MNB)

The estimated effect of the final repayments at non-market price on the **stock of mortgage loans** (till the end of January): There is a 70 billion HUF stock of newly raised loans against the 750 billion HUF of repaid loans meaning a drop of 680 billion HUF, which represents **one seventh of the total stock**. The consequences of this fact can be seen in *Chart 9*.

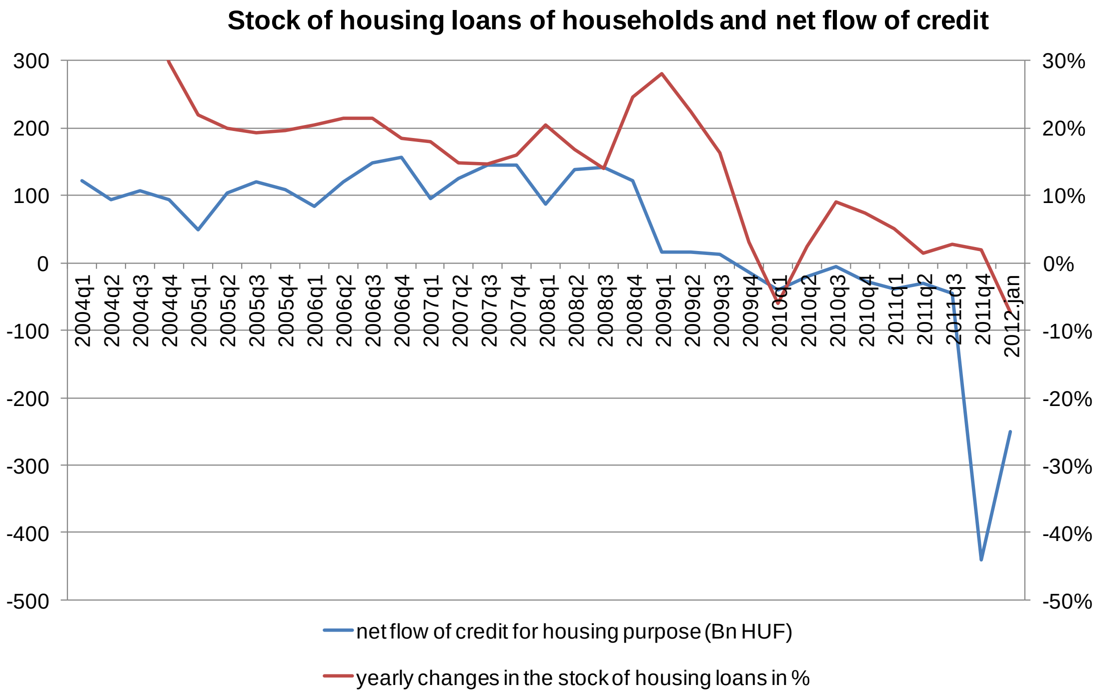

Chart 9. Stock of residential mortgage loans and net flow of credit (Source: MNB and FHB estimates)

As a result of the final repayments at non-market price, a loss of over 300 billion HUF is expected to be recorded in the banking sector. Considering the fact that - due to the deterioration of both the public and corporate credit portfolio, the declining profitability and the changes in the legal environment the banking capital positions have been under considerable pressure over the last three years – the one-time loss (both in financial and trusting sense) caused by the final repayments at non-market price will definitely reduce the willingness of some institutions in the banking sector to provide loans and increase risk sensitivity, which is a further **strong negative factor for the housing market**. **The introduction of a fair, incentive based package of state housing policy measures, which will positively influence the demand of households for housing loans is crucial.**

The supply side of the construction of housing units underwent structural changes as well during the recession

Regarding the number of newly built housing units the new figures did not cause a surprise either: the construction of housing units in 2011 is only a fraction of the peak value recorded in 2004 (*Chart 10*). Last year 12,655 new housing units were completed and received occupation permits in Hungary, whereas in Budapest this number was only 3 192 during the same period.

