

- CREN - Croatian Real Estate Newsletter

filipović
business advisory ltd.

Volume 28, July/August 2008

CREN PATRONS



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Josip Tica, Ph.D.
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RESIDENTIAL MARKET IN CROATIA AND EU COUNTRIES

1. INTERVIEW

Josip Tica, Ph.D.
Faculty of Economics and
Business, Zagreb University



RESIDENTIAL MARKET IN CROATIA AND EU COUNTRIES

Please introduce yourself to our readers

I was born in Zagreb, grew up in the Dubrava neighbourhood, studied at the Faculty of Economics and Business in Zagreb, the Higher School for International Economic Relations in Austria, and the University of Pittsburgh, as a Fulbright Scholar. I currently work as an assistant professor in the Department of Macroeconomics and Economic Development at the Faculty of Economics and Business in Zagreb. I have been researching the housing market in Croatia intensively since I arrived at this Faculty in late nineties, I have published many scientific and professional articles, and in 2002, I published a book entitled "Transition of the Croatian Residential Property Market".

To what extent and in what way do you study the development of the property market in Croatia?

At first I studied the problems of the property market through the prism of what was called the "housing crisis", and the transition from the old system of "socially-owned flats" to a modern market-based system. Currently, I teach Urban Economics, which focuses on identifying economic interests influencing the formation of cities, housing and business zones,

public urban infrastructure, etc. Naturally, the main goal is to envisage the framework and means of achieving economic policy goals as efficiently as possible in the real world.

How would you describe the current state of the Croatian property market?

The main characteristic of the Croatian property market is the fact that most local players are still learning how to behave on the market, whereas the majority of global players have ready-made models as a result of their experience in other countries, on the basis of which they make important decisions. In such circumstances, the market is extremely dynamic, volatile and prone to ups and downs. The current state of play is characterised primarily by caution on the part of all stakeholders, due to the global situation. Developers are investing less, there are fewer buyers, and everyone is waiting for the global economy to recover and for positive signals from abroad.

What methods do you use in monitoring trends in housing construction in Croatia?

Most analysis is based on breakdowns of secondary market data from developers and intermediaries, the Croatian National Bank, the Real

Estate Centre, the Real Estate Exchange, and Central Bureau of Statistics. The data are far from perfect, and are mostly presented in very basic, simple statistic microeconomic models. Unfortunately, the quality and quantity of data collected in Croatia will not lead to the construction of dynamic models, which would enable sophisticated projections or assessments of long-term balances, for at least another three or four years. At the moment, we can only provide assessments of market development trends, and to a lesser extent discuss numbers and/or percentages.

How would you compare the housing markets in Croatia and other EU countries?

The Croatian housing market is more comparable to the markets of Eastern, or 'new' Europe. During the past decade, prices on the housing markets in Eastern and Central Europe have been catching up with prices in the West, and in this sense, Croatia fits the profile of a standard, transitional country. Similar trends will persist until international developments on the capital markets reach the point at which conditions on the housing markets of 'old' and 'new' Europe level out. Apart from this, Croatia is interesting due to the influence of the tourism sector on the housing market, and in this area we can expect developments which might deviate from the above scenario .

Do you expect any major changes on the property market after Croatia's accession to the EU?

One basic law of economics is that anticipated changes have no real effect on market functioning. In other words, the effects of EU accession through

expected future profits are already being incorporated into property prices in Croatia, and the actual accession should not have any major positive effects on the market. It is more probable that some people will be disappointed: for example, I am not sure that the EU has buyers for the many architectural horrors which are being built along our coastline, and even Zagreb is not short of "optimistic" developers. A four-storey concrete apartment building with countless arches and walls painted in garish colours certainly will not attract buyers from outside the region (I don't want to mention its name, but we are often included in it, against our will).

