

A characterization of the real estate market

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Abstract:

Aim: The aim of the study is to identify and discuss important features of the real estate market with particular emphasis on their economic dimension, as well as to demonstrate cause and effect relationships between these features and the functioning of the market (mainly Polish conditions were taken into account).

Design / Research methods: In the main, research and literature studies were carried out, which concerned two basic directions, i.e. identification of essential features of the real estate market from the point of view of their economic dimension, and showing the relationship between these features and the efficient operation of the market.

Conclusions / findings: Research and analysis of theoretical and literature issues raised in the issues allowed to show that both the real estate market and the property itself have special features, which significantly disturbs the efficiency of the market mechanism. The indication of attributes characterizing the imperfection of the real estate market allowed us to discuss and show the practical side of the functioning of the Polish real estate market as an important element of the development of the national economy.

Originality / value of the article: The results of research on the economic importance of the real estate market in the form of theoretical considerations can be used by entities and institutions that take part in the real estate trading process, as well as by scientists and researchers in conducting research in the subject matter.

Keywords: real estate, real estate market, real estate features.
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1. Introduction

Real estate market plays an important role in economy (Bryx 2006, pp. 40-42). Despite the fact that it is an informal market, i.e. it is devoid of institutions arranging exchange (Kucharska-Stasiak 2006, p. 40), it is still capable of efficiently facilitating trading in real estate while

allowing for a reliable analysis of transactions. It should, however, be noted that the real estate market differs considerably from the bulk market. It is a market that is worse organized, less transparent and more difficult for analysis and exploration.

The functioning and development of the real estate market is constrained by the same features which constrain the functioning of the market in general and by specific characteristics pertaining to an immovable property as an object of market trade (Bryx 2006, p. 74). The unique nature of the real estate market stems from the fact that one of the key attributes of property is the permanence of its location in a specific area on the earth's surface. This feature implies a catalog of other distinctive characteristics of the real estate market.

The aim of the paper is to shed more light on the significant characteristics of the real estate market and to discuss them, taking into account especially their economic dimension, as well as defining the impact of those characteristics on the functioning of the market under discussion. The selected aspects of the economic issues surrounding the real estate market will refer to the Polish market. In the introductory part of the paper, the unique character of the market will be presented which arises from the very definition of immovable property and its particular features. This allows for defining the real estate market concept and identifying its distinctive characteristics. Both the real estate market and the property itself have special characteristic features, which materially distorts smooth functioning of the market mechanism. Identifying the attributes which characterize the imperfections of the real estate market will enable one to discuss the determinants surrounding the functioning of the Polish market for real estate.

2. The essence and specificity of real estate market

In order to define the concept of "real estate market", one needs to provide some insight into the term itself denoting "immovable property". The definition of an immovable property that applies in Poland arises from the provisions of the Polish Civil Code and numerous other legal regulations. Pursuant to Article 46 of the Civil Code, immovable properties are "part of the earth's surface which constitutes a separate object of ownership (land) as well as buildings permanently attached to the land or parts thereof, if by special provisions they are an object of ownership separate from the land" (Polish Civil Code Journal of Laws, 1964, no. 16 item 93 as

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amended). This implies that buildings or their parts are immovable properties only upon becoming a separate object of ownership by virtue of special provisions; otherwise they are component parts of an immovable property.

The provision of Article 46 § 1 of the Polish Civil Code sets forth three types of an immovable property:

- 1) land property,
- 2) buildings,
- 3) premises (dwellings and commercial lots).

According to the Civil Code, land property is a part of the earth's surface which constitutes a separate object of ownership (land). It includes the ownership right to the land and to its component parts. Component parts can be buildings and facilities permanently attached to the land as well as trees and other plants from the moment they are planted or sown (Article 48 of PCC) and rights related to the ownership of real estate (Article 50 of the PCC).

Separating a building is effected under the provisions of the Civil Code and special provisions. Pursuant to Article 235 of the Civil Code, "Buildings and other facilities erected on land owned by the State Treasury, local government units or their associations by a perpetual usufructuary become his property. The same applies to buildings and other facilities which the perpetual usufructuary acquired under relevant regulations at the time the contract giving land in perpetual usufruct was executed". The separation of buildings from the land also takes place in the situation when developed land is given in perpetual usufruct, as it is effected simultaneously with the sale of the building located on the land. The building is considered to be a legal fiction, for the land and building constitute the whole.

Premises, pursuant to Article 2 paragraphs 1 and 3 of the Act of 24 June 1994 on Ownership of Premises, is an independent dwelling as well as an independent lot used for purposes other than housing (e.g. office use) if it is a separate object of property. The premise must be independent in terms of its architecture and functioning. An independent dwelling is a room or a set of rooms separated by permanent walls within a building, which are intended for permanent accommodation of people and which, together with ancillary spaces, meet people's housing needs. As component parts of independent premises, we include so called auxiliary rooms such as: utility room, attic, closet, basement, garage, even if they are not directly adjacent to the premise. The rights relating to the ownership of separate premises is also having a share in

co-ownership of jointly-owned parts of the building and land property that is jointly owned and given to a joint perpetual usufruct. Separate ownership of a premise is established at the moment of signing a notarial deed and having the premise entered in the Land and Mortgage Register.

