

## 2011 likely to be a year of two halves for Cypriot property market

**“Property values are unlikely to find much support during H1 2011 as the labour market has yet to stabilise...”**

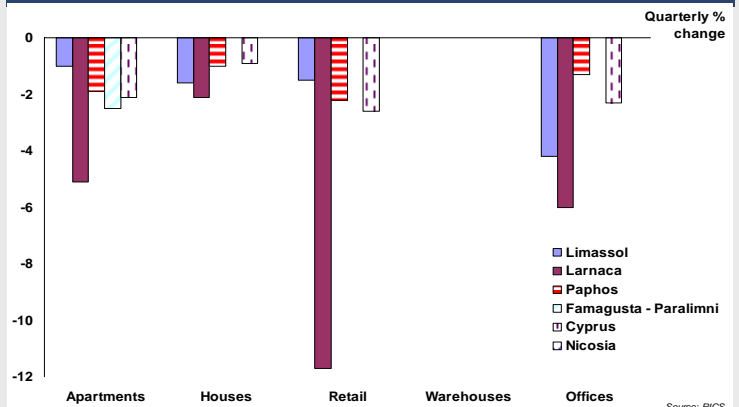
The Q3 2010 RICS Cyprus Property Price Index, the only kind in the country, was released on Monday 10<sup>th</sup>. The index has four broad dimensions. First, the following urban areas are tracked: Limassol, Nicosia, Larnaca, Paphos, Famagusta-Paralimni. Second, both the residential (apartments and houses) and commercial arenas (offices, retail and warehouses) are included. Third, average unit prices and average monthly rents are tracked. Finally, the index is based on valuation estimates for hypothetical properties not actual properties.

Broadly summing up the Q3 results, all sectors bar warehouses, across all regions bar Nicosia, saw price falls, averaging about 2% over the quarter. The warehouse sector and Nicosia saw no change according to the Q3 results. In terms of the greatest falls, Larnaca was the standout region, retail was the standout sub-sector in the commercial market and apartments were the standout sub-sector in the residential market. Specifically, on the residential side, the national average decline for houses was about 1% during Q3, though falls closer to 2% took place in Larnaca and Limassol. Apartments saw on average a slightly greater fall than houses of just over 2%, though falls nearing 5% took place in Larnaca. The commercial arena generally saw stronger price falls than the residential market; in Larnaca, retail values fell by nearly 12% on the quarter, while office values fell by around 6% (the national average fall in both sectors was around 2%). Notably, warehouse values were stable across all regions during Q3.

2011 is likely to be a year of two halves for the Cypriot property market. During H1, the labour market will probably continue to deteriorate given still depressed levels of sentiment; as a result, property values are unlikely to find much support. However, the economy returned to growth at the beginning of last year and, given the usual time lags, this should eventually feed through to the labour market and stabilise property values towards the latter part of the year.

**“...however, the return to economic growth should feed through to the labour market and property market by H2 2011”**

### Larnaca experienced the sharpest price falls in Cyprus



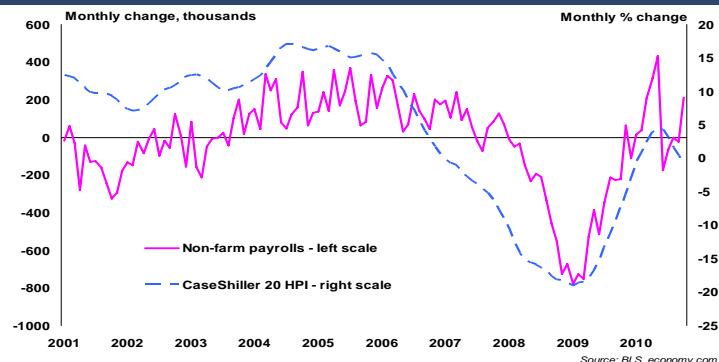
## US house prices likely to decline by 5% in 2011

**“CaseShiller 20 city index fell by 0.8% on the year in October”**

The Federal Reserve meets on Wednesday 26<sup>th</sup> for its first monetary policy meeting of the decade. With inflation just above 1% in December, and unemployment at 9.4%, the FOMC is highly unlikely to alter the interest rate from 0.25%. Additionally, the S&P/CaseShiller 20 city house price index (HPI) and the FHFA HPI for November are released on Monday 24<sup>th</sup>. October's CaseShiller index slipped 1% on the month, but more significantly it recorded a negative annual growth rate for the first time in 2010 (-0.8%). With a vacancy rate of 2.5%, we calculate there to be around 580,000 excess units in the housing market, which will need to be

absorbed into the market for house prices to stabilise. This helps to explain why the RICS expects a fall of 5% in the CaseShiller 20 city HPI during 2011.

### Employment key to stabilising house prices



Employment is the major underlying factor for the stuttering housing market. In particular, household formation has fallen drastically from pre-recession levels, from 1.4 million per year in the three years through Q406 to only 0.5 million per year in the three years through Q409. New households in 2010 are forecasted to be around 600,000. With hiring levels picking up at the end of 2010, this should continue into 2011 and is expected to boost the rate of household formation over the coming year. Indeed, various models of household formation uniformly show that stronger job growth leads to more rapid household formation. Research shows that if payroll growth averages 150,000 in 2011, household formation will pick up from the current annual rate of 0.6 million to 0.95 million. This increase in new households should clear excess supply by around the end of the year.

