

Real estate value – the vicious spiral

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There has been a significant decrease in demand for real estate in the last few months, with property prices in Bulgaria registering a slump in value throughout. The official statistic is that as late as September 2008, real estate was still registering the sporadic rise in value, but the overall trend in the country is expected to see a drop of as much as 27 per cent on average. The data from the fourth trimester will most probably show the stagnation of the market in its realistic form, as opposed to what is being received now as feed back from the third trimester, according to Industry Watch, as quoted by weekly Stroitelstvo Gradut.

Most importantly, it is necessary to determine what is the significance in terms of numbers and the situation of real estate loans for the economy. Theoretically, the bigger the share of mortgage financing, the bigger the eventuality in occasional slumps in the market of real estate, meaning that the net real estate value could be negative – the volume of mortgages exceeds the market price of the houses) – or the loan to value ration could exceed 100 per cent.

In spite of the credit expansion registered in the past few years in Bulgaria, real estate loans as percentage of the total economy of the country is more than three times less than the average in other European Union member states. Accordingly, should there be an eventual exasperation of the economic crisis, and additional shrinkage of the real estate market in particular, the overall negative effect for the consumer and the impact on the savings of the populace being far worse in the eurozone than in Bulgaria.

Moreover, it is vital to determine what is the average percentage of bank financing of real estate – either for purchase or for refinancing – which is done through loans, in the Bulgarian economy. The correlation between the loan of a house as opposed to the actual value of a house could present a potential problem, as it is likely to alter the behaviour of the borrower. Should the prices fall considerably, and impose a negative net value of the house, the borrower might decide that it is better to leave the house to the bank without paying off the mortgage, by deciding that he is better off renting a house or opting to purchase a new house altogether offered on the market at a significantly lower price. This behaviour of the consumers is quite rational; however, it creates an even sharper decline in prices, in turn.

The negative effect on the economy (all other parameters being equal), is stronger, with a drastic decline in the value of the real estate, with a large supply of housing for sale and with the presence of an initial period with reduced conditions for servicing the loan. The risk will not be equally distributed, instead, it concentrates in a particular group of people – those who purchase on top – when the real estate value has reached its summit.

On the background of insecurity regarding the income growth in the country, and the direction of the prices for real estate, the banks partially restrict the crediting of consumers in the sector. The more conservative behaviour of banks reduces the risk of eventual problems, not only for the financial system and the borrowers, but for the economy as a whole.