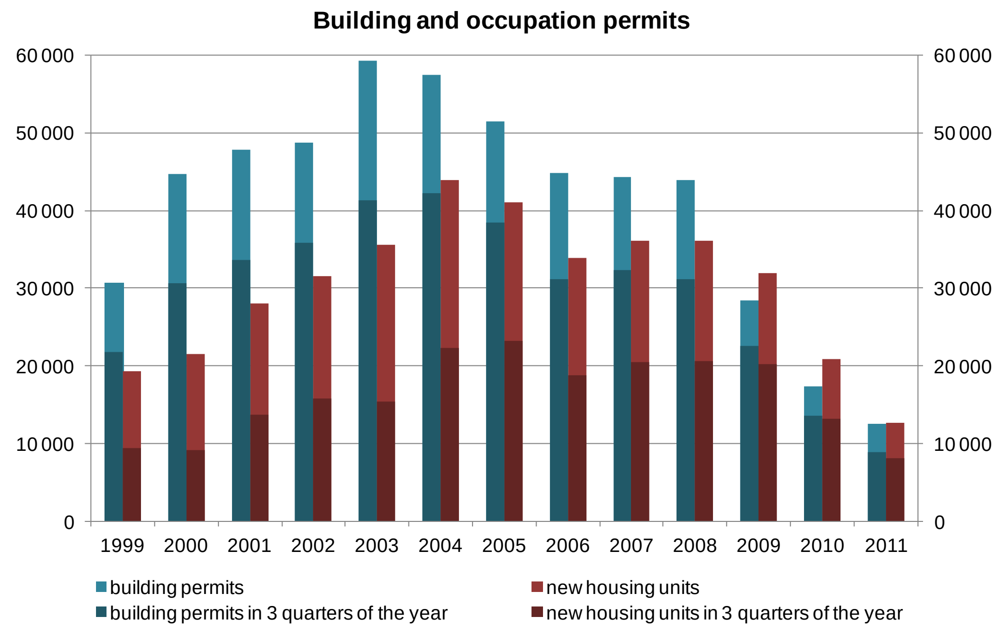

Chart 10. Building and occupation permits in Hungary (Source: KSH)

The number of housing units built hit a historic low point: according to the figures of **KSH, the number of residential buildings constructed was not as low even between the two world wars as in 2011** (*Chart 11*).

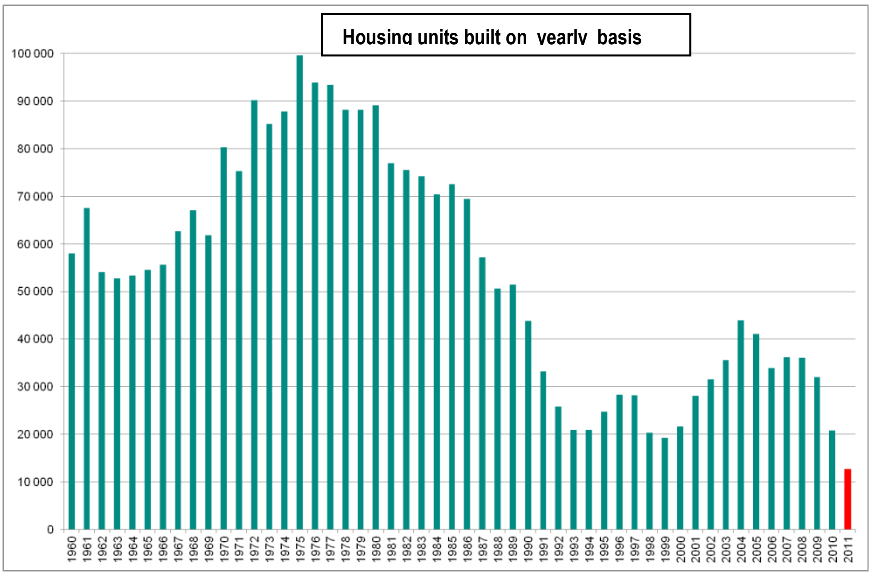

Chart 11. Long series of housing units constructed in Hungary (Source: KSH)

The decline is also visible in the structure of constructed housing units (*Chart 12.*). **Considering the whole of the country, the construction of houses has dropped less significantly, therefore, the average floor area of housing units built in the country has risen**. **The proportion of professional developers has sunk to a level recorded eight years ago**, which also resulted in the decline of project financing.

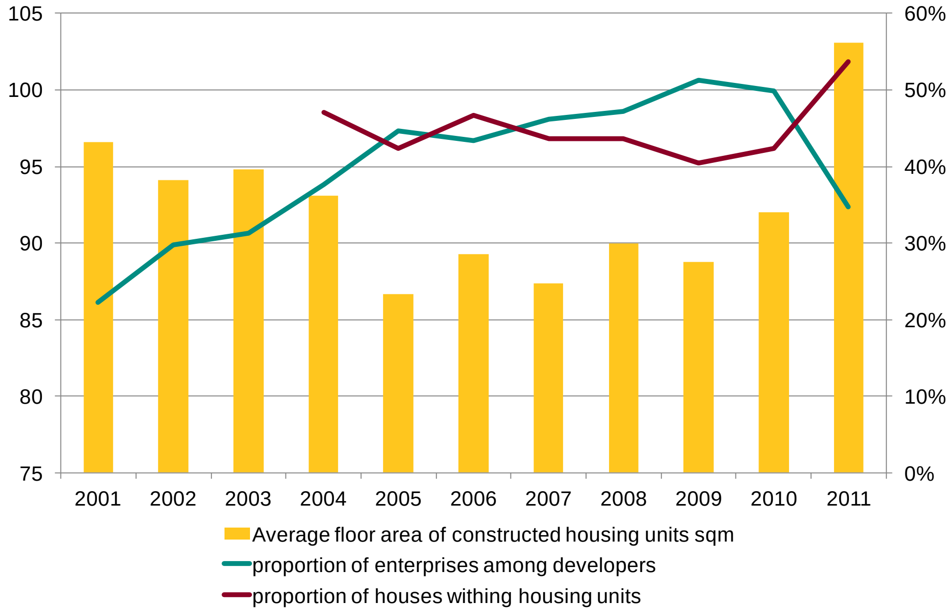

Chart 12. Characteristic of constructed housing units (Source: KSH)