Meanwhile, we continue to recognise the downside risks, mainly the amount of foreclosures coming onto the market; we see a limited negative foreclosure 'price contagion' due to the spatially concentrated foreclosure activity (60% of foreclosures are occurring in 7 states). Additionally, the low rate of housing starts in 2010 (0.6 million compared to 1.5 million in 2007) is due to continue into 2011, helping to restrict growth in supply.

**“Excess supply in housing units to cause further falls in prices”**



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## HKMA waiting for evidence of slowing market in December mortgage approvals

**“In November there was a broad pick up in activity as both loan applications and approvals improved”**

Expected in the coming week are the results of the December residential mortgage survey from the Hong Kong Monetary Authority (HKMA). The results will wrap up the 2010 data on mortgage conditions for the HKMA, who will be interested to see what affects the latest prudential measures implemented in November have had on the real estate

sector. This followed a similar move in August when the HKMA tightened lending conditions by lowering LTV ratios and introducing stress tests for mortgage applicants.

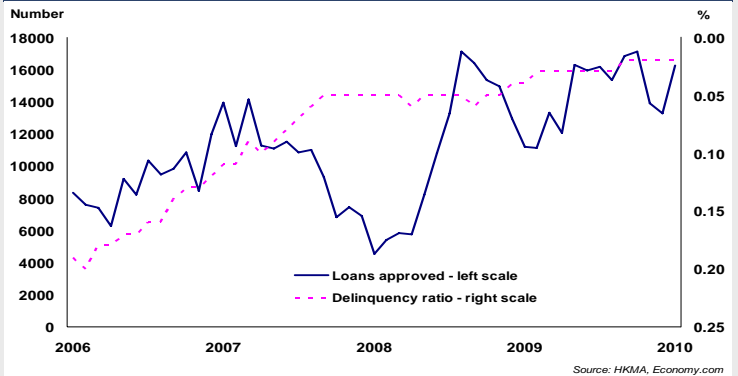
According to the November results of the residential survey, there was a broad pick up in activity as both loan applications and approvals improved on a month by month basis; approvals rose 22% to 16,230, while applications picked up 13% to 23,060. It is noteworthy that after the August measures were implemented, applications fell by 26% in the following month. Initially, LTV ratios for properties with a value of HK\$12m were reduced to 60% from 70%, while for properties with a value below \$12m the rate remained at 70%. The drop in appetite for mortgage loans did not last long, with applications picking up once more in October. This was the basis around which the HKMA was forced to act again in November. LTV ratios were reduced by a further 10%, but this won't have affected the mortgage data for that month. Significantly, the delinquency ratio has remained at subdued levels.

The HKMA are likely to have been concerned with the November results and will be eager to see some slowing in the number of

applications and approvals, as both remain near all time highs (since April 2004). The recently released house price index from Centadata shows that prices grew 2% in the month to January 9<sup>th</sup>, and are now above pre-crisis levels. The HKMA maintain that speculative buying is a concern and will almost certainly have to act again if the residential market shows no signs of cooling.

**“The HKMA will want to see levels fall back in line with long run averages”**

Loan approvals are near all time highs



## Indian property market to feel further effects from interest rate hikes in 2011

**“A resumption of monetary tightening is due next week...”**

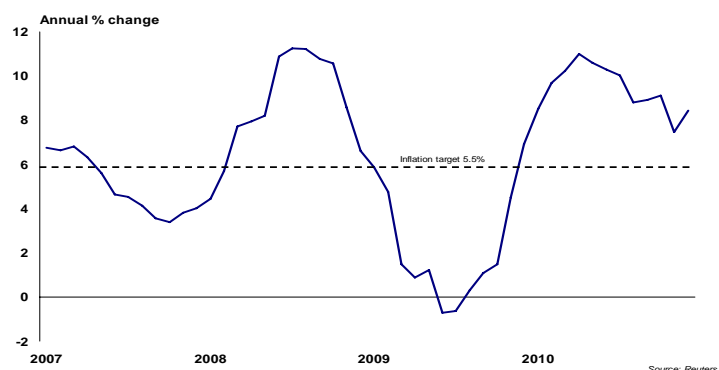
The Reserve Bank of India (RBI) meets on Tuesday 25<sup>th</sup> to set interest rates, with RICS anticipating a 25 basis point hike. Indeed, having paused in their monetary policy tightening cycle during December, RICS expects a resumption of tighter policy measures in early 2011 as the RBI aims to temper lingering inflation concerns.

period of high inflation during 2008, stronger growth both at home and in emerging markets has seen inflation display more “sticky” characteristics since peaking in April of last year. Some political figures such as the trade minister have been voicing their concerns in recent days that specific credit rationing measures in addition to tighter monetary policy may also be needed to rein in inflation. As a result and following some comments from the RBI, RICS would not be surprised if greater regulation in the real estate market could be enacted in the coming year.

Wholesale price inflation has been hovering well above the 5.5% annual target for the last 9 months despite 150 basis points of hikes to the prime lending rate during 2010. Significantly, compared to the last

That said, there are already some signs that previous interest rate hikes seen in 2010 are starting to cool some sectors of the economy. The latest PMI business surveys of both the manufacturing and service sector for December showed a slowdown in activity with industrial output also growing at its slowest pace in 18 months in November. In the housing market, 2010 may have been a high water mark for activity and prices in some regions. A recent report by CRISIL, the credit rating information service of India, has forecasted price declines of around 10% in Mumbai this year in response to previous interest rate hikes and affordability concerns.

Indian inflation has been sticky compared to previous peak



**“..with residential prices predicted to fall in some segments in 2011...”**

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