

# Impact of Greece financial crisis on Balkan real-estate market

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## Abstract

This paper proposes that in a financial crisis the Real-estate market is the most sensitive market. It is the first to react when there is expansion of decline in the economy. Through the analysis of market conditions in several Balkan states in response to the impact of the Greece financial crisis on regional real-estate markets it is found that the financial crisis in Greece affected the regional economic activity. This was the main reason for declining of prices on the real-estate market. Real-estate market is first to face of a declining economy. But all markets didn't have the same response to lowered economic activity and recession. Some countries faced large vacancies, other dealt with lowered prices and big projects being abandoned because of lack of interest and lack of finance. A clear understanding of the impact of the financial crises in the Balkan area provides a basis for lending institutions to develop lending policies. The correlation between real-estate market and financial conditions, as well as the changes in periods of expansion and contraction provides a basis for development policies for investors in the Balkan area.

**Keywords:** Greece financial crisis, US financial crisis, Balkan real-estate market, residential market, office market, retail market

## 1. Introduction

Real-estate markets are the first to show the inflationary consequences of credit expansion policies and liberalization of finance and lending regulation (Georgievski, 2008). Historically, a significant number of financial crises that have happened in previous years first inflated the real-estate market. In years before the Japanese financial crisis (see Figure 1), the Japanese real-estate market outgrew the American real-estate market by double despite the fact that Japan's GDP income was 60/70% of that of the USA (Georgievski, 2011).

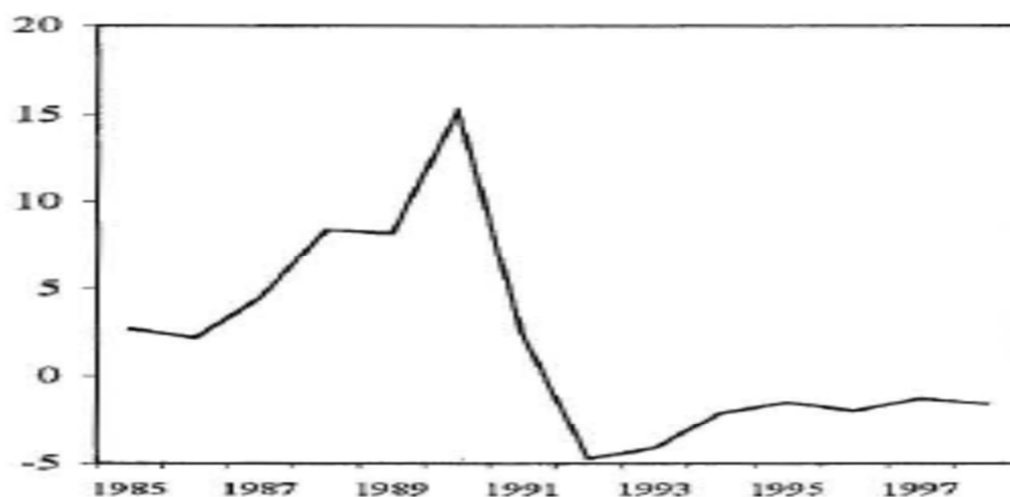


Figure 1 Growth in residential land prices in Japan

This rise affected not only residential real-estate but also commercial real estate: bigger companies decided to move its headquarters to business centers and other class A real-estate. This resulted by an increase of real-loans for over 50% in pre-financial crisis period (Shimizu, 2000). Japan is not an individual case. The Scandinavian financial crisis also was followed with a rise in real-estate prices. What predeceased the financial crisis followed a similar pattern in all Scandinavian countries and it was similar to Japan. The central bank initially liberalized lending and banking policies. This was followed by expansion of cheap credit, which impacted the real-estate market in these countries. Banks were only interested in market percentage and not the quality of the portfolio. Real-estate markets were blooming in Scandinavia. Sweden had the biggest price grow. In this country prices

grew for 300%, in the period from 1984 -1990 (Drees, & Pazarsioğlu, 1995). Finland and Norway followed also with several years of price increases of at least 25% per annum. All three countries faced increases in the lending portfolio, which resulted in increase in the real-estate market. When the market started slowing the bad loan decisions started to emerge. Losses suffered by banks mounted, which in turn resulted in the restructuring or bankruptcy of several banks. The only country that escaped financial tribulations was Denmark insofar as non-liberalization of the financial market, which consequently did not lead to, inflated markets.

