



RESIDENTIAL PROPERTY PRICE INDEX

Annual Review

2010-2011

During 2010-2011, the Cyprus property market experienced a significant downturn reflected through lower property prices, drastically reduced number of transactions, lack of market liquidity and weak construction activity. The gloomy picture that prevailed in the market during this period, which was mainly attributed to the negative impact of the global financial crisis on the domestic real estate market, is also presented in the results of the residential property price index and other relevant economic and construction sector indicators.

Introduction

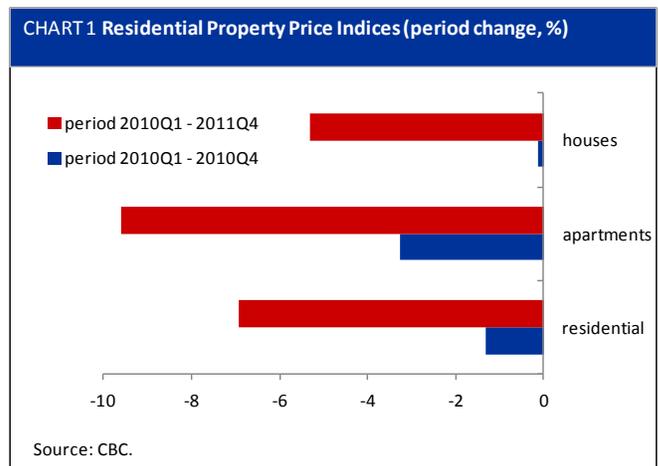
The purpose of this review is to present a more comprehensive and thorough analysis of the residential property market developments which took place between 2010 and 2011. This is complementary to the analysis included in the already published quarterly Residential Property Price Index (RPPI) reports. The review is based on the revised results¹ of the RPPI published by the Real Estate Unit of the Central Bank of Cyprus (CBC).

According to the RPPI, residential property prices (houses and apartments) declined by 1,3% during the period 2010Q1-2010Q4 and by 6,9% during the period 2010Q1-2011Q4 (**Chart 1**), amid the continued deterioration of economic conditions in the real estate sector .

Apartment and house prices

Apartment prices appeared to be more vulnerable to worsening market conditions, exhibiting larger decreases relative to house prices, as well as greater deterioration over time. Specifically, the apartment price index recorded a decrease of 3,3% during the period 2010Q1–2010Q4, and a decrease of 9,6% during the period 2010Q1–2011Q4. The corresponding

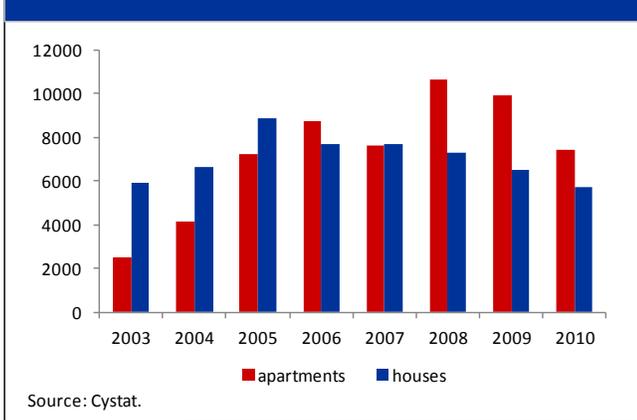
¹ More detailed information relating to the revision is found in the notes section of the present report (p. 7).



decreases in house prices were smaller, 0,1% and 5,3%, respectively (**Chart 1**).

The gloomier picture presented by the developments in apartment prices relative to those of house prices is attributed primarily to the fact that, during the property market boom, apartments constituted the main product of the sector, marketed to both foreign investors and local buyers, thus leading to an oversupply during the downturn. This is reflected in the results of **Chart 2** (p. 2), which record the number of residential units (houses and apartments) completed in the private sector during the period 2003-2011. Notably, the number of apartments completed in 2008, the year during which the Cyprus property market reached its peak, was 45,7% higher than that of houses.