A regional panoramic picture of the Setback period

The Setback period hit the counties seriously but in a different way

The evolution of FHB Index can be divided into four periods as seen in Chart *13.* The tendency of house prices can be clearly distinguished in each period. The growth at the beginning of the millennium turned into a decline during the periods of Credit boom and Setback, **by the end of 2011 prices dropped by 15% in nominal and 28% in real terms compared to the pre-crisis period**.

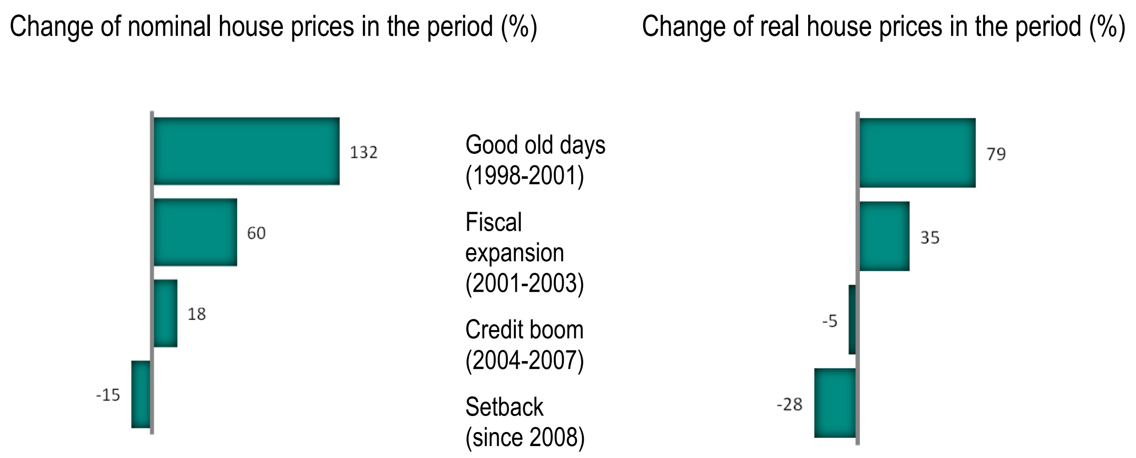

Chart 13.The four periods of FHB Index

The period of Setback itself (since 2008) is a period long enough to be analysed separately. Scrutinizing the changes in prices between 2008 and 2011 in the different counties (*Chart 14: brighter red colour indicates a greater drop in prices)*, it can be seen that the eastern and western parts of the country responded to the crisis in a different way: while **house prices stayed relatively high in the west, in the majority of the eastern counties a decline significantly greater than the average was recorded.** The most significant decline can be seen in Komárom-Esztergom, Fejér and Borsod-Abaúj-Zemplén Counties. It is important to note, however, that the starting position of the aforementioned counties differed: whereas prices in Fejér County slumped from a previously higher level, in Borsod-Abaúj-Zemplén the economic crisis decreased the originally low price level seriously.