As a phenomenon of market dynamics, it is seen that as there is a rise in lending (prior to the financial crisis occurring), the inflated prices are often the first to diminish when these markets face financial crises (Dullien, Kotte, Marquez, & Priewe. 2010). In some cases, for instance that of Argentina in 2001, real-estate prices declined by 60% during the first year of the financial crisis. Moreover, easy credit creates a sense of euphoria that coexists with the new home-ownership. There is a tendency that an increase of consumer loans often coincides with the debt weight of mortgages during real-estate bubbles: excessive spending in luxury articles such as cars and house hold luxuries add to the instability of the financial markets.

In the same way, the most recent global financial crisis was created in the real-estate market and what was initially considered as an asset price bubble, grew to a global financial problem. Contributing factors for the financial crisis was a lack of regulation and over-investments on the part of the banking sector within the real-estate market. Additionally, the concept of mortgage securitization and predatory lending practices that were introduced, allowed real-estate markets to inflate dramatically. As a result of deregulation and questionable practices, the crash of the sub-prime lending market created the biggest financial distress of the world economy in almost a century.

## 2. US Financial Crisis

The latest financial crisis was created with excessive lending activities in the real-estate sector. The sub-prime loans created a real-estate bubble that was ready to burst any time. The total market size of the sub-prime market was almost 8 trillion dollars and represented almost 15 % of the total mortgage market (Grammatikos & Vermeulen. 2012). This resulted in increasing of the homeownership average of 64.1 percent in 1982-94 to 67.3 percent in 1995-2007. Sub-prime lending crisis was considered risky and fraudulent. On the other side this was supposed to increase homeownership to people with low to moderate incomes. The increased credit and cheap money inflated the market. Historically, the real-estate value started increasing significantly. House prices have risen by 70 %, by 1995. Before 1995, in a period of almost 50 years, housing prices moved at the same pace as the inflation rate. This was a result from these cheap loans that created large demand for real-estate and homeownership. Increased demand resulted in increased housing prices, which led to an increase lending which in turn resulted in an 8 trillion market that collapsed. All of these activities resulted in an increase in vacant houses. The inventory of new unsold homes mounted up to 573 000 in July 2006, which is more than 50 % from the previous high in 1989. As seen in Figure 2, during the savings and loan crisis the number of vacant houses scaled to 377 000 (Bianco, 2008).

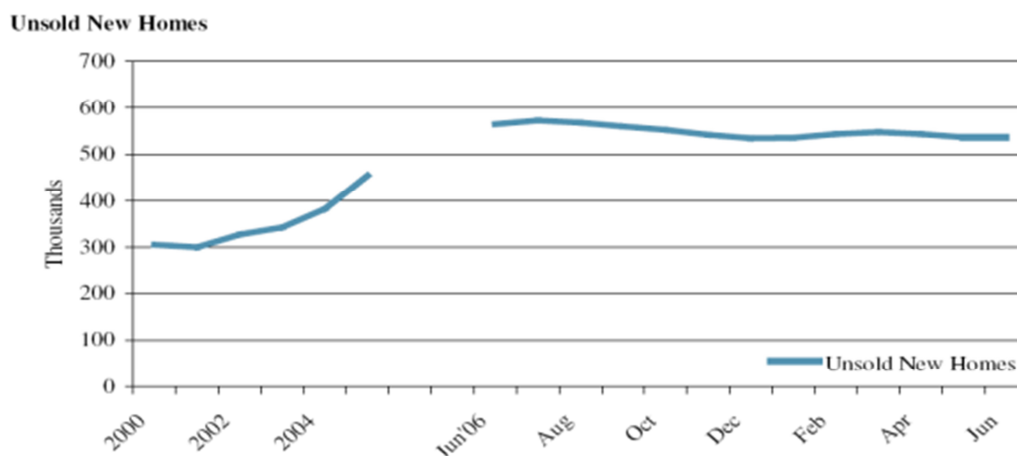


Figure 2. Historical rates of unsold US homes

Source: New residential sales in February 2013, National Census Bureau

This resulted in declining of real-estate values. The value of real-estates declined by 35, 5% from its pick before

the financial crisis (see Figure 3).