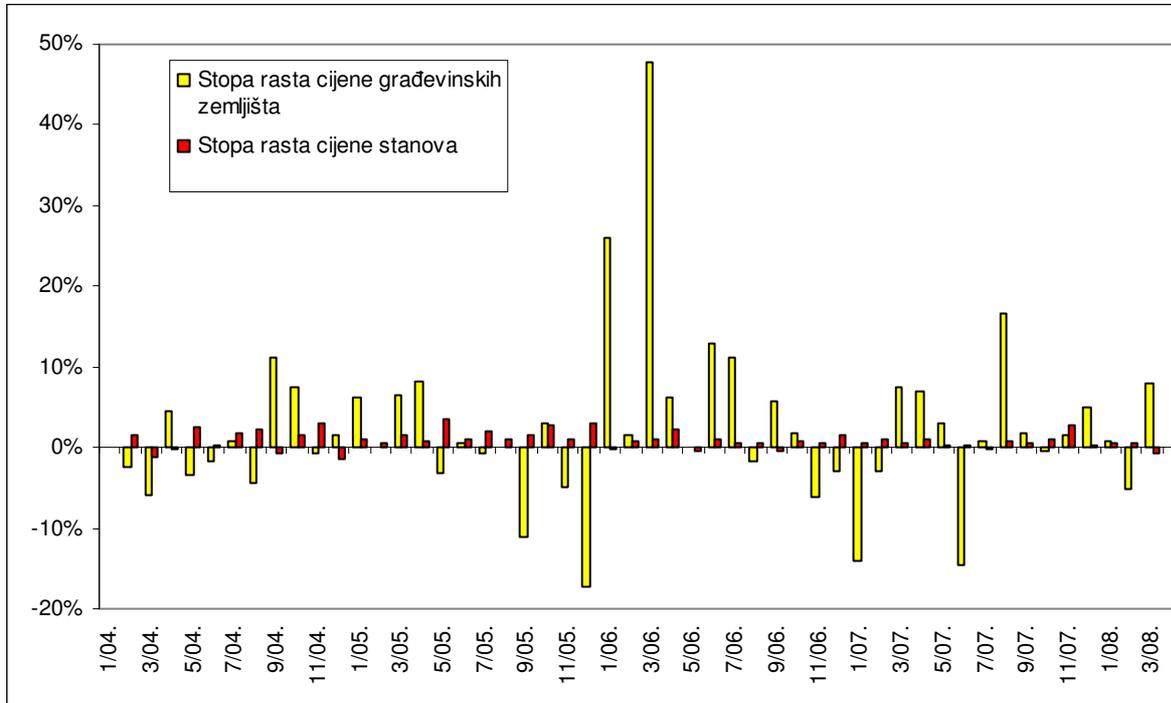
We are familiar with the constant rise in land prices in Croatia. In your opinion, what are the main reasons for this, and is the cycle nearing its end?

The main reason for a rise in prices is always either growing demand or falling supply. Demand has increased rapidly, the number of developers has increased five-fold, loans have risen sharply, while the surface area of the coast and urban areas has remained approximately the same. In addition, in a country not burdened by property/land taxes, investors in this sector are at the mercy of landowners, who can demand unrealistic prices endlessly. If, for instance, part of the income tax burden were transferred to taxation per square metre of property, only a small number of landowners would be able to afford long-term ownership of non income-generating property. Tax calculation based on the number of square metres owned would release unused land onto the market and force owners to sell what they do not need. Naturally, it will take a long time before this is implemented in

Croatia. In the meantime, we are hoping that municipalities will increase the number of urban locations suitable for building by investing adequately in

transport and urban infrastructures, in order to avoid serious problems for the profitability of the construction industry.