CHART 2 Number of apartments and houses completed in the private sector



During the boom in the construction sector, coastal areas, tourism and leisure communities, experienced unprecedented growth in the number of newly completed apartment complexes targeting second home buyers, local and foreign investors. However, the gradual worsening of the economic crisis, both globally and in Cyprus, and the consequent withdrawal of foreign investors' interest in Cyprus properties, led to the creation of a significant inventory of apartments, with predominantly second home features. As a result, and given that this type of property is usually the most severely affected during recessions, the downward pressure on prices brought about by the large available stock was significantly greater for apartment properties than for house properties, which are mainly driven by local demand for primary residences.

The larger oversupply of apartment properties on the market relative to that of house properties is also evidenced through the course of the coastal areas' apartment price indices. Over the last two years, there have been more pronounced declines in apartment prices in districts which are prominent tourist resorts, and therefore where property demand relies heavily on foreign investors, than in districts which rely mostly on domestic demand.

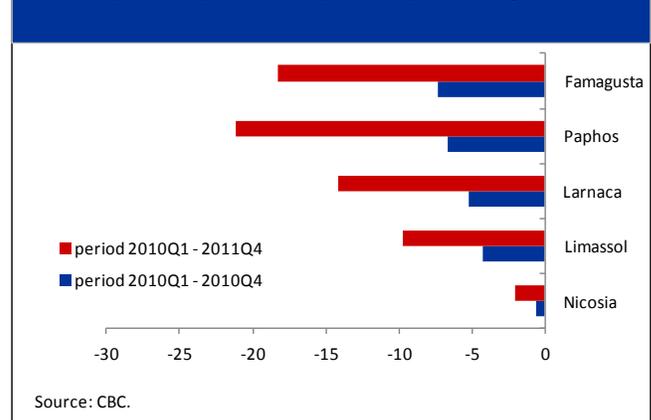
Thus, the biggest decline in apartment prices during the period 2010Q1-2011Q4 was recorded in

Paphos (21,2%), followed by Famagusta (18,2%), Larnaca (14,2%), Limassol (9,8%) and Nicosia (2,1%) (**Chart 3**).

Prices in coastal areas and urban centres

During the period of high growth in the construction sector, Paphos attracted high levels of foreign investment and the investment interest of a large proportion of holiday home developers. This is reflected in **Charts 4** and **5** (p. 3), which depict the by district share of sale contracts issued to foreign and local investors, respectively, for the period January

CHART 3 Apartment price indices by district (period change, %)



2008 to April 2012, when data are available.

According to **Chart 4** (p. 3), Paphos held the largest share of sales contracts issued to foreigners (33%), followed by Larnaca (21%), Limassol (19%) and Famagusta (17%), while Nicosia held the smallest share (10%). In contrast, **Chart 5** (p. 3) confirms the view that Nicosia constitutes the district which attracts the highest level of local investment in real estate with a share of sale contracts issued to locals of 26%, closely followed by Limassol with a 25% share.

Hence, the demand for real estate in Cyprus is strongly divided between the regions that mostly attract foreign investors' interest and those that best meet the housing needs of the local population. We can, therefore, talk about a "two-speed" development in the property sector.

CHART 4 Sales contracts to foreigners, by district, January 2008 - April 2012 (share over total number)