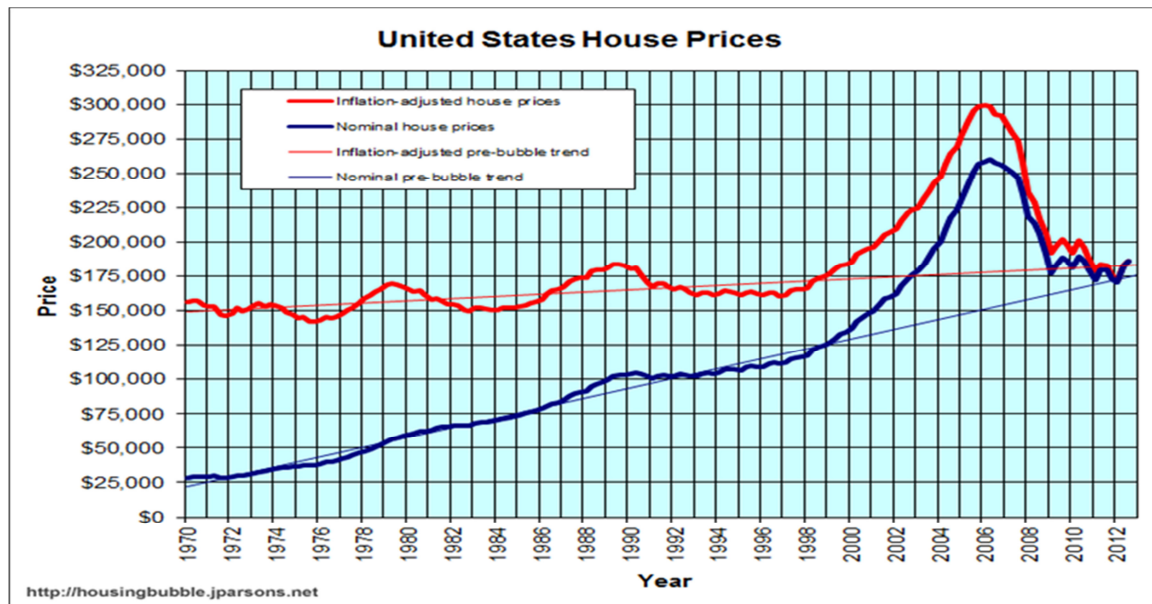


Figure 3: US housing prices

Source: Jparsons.net (<http://www.jparsons.net/housingbubble/>)

Stabilization has already started in United States and as the economy started to strengthen so did the real-estate prices. However, full market stability not be achieved before the market amends all inappropriate investment decisions. As in every period of credit expansion when the country economy is blooming, investments look much more positive than during regular times. Thus as recession and financial crisis will expose all of the wrong decisions, the market will create a fair value for every investment that has been blown out of proportion. Nonetheless the spillover effect of this crisis was enormous. What started as a real-estate bubble, turned in to a world economic recession: several countries went into bankruptcy, with Greece as the most notable example.

### 3. Greek Financial Crisis and its Impact on Balkan Real-estate Markets

Emerging Balkan real-estate markets have seen a significant slump due to the financial crisis in comparison to what was seen as a typical bullish market prior to the Greek financial crisis. Two types of market can be distinguished: the first, which includes Greek, Bulgarian and Serbian markets that are at a later stage of development. The second, consisting of Macedonia, Albania and Montenegro, which are in an earlier stage of real-estate development. The potential of the markets is different and depends on size connectivity, and other economic and political conditions. Thus, the financial crisis had a different effect on almost every single market be it through high vacancy rates or through lower selling prices and rents of a certain sub-marker.

#### 3.1 Greek Financial Crisis

The spillover effect from the US financial crisis made serious financial troubles in the European Union. One might argue that the US Financial crisis showed all the problems of the creating of the European Union inasmuch as this financial crisis exposed the structural weaknesses of the European Union. Not only did the US financial crisis exposed weaknesses of the Greek Economy, it also uncovered the lack of legislation and institutional guidance that is part and parcel of the European Union.

Greek economy has been known for its history of debt. Starting from the country's independence in 1832 (Reinhart & Rogoff, 2009), only the South American countries have spent more time in default than Greece. By entering the European Union and the adoption of the Euro, the country gained access to cheap capital. This, on the other hand created investor confidence in weaker European countries. This access to cheap capital was used for government spending and offsetting tax revenue. Instead of promoting economic activities and improving both the financial and economic market, Greece created some of the biggest budget and trade deficits. Instead of using this money for production investment, funds were used for debt repayment. All governments focused on

current consumption instead of using these cheap funds for investments that could generate growth, improve the competitiveness and increase the economic output of the country.