Figure 1: Growth rate of apartment prices (red) and building land prices (yellow)

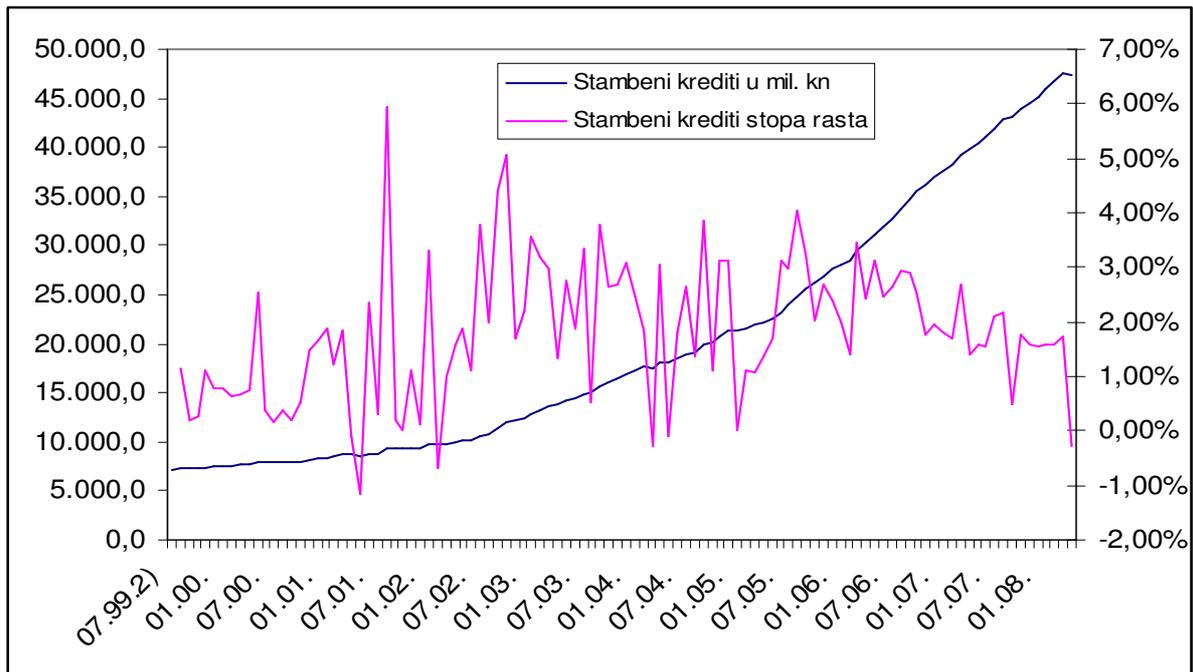


What is your view of the constantly rising level of housing loans in relation to supply and demand in the housing construction sector?

It is true that the number of approved housing loans is constantly growing, or to be precise, it grew up to April 2008, when (according to the data by the Croatian National Bank), a negative growth rate was recorded for the first time after a long period. Stagnation in purchasing power is the result of growth in interest rates on one hand, and on the other, increased competition on the residential property market, which is reflected in higher numbers of unsold apartments, and which has also resulted in stagnation in price growth during the last year (source: Centar nekretnina – Real Estate Centre). The effect of the market slowing down has eventually

reflected on the number of loans approved. It is true that the level of housing loans for households is growing constantly, however, if we look at the growth rates, it is obvious that the slow-down began early in 2007. Even from mid-2006, the growth rate for housing loans approved to private individuals fell from over 3% to under 1% p.c.m., according to the Croatian National Bank. Besides, long-term trends point to a reduction in the growth rates of loans, which has been going on for almost two years now. The current growth rate of housing loans is equal to the rate last recorded in 2000.

Figure 2: Amount of housing loans in millions of HRK (blue) and the monthly growth rates of housing loans (pink)



What is the situation in the housing sector in continental Croatia compared to the coast? How do the prices of land and properties compare?

