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THE PRICE OF EU ACCESSION:

AN INSIGHT INTO THE BULGARIAN REAL ESTATE MARKET

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Abstract

Accession of Bulgaria to the European Union is expected to result in an increase in the prices of all types of real estate as changes are expected to differ across the segments of the national real-estate market. Property prices have been influenced primarily by local demand, government policies and the perception that EU accession is promoting investment. It is likely that prices of flats will further differentiate, the market for office space will stabilize, the provision of infrastructure will importantly influence prices in holiday resorts and industrial estates, and agricultural land prices will upsurge.

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Accession of Bulgaria to the European Union is expected to result in an increase in the prices of all types of real estate as changes are expected to differ across the segments of the national real-estate market. Property prices have been influenced primarily by local demand, government policies and the perception that EU accession is promoting investment. It is likely that prices of flats will further differentiate, the market for office space will stabilize, the provision of infrastructure will importantly influence prices in holiday resorts and industrial estates, and agricultural land prices will upsurge.

1 Introduction

A number of recent studies on the main determinants of price dynamics in Central and Eastern Europe (Baldwin et al., 1997; Coorey et al., 1998; Cottarelli et al., 1998; Moore, 2001; Tzanninis, 2001; Van Elkan, 1996; Wozniak, 1998) argue that non-monetary factors, in particular relative price adjustments, are of paramount importance in explaining not only short-term but also medium-term price developments in the accession countries. Relative price changes are seen as having upward effects on inflation, as the distribution of the size of relative price changes in all sectors of the economy is typically positively skewed and the price changes frequent; all these strongly affect economy's sustained increase in relative prices. Furthermore, the behaviour of wages is found to exert an important influence on inflation and thus price dynamics in Central and Eastern Europe.

It is reasonable to assume that these general features will continue to characterize the price dynamics in the accession countries. However, the individual factors will continue to undergo dynamic changes as economic structures and the institutional environment are evolving. In such context, past relationships among factors tend to become misleading. For the purpose of the essentially forward-looking analysis undertaken in this paper, it appears to be more promising to examine what key driving forces of current and future price dynamics arise from the completion of transition, the prospective entry into the European Union (EU) and the ongoing catching-up processes in Central and Eastern European countries.

A basic proposition of the paper is that EU accession and integration is an important anchor and incentive for sound macroeconomic and structural policies. This will mitigate or do away with several factors that currently drive price changes in accession countries, even though accession itself may entail some one-off price adjustments. In particular, any potential inflationary bias of monetary, exchange rate and fiscal policies will be reduced to a large extent under the EU economic policy coordination and surveillance framework. In fact, already now, applicants are exposed to a policy dialogue and surveillance instruments. In a similar vein, transition will still impact price dynamics in accession countries, but only for a limited period of time, especially, in the most advanced transition economies. Catching-up, in turn, is a longterm process which will impact on price developments in accession countries for many years to come. Against this background, three sources of current and future price dynamics in accession countries can be singled out, namely (i) the completion of price deregulation and the adjustment of agricultural prices upon EU membership, (ii) productivity developments, and (iii) wage developments in the traded sector of the economy.

Considering the real estate market in Bulgaria, in particular, there are three points worth emphasising. Firstly, property prices have been influenced primarily by demand, which depends largely on the nation's standard of living and the expectations of the population. Secondly, the government has been playing an important role in affecting market trends as any conditions, which may result from new regulations actively influence the decisions of market players. The nature of the legal framework largely depends on the policies and attitudes of the government towards housing and provision of social services, taxation, and security of property rights. Thirdly, it should be pointed out that in most market sectors, although EU accession is not likely to increase demand substantially, it will promote a greater general spirit of investment.

Our analysis shows that accession of Bulgaria to the European Union (EU) is expected to result in an increase in the prices of flats, a boom in the market for office space, an improvement in the position of industrial real estate and a rise in agricultural land prices. Furthermore, the magnitude of these effects is expected to differ across the segments of the national real-estate market. Nevertheless, the chances of a seismic shift in prices are small. The experiences of countries such as Hungary and Czech Republic, accessing the EU next year, and Sweden and Austria, the newest EU members, show a slow catching-up process in areas where price differences between these countries and the EU are most pronounced. Next, the paper analyses in detail the driving forces on the Bulgarian property market and then, in turn, the likely developments in four important segments of the real estate market in Bulgaria: residential properties, offices, resorts and industrial estates, and agricultural land.

