RESIDENTIAL PROPERTY

Deferred Demand Slows Growth Down

Moscow's residential property market boasts moderate growth rates after an almost unrepeatable 2006

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The Moscow News

Having put behind an unbelievable 2006 when apartment prices soared at wild rates, Moscow's residential property market is bracing for a moderate 2007, which should see its growth continue at a slower pace.

While analysts say that last year's price surge has deferred demand, brokers still expect healthy growth.

"For 2007 we forecast growth of residential property prices at around 20 percent," Vladimir Lutskov, director at MIEL Holding's Analytical and Consulting Center, told *The Moscow News*.

Growing by one fifth would look like a rather good performance in most markets, but coming on the heels of Moscow's almost doubled selling rates in 2006, these figures are just a far cry from last year's rampant price growth.

However, not all sectors in the business are equally hurt by the buyers' sluggish activity – while average Muscovites are busy studying the banks' mortgage products that should help them close their lifetime acquisition, the Russian capital's – and not only its – rich are vigorously buying housing in the market's premium segment.

With the average price of a square meter of residential space around town currently standing at $5,000, the market's top segment offering upscale, elite apartments is still growing pretty fast.

"The first quarter of 2007 was characterized by steady growth of prices for premium housing, totaling 15.4 percent. Last year's unprecedented growth, however, undoubtedly won't repeat this year," says Yekaterina Thain, partner and head of Elite Residential Department at Knight Frank.

Meanwhile, prices for resold prime housing grew by a mere 0.8 percent in the first quarter of 2007, adds Thain. In the same quarter last year they surged 15.2 percent. These figures reveal a new tendency – correction of prices in the re-sale upscale market, which has apparently been somewhat overpriced.

According to Anya Levitova, managing partner at EVANS, the hardest to sell is the economy-class housing.

"Sellers still don't want to lower prices, while buyers are not ready yet to pay $500,000 for 60 square meters in a plain brick building without specific advantages at a nice location," explains Levitova. Confronted with the lack of demand, some sellers eventually withdraw their apartments from the market, opting to rent them instead. "The majority of these apartments had been either privatized or bought for cash, so keeping a flat isn't expensive and can always be recouped through renting," adds Levitova.

Brokers are not surprised by varied demand in economy and premium segments as average buyers in the two sectors pursue different goals. While for many prospective economy-class apartment owners the purchase of a flat is a once-in-a-lifetime affair, a large share of deals in the premium segment is closed by investors who look at these acquisitions as a source of relatively fast, high profit.

"A year ago, to buy a small apartment in a new building at Ostozhenka Street a client had to spend $1 million, today he has to dish out $2.5 million," says Levitova. "For someone that rich both these figures aren't his last penny, and that apartment is most likely not the only dwelling he owns. For an average Muscovite both prices are absolutely out of reach."

RIA NOVOSTI

New premium class homes in an upmarket neighborhood at Sparrow Hills

According to Levitova, 2007 could reveal how big a share of residential property acquisition deals was actually struck by investors. Shrinking profit margins are likely to prompt such owners to quit the market, while demand will be chiefly generated by Muscovites looking for a place to live in, and wealthy buyers from Russian provinces and foreign countries who fancy having a flat in the capital "just in case."

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Regional clients from Russia's oil producing regions feature regularly in the residential property market. The Russian oil industry's continuing boom in recent years has largely contributed to steady demand for Moscow apartments by residents of West Siberia and other oil production areas.

According to a Blackwood survey, regional clients account for approximately 50 percent of apartment purchases in the market's premium segment. "In the first place, they buy residential real estate here because they need a place to stay when they are in Moscow during their travels and business trips," says Blackwood managing partner Konstantin Kovalyov. "Secondly, they invest in real estate. Apparently, these buyers come from Russia's regions where average incomes are higher than in other provinces. Besides Moscow, these include Tyumen region, Khanty-Mansiysk and Yamal-Nenets autonomous districts. Naturally, such customers are after expensive property."

Though prices are already high, Kovalyov thinks the market may be in for more price hikes, mostly owing to "new destabilizing factors."

These include expected growth of the share of so-called 'social housing' deals – apartments provided to the needy through city government subsidy programs.