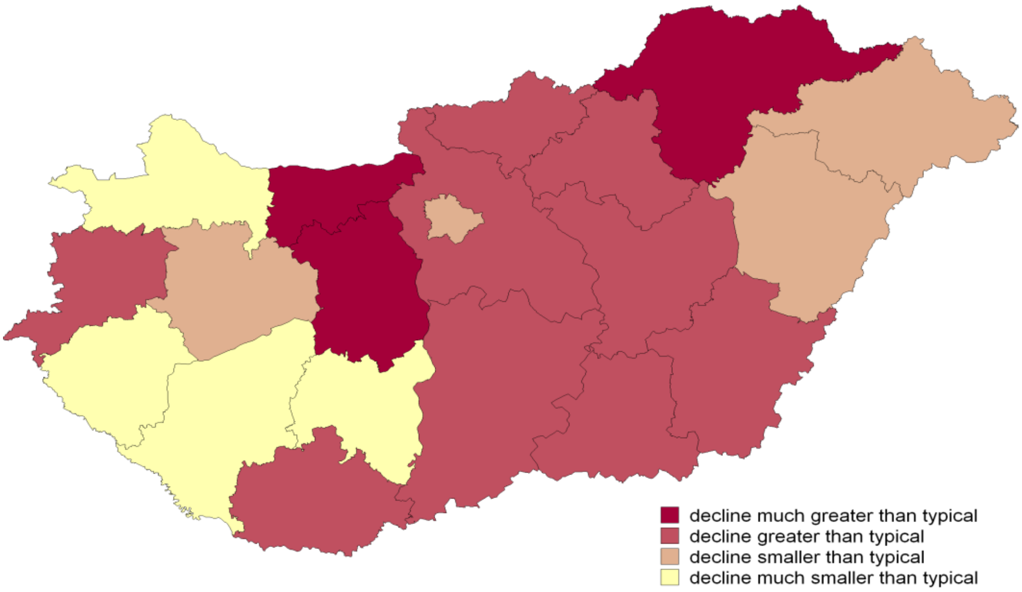

Chart 14. Prices in the Setback phase in the different counties (Source: FHB estimates)

Some typical characteristic features can be observed regarding the intensity of housing unit construction activity in the different counties (*Charts 15a-b*). Similarly to the change in prices, the crisis hit the eastern counties harder because the construction activity declined more dramatically between 2008-2011 (*Chart 15a)*. According to the current building activity– which is measured by the proportion of the newly built housing units in 2011 in the given county to the complete newly built stock - Győr-Moson-Sopron and Veszprém Counties near the western border still perform above the country average even at the end of the Setback period (Chart *15b:* greener counties have more intensive building activity). This way it can be proved that despite the decline, Pest County and Budapest performs above the country average. It is quite visible that construction activity is closely related to the dynamics and amount of GDP of the given county.

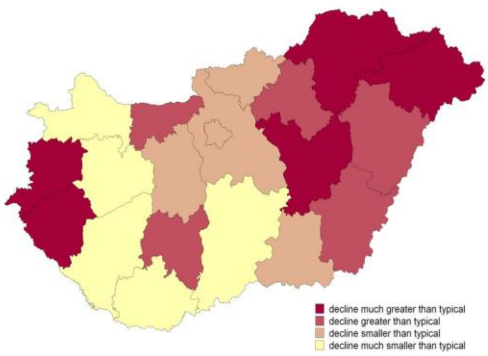

Chart 15a. Construction of housing units in the different counties during the Setback period, 2008-2011. (Source: KSH)

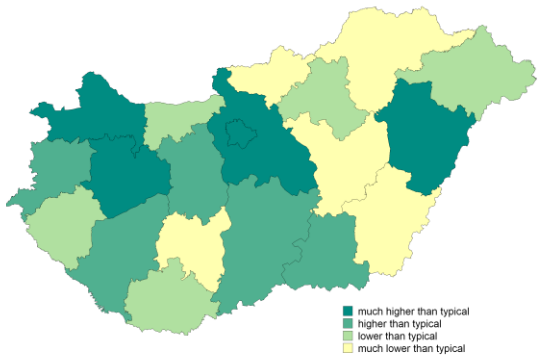

Chart 15b. Construction of housing units in the different counties in proportion to stock in 2011 (Source: KSH)

Besides construction activity, figures of turnover (*Charts 16a-b*) also confirm that – despite a decline greater than the country average - activity in Budapest is still above average. Again, we must point out Győr-Moson-Sopron among the western counties where turnover was above the average before 2008 and it has not declined during the period starting from 2008. As opposed to this, in Borsod-Abaúj-Zemplén and Heves counties in the north-east the crisis hit the housing market (which had a slower turnover in the first place) harder than the country average. At the same time, it is surprising that Fejér and Komárom Counties, which performed well concerning new constructions, show a decline greater than the country average. The reasons are manifold: on the one hand, activity in the pre-crisis period was much more intense, therefore the decline is more dramatic; on the other hand the demand is less flexible so the turnover is smaller.

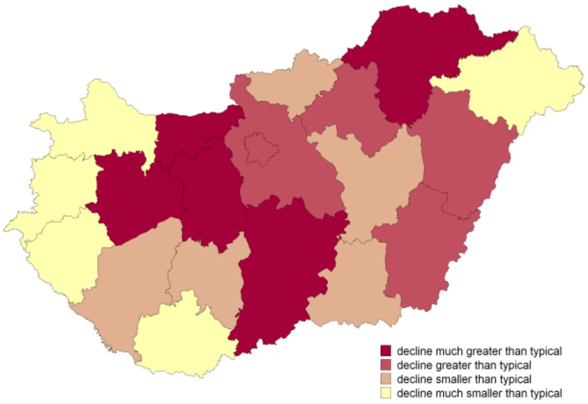

Chart 16a. Turnover in the different counties during the Setback period 2008-2011. (Source: FHB estimates)