Greece is still one of the biggest investors in the Balkans. But the role as a probably biggest investor in the region is stalling, opening a door for some new investors like Turkey and other countries. Some of the most substantial investments from Greece have been made through The Hellenic Plan for the Economic Reconstruction of the Balkans (HiPERB). Greece invested 550 million of Euros to promote Greek Business activities in the region. The largest contribution was made in Serbia, a traditionally friendly country to Greece where the investments mounted up to €232 million. Additional contributions were allocated to Macedonia, €70.4 million to Romania, €54.3 million to Bulgaria, €49.9 million to Albania, and €19.5 million to Bosnia-Herzegovina and Montenegro €17,5 million (Ministry of foreign affairs of Greece). In addition to such fiscal stimulus, Greece represents one of the biggest trading partners of these Balkan countries. Therefore, the lack of activity only worsens the situation in the countries, which affects the total economic activities in these Balkan countries (Athens chamber for commerce and industry).

Consequently, great Greek budget deficits (see Figure 4) a lack of secure investment and the lack of protection within the EU against such large-scale financial strains diminished the role Greece had as one of the biggest investors in the Balkan region. As a result (as previously mentioned) real-estate markets are one of the most sensitive towards the movement of the banking sector in total, the collapse of the Greek economy had a coiled effect, pulling its neighbors closer to financial failure.

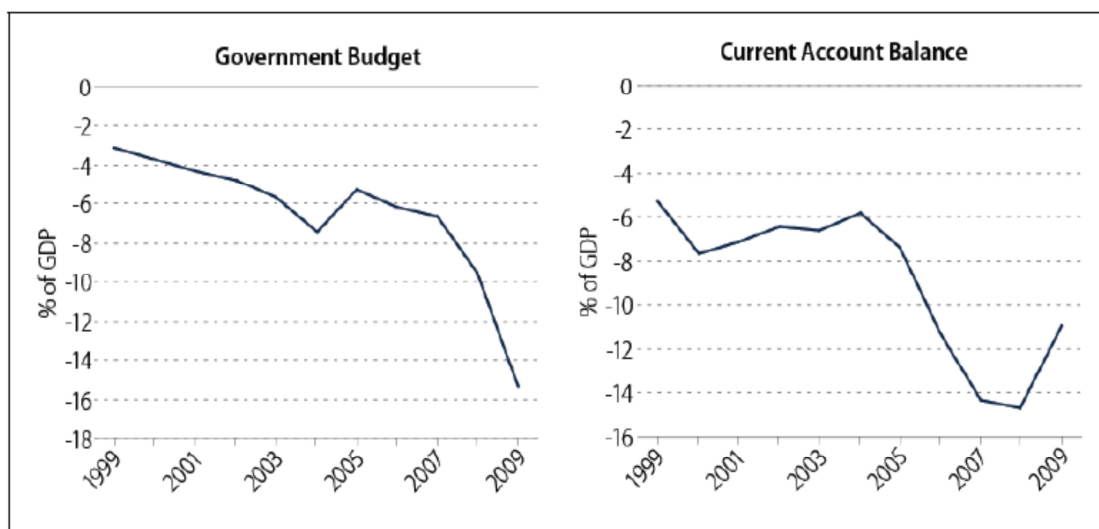


Figure 4: Greek Budget and current account deficit

Source: International Monetary Fund, World Economic outlook, April 2011

### 3.2 Greek Real-estate Market

As in every financial crisis the real-estate market is the first to be shattered when financial bubbles burst. The Greece real-estate market was the first to decline (see Figure 5) and a bleak picture of spiraling decline followed as the total economy was collapsing, inevitably so did real-estate prices. The construction industry is almost non-existent in the economy. If there is no potential sales of Greek islands and the selling of cheap villas to foreigners the market is not currently fashionable.