As a rule, the construction industry is going through its worst year of the last decade. After several years of expansion, in which the sector was highly profitable in spite of vigorous growth in land prices, we are slowly entering the mature stage of a cycle in which profits will probably never be as high again, at least not over such a long period. Due to speculations concerning EU accession, prices are still rising on the coast, so that investment projects on the coast are in a much simpler situation from the business perspective. On the other hand, price growth on the continent has clearly been exaggerated since 2006 and now the residential property market is going through a stage similar to the business property market in 2005. Naturally, the situation is made even more difficult for investors, as I

have already explained, by the fact that landowners refuse to accept market realities, and are keeping up the price of land, thus seriously reducing investors' profits. As far as the coast is concerned, it is important to emphasise that we are talking about several urban zones which have a crucial influence on the formation of an average prices, but within which a fairly small number of properties is being built and sold. Accordingly, investors have to be very cautious, because medium-sized projects in such markets might influence the overall market in a critical way.

In your opinion, what are the key elements which the state must address in order to bring the construction industry up to the level of European countries?

The construction industry and investors in the property market must realise that, as the most profitable sector next to banking, they should not expect to get anything from the state for free. In

the light of this, the construction industry should define its strategy (or game rules) at the level of professional organisations, concerning the development of urban centres, state infrastructure, and entry into markets abroad, which will eventually become the most important issue, especially in the immediate region and the Middle East. Only after the construction industry and investors clearly define their objectives, in terms of what they expect from local and state government regarding regulation, subsidies, and investment, will it be possible to exert economic pressure. This can be done through different forms of lobbying, in order to influence policies for creating a business-friendly environment at local level, and creating a platform for submitting large public tenders in the region and in the Middle East through lobbying at state level, through the Ministry of Foreign Affairs, and the Ministry of the Economy. The current growth of the Croatian construction industry cannot be maintained if it remains restricted to the Croatian market. There will simply not be enough projects, compared to the past decade, and in order to maintain profitability and current growth rates, our construction industry has to go abroad. What investors in this sector have to understand is that there is no such thing as a free lunch in economics, and that the time has come to take the initiative and establish a formal legal and business framework, appropriate to their needs. They should approach the decision makers with ready-made solutions.

Do you foresee any new trends in housing construction, present in developed countries, but still not visible in Croatia?

We can expect a whole series of trends in the Croatian residential property market. A rise in the standard

of living will increase purchasing power, but it will also lead to a change in buyers' tastes. Previously best selling apartments, priced at up to 100,000 €, will be taken down from their pedestal, and people who used to buy two-roomed apartments will be demanding an extra room, as soon as the rise in their standard of living allows them to. It will be interesting to observe how the construction business and real estate agents respond to these challenges. It is unrealistic to expect that people in the upper medium income range will want to continue living in apartments in the long-term. It is only a matter of time before houses make a great comeback among better-off Croatian families. The stigma of living in houses in residential areas haphazardly built during the Communist period, with no consistent planning, will – in time – be replaced by living in well-designed residential areas. Naturally, this turnaround will not happen without significant improvements to public transport systems in most urban centres and the involvement of urban developers in pursuing good city-planning.

Do you believe that the future of housing construction in Zagreb is in the construction of detached houses and villas or planned housing developments?

Market development will influence the development of the construction industry and of developers themselves. In order to be able to sell today, you must offer much more sophisticated housing than three years ago. Some developers will concentrate on improving individual housing units, while others, mostly larger developers, will probably opt for designing housing estates as finished products. Both directions are promising, but in either case it should be emphasised that after

the initial stages of construction industry development in Croatia, urban development was more often the loser than the winner with new investment projects. One of the basic rules of economics is that rarities are expensive, so it is just a matter of time

before unspoiled urban areas will command significantly better prices than others. So in this context, there are definitely opportunities for making extra profits by constructing planned residential areas.

2. PRESENTATION OF THE PROJECT

GRAWE NEKRETNINE
d.o.o.