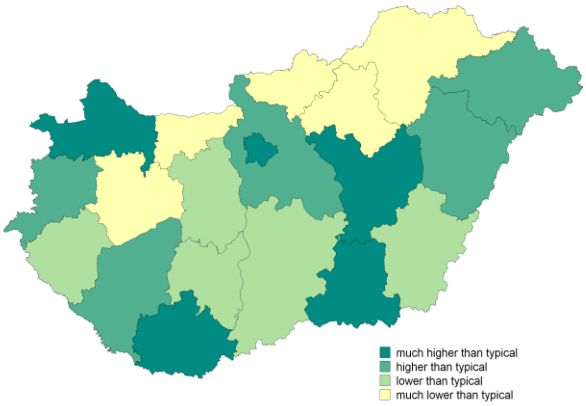

Chart 16b. Turnover in the different counties in proportion to stock in 2011-ben (Source: FHB estimates)

House Prise Prognosis 2012.

Since the first publication of the FHB House Price Index in 2009, **we are providing a forecast** on the possible trends and happenings of the current year on the housing market **for the third time**. Using all the available information the House Price Prognosis aims to inform the market players and all the other parties involved. As it was clearly visible in 2011, the housing market is strongly influenced by unexpected macroeconomic events or regulatory measures, therefore, our forecast will be updated at the end of the summer.

No major turn is expected on the market of new housing units

According to our experience – as well as the figures of the graph – **the issued building permits define the number of housing units receiving an occupation permit within three quarters of a year very accurately** (*Chart 17*). **The quarterly performance of construction does not seem to sink any lower but it will not rise significantly from its low point either during 2012.** Due to the relatively higher level at the beginning of 2011, the annual number of completed housing units in 2012 will not exceed the value recorded in 2011 considerably.

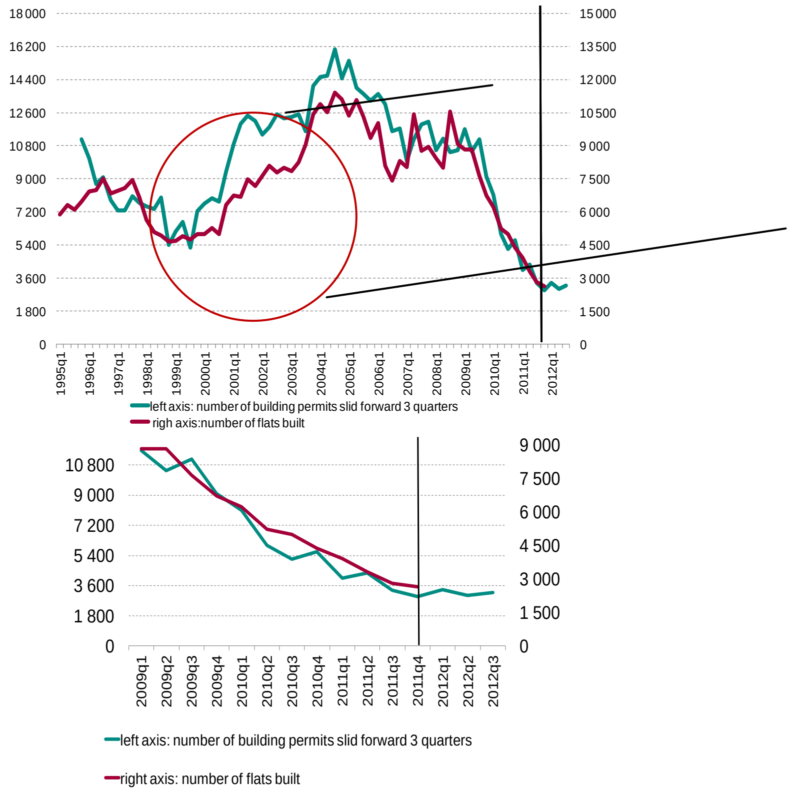

Chart 17. Forecast on the number housing units constructed (Source: KSH, seasonally revised figures)

Prospects of recovery and lending show no signs of improvement

Prospects of recovery are weakened by the unstable international environment, the budget measures and the further deterioration of lending conditions. According to the major macroeconomic forecasts (*Chart 18*) 2012 is expected to be a weaker year than 2011. Forecasts of growth anticipate values around stagnation, which projects a **constantly low housing market demand**.