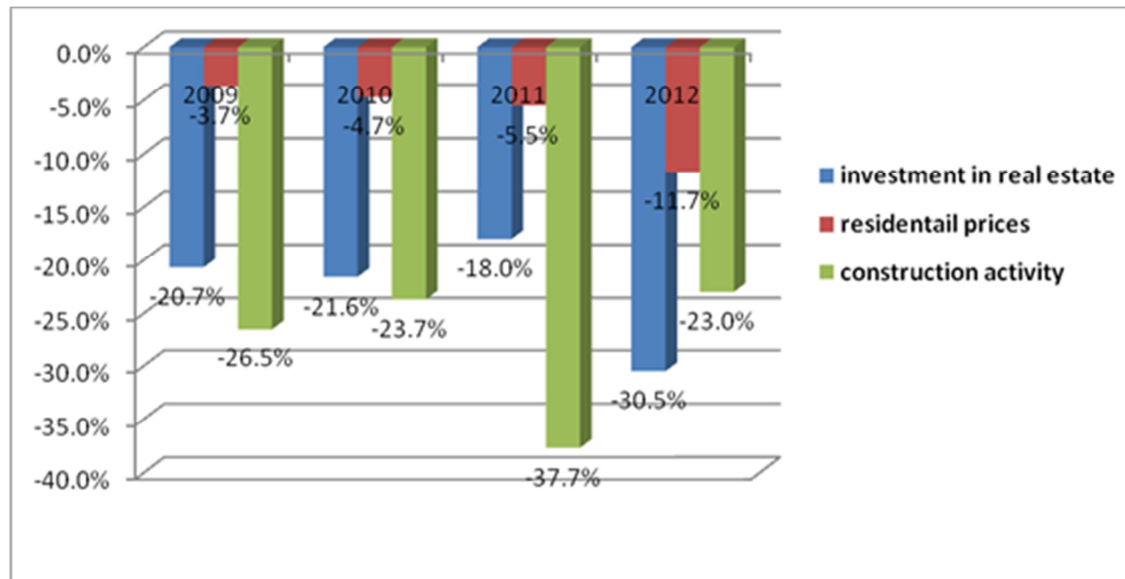


Figure – 5 Decline in real-estate related activity

Source: Central Bank of Greece (<http://www.bankofgreece.gr/>)

As a result, the domino effect continued and influenced the construction sector, which has declined rapidly since the beginning of the financial crisis. This sector reached its lowest moment in 2011 when the total activity declined for almost 40%. Moreover, employment in this sector was lowered for almost 50%, lowering the number of employees from 399.3 thousand in 2008 shrinking to 213.5 in 2012. Additionally, investments in real-estate and real-estate prices also decreased significantly with a nominal decrease of 27,9 %. This affected mostly bigger cities, most notably Thessaloniki (-34.7%) and Athens (-27.9%). Banking and financial problems in the country affected both the residential prices (lack of lending activities), and the investment in construction and real estate. The lack of potential finance was most noticed in 2012 when the investment in real-estate was lowered over 30 % (Danos real-estate consultants).

Not only domestic real-estate is influenced by the spiraling decline. The Athens market, which is the biggest market in Greece, offers office space of almost 7.000.000 m<sup>2</sup>. What is remarkable is that space aimed at the corporate market of almost 1.500.000 sq/m is occupied by the administration and public sector. This represents over 20% of total office market. With the lowering of the administration, which is one of the preconditions for financial support, this will further increase the vacancy rates in Greece. For example, the vacancy by the end of 2012 was 16%, an increase of 4% from previous year. Additionally, rent prices have been lowered drastically from 21 in 2011 to 14 in 2012 (Central Bank of Greece). Moreover, the Retail market is also on the brink of collapse. With average vacancy rates of over 30% Greece Retail Market is the highest on the Balkans. Rent prices are also declining. Average prices declined for 10 % both on high-end streets and shopping centers.

### 3.3 Albanian Real-estate Market

The Albanian economy was the only Balkan economy that didn't go in to recession during the period of financial crisis. Although it had a severe decline in GDP growth, still countries GDP remained growing with a slower pace during the financial crisis. Albanian real-estate market is still very young and undeveloped. The country's residential construction is in its embryonic state, where people are only starting to be aware of leaving in safe, environmental apartments. The financial crisis impacted the construction activity in the country, leaving several large projects to remain unfinished. Only in 2010, there was a decrease of construction activity

Albanian office market remains relatively new. Most of the buildings were built after 2000 and the area remains under-developed. The financial crisis impacted its expansion, with several projects remaining in construction or not yet started (see Figure 6). The size of the market remains unchanged in the last several years. The supply in the office market remains almost identical in the last 5 years, at about 65000sqm. Maybe the biggest office project in the Balkan, named Tirana business park remains uncertain. This project was supposed to deliver 200.000 sq/m in the period of 10 years. But, the lack of financing opportunities is limiting the prospects of this project.

