Residential real estate: spotlight on Hungary
How tax policy can drive the housing market

House prices have mostly held up in the past year across Europe despite the disruption from the Covid-19 pandemic. Hungary is one country that was an exception. The recent reinstatement of tax incentives which expired end-2019 may now revive the market.

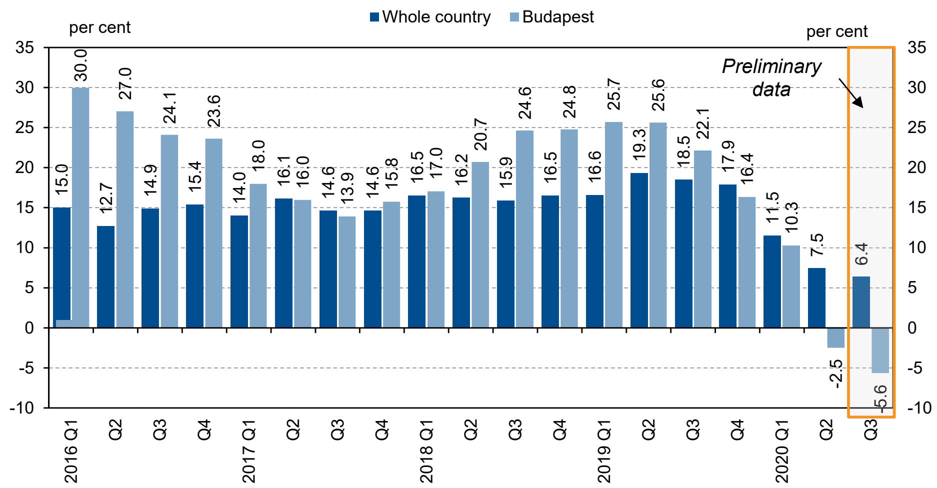
The resilience of the residential real estate market is visible in stable or falling yields across Europe as asset prices have risen, a trend reinforced by restrictions introduced by governments to contain the spread of Covid-19 infections and minimise the economic impact on households and business.

First, home buyers still have access to very cheap mortgage financing, typically 0.4% to 0.8% interest a year for loan-to-values of up to 60% to 80% for a 10-year fixed-rate loan. In some countries such as Germany, buyers with good credit scores can still take out 100% loans.

Secondly, the lockdowns and subsequent physical distancing restrictions, including encouragement of remote working, has forced people to spend more time at home, putting a premium on quality living space. A related factor is that people no longer expect this to be just a temporary shift, with remote working set to be a more important feature of professional life.

Thirdly, ultra-loose monetary policy and low, if not, negative interest rates have ensured lack of attractive low-risk, positive-yield alternatives to real estate for private and institutional investors faced with the economic uncertainty created by the pandemic. Residential real estate's reputation as a safe-haven investment has grown despite low net yields: 2.5%-3.0% for high-quality residential real estate in Germany for example.

Figure 1: Hungary – year-on-year change in housing prices



Source: Hungarian Central Bank (MNB)

This brings us to the anomaly of Hungary's residential property market.

The Hungarian market experienced a steep decline in transactions and prices during 2020 in contrast with nearby markets such as Austria and the Czech Republic. In the capital, Budapest, house prices fell 5.6% in Q2 2020 from the previous quarter, according to the National Bank of Hungary (MNB). Preliminary data point to further decreases in prices in Budapest in the third quarter. Domestic house prices increased on a national average, but at a much slower rate than before, up 7.5% in Q2 year-on-year compared with an annual growth rate of 17.9% at end-2019.

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Hungary's tax policy: determining factor in housing demand and prices

Tax incentives drive demand

The tax-related volatility in Hungary's house prices goes back to 2016 when the government lowered value-added tax on the sale of new-build apartments to 5% from 27% to encourage home ownership. The government put a time limit on the tax benefit, with the concessionary VAT rate expiring at the end of 2019.