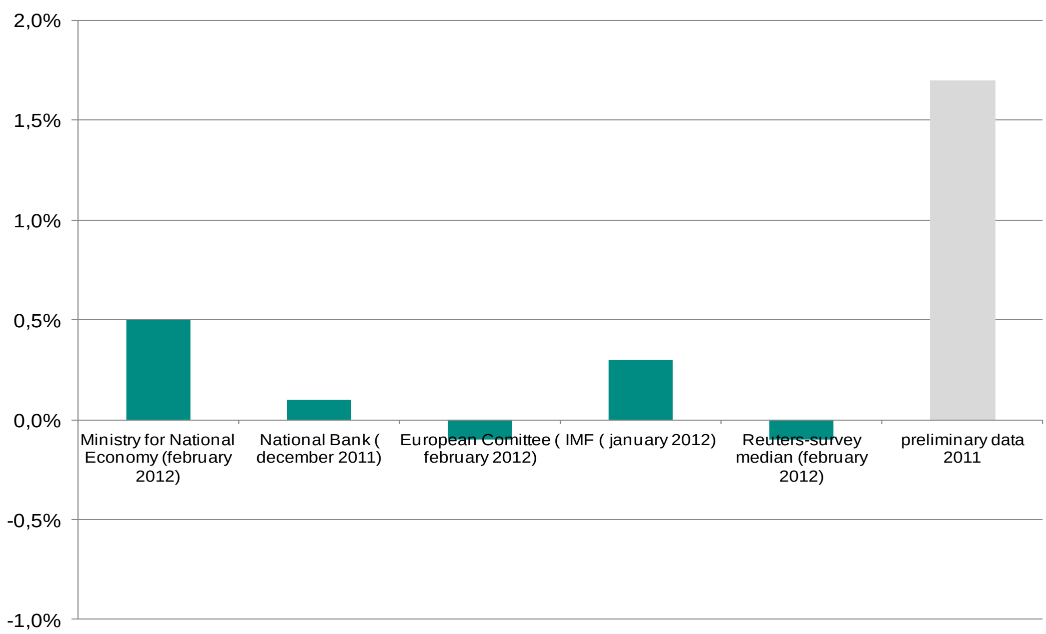

Chart 18. Expectations of major macroeconomic forecasters (Source: organizations indicated in the chart and KSH)

The positive effects of the government's „home-making" scheme can not be felt yet

From 2012 – within the frames of their home-making scheme – the government started a subsidizing system to stimulate the housing market. The **introduction of the subsidy for building housing units (commonly referred to as „social policy") has successfully been carried out but according to the experiences acquired so far it can only boost households' demand for housing units together with an efficiently working subsidized loan scheme. According to analyses carried out by banks, the set of tools of the subsidized loan scheme to stimulate both building new housing units and purchasing second-hand residential buildings still need to be revised, in its present form it is not a fully workable solution[1].**

Due to the operative tasks of introduction (contracts with the state, product and system developments, etc) **and the fact that the regulatory measure will come into effect in spring, the new subsidized loan will not be able to make a measureable effect on the housing market in the first half of the year.** What is sure, however, is that the above mentioned two important tools will only be able to influence the demand for housing units in the second half of the year and only with modified conditions. Couples who are about to make a decision concerning a residential building, developers and banks are all looking forward to seeing the new schemes and in case the subsidies on housing units and interests start off appropriately, they will certainly have a measureable effect on the dynamics of the housing market from the second half of the year, first on the market of second-hand housing units, then from 2013 on the market of newly built residential buildings.

The operation of the National Asset Management Agency (NAMA) and the rising number of bank initiated foreclosures are price decreasing factors

The state does not influence the housing market only as a subsidizing body but also as a regulatory body. **According to PSzÁF figures, currently more than 150,000 mortgage loan debtors are more than 90 days late with the payment of their undertaken obligations.** From 1 March the prohibition of foreclosures and eviction ceased to exist so this year the **number of foreclosures may slightly increase to the extent stipulated in the quotas**. By operating the **National Asset Management Agency (NAMA),** the state can help to improve the situation of needy debtors with children by purchasing the given housing unit serving as collateral and this way saving the insolvent debtor who has been unable to pay for more than 180 days from the consequences of foreclosure provided that the value of the given real estate does not exceed 20 million HUF. The buyer can be the NAMA, the debtor is allowed to stay in the housing unit as a tenant. Another important change is that real estates purchased by NAMA are removed from the eviction quota of credit institutions, thus providing them with more room for the enforcement of collaterals. On the other hand, NAMA received authorization to purchase 8000 pieces of housing units for 2012 based on the agreement between the government and the banks. **As in the case of NAMA purchases prices are kept low by the regulations, and the achievable price level during foreclosures is also depressed due to demand constraints, the thousands of real estates of problematic debtors will mean a push pointing downwards regarding the prices currently prevailing on the market.**

The measure according to which it is possible to convert the debt of some of the households with FX loans whose debt exceeded 90 days into HUF and release 25% of their debt might have a positive influence on the housing market. For households where the amount of claim has exceeded the current value of the real estate and this 25% release restores this negative financial status, the re-establishment of solvency seems to be much more possible. This might be overshadowed by the above presented higher interest rate level of HUF loans compared to the interest rates of FX loans, therefore, the rate of recovery still very much depends on the success of the banks' restructuring schemes as well.