Another prospective price booster could be the adoption of amendments to the law on participatory construction, which aims to enhance protection of the apartment buyers' rights. According to new amendments, buyers should be allowed to deposit funds covering construction at the bank which finances the project, says Kovalyov.

Developers will not be allowed to draw money from the buyers' accounts before the funds are collected in full, but can apply to the bank for loans to cover construction costs during the funds' accumulation. Moreover, apartment purchase deals will be closed by signing purchase and sale agreements after new buildings are commissioned. This will critically improve the clients' status from "co-investors' to proper 'buyers', giving them firmer protection from fraud, which has become notorious in this business in recent years.

On the other hand, if these amendments are adopted, they will incur higher costs for developers, ultimately hiking the net price paid by the customer.

With prices shooting through the roof and seeming out of reach for average Muscovites, mortgage loans could play a critical role in reviving demand for economy class dwellings.

"Current prices are unaffordable for the majority of prospective buyers due to expensive loans and short payback terms," EVANS managing partner Karina Kheifetz told *The Moscow News*. "In Western European countries or the United States the standard length for loan repayment is 30 years, while interest rates on mortgage loans are usually not higher than 7 percent in the United States, and 4 percent in Europe."

Under current interest rates, a Moscow couple raising a mortgage to buy a $500,000 flat should have a monthly income of around $15,000 to qualify for the loan, which amounts to approximately $5,000 per month over a 10-year payback period.

The same loan repaid over 30 years at a 7-percent interest rate translates to a monthly repayment rate of around $2,600, which means the couple should earn around $7,000 per month to be able to repay the loan. "This significantly widens the target group when compared to $15,000 these people need to be making monthly in order to honor such loan today," adds Kheifetz.

Currently, more than 350 banks are working in Russia's mortgage market offering approximately 2,000 products. Competition is fierce and bankers are spurring it further: one of the recent practices includes paying commission fees – up to 1 percent of the deal – to middle-men bringing new clients, says Blackwood's Kovalyov.

New products also offer incentives for potential buyers such as lower interest rates and mortgages that don't require down payments.

"Today the average interest rate on a mortgage loan in hard currency ranges between 10 percent and 11 percent per year, while the minimal rate stands at 9 percent. However, Bank Moskvy recently announced it would slash it to 7 percent," says Kovalyov.

Some banks are even going a step further as they try to lure new clients – they agree to provide mortgage loans to applicants who state their unofficial, 'gray' incomes that come in the envelope, but can't be tracked down in accounting books.

Other incentives include the opportunity to expand the list of co-borrowers to common law spouses and even friends, says MIEL Brokerage general director Natalya Kirpichenko. Until recently, that list predominantly included only married couples, their siblings and parents.

New banking policies have undoubtedly contributed to healthy growth in the mortgage sector. According to Kovalyov, over the last two years the number of credits provided to Russia's population rose three times, and the number of mortgage loans has increased 13 times!

Long-term prospects look healthy, too. Kirpichenko expects that demand for mortgage loans will continue to grow in five to 10 years' perspective, and mentality of younger generations of Russians will play a major role in supporting that growth.

The fear of living in debt – one of diehard relics of the Soviet past – can affect older borrowers for whom this may be their first major loan. "Younger generations who understand that living on credit is nothing out of ordinary, will approach this matter a lot simpler," Kirpichenko says.

Shrugging off prejudices from the past and sorting out the issues of Russian mentality is instrumental if you want to succeed in a modern society that Russia is today, believes Kheifetz.

"The proactive person who can calculate quickly and do it well is the one making the biggest success today," she says, backing her statement with an illustrative example.

Last May, a mortgage loan for an apartment worth $280,000 required clients to pay $56,000 in advance and borrow the remaining $224,000 from the bank, paying a monthly fee of $3,085. Meanwhile, the apartment's price soared to $500,000 within a single year.

"This means that – having paid a combined fee of $93,020 ($56,000 in advance and $37,020 in repayment installments over 12 months) – you could have earned $220,000 under a mortgage deal and at the same time live in the apartment, saving on rent," concludes Kheifetz. ■