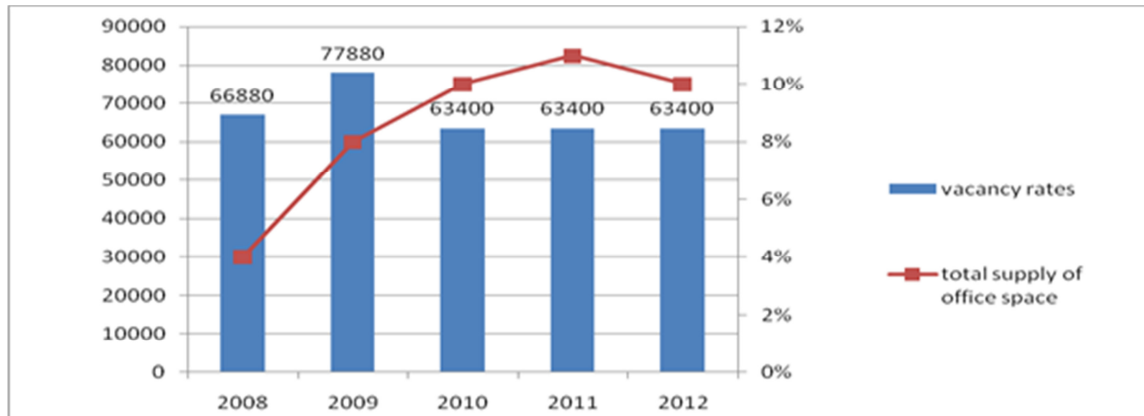


Figure – 6 Albania office market  
 Source- Albania Research and Forecast Report 2009-2012 Colliers international  
 (<http://www.colliers.com/en-gb/albania>)

Unlike the office market, which remained unchanged and with lack of new projects, the office market faced significant changes. New additional projects were delivered in the past few years. Tirana retail market is consisted of 17 shopping centers. The latest addition of Tirana East Gate shopping center that spreads on a construction area of 90.000 m<sup>2</sup>, opened in 2011. Nevertheless this does not indicate that the Albanian market escaped impact by the financial crisis. The biggest effect of the financial crisis was noticed on the vacancy rate that increased from 8% in 2010 to 12% at the end of 2012. Additionally, rent rates decreased for 20%, and are at an average of €40/sqm. The recovery of the economy is also expecting to stabilize the market. If the project of Tirana Business park is utilized it will change the prospectus of the real-estate market in the country.

### 3.4 Bulgarian Real-estate Market

The Bulgarian market is the most developed in the Balkan Area. Dissimilar to other Southeastern countries, Bulgarian real-estate market is well developed and it is not only focused on the capital of the country. However, the development of the real-estate market was hit by the European and Greek financial crisis. Greece is one of the biggest trade partners of Bulgaria, and the collapse of Greece is affecting the economy. In recent years the country had shown lesser growth: in 2011 GDP increased by 1,7%. The lowered financial activity was noticed in the construction and real-estate market. In nominal terms the average property prices in Bulgaria have increased with 201% for the period 2000-2010 (in real terms average property price growth for the same period sums up to 68.76%). This is an average growth of 11.65% per year, even after the huge drop in prices from 2008 onwards.