End of VAT concession coincides with Covid-19 shock

In doing so, the government's policy drew forward house purchases to the second half of that year, creating a boom in transactions swiftly followed by a significant decline in early 2020. The tax-induced slump coincided with the onset of the Covid-19 pandemic which further reduced demand for new homes through lockdowns, temporary restrictions regarding house visits and on-site inspections, all amid increased economic uncertainty.

Government U-turn on VAT

Tax policy has now changed again. The government introduced measures to support the housing market in October last year, reducing VAT again to 5% for all new apartment sales carried out before 31 December 2022, thereby re-introducing this measure for another three years. Secondly, families already eligible for another government subsidy program (CSOK), can now also reclaim the remaining 5% VAT as a cash refund.

Tax changes: who will benefit, and by how much?

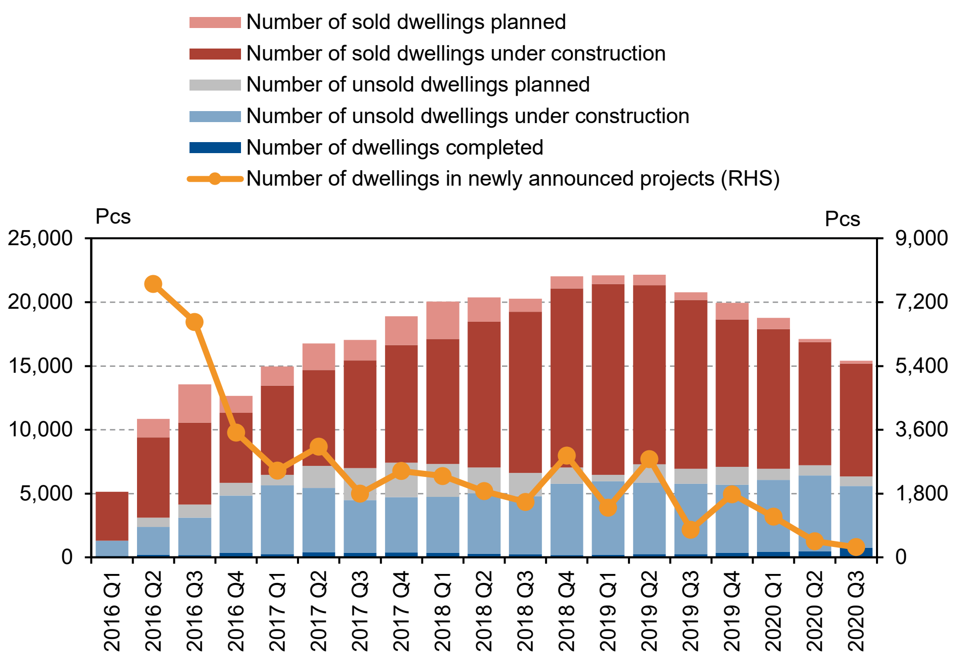
House buyers, developers to benefit from tax shift

We expect these measures to have multiple consequences for the Hungarian market – for consumers and for the credit outlook for the corporate players in the residential property sector.

Transaction volumes set for rebound in 2021

First, transaction volumes should rebound given the strong underlying demand for modern living space in Hungary, especially in Budapest where there is net population growth and a large stock of outdated living space.

Figure 2: Hungary – housing market supply



Source: Hungarian Central Bank (MNB)

Expect a significant price effect

Secondly, the substantial savings of the lower tax will result in both cheaper gross prices for buyers as well as higher net sales prices for builders.

The previous cut in VAT on new home sales in 2016 translated into an average 9% cheaper gross price for buyers – equivalent to a 40% incidence of the measure on consumers – according to MNB analysis.

Biggest beneficiaries likely to be real estate developers

We will likely see at least half of the delta in taxes on new built apartments benefitting real estate developers.

How much of this will be transferred from developers to construction companies remains to be seen, but we expect this effect to be limited in the short run as a large portion of the projects to be delivered within the next two years is already contracted.