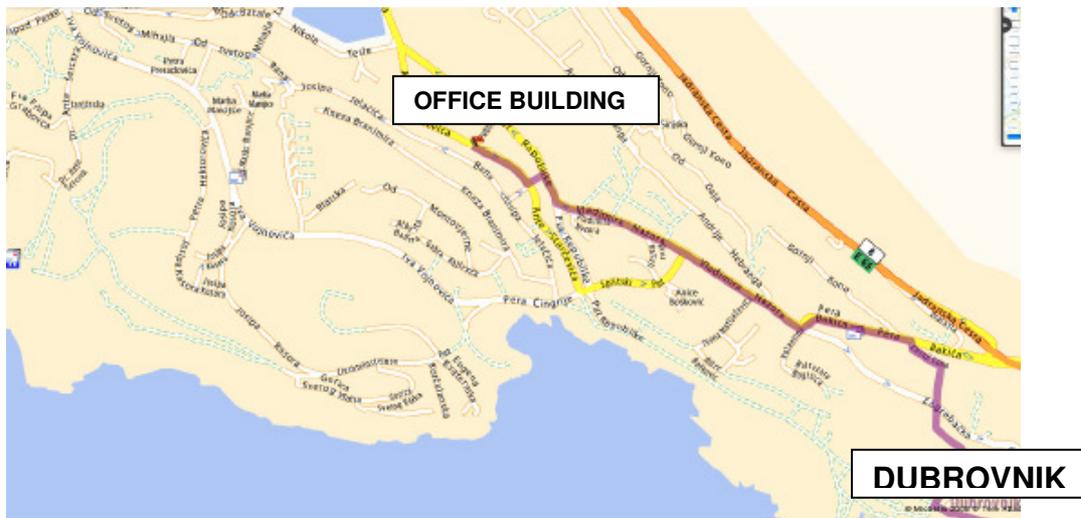
**GRAWE OFFICE
BUILDING GRUŽ**



GRAWE Nekretnine d.o.o. is the first contemporary office building in Dubrovnik, in the very centre of Gruž. The building will be finished in the first quarter of 2009.



The office building is located on the unique location in the close vicinity of the harbor Gruž in the dr. Ante Stračevića street in Dubrovnik. The location of the building enables fast and easy access to the city center of Dubrovnik (only 2 kilometers) and all major city roads because of good traffic connectivity and city transportation.



Grawe office building in Gruž spread's on 4.282,26 m² of net area. The facility consists of one underground level and 6 aboveground levels. The ground floor has 610,97 m² intended for business premises dealing with clients (bank's etc.) Upper levels, from mezzanine to the fourth floor, will be for „A“class offices.

According to requirements of potential tenant's, each floor can be leased as A whole or separately by units. Each floor has 700 m². The floors are in principle divided into four separate units, but also can be constructed as open space area.

The building will be constructed from high quality materials with quality sound and heat insulation and equipped with modern information technology installations. The building will be modern and functional with elevators, reception desk and security.

The ground floor area has offices from 44 m² to 126 m², and the lease price will be 45 to 50 eur for a square meter.

Offices on the upper levels are different in size and vary from 50 to 750 m² (the whole floor). Letting price will be 18 eur for a square meter.



The building will have 95 parking places, with the price of 80 eur monthly for a parking place.

Rekapitulacija Recapitulation	Neto površina (m ²) Space (m ²)	P1	P2	P3	P4	P5	P6	P7	Σ
Prizemlje	Groundfloor	44.80	103.77	86.01	103.05	89.24	126.07	58.03	610.97
Mezanin	Mezzanine	219.19	268.07	127.90	86.14				701.30
Kat 1.	1st Floor	239.00	100.01	157.81	220.63				717.45
Kat 2.	2nd Floor	243.21	100.01	157.81	224.84				725.87
Kat 3.	3rd Floor	247.44	100.01	157.62	229.07				734.14
Kat 4.	4th Floor	210.51	85.54	274.30	222.18				792.53
UKUPNO	TOTAL:								4,282.26
Garažna - parkirna mjesta									95 kom.