Summing up, the term an immovable property should be understood as land with all its component parts attached permanently to it. Only in special cases, a building or separate premises in a multi-apartment buildings may be recognized as a separate immovable property.

In order to make the distinctive nature of immovable property understood, it seems necessary to identify its unique features, in particular those of physical and economic nature. The comparison of the characteristics of property, their manifestations and consequences are presented in Table 1.

Thus, immovable property has distinctive features which determine its unique character, distinguishing it from other economic goods.

Following that, immovable property, as a specific type of goods, requires a specific market which facilitates trading in immovable properties.

According to Kucharska-Stasiak(2006, p. 40), real estate market encompasses:

- „actions and interactions between people involved in the purchase, sales, exchange, use and development of property,
- economic activity whose outcome is an exchange of goods,
- an abstract term encompassing all property transactions across the country,
- a contract which makes it possible for buyer and seller to meet so as to determine the price at which the exchange of a particular immovable property will be carried out,
- a set of mechanisms used to transfer the title and shares in property, to determine prices and to move around the ways in which one might use the land,
- a forum for buying and selling, in other words, a means to bring together buyers and sellers,
- a set of arrangements within which buyers and sellers meet through the price mechanism,
- mutual interaction of people who exchange the title to property for other assets (money)”.

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Table 1. Characteristics of property, their manifestations and consequences

| Property characteristics | Manifestations | Examples of the consequences arising from the characteristics |
|---------------------------------|---|--|
| Physical | | |
| Complexity | plurality of component parts (land, buildings, structures, plantations) | problems in terms of estimating the market value considering the diversity and complexity of the characteristics of the property elements |
| Permanence | no possibility of dislocating most of the property component parts | it is possible to tax property, property as collateral for debts, local character of markets for real estate, the property value is vulnerable to the changes unfolding in its surrounding environment |
| Durability | imperishability of the land, long useful life of buildings and structures | property as good capital investment, it is possible that there exist simultaneously diverse legal shareholdings in the same property and the possibility of separating the right of usufruct to property from the property ownership right |
| Diversity | there are no two identical properties | the difficulty of comparing property engenders problems with its valuation |
| Indivisibility | it is not possible to separate the land from the building, indivisible cubature of the building | changeable use of the property (reconstruction, renting, sale of the whole or part of the property) |
| Economic | | |
| Scarcity | the number of properties does not cover the demand | the property value fluctuation, the need to modernize buildings in order to satisfy the demand |
| Location | physical and economic location | the way property is used and how it changes is dependent on location, surrounding environment and access to property |
| Interdependency | the function of an area and the realization of the function affect other properties | individual characteristics of a particular property might be of secondary relevance given the substantial impact of the surrounding environment |
| Capital-intensive nature | high outlays needed for land purchase and construction of a building | external financing is necessary, such as taking a loan at the implementation stage, a long period needed for paying back the funds invested and a relatively long period of economic sustainability |
| Low liquidity | the property sale is neither certain nor easy | difficulties obtaining quick return on the capital |

Source: self-reported data based on Kucharska-Stasiak, 2004..

A similar definition of the real estate market provides Bryx, who emphasizes that the market is “the exchange process within which the purchasers’ needs, supported by their financial

means, are satisfied by sellers. In this process, both parties agree as to the type of goods (as to their quality and volume), price, date and place of delivery. From the perspective of the market's specific segment – the real estate market, the location of the goods (the object of the transaction) is specified extremely precisely, and what is more, - permanently (Bryx 2000, p. 12).

The real estate market can thus be defined as all the terms and conditions according to which a transfer of property ownership rights is effected and contracts concluded, setting forth mutual rights and obligations involved in exercising control over the property.

The definitions of the real estate market presented herein show that it is not homogenous and as such we can distinguish the following markets (Kucharska-Stasiak 2006, p. 55):

- investment market, where the transfer of ownership rights and the rights similar to the ownership right takes place,
- rental market, where contracts are concluded defining mutual rights and obligations linked to controlling the property.

The real estate market has characteristics which are general in that they are present in every market and the distinctive ones arising from the specificity of trading in property.

The general characteristics of the market include:

- voluntary character of trade,
- market equivalence,
- lack of a dominant market participant (monopolist).