[1]*Setting the interest rate cap of subsidized loans is highly debated. An interest rate cap of maximum 3% above the T-bond reference rate – due to the increased funding costs of banks – will result in a margin nearing or below zero, therefore, it is questionable how many banks will be willing to offer such loans. The modification of the interest rate cap has already been initiated by the Banking Association.*

No major turn is anticipated in providing market-based loans for households

No improvement can be expected regarding borrowing either. (*Chart 19*). The stability report of the National Bank of Hungary places the turn in lending to only 2013. **The credit stock of households** – partly due to the possibility of final repayment at non-market rate at the beginning of the year – **will continue decreasing this year**. The increased interest rates of HUF loans, the stricter measures regarding risk-taking and the changes in the policy of some institutions in the banking sector due to the final repayments at non-market rate will also affect the granting of housing loans in a negative way as well as the project financing of developers.

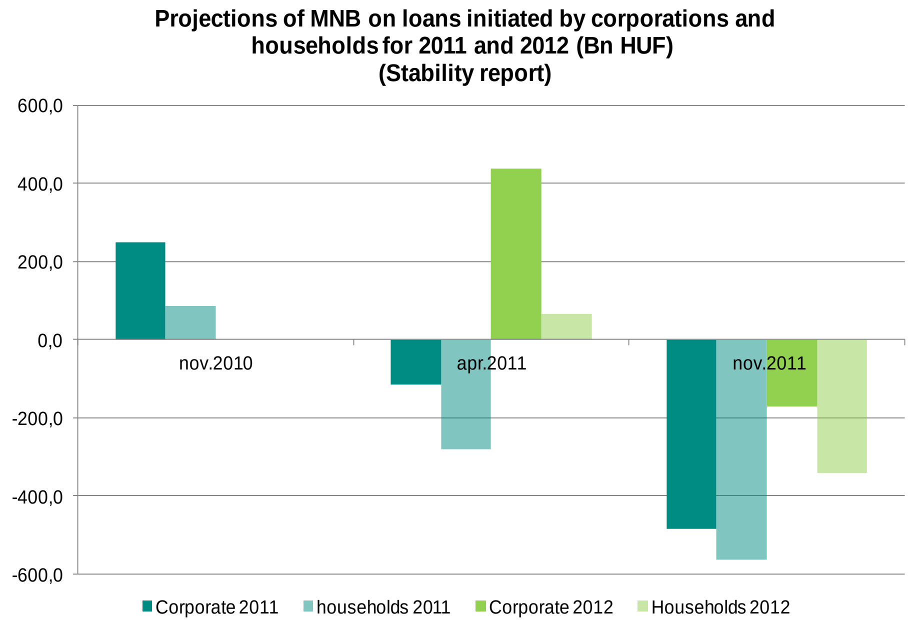

Chart 19. Projections of MNB on initiated loans (Source: MNB Stability report)

The structure of lending housing loans will transform

The years of recession did not only result in a decline in credit disbursement but they are changing its structure as well (*Chart 20*). During 2012-2013 more and more people are successfully repaying their subsidized HUF loans raised at the turn of the millennium. They are experienced debtors having gone through a credit period, therefore, - depending on their conditions of living – they have a good chance of returning to banks as customers. Their re-application for a loan may be assisted by the **introduction of the Positive Credit Bureau.**

The **government's steps to support the housing market are aiming to target the construction,** therefore, the segment of loans granted for the purchase or building of new housing units may catch up. Modernization will certainly have a more significant role as the demand for more economical housing units is on the increase. From the beginning of the year it is mandatory to obtain a so called **energy efficiency certificate** for all domestic housing units**,** which will also open a window of opportunity for the construction industry to reach take-off point.

FHB Energy efficiency certificate

The certificate, which can be ordered online on the website of FHB Ingatlan Zrt. from January, is issued within five working days. At the time of requesting such certificate, in the form of a package you can also order the appraisal service of FHB, give an assignment to FHB real estate brokers and/or initiate a housing loan (for purchase or refurbishment/modernization) from the bank.www.fhbingatlan.hu