Note: Net floor areas are spaces without shared premises (staircases, elevators, entrance hall)

3. STATISTICS

3.1 Average Asking Prices of Real Estate Offered for Sale – July 2008

	average price EUR/m ²	price range EUR/m ²
ZAGREB		
Housing		
Apartments	2.233	817 - 6.000
Houses	1.921	750- 8.635
Commercial space		
Offices	1.7478	840 - 3.000
Business premises	2.193	668 - 8.663
Office blocks	1.304	618 - 2.107
COAST		
Housing		
Apartments	2.102	400 - 6.315
Houses	1.943	263 - 11.600
Commercial space	1.632	555 - 4.605
Tourist facilities	2.709	750 - 9.537

Average is calculated on the basis of the currently quoted prices on the Burza nekretnina d.o.o. (Real Estate Stock Market Ltd.), which is available online: www.burza-nekretnina.com.

3.2. Statistical Reports of the Central Bureau of Statistics from the Area of Civil Engineering

3.2.1. Building permits issued, May 2008

In May 2008, there were 909 building permits issued, which was by 6.0% less than in May 2007.

The total number of building permits issued in the period from January to May 2008 was by 21.8% lower, as compared to the same period of 2007.

In May 2008:

- by type of constructions, 89.7% out of the total number of permits were

issued on buildings and 10.3% on civil engineering works

- by type of construction works, 78.5% of permits were issued on new constructions and 21.5% on reconstructions.

According to permits issued in May 2008, it was expected for 1 661 dwellings with the average floor area of 82.9 m² to be built.

Notice: Building permits issued, May 2008, central Bureau of Statistics, Zagreb, 2008.

3.2.2. Building permits issued, April 2008

In April 2008, there were 948 building permits issued, which was by 10.2% less than in April 2007.

The total number of building permits issued in the period from January to April 2008 was by 25.4% lower, as compared to the same period of 2007.

In April 2008:

- by type of constructions, 89.5% out of the total number of permits were

issued on buildings and 10.5% on civil engineering works

- by type of construction works, 79.1% of permits were issued on new constructions and 20.9% on reconstructions.

According to permits issued in April 2008, it was expected for 1 666 dwellings with the average floor area of 85.7 m² to be built.

Notice: Building permits issued, April 2008, central Bureau of Statistics, Zagreb, 2008.

4. PRESSCLIPPING...

Source: Poslovni dnevnik, 9 July 2008

4.1. Due to falling sales, free parking space offered with new apartment

Various marketing strategies employed by sellers to attract buyers are testaments to stagnation in the real estate market. A pioneering step in this area has been taken by the *Colosseum* real estate agency from Zagreb, which is offering buyers purchasing apartments at 1850 euros per square metre a bonus – a brand new Toyota Yaris. As well as cars, new owners of apartments in the city centre have received LCD TVs from *Filip Zagreb nekretnine*, and in co-operation with several department stores, discounts towards the purchase of furniture or IT equipment.