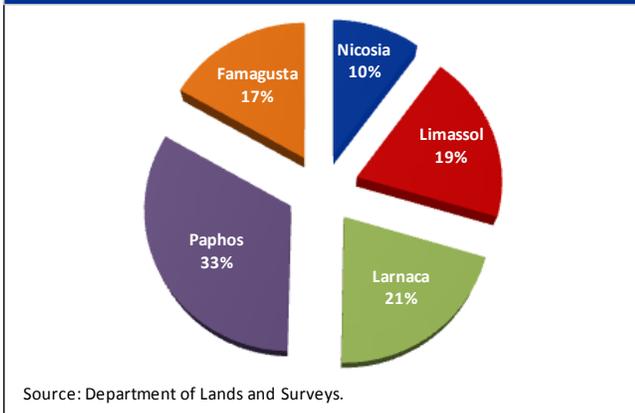
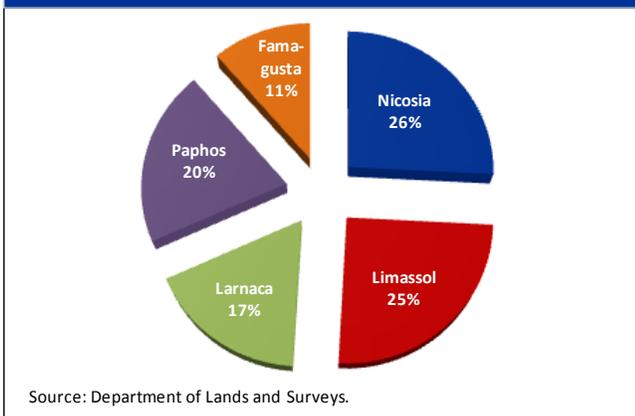


CHART 5 Sales contracts to locals, by district, January 2008 - April 2012 (share over total number)



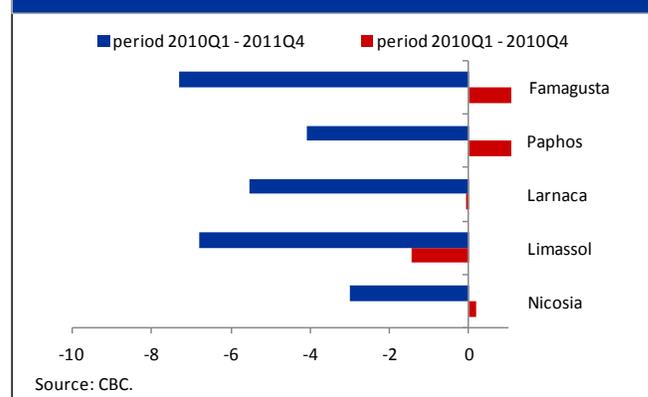
“Two-speed” development

The aforementioned partition of the Cyprus property market is further highlighted in the course of house prices. Houses constituted over time the type of property most preferred by local buyers as a primary residence. As a result, in contrast to apartment prices, house prices exhibited less volatility and less differentiation across districts and across time.

According to the CBC house price index, the rate of decline of house prices remained relatively constant across districts, with the exception of Nicosia, which recorded the smallest decline. During the period 2010Q1-2010Q4, the degree of change in house prices across districts with the exception of Nicosia, ranged between +1,9% (Paphos) and -1,5% (Limassol). For the period 2010Q1-2011Q4, this ranged between -4,1%

(Paphos) and -7,3% (Famagusta) (Chart 6). In Nicosia, the corresponding price changes were +0,2% and -3%,

CHART 6 House Price Indices, by district (period change, %)



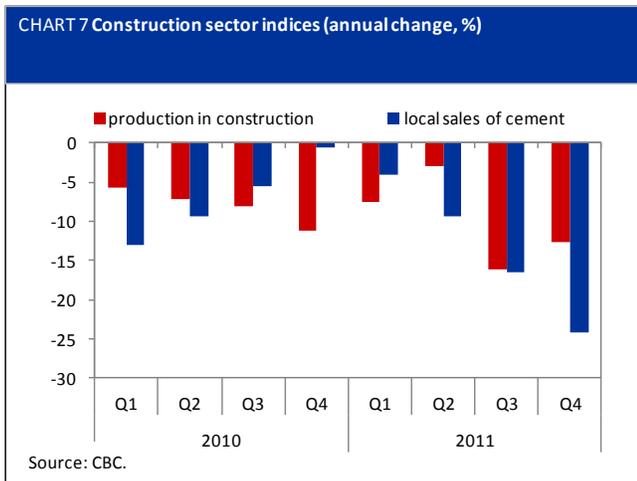
respectively (Chart 6).

