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# Real Estate
## Market Report
# Latvia

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REAL ESTATE

# The Market Is Waking Up

- **The economy of Latvia has reached the bottom, positive trends noted – improving GDP rates, increasing exports**

- **Prices in the housing market have been increasing again since 2009; the growth is 18% during the year**

- **Banks are not selling foreclosed properties, as they are confident in a price increase**

- **The recovery of the economy and the expected price increase again make the real estate market of Latvia attractive for investments**

- **Construction of new housing projects will restart in the coming years**


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# The General Economic Situation

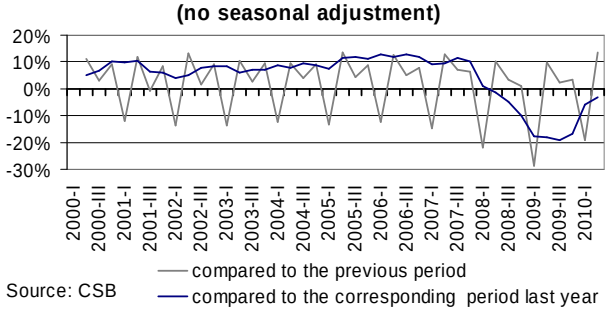
The economy of Latvia has reached its lowest point in the second quarter of 2010 – gross domestic product (GDP) has stopped falling. GDP changes are comparable, the adjusted prices were already positive in the first quarter of this year. Different areas of the economy showed different growth, and some of them are still shrinking. There has been a positive trend in exports for a while now, while the construction industry is still declining.

The actual GDP rates are higher than the Ministry of Finance predicted: GDP changes in actual prices were predicted to reach - 8% in 2010, 0% in 2011, 5% in 2012, and 10% in 2013.

On September 3, international ratings agency *Fitch* upgraded the credit outlook of Latvia from negative to stable; international ratings agency *Standard & Poor's* had downgraded its rating from A- to BB in 2007–2009.

The improving credit outlook of Latvia demonstrates positive trends of development of the internal and external financial market and economy, improves the confidence in Latvia on international financial markets, as well as the confidence of investors.

**GDP changes in comparable prices (no seasonal adjustment)**




Source: CSB

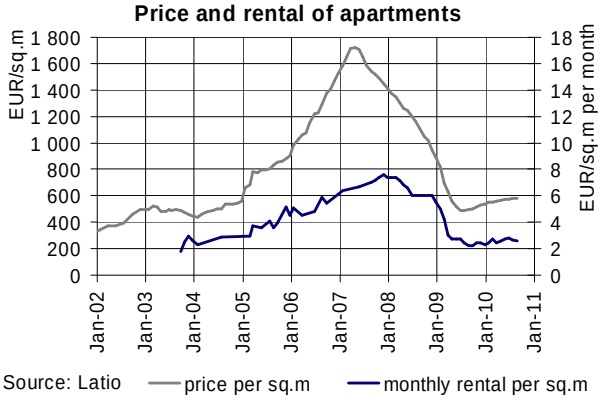
# The Housing Market

Over the past five years, the housing market of Latvia has experienced both the most rapid price growth and the fastest decline in the world. The housing market reached the lowest point in the middle of 2009.

Prices have been on an uptrend since reaching the lowest point – over a year they have increased by 18% or 1.4% monthly, which is again the fastest price growth in the world.

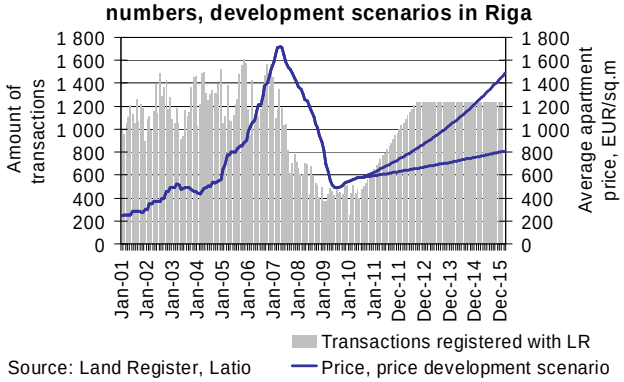
Growing rent charges are also noted on the housing market, although the rental levels are significantly below the peak reached in 2007.

**Price and rental of apartments**




Source: Latio

**Average apartment sale price, apartment sale numbers, development scenarios in Riga**




Source: Land Register, Latio

*The chart shows two scenarios of development – monthly price increase 1.4% (average since 2009) and monthly price increase 0.5% (average during the last three months)*

The rapid growth of the housing market in 2005 - 2007 caused a sharp decline in 2007–2009, which resulted in housing prices falling below the economically-justifiable level, even during recession. Therefore, there are objective economic grounds for price increases in the future.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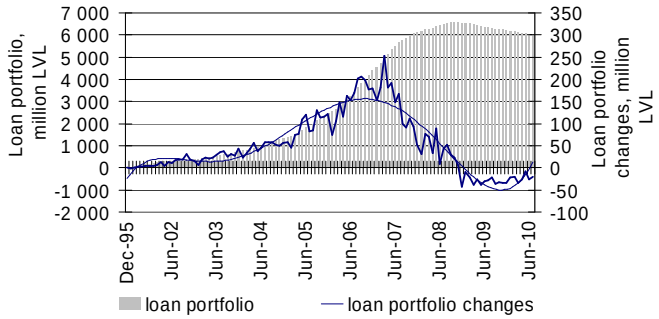
Commercial banks having been overly generous in lending for the housing market during the years of growth had to deal with creditors gone in financial difficulties. Part of their mortgaged real estate was taken over by the affiliated structures of commercial banks – funds – thereby optimizing the balance sheets of banks.