2 Driving forces on the Bulgarian property market

During the forty five years of central planning in Bulgaria the land use rights were administratively allocated, very often a way below "market" price and without time limit. Transfer, mortgage, and other economic activities of the market for land use rights were very restricted or even not allowed at all. Land was considered simply as a location offering space for living and production but not as a valuable asset itself. It led to waste of land resources because of irrational allocation and inefficient land use, hindering the efficient adjustment of industrial and commercial structure. In addition, little revenue from land and property was collected.

As part of economic reforms, the system of land use and management has greatly been changing. Privatization and reintroduction of real estate market has resulted in commoditisation and rising cost of real estate. Intra-city migration is rapidly increasing and new patterns of social segregation are emerging. The main changes in the differentiation of urban space in post-communist Bulgarian cities are related to: (i) subdivision of the central zones into specialized areas, (ii) transformation of old transition zones by the expansion of city centres, (iii) formation of new transition zones on the territory of old residential zones, and (iv) expansion of cities beyond the periphery, i.e., suburbanization (Rizov, 1994).

3 Analysis and forecasts of the real estate market sectors

Residential property

After EU accession no drastic increase is expected in the price of flats, the predominant type of residential property in urban Bulgaria. Even if there is a strong probability that

the Bulgarian real-estate market will be brought further into line with western European price levels, this will not happen overnight but will be a long-term process. corresponds to the expectations of the market players themselves (Bulgarski Imoty, 2002) and Yavlena Consult, 2002). According to forecasts of real-estate brokers in Sofia, there will be speculation related to the changes brought about by accession, but this will not be felt in the marketplace during the first year or two. In the long term, EU membership will mean a more differentiated price structure. Today's market is very sensitive to the location of a property, that is, in which town or district a flat is situated (see figure 1). On the other hand, quality is neglected to a large extent. Such distorted characteristics of the market are likely to disappear after accession and cheap flats, which are also often in poor condition, will become relatively even cheaper. Certainly, a market boom from western European citizens moving to Bulgaria is not expected. It is much more likely to be people wanting to invest in Bulgaria that will have an impact on the market. One result of this will probably be an increase in the demand for luxury flats. However, this process began even before the signing of the accession treaty. Thus membership will result only in moderate price increases.

As far as the capital city is concerned, analysis and data of brokers in Sofia show that the process, which has resulted in price rises in the outlying green belts will be reversed. It is much more likely that EU accession will result in an increase in the value of centrally-located flats – and not just those situated on the already overpriced inner boulevards and avenues but those in side streets too.

Comparing Sofia and the other regions of Bulgaria, prices and expectations of market players differ significantly. Until now the housing market outside Sofia was more

or less in a state of equilibrium, but in the future a slight oversupply is expected. The postponement of a decision regarding the possibility for foreigners to purchase land has drawn out the period of price equalisation. On the other hand, infrastructure developments may well help in the catching-up process, especially in bigger cities in the provinces.

The accession marks a very important step in Bulgaria's integration into western Europe but this does not mean that the resulting economic impact will come only from the West. Current evidence shows that it is likely, once Bulgaria has joined the EU, the amount of investment coming from countries to the east of Bulgaria will increase, especially from Russia, Turkey and Ukraine.

Commercial property – Offices and shops

Accession offers a real chance of salvation for the office-space market in Bulgaria, often described by Sofia brokers as fragile and haphazard. The dominant oversupply of low quality premises can be explained first of all by the repeated postponement of the date for accession. However, it is uncertain how far EU membership, for which investors have waited so long, will solve this problem. Evidence from property development practices (Bulgarski Imoti, 2002) shows that it is the real-estate market that is most interested in the Bulgarian government attracting as many significant EU institutions and businesses as possible. Previous international experience of accession makes the expectation of stagnation more likely than a boom. After EU accession in Sweden, office prices soared; however, in Austria they stagnated and even fell in real economic terms. In the case of Bulgaria, the Austrian scenario is more likely. One reason for this is that Bulgaria will

become the "terminus" of the EU and will therefore be relatively distant from the centre of economic power. The other reason is that the rapidly increasing supply of office space, especially in Sofia, will result in fierce price competition. The picture might not be too pessimistic though, if EU political interests towards Turkey's accession become more real.

Resorts and industrial estates

The process aiming to eliminate large price differences between Bulgarian and western European holiday resorts is in an advance stage of development. Today international prices for plots of land are not much higher than in some Black Sea coast resort areas around city of Varna. However, important differences in the averages still remain. Expectations are that EU accession will lead to tourists looking beyond the established resorts and discovering the northern Black Sea cost as well as inland picturesque mountain towns, which may well become a popular holiday destination among foreigners.

Government economic policy and planning regulations have an important role to play in the future of both resort and industrial estates. The tax advantages offered to investors and other measures aiming to attract multinational companies have to be brought into line with the EU regulations. This process would certainly increase the attractiveness of such estates. Specifically, EU regulations do not allow direct state support for companies; however, the development of infrastructure for business operations is permitted, and indeed, actively encouraged. The formula appears to be simple: instead of providing tax advantages the government can make the country

attractive for investors by developing industrial parks. The only obstacle is that the creation of such industrial parks can cost billions of Euros because of the bad current state of existing infrastructure.

Agricultural land

The price of rental fees for land represents an important part of production costs and therefore has a direct impact on food prices and consumer-price inflation. At the same time, it must also be recognised that, for the farmer, land is an asset and from the point of view of credit ratings a higher land price is favourable. To achieve equilibrium there must be an effective land (lease) market since without it realistic land prices cannot be established. Speculation has already begun: many of the interested parties think that with the approach of EU accession the price of agricultural land will rise. They have therefore started buying land, which is both suitable for agricultural activity and is conveniently located to markets. Furthermore, the initial price increases determined by such speculations are likely to be sustained in the long run. The reason is that direct support per hectare in the EU is substantially higher than current levels of support per hectare in Bulgaria. This fact will have a considerable impact on land prices.

Such an assumption is also supported by the experience of Germany. In East Germany, before reunification, land prices soared to around DM 5,000 per hectare. After unification, prices kept on increasing up to DM 7,500 per hectare, as since then they have stabilized. Because in Bulgaria support levels are much lower than those in East Germany, directly after the admission of Bulgaria to the EU, a more substantial single price increase can be expected.

Firstly, this is because farmers from the EU who are already operating in Bulgaria (around 500 in 2002) will be entitled to buy land. Even if there is a limit per farmer of 250 hectares, these and a number of new-comer farmers would represent a solid base of demand. Of course, the demand would predominantly be in areas with good infrastructure, which would further push up prices there.

In the case of Bulgaria, it is probable that prices at the southern border with Greece and in good quality agricultural areas around the city of Plovdiv and bigger seaside towns will deviate from those in other parts of the country due to the proximity of main markets. Foreigners living near the Greece border may well find it attractive to come over with their own technology and machinery and cultivate agricultural land in Bulgaria. The possibility of foreign farmers moving into Bulgaria also exists for areas in the north-eastern part of the country, characterized by high quality soil and fields appropriate for large scale mechanized farming.

4 Conclusion

Accession of Bulgaria to the EU is expected to result in an increase in the prices of all types of real estate. These increases are expected to differ across the segments of the national real estate market while the chances of a seismic shift in prices are small. Property prices have been influenced primarily by local demand, government policies and legal framework in place, and perceptions that EU accession will be promoting attractiveness and security of investment. With respect to the specific effects of accession on different real-estate market segments it is likely that prices of flats will further differentiate, the market for office space will stabilize, provision of infrastructure

will importantly influence prices in holiday resorts and of industrial estates, while agricultural land prices will upsurge initially due to higher direct support to EU farmers.

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