As indicated by the above, Nicosia constitutes a singular property market in Cyprus. The positive picture presented by the course of residential property prices in the capital relative to that in other districts is directly linked to the fact that Nicosia, being the only district in Cyprus that does not border the coast, is not directly affected by external demand. Additionally, Nicosia being the district in which the majority of government organisations and agencies, banks and other private companies are located, attracts the largest proportion of local investors and satisfies the largest share of residents’ demand for primary residence. As a result, it exhibits greater resistance to market pressures.

Slowdown in construction activity

The continuing decline in residential property prices is closely intertwined with the general slowdown in the construction sector, further deteriorated during the period under review.

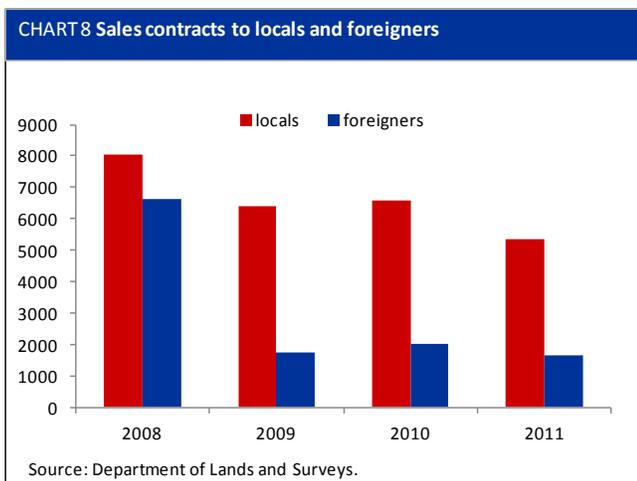
According to the index of production in construction (PIC), construction activity fluctuated at very low levels during the period 2010-2011, falling by 8% in 2010 and 9,5% in 2011 (Chart 7, p. 4). As in the case of the RPPI, the negative trend of the PIC has worsened over time, mirroring the further deterioration of market conditions.



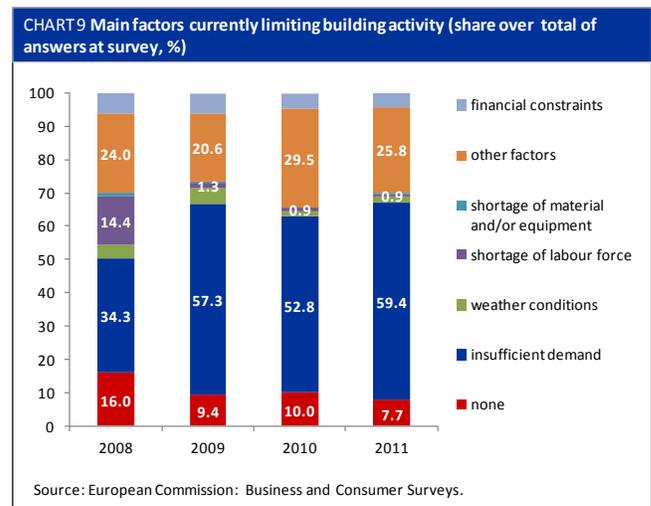
A similar picture is presented by the developments in the local sales of cement. These have also fluctuated at very low levels during the period under examination, exhibiting a tendency towards further decreases (**Chart 7**). Specifically, the annual reduction in the local sales of cement was 7,2% in 2010 and 13,7% in 2011.

Reduced demand

The contraction in construction activity was primarily caused by the sharp decline in both domestic and foreign demand for real estate, which was in turn a consequence of the global economic crisis and the uncertainty prevailing in the market. This decline in demand is reflected in the number of sales contracts submitted to the Department of Lands and Surveys during the period under examination (**Chart 8**).



Specifically, for 2010 and 2011, the number of submitted sales contracts reached 8.598 and 7.018, respectively, whereas in 2007, at its highest, this was 21.245. In contrast, the number for 2011 was the lowest since 2006, when data are available.