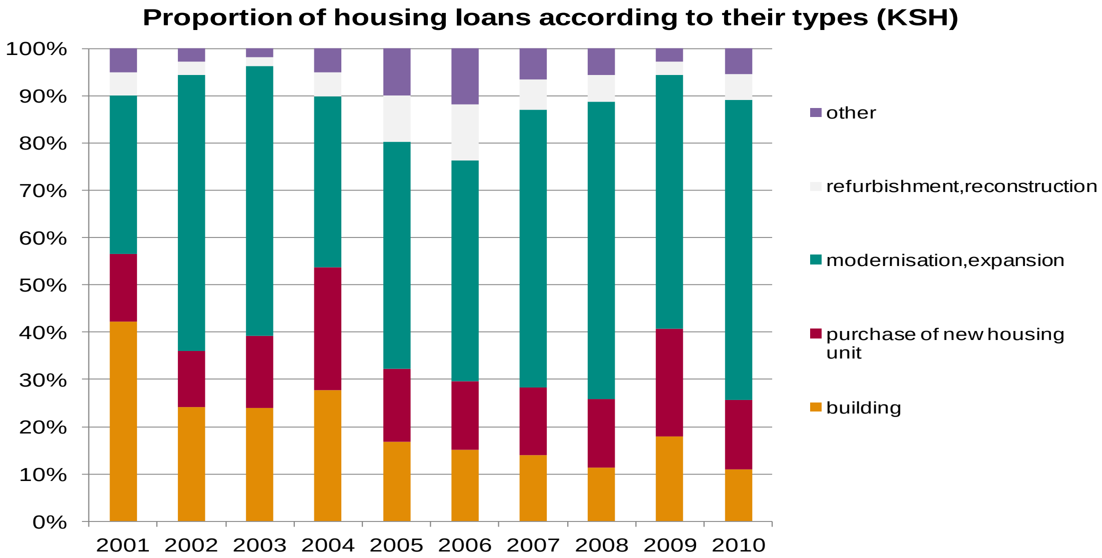

Chart 20. Proportion of housing loans according to their types (Source: KSH)

House prices are expected to remain stagnant in 2012

Overall, **compared to 2011, no major changes can be anticipated regarding house prices although factors influencing the housing market will differ significantly in 2012.**

The subsidizing elements introduced in 2012 will only be able to influence the market positively from the demand side together, and provided that proper amendments are made but only in the second half of the year. The re-start of bank initiated foreclosures of housing units functioning as collaterals as well as certain measures appearing in the agreement between the government and the banks concerning bad debtors (NAMA) will have a downward pointing influence on prices. The effects of measures aiming to improve the banking portfolio on the banks' credit range are rather difficult to forecast at the moment, they can be influenced by other factors (e.g.: capital position). Supply constraints on the market of newly built housing units will be felt even more strongly than last year.

Considering all the above factors and effects – with a slightly more vivid turnover than last year – **for the whole period of 2012 we are expecting house prices to remain stagnant with prospects of a rather fragile growth in the second half of the year.**

Our services connected to FHB Index

Allow us to introduce you the services FHB Index offers.
FHB House Price Index is published quarterly. Before its introduction, no other product of this kind was available in the Hungarian market – being distinctive in terms of the measured time intervals and the quality of the underlying data, as well as its methodological foundations conforming to international expectations. Since the introduction of FHB Index in 2009, MNB (Hungarian National Bank) and RICS (The Royal Institute of Chartered Surveyors) have been referring to it as a featured housing market indicator.

Updates for FHB House Price Prognosis are published regularly.
The methodology behind the model lies on three pillars:
I. On the basis of international and local experience, we have identified relations between selected Hungarian macroeconomic indicators, money-market and credit market indices, transactional data of the housing market and housing prices. (We base our view of the development of the macroeconomic and financial environment primarily on the projections of the Hungarian National Bank.)
II. FHB Banking Group has been one of the major actors of Hungarian housing market financiers for over a decade. Our operations cover the entire country, and we have access to information from the most significant real estate appraisers, which is complemented by FHB Real Estate Ltd's own professional experience. Our forecasts, therefore, include processed and verified local assessments as well.
III. With respect to the economic crisis, we shall not disregard empirical facts gained from analyses of similar depressions that have affected real estate prices so far. We have, therefore, included the international experience obtained from similar crises in our model.

FHB House Price Prognosis is now an important reference tool for people interested in the Hungarian housing market.
Our database covering the entire country and the methodological development of FHB Index make FHB able to provide help to the financial sector to fulfil the collateral re-valuation obligations under Basel II (Government Decree No 196/2007 on the Management of Credit Risk and the Calculation of Credit Risk Capital Requirement). We are proud that our service has already been ordered by a number of Hungarian banks, subsidies of big international financial institutions. The banks will need
to comply with the strict regulations in the future too, it is, therefore, useful to apply the procedure that conforms to international standards and can also be supported by documented methodology if required by authorities. For the implementation of the modern, internal valuation methodology, it is preferable to use a model that is based on transactional data and documented methodology whereby efficient and mass re-valuation becomes possible. By using this model, credit risk capital requirement

can be reduced substantially, excess capital can thus be freed. FHB Jelzálogbank Nyrt. has been using the real estate monitoring procedure – which also meets the requirements of the modern, internal valuation methodology – since 2008.

FHB also undertakes the preparation of unique resarch products meeting individual needs. In these, we offer local information on apartments and lots, more detailed explanation for the extent and dynamics of our prognosis as well as the analysis of the risks surrounding the realization of the trends forecast

We are pleased to give customized offers and to respond to any inquiries.

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