Hungarian house prices are expected to have risen in 2020, according to the MNB, though at a much slower pace than initially forecast – up by around 5% instead of 10-15%.

Favourable credit implications for corporate sector

Here is our summary of the credit outlook for the Hungarian residential real estate sector as the change in tax policy washes through the market:

- Credit quality of leading residential developers is set to improve through better operating margins.
- Pre-sale ratios of at least 30%-40%, existing land bank and moderate balance sheet leverage of below 50% loan to value remain key for builders to secure funding for new development projects at attractive conditions.
- Land values for residential real estate projects should appreciate again, notably in top locations in Budapest., also given the option for developers to benefit from an extended VAT reduction on apartment sales even beyond 2022 if the plot was acquired until the end of 2022.

Hungary’s exceptionalism in Europe set to prove temporary

Residential market largely proves safe-haven status in 2020

Hungary’s residential market was an exception last year, marked by a steep decline in transactions in H1.

In much of the rest of Europe, residential real estate has proven to be the most resilient property segment, with the peculiarities of the Covid-19 crisis serving to offset much of the disruption of the broader economy which might otherwise have weighed heavily on the demand for and supply of new homes.

However, as the Hungarian government has restored tax policy that favours buyers of new homes, the country’s residential market – notably Budapest’s – should experience similar bullish trends – in terms of volumes and prices - to the rest of Europe.

Favourable supply-demand; Hungarian market to rebalance

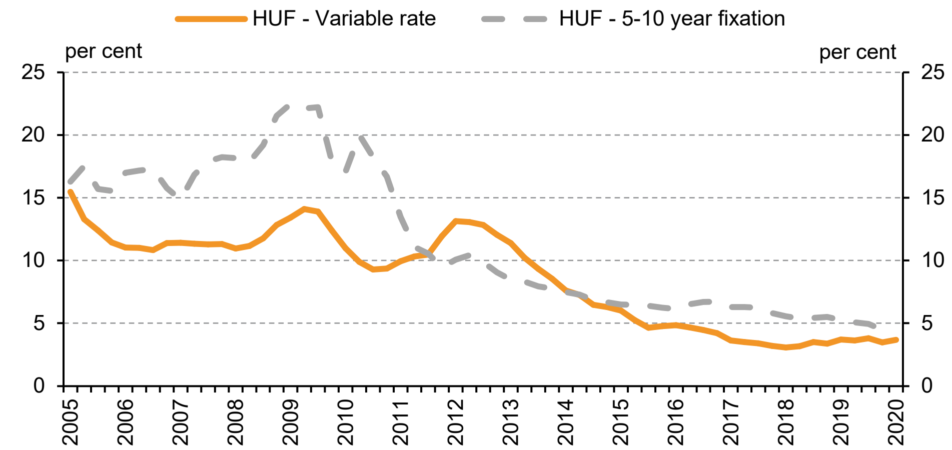
We expect good demand/supply fundamentals backed by limited new building volume and the attractive financing conditions to continue (See charts in the Appendix on page 4). In these circumstances, Hungary is set to match developments in western European housing markets more closely in the next year or so.

Tax policy does indicate risk of overheating

The risk of the market overheating again remains the biggest threat to the stability of the country’s residential real estate market.

I. Appendix: Hungarian interest rates; residential property development pipelines

Figure 3: Retail interest rates – residential real estate Hungary



Source: Hungarian Central Bank (MNB)

Figure 4: Residential development pipelines – Scope Ratings coverage

Company	Scope issuer rating	Senior unsecured debt rating	Residential pipeline* (units)
Wingholding Zrt. ("Living")	B+/Stable	BB-	1,909
Proform Ingatlanbefektetesi Zrt.	B+/Stable	BB-	154
CORDIA International Ingatlanfejlesztö Zrt	BB/Stable	BB	2,835
SunDell Estate Nyrt.	B/Stable	B+	1,350

Source: Hungarian Central Bank (MNB)

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