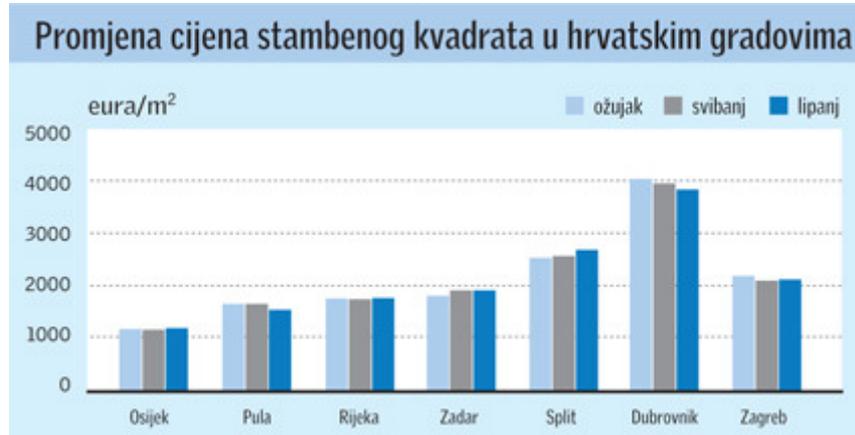
Market saturation

It is highly indicative that although *Colosseum* sold six apartments accompanied by “gifts”, buyers asked for the price to be reduced by 13,000 euros, instead of accepting the car. “In view of market saturation for new apartments, the market has tipped in favour of buyers, who are now in a position to choose,” explained *Colosseum*’s manager, Milan Mlakar, adding that there is only one apartment left with an accompanying gift of a Toyota. The rest of the unsold apartments, which are 74 square metres in size, will be accompanied by a “smaller” Peugeot. He also commented that although the enactment in October 2007 of the new Construction Act, which replaced the

building permit with building approval, the number of approvals granted annually was reduced by half, putting the wind up construction companies. As a result, many started the maximum number of new projects possible before the new law came into force, so that the drastic decrease in the number of approvals issued this year will not significantly affect supply and demand. Precisely for this reason, the next two years will be a time of “sales” in Zagreb. Since the enactment of the new Construction Act, 94 approvals for building were issued in Zagreb, in comparison to 837 building permits issued under the previous act. Mlakar believes that people who complied with conditions for obtaining a housing loan have already received their loans and “resolved” their housing problems, and that those who remain have less purchasing power. In this light, and taking into account stricter conditions for obtaining loans, the situation does not look promising, according to *Colosseum*’s manager. Nevertheless, in its monthly report on price levels, the Real Estate Centre (Centar Nekretnina) presents data showing that housing loans in the first four months of 2008 continued a strong upward trend of almost 19% annual growth, in spite of stricter conditions for approving loans. At the end of April, housing loans reached HRK 47.3 billion, i.e. 40.2% of total loans to households, which is a growth of HRK 7.5 billion or 18.9% in comparison to April last year.

Diana Perger, manager of the *Euro-interijeri* real estate agency, believes that the market is not undergoing any significant changes. She says that a reduction in prices has been recorded

since summer last year, but is not drastic. In her agency it amounted to about 50 euros per square metre.



Price decrease

Perger believes that price stagnation will persist for about a year and a half, after which prices will rise again. "With respect to the new Construction Act, which prescribes the minimum width of any road as nine metres, the number of residential buildings built in Zagreb will be reduced, because most building plots cannot comply with these regulations. This will lead to a significant reduction in construction, reducing the supply of apartments, which will then increase their price," says Diana Perger. However, the *Colosseum* manager believes that a decrease in prices is a natural market law, and that the buyers will be able to

buy better quality apartments at a significantly lower price in comparison to asking prices a year or two ago. The recovery of the market, Mlakar believes, will introduce order in the real estate market, and many who "wandered" into it will have to give it up. And banks will be forced to write off certain debts for incautious investors who took out loans based on calculations made according to old prices. "Profit in the construction business is not as astronomical as the media presents it, because you can only earn up to 15% per investment, so that – depending on the size of the investment – even minor errors can eat up this profit," said *Colosseum* manager Milan Mlakar.

4.2. News from the region

Delta takes over operational management of Belgrade's Continental Hotel

Delta's NBGP Properties has officially assumed management control of Belgrade's Continental Hotel.



Orco wins awards for Złota 44

The CNBC Europe & Africa Property Awards 2008 saw Orco Property Group winning awards in the categories of Architecture, Redevelopment, High-Rise Architecture and High-Rise Development for its flagship investment in Poland - Złota 44



Colliers International Poland chosen exclusive agent in negotiations for new Hilton in Gdansk

Colliers International Poland said in a statement on July 7 that it has been selected exclusive agent for the Hilton in Gdansk, with its representative Jan Wojcikiewicz Hotele Sp. z o.o. from Gdansk negotiating a franchising agreement with Hilton.