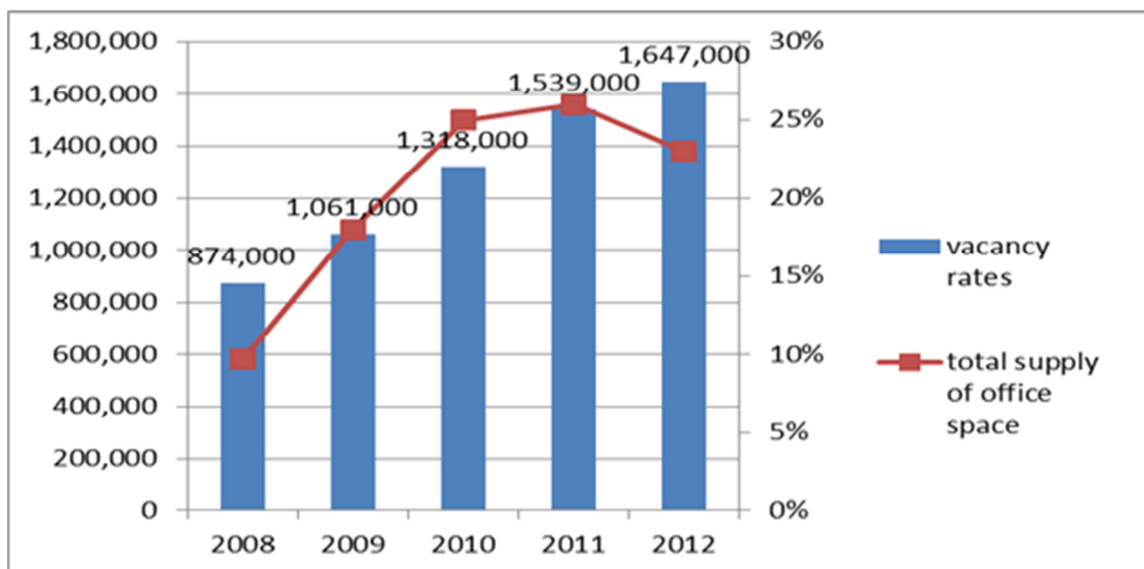


Figure 7 – Office market of Sofia

Source- Bulgaria Research and Forecast Report 2009-2012 Colliers international (<http://www.colliers.com/en-gb/bulgaria>)



Again, the consolidation of the economy was reflected on the real-estate market. The office market saw a decline in both rent prices and vacancies (see Figure 7). After several years of declining the vacancy rates have decrease in the last year, and rent prices remained stable although at a much lower level than in pre-crisis period. The supply in the market almost doubled in the last 4 years. The increased supply and the financial crisis pressured the rents. Average rent prices in Class A objects lowered from an average of €16-18 /sqm in 2008 to €9-12 /sqm. Currently there is 363,857 m<sup>2</sup> of vacant office space, which is approximately 23% of total market. In the same way, Bulgarian residential market is also decreasing. Average prices declined for about 25 %. Only larger activity remains in Sofia. Even the coastal areas faced severe decline in the number of transactions.

Conversely, the retail market is more stable than the office market and the financial crisis affected high street rents, where they declined for over 70 % in the period of 2008-2012. The rates in the shopping centers remain stable. Although rates are lowered they remain stable unlike rents in high streets. The market in the last year started showing the first signs of recovery. Investments increased. Vacancy rates decreased, rent prices stabilized, real-estate prices also stabilized. Additionally, foreign investors reestablished their interest in the Bulgarian market. This should impact all areas of the real-estate market.

### 3.5 *Macedonia and Montenegro*

Macedonia and Montenegro are the least developed markets in the Balkan region. The financial crisis affected both markets severely leaving several bigger objects unfinished or diminishing the prices of real-estate in general. Although all three segments of real-estate that we analyzed increased in 2012, still the financial crisis had a large role of un-developing the market and as a result the financial crisis arrested the development of the Macedonian real-estate market. The residential segment is most affected. According to unofficial data there are around 5000 unsold apartments at the end of 2012 (Vukcevic, 2013). This also affected the prices of residential real-estate that still remain high enough, despite the lack of demand for them.

In addition, office rental space has not developed. There are several Class A and Class B objects available, nevertheless companies prefer apartments and other objects instead of office buildings resulting in rent decreasing by 20% in just one year. What is more concerning is the fact there are several Class A and Class B objects that have 100 % vacancy, which have been on the market for more than two years. The retail segment remains the most developed market. With the addition of the new City mall the market increased for 33.000 sqm. The financial crisis affected the vacancy in district city centers and high street segment with increased to over 20% for the first time.

In addition to the Macedonian market, the Montenegrin market can be divided in two segments. Firstly there is the office market that is small and exists only in the capitol of Podgorica and secondly, the there are some residential developments that envelopes the coastal area. The office market is relatively small and consists of only of 30.000 sqm. The biggest project on the market named Atlas Business Center which is supposed to add additional 24.000 sqm is in construction in the last four years. The financial crises only decreased rental prices by 10% ([www.cbre.co.me](http://www.cbre.co.me)). The residential market remains the most active segment on the Montenegrin real-estate market and as in the case of the other Balkan States the financial crisis affected some new projects. Several companies decided to postpone some apartment constructions. But only in the last several years there were over 100.000 sqm of apartments constructed in the coastal area.

### 3.6 *Serbia*

The Serbian real-estate market is one of the most developed markets in the Balkan area. The financial crisis affected the economic activity in the country with a GDP growth of 3.5 % (Global Finance). The economic recovery in the country was surpassed with FDI. Even during the period of global financial crisis, Serbia's FDI recorded €2,2 billion in 2011.