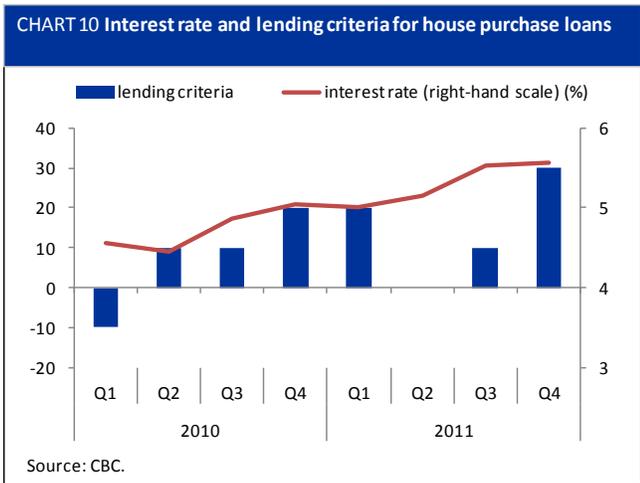


The above is confirmed by the results of the Business and Consumer Survey Questionnaire (BCS) of the European Commission, which indicate that the main factor limiting building activity in Cyprus is weak market demand (**Chart 9**).

Liquidity problems

Subsequently, and in addition to reduced demand, the lack of liquidity resulting from the worsening of the economic crisis has led to a further increase in borrowing costs and stringent criteria for access to credit funds (**Chart 10**, p. 5). Specifically, mortgage rates² rose to an average of 5,3% in 2011 from 4,7% a year earlier. The negative correlation between mortgage rates and house prices is recorded in statistical terms through the correlation coefficient between the mortgage rate and the annual rate of change of the CBC residential property price index, which was -0,7 for the period 2010-2011. Moreover, lending criteria became stricter during the same period (**Chart 10**, p.5), contributing further to the significant reduction of liquidity in the market.

² Floating Rate and up to 1 year initial rate fixation.



Prospects

According to the above analysis, the short and medium-term path of the real estate sector is expected to remain bleak, amid the intense climate of uncertainty currently prevailing in the market. This is also supported by various economic indicators. For example, the number of authorised building permits for residential properties recorded an unprecedented annual decline of 17,6% in 2011, compared with 1% in the previous year, further stressing the ongoing downturn in the construction sector.

Furthermore, the economic sentiment indicators published by the European Commission through the BCS are an important reference point for the sector’s future. The indices for sale price and employment expectations in the next three months, for example, were throughout the two year period of 2010-2011, at very negative levels (**Chart 11**), emphasising the sense of uncertainty prevailing in the market and suggesting that the recovery of the sector is not likely to occur in the foreseeable future.

TABLE 1 Residential property price indices by type and by district
(quarterly data, 2010Q1 = 100)

Quarter	<u>Residences by type</u>		<u>Residences by district</u>					Residential property price Index
	Apartments	Houses	N/sia	L/sol	L/ca	Paphos	F/sta	
2008 Q1	104,4	103,2	103,0	99,7	103,6	99,7	102,9	103,8
Q2	104,6	107,9	104,3	103,5	104,9	99,9	100,6	106,4
Q3	104,4	108,9	106,9	103,2	104,3	102,5	113,4	106,9
Q4	105,8	104,3	104,4	106,6	100,0	102,4	108,9	105,0
2009 Q1	100,9	98,8	99,7	95,6	99,4	103,7	108,3	99,7
Q2	96,8	101,2	100,8	93,7	99,3	104,1	106,0	99,4
Q3	101,0	100,6	101,1	96,7	103,4	102,6	101,1	100,8
Q4	102,1	103,0	100,2	101,5	103,0	101,6	102,3	102,7
2010 Q1	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Q2	98,6	100,0	99,2	99,5	99,5	99,9	98,6	99,4
Q3	97,3	100,4	99,9	98,0	98,4	99,8	98,2	99,0
Q4	96,7	99,9	99,9	97,6	97,9	98,3	98,4	98,7
2011 Q1	94,0	99,1	99,6	95,6	96,1	94,7	92,5	96,9
Q2	93,2	98,0	99,3	94,4	93,9	92,4	94,3	96,0
Q3	92,2	96,5	98,6	93,7	92,4	89,6	91,8	94,8
Q4	90,4	94,7	97,4	92,3	90,4	87,3	90,1	93,1

Source: CBC.