Millennium Towers II and III office buildings open

Lorant Varga, CEO of TriGranit Development Corporation has officially opened the 20,000 sqm Millennium Tower II and III office buildings located on the East bank of the River Danube in Budapest.



Orco launches construction of Vaci 1 in Budapest

Orco has launched construction of Vaci 1, a new fashion and gourmet emporium to be built in the former home of the Budapest Stock Exchange, on Vörösmarty Square right in the heart of downtown Budapest.



5. PAST EVENTS...

Date	Name	Location	Web
May 06 -07, 2008	GRI WORLD SUMMIT 2008	London, England	www.globalrealestate.org
May 08, 2008	The 3rd Annual SEE Real Estate Awards Gala for 2007	Bucharest, Romania	www.europaproperty.com
May 09 -10, 2008	CEPIF	Warsaw, Poland	www.europaproperty.com
May 21 -22, 2008	Europaproperty CRE Russian Investment Conference II	Moscow, Russia	www.europaproperty.com
May 27 - 29, 2008	REAL VIENNA	Vienna, Austria	www.realvienna.at
May 29 -31, 2008	2008 FIABCI World Congress	Amsterdam, Netherlands	www.fiabciamsterdam2008.com
June 01 – 03, 2008	Retail City 2008 - Bringing Together Retailers & Malls In Emerging Markets	Dubai, United Arab Emirates	www.retailcity.ae
June 10 – 13, 2008.	The Italian Real Estate Event	Milan, Italy	www.italiarealestate.it/eire/eng
June 16-18, 2008	CIB W70 International Conference in Facilities Management	Edinburgh, Scotland	www.fmresearch.co.uk

6. DO NOT MISS OUT...

Date	Name	Location	Web
September 03-05, 2008	PROEstate Forum 2008	St Petersburg	www.PROEstate.ru
September 17-18, 2008	Property Forum Budapest 2008	Budapest, Hungary	www.reevolutio.hu

September 17-19, 2008	Mall Expo	Kyiv, Ukraine	www.mall-expo.com
October 02, 2008	4th Experts Forum	Austria, Vienna	www.regioplan.eu
October 06-08, 2008	Expo Real 2008	Munich, Germany	www.exporeal.net
October 13-17, 2008	The World Urban Forum IV	Nanjing, China	www.unhabitat.org
October 22 -24, 2008	Real estate of Siberia 2008	Novosibirsk, Russia	www.realty.sibfair.ru/eng/
October 28, 2008	Office Buildings in Poland 2008	Warsaw, Poland	www.nowyadres.pl
October 29 -30, 2008	European CRE Investment Forum III: Russia, Germany, and CEE	New York, USA	www.europaproperty.com
October 30 - November 01, 2008	BeIRE	Belgrade, Serbia	www.belre.org
November 05-07, 2008	MREF	Moscow, Russia	www.mref.ru
November 06-07, 2008	Investment Conference 2008	Portorož, Slovenia	www.investment-conference.si
November 10-12, 2008	International Property Show	Moscow, Russia	www.internationalpropertyshow.ru
November 19-21, 2008	Mapic	Cannes, France	www.mapic.com

November 24.- 25.11.2008	GRI New Europe	Bucharest, Romania	www.globalrealestate.org
December 02-04, 2008	Mipim Horizons	Cannes, France	www.mipimhorizons.com

PUBLISHER:

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It is our wish that the Croatian Real Estate Newsletter / CREN be a source of speedy and quality information for all who are active in the real estate sector – developers, planners, contractors, mediation agencies etc. Please send your comments, proposals and opinions to cren@filipovic-advisory.com to help us improve CREN and make it the leading medium on the Croatian real estate market.

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