Moreover, the specific characteristics of the real estate market are features derived from the property characteristics and those distinguishing this market from others. They include (Kucharska-Stasiak 2004, pp. 37-44):

- **local character of property**; this is effected by the uniqueness of properties themselves; the nature of competition on this market is clearly local, it is most likely to encompass the area of a single city or even specific districts; the potential buyer has to assess the property he or she is interested in so as to learn about its advantages compared to other properties; this characteristic is not so crucial for commercial and industrial properties for which the market is often wider;
- **non-homogeneity of real estate market**; this characteristic manifests itself in a large diversity of the markets – we can distinguish here housing and commercial markets, rental and investment markets or local markets as well as those with a wider range in terms of

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their types; hence large differences between similar, yet little comparable objects, and their variability over time triggered by local and non-local factors; this necessitates separate analyses;

- **transaction conclusions are rare and there are substantial differences between similar and yet little comparable property;** this hampers the market clarity while providing no substitutable opportunities;
- **little flexibility in terms of supply and demand;** property supply is constant over a short term and cannot be changed, while the little flexibility stems from a lack of substitutable property; the mechanisms operating across all other markets which allow the equilibrium to be attained are also present on the real estate market, yet this effect comes at a considerably later time;
- **requirement of professional service;** the real estate market is serviced by a number of entities, of which the vast majority is required to hold licenses and qualifications; the market volatility makes it necessary to improve one's professional qualifications continually;
- **low level of effectiveness;** this feature is attributed with a very small correlation between the subsequent changes unfolding on the market and the valuation outcome; the investor's activities conducted on this market carry a high risk, for it is not possible to develop a single effective investment strategy;
- **deficiency;** this is determined by the following characteristics (Kucharska-Stasiak 2004, pp. 37-44): the permanence of property, property value is vulnerable to changes occurring in the surrounding environment (the surrounding can have either positive or negative impact on property value), speculative and monopolistic behaviors, the need to have a large amount of money (high financial threshold for entering the market), irrational behaviors of the market participants (decisions made by buyers are not entirely based on prices, since they are also driven by such factors as, e.g. fashion, neighborhood, tradition, advertisement, family place of residence), difficulties in obtaining information about the market, with transaction participants lacking information (insufficient clarity), property variety, relatively constant supply of property over short term, the way property is utilized affects its value (value of a tenement building used for housing is much lower than the value of the same building used for other purposes, e.g. provision of services), a variety of

ways of financing transactions on the real estate market (own sources, credit, issue of shares or bonds), unstable interventionism.

3. Distinctiveness of property and its economic characteristics

That an immovable property is distinct is determined by numerous factors, including those of economic nature, which include the following (Kucharska-Stasiak 2016, p. 29):

- rarity (scarcity),
- location,
- interdependence,
- capital-intensive nature,
- low liquidity.

Rarity (scarcity) stems from the fact that nature limits the supply of earth's surface. This characteristic refers especially to the specific and constant number, especially over a short period of time, of land parcels which have good location, e.g. supply of urban areas with full infrastructure. The number of buildings and structures is limited in relation to the needs, with its increase coming at a relatively slow pace. The scarcity of property engenders a characteristic phenomenon which is fluctuation of its value over time – with a high demand for a specific kind of property its value increases, while with the decline in demand the value decreases accordingly.

In terms of location, one needs to consider two aspects of this feature, i.e. physical location and economic location. The elements present in the physical location include, for example, the position of property according to the four cardinal directions, levels of light or the direction of winds. The economic location, on the other hand, (which is of greater importance) includes, among other things, the availability of local means of transport, sale, service and production outlets. Location is yet another factor which influences substantially the market value of property. It is a common view among practitioners who deal professionally with real estate that of all the factors, it is location that exerts the greatest impact on the value of property.

Interdependence is a feature which affects significantly the value of property and its fluctuations. The consequence of this characteristic is the way in which property is used. The mutual dependence of properties brings about a situation where areas of properties with specific

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use emerge. This characteristic often leads to differences between individual city districts and between the city centers – which in general are also commercial and business centers, and city outskirts which provide housing areas.

An important economic characteristic of property is its being high capital-intensive. Purchasing property, and maintaining it in a sound technical state later on, always involves having to incur high expenditures and, in the majority of cases, having to take a loan. This feature has yet another direct outcome which is a long period needed to get the capital paid returned – finding a person willing to buy property offering for it a satisfying price often takes months if not years. Thus, this characteristic implies a relatively long period of economic sustainability, which depends much on the property location and its surrounding. An increase in demand for office surfaces may lead to the demolition of existing buildings, e.g. housing buildings, and investments focusing on the construction of modern office buildings (Kucharska-Stasiak 2016, p. 30).

Low liquidity means that it is not easy to turn property into cash. This characteristic arises from the difficulty in finding buyers willing to buy property at the market price as well as high costs linked to the purchase, including notary or court fees, and it is strongly linked to the capital-intensive nature of property. Liquidity depends on the real estate market condition. When the market starts recovering, the time needed for selling property is reduced while it is longer at a time of recession.

Property has particular features which determine its specificity distinguishing it from other economic goods. Physical characteristics are primary in their nature, while the economic ones are derivative of shortcomings and advantages of property, implying economic effