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COMPETITION COMMITTEE**

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Working Party No. 2 on Competition and Regulation

IMPROVING COMPETITION IN REAL ESTATE TRANSACTIONS

-- HUNGARY --

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1. General characteristics of the market, frequency of transactions

1. There are about 150.000 changes in homes on a yearly basis in Hungary, but only a two-third of these alterations will be realized in the form of a 'real estate transaction', according to data provided by the Hungarian Central Statistical Office (CSO). This means that every year, there are 95.000 homes transferred on the real estate market.¹ Although there is no official indicator available for that, one can compute that a residential home will change ownership once in every 27.2 years and a change involving a transaction on real estate markets happens every 43.9 years (the total number of residential homes divided by real estate transactions in a given year).

2. The percentage of households owning their primary residences in Hungary is quite high. According to 2005 data, of the 4.17 million residences 3.64 millions were inhabited by their owners. This leaves with the fact that over 87% of the residences are owned by their inhabitants. A further 0.21 million residences (5%) were decided to be left temporarily empty by their private owners. Renting a flat is not very popular in Hungary: only 6% of the homes are rented by households, with slightly more than a half of that having a private owner, the rest being in municipal property. The proportion of secondary residences is about 0,5%.

3. There has been a huge boom in residential home prices in Hungary, which can at least partially explained by government subsidization policy.² In 1999, the average price of a residential home was 3.4 million HUF, which has almost tripled in four years, reaching 9.3 million HUF by 2003. (The total inflation rate was a mere 32% in the given years, compared to the 270% in the case of real estates.) The average growth rate in prices is even surpassed by larger towns and especially in the capital of the country: in Budapest average square meter prices amount to 1200-5500 euro.

2. Matching

4. There are no reliable information sources available for matching in Hungary. According to the CSO, the agencies that were capable of providing information in this respect, the professional intermediaries are not interested in providing data that can be made publicly available. This can be explained by the fact, that the limited market transparency is a significant source of market power for them. The information provided below is therefore based at least partly on anecdotal evidence, newspaper articles or analyses published by real estate agents themselves, latter often also with a marketing perspective.

5. The most common intermediaries in Hungary are real estate agencies. There are numerous undertakings active on the market, their size range from one-man enterprises to multi-town networks with the largest company having over 60 offices located in different regions. Their most common activity is to act as an intermediary for the seller, an intermediary for the buyer is less frequently used.

6. The real estate intermediaries offer services mostly in the field of information providing, advertising and negotiating. Based on their general expertise, they inform the seller about the recent demand and price tendencies in the area, and help the seller to formulate an adequate price basis. In the field of marketing, together with offering the real estate in question for their existing clients, the intermediaries place advertisements aimed directly at the seller's home into various media. These advertisements are often published with pictures, which are taken by the agents of the intermediary. The potential buyers then meet these agents and negotiate a price with them, which should finally be approved

¹ *Current situation in the residential home sector 1999-2005 Hungarian Central Statistical Office, October, 2006*

² See Point 17

by the buyer. Services more extensive than the ones listed here (making homes more attractive) are rather uncharacteristic for the Hungarian market.

7. Internet is a widely used source for marketing the services of real estate intermediaries. The largest intermediaries have well-developed websites, capitalizing on the fact that advertising with pictures is relatively cheap using this method. Further to these, there are independent sites publishing advertisements about homes offered by various intermediaries, and these sites are used extensively. Due to the fact that internet penetration is limited in the country, other forms of advertisements are used commonly as well. The most important of them is printed press, but leaflets and street posters are also commonly used.

8. It is relatively seldom, that real estate intermediaries are granted an exclusive right to sell. Most of the consumers dislike to be locked in for several months with a single intermediary. That is why exclusive contracts are only used to a limited extent on the market.

9. There have been some initiations from the side of market players to introduce some regulations to the matching sector. These initiations were triggered by the appearance of new players offering low quality service. As a result of the boom in the industry, there have been numerous new agents entering the industry, that did not possess the necessary qualifications for the work and their reliability was also sometimes questionable. To restore confidence in real estate matching, industry players wanted to introduce extensive self-regulation with entry barriers. This plan, however, was not supported by regulators, since it has included some anti-competitive practices, and not the right measures to solve consumer protection problems.

10. The typical announced fee for matching varies between 3-5%. In almost every case it is the seller who pays the intermediation fee. As a result of the growing number of transactions in recent years, matching fees are hardly negotiable, especially when larger intermediaries are involved.

11. There are no governmental restrictions on offering low-cost, no-luxury agency service, neither are there regulatory obstacles that make it difficult for individuals to sell their own homes. Individuals have basically the same marketing channels available as professional intermediaries. Scale economies may, however, result in significantly higher costs for advertisements by agents.

3. Transfer of control

12. As in most countries, the transfer of ownership is a highly regulated process in Hungary as well. A sale and purchase agreement is only valid in Hungary in a written form, and with the signing of an attorney-at-law.

13. Attorneys seem to capitalize on this condition: the price of the service by an attorney has remained constant at 1% of transaction value over time, although the number of attorneys has grown rapidly, and the amount paid has also increased steadily due to booming real estate prices. The number of attorneys is not limited in the country. However, one has to be a member of the chamber of attorneys, having passed a second exam after graduation from the university and having gained three years of professional experience. Another profession that profits extensively from real estate transfer are notaries, however, this is only the case if purchasing on loan. The loan granting financial institutions normally rely on the services of notaries to ensure a form for the loan contract that makes it directly enforceable in the case of a non-performing loan. Although this service is for the interest of the credit institution it is the consumer that pays the price for the activity performed by the notary.

14. There are taxes imposed on real estate transactions. The most important of these taxes is the duty imposed on the onerous transfer of residential property. The rate of this duty for each housing unit is 2% up to 4 million HUF and an additional 6% for the portion of the market value above 4 million HUF.³ It has to be mentioned, however, that these rates have not been changed since the act has been passed in the Parliament in 1990, which results in the fact that the more favorable 2% rate is generally only applicable to a small proportion of the property transferred, whereas in 1990 it covered the whole price of an average home.

15. Re-investing funds into real estate is favored by the legal prescriptions in a number of ways. As for the duties discussed above, if a private individual buyer sells his other residential property within a period of one year preceding or following the purchase, the basis of the duty is the difference between the market values of the properties purchased and sold.

16. The seller has to pay general income tax if he does not re-invest the money into real estate within a given time period. The rate of this income tax on the income from the transfer of real property is 25 per cent. If the seller decides to re-invest the money into real estate, the tax is refunded to the seller on the part of the income that was used for housing purposes (within the 12 months preceding and the 60 months following the date on which the income was acquired).⁴

4. Housing loans

17. Home loans can only be granted by financial institutions that have the necessary permission from the sector supervisory authority. The already improving market situation has taken another significant upturn at the beginning of 2001 with the introduction of government subsidized home loans. These loans aimed to significantly reduce the interest rate of home loans thereby making them accessible for a wide range of consumers. By the middle of 2004, the stock of home loans multiplied nine times compared to the beginning of 2001. The significant role of government subsidization in home loans is illustrated by the fact that their proportion was 95% of all home loans in 2003. The reduction in the home credit interest rate was achieved by limiting the maximum amount of interest rate and other fees charged to consumers, while banks were compensated by government subsidies. The rules of government subsidization have changed a couple of times since 2001, mostly to the reduction of the subsidies available, but housing loans is still a vivid industry in Hungary.

18. Market actors on the demand side of the home loan market are credit institutions (commercial banks and mortgage loan companies, saving cooperatives and home savings and loans associations) and, rather theoretically, insurance companies. For offering a certain type of subsidized loan, the participation of a mortgage loan company is indispensable. As a result of this, commercial banks and savings cooperatives had to enter into a co-operation agreement with mortgage loan companies, of which only three are active on the Hungarian market, which is not very favorable for competition.

19. The Hungarian Competition Authority carried out a sector investigation in housing loans in 2005. The market was characterized by the increasing dominance of commercial banks in the stock of home loans, exceeding a 90% share. Despite the increasing number of competitors, market concentration in general has increased during the examined period; the value of the Herfindahl-Hirschman Index calculated from home loans data has increased from 1887 at the end of 2002 to 2268 at the end of 2003 and to 2351 at the end of the first half of 2004. Almost 83% of home loans are concentrated to nine banks.

³ Section 21 of the Act 93 in 1990 on Duties.

⁴ For more details see Section 63 of Act 117 in 1995 on Personal Income Tax

20. A major finding of the investigation is that market transparency is very limited on the market. Banks use different types of extra costs which make it difficult for consumers to compare the products offered. The most striking feature of extra costs in connection with home loans is the great variety of labeling. The name, quantity, introduction and cancellation of extra costs vary from institution to institution, depending on the product and pricing policy of the bank. In comparison to handling costs, the most important common feature of extra costs is that they do not represent a permanent burden on the debtor for the whole duration of the credit, although some of them may be recurring in time. Another feature is their variety: some of them are given in a percentage form, others in absolute numbers, while some form different combinations of both (minimum and maximum levels), which makes their comparability questionable.

21. As a limitation in government subsidization became more and more apparent, foreign currency loans became more and more popular in financing real estate purchases. From 2004 onwards, loans denominated in Swiss Franc became predominant in the Hungarian housing loan sector. Starting from a very low basis, foreign currency denominated loans quickly surpassed the HUF loans in new transactions: in the first half of 2006, 64% of the housing loans were granted in foreign currency (72% in value).⁵ At the end of 2005, more than a half of the total credit granted in Hungary was granted in foreign currency, however this growth is not fueled by housing loans any more, since its growth rate has dropped significantly, with consumer credits leading the way.⁶

22. Tying became a quite significant problem in the Hungarian market, as most credit institutions obliged their contractual partners to open a current account as well. Given the fact that most credit institutions require some kind of payment card contract for a current account, this double tying may result in regular extra costs for the debtor (fees for current account, annual fees for cards and transaction fees). Credit institutions commonly use housing loans as an acquisition product in a sense that they tried to persuade the debtor to open a current account through which they try to sell a whole range of product to the consumer. Credit institutions also try to sell insurance products as well. Although there is no formal obligation to enter into an insurance contract with the loan provider, belonging to the same group as the loan provider can clearly represent a competition advantage for insurance companies.

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⁵ *Housing loans, first half of 2006, Hungarian Central Statistical Office, October, 2006*

⁶ *Report on the activity in the supervised sectors, Hungarian Financial Supervisory Authority November, 2006*