Loans for the housing market came to a halt practically in 2008, as banks had become more cautious. Changes of the loan portfolio turned negative – more loans were repaid than new ones granted.
Although the banks are claiming today that lending has been restarted, a dialogue is not forming between potential borrowers and commercial banks – loan conditions are stricter, and borrowers are more cautious.

**Portfolio of loans issued to households by commercial banks, changes in the portfolio**




Source: Financial and Capital Market Commission, Latio

Apartment purchase transactions, where the amounts reach only a third of the historical ones, mostly are funded without any bank support, although there is a growing trend of transactions with loans.

# New Housing Projects

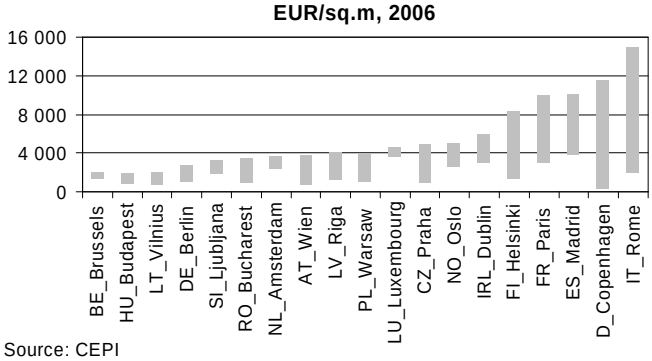
The real estate boom spurred extensive development of new housing projects. Prices were increasing rapidly, some months even by 10%. Due to the rapid price increases, speculations were widespread – in many cases apartments were purchased as an investment with the expectation of high future profits.

Most of the investors became bankrupt during the recession; the properties were transferred to the bank structures. However, the banks did not rush to sell them, as they justifiably believed that the prices would only increase in the future, due to the following reasons:

1. Compared to the average indicators in Europe, Latvia lacks both the total living space and a sufficient number of apartments.
2. Capital is currently cheap on the international financial markets – EURIBOR ~1%; therefore, the time factor is not expensive either – if financial resources are available, waiting for a price increase is more profitable than selling today.
3. Compared to the average prices in Europe, apartments in Latvia are cheap, thus prices thereof logically must increase along with Latvia's convergence toward the average rates of the EU.

During the recession, construction of many new developments was suspended and many new projects were frozen due to the price decreases.

**Apartment prices in European capitals, EUR/sq.m, 2006**




Source: CEPI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# Forecasts

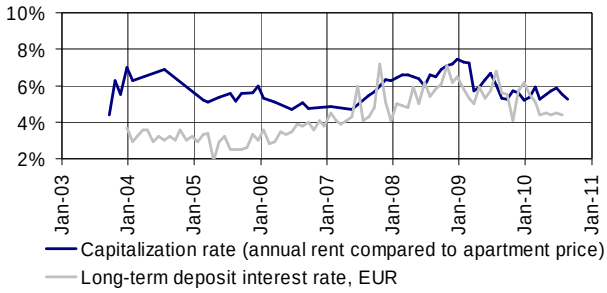
Latvia is already showing better economic recovery results than previously expected. Therefore, along with the economic recovery, the purchasing power of consumers must also increase that would result in growth of real estate prices.

Latvia's risks are falling and credit ratings are improving; that means loans granted by banks will increase. The main method of purchase in the real estate market must be a loan rather than cash having been typical of the recession period and still being an issue today. Therefore, prices must increase and the amount of transactions must return to the historical level.

The current and expected price increase spurs interest of investors in the housing market as an object of investment, which not only gives the opportunity of receiving a cash flow from rental, but also is expected to increase in value during the next five years. In terms of the cash flow, investment into an apartment property is more profitable than a bank deposit, today.

Compared to the pre-recession period, regulation of lending has become more conservative (first installment, loan-to-value ratio, etc.), thus the overheating risk of the housing market has been minimized.

**Rent, capitalization rates, credit and deposit interest rates**




Source: Latio, CSB

As construction costs have fallen by ca.50% compared with the peak in 2007–2008, housing construction could be restarted in the following years. Projects that have already been started will be completed first. This situation is already observed in the private house segment.

Thereby, the land market for building of private and multi-residential houses is expected to become more active; it has currently practically come to a halt judging by amount of transactions, and the prices have become record low. Consequently, land also becomes an attractive object of investment expected to increase in value.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