Real-estate markets in Serbia remained stable and was the market that was least affected by the financial crisis. It didn't grow as previous years, but it didn't show the declines as well developed Balkan markets did in other countries. The retail market remained virtually untouched. The financial crisis affected the residential market mostly, and increased the vacancy rates in the office market. However, the financial crisis had impacted the construction market quite significantly. In 2010 there were 20% less issued construction permits than in previous years. The biggest hit was set on residential objects and in 2009 alone the delivery of residential objects was lowered by 30%. This also affected prices on the market that declined between 5-15 % on a yearly basis from 2009-2011.

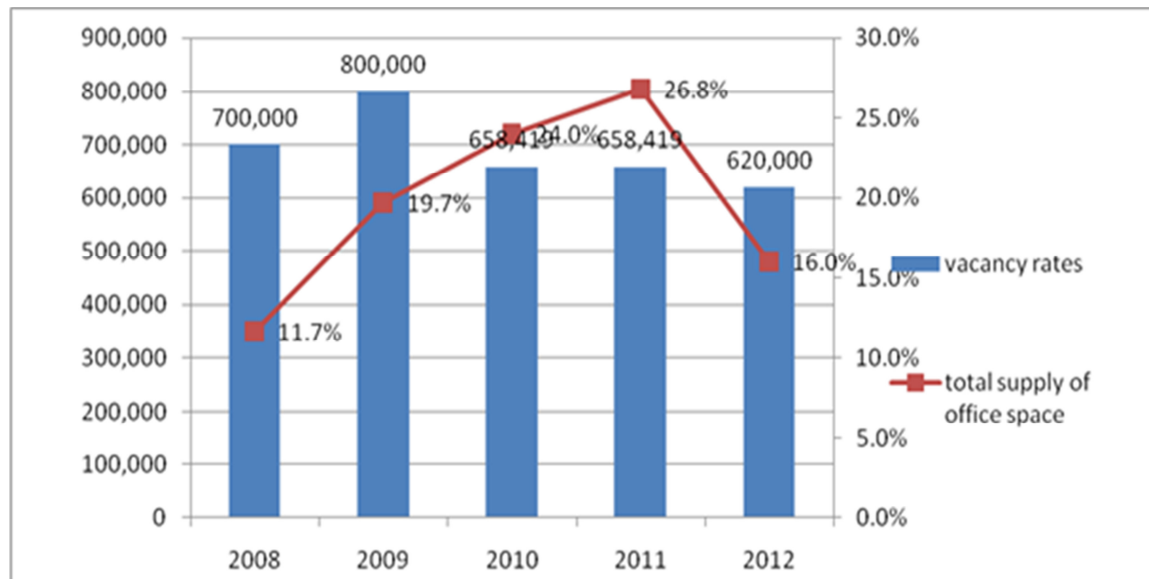


Figure 8 – Office market in Serbia

Source- CBRE, Belgrade Office Market Reports 2009-2012 ([www.cbre.rs](http://www.cbre.rs))

The office market remained stable (without any new deliveries) and with stable rent rates (see Figure 8). However some impact was noticed in vacancy rates that ascended to 26.8% in 2011 - representing an increase of 230%, from the vacancy rates in 2009. Similarly, the retail market had a small decrease of rent prices by only 5%. The vacancy rates were at 0 level in shopping mall with a small effect on high street vacancies.

In addition to the increased interest by foreign investors as well as the stabilization of the economy that goes hand-in-hand with government policies for subvention of residential constructions and easing of credit policies, we expect an expansion of the market.

#### 4. Conclusion

Real-estate prices are most sensitive to credit expansion. In period of financial prosperity that is pressed by an increase in credit, a faster pace than usual increases real-estate prices. The Balkan region has had high increase in real-estate prices, mainly because of lack of quality space, and an increase of foreign investors. This led to higher prices in almost every real-estate aspect. However, the world financial crisis accompanied with the financial crisis of Greece started to diminish those prices. Several countries are stuck with construction projects that will never be finished, or with larger than average vacancies. Additional investigation into augmented spending behaviors by home owners that contribute to overbearing financial burdens may benefit safeguarding lending institutions in developing lending policies. In addition a greater understanding of the regional impact of financial crises may support safeguarding measures for lending institutions.

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