TABLE 2 Apartment and house price indices by district
(quarterly data, 2010Q1 = 100)

Quarter	<u>Apartments</u>					<u>Houses</u>				
	N/sia	L/sol	L/ca	Paphos	F/sta	N/sia	L/sol	L/ca	Paphos	F/sta
2010 Q1	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Q2	98,8	99,2	97,9	97,5	100,4	99,6	99,7	100,8	101,7	97,7
Q3	99,1	96,0	95,9	97,1	95,5	100,6	99,2	100,8	102,1	101,7
Q4	99,4	95,8	94,7	93,3	92,6	100,2	98,5	99,9	101,9	101,1
2011 Q1	99,5	93,3	91,3	87,6	86,5	99,7	97,1	99,4	102,4	97,9
Q2	99,4	91,9	89,8	84,0	83,4	99,2	95,6	97,3	99,5	101,1
Q3	99,1	91,8	88,0	80,3	80,7	98,2	94,5	96,1	98,6	96,9
Q4	97,9	90,2	85,8	78,8	81,8	97,0	93,2	94,5	95,9	92,7

Source: CBC.

Notes:

The residential property price index and other residential property price indices and sub-indices presented in the current report are produced by the Real Estate Unit of the Economic Research Department at the Central Bank of Cyprus (CBC).

Data from 2006 to 2009 were collected retrospectively from a number of monetary financial institutions. The data for the period after 2009 are collected by the CBC from the member banks of the Association of Cyprus Banks (BOC, Marfin Popular Bank, Hellenic Bank, Alpha Bank, Emporiki Bank, National Bank of Greece, Piraeus Bank, USB Bank, Cyprus Development Bank, Société Générale and Eurobank) and the Cooperative Central Bank in a standardised form, through an online data submission platform.

The partnered banks receive the relevant information from independent property surveyors for the purpose of granting mortgage loans. The data received are representative of the Cyprus residential property market, covering the whole of the government controlled territory of the Republic of Cyprus (Nicosia, Limassol, Larnaca, Paphos and Famagusta districts) and they refer to all types of residential property (houses and apartments).

All the estimated indices have been rebased so that the first quarter of 2010 equals 100. The RPPI is calculated as the weighted sum of the two by type sub-indices (house and apartment price indices), using the quarterly number of observations as weights. In the same manner, the aggregate house and apartment indices are the weighted sum of the by district house and apartment price indices.

The results of this report are based on the revised series of the residential property price indices, as they have been published in the Residential Property Price Index report of the first quarter of 2012, available at: http://www.centralbank.gov.cy/nqcontent.cfm?a_id=11836&lang=en. The revision of the various residential property prices was the result of the submission of additional historical valuation data from the partnered Monetary Financial Institutions and the subsequent availability of a bigger sample of data. Additionally, the CBC's electronic system for data submission has been updated with the latest valid planning zones and sheets from the Department of Town Planning and Housing. Furthermore, the availability of a larger sample of raw data enabled the improvement of the filtering techniques applied to the data. Hence, a deeper analysis of the results, and consequently of the appropriate limits for determining extreme and incorrect entries in the data, was possible. The improvement in the standardisation of the sample enabled a more accurate determination of the main characteristics of the sample, which capture to a great extent the variability of residential property prices through time, and consequently the identification of the functional forms of the regressions in the hedonic models used for the construction of the residential property price indices.

In constructing the indices, the hedonic methodology was employed. Further details about the methodology and other relevant information are available on the CBC website, http://www.centralbank.gov.cy/nqcontent.cfm?a_id=1.

The current report is available at: http://www.centralbank.gov.cy/nqcontent.cfm?a_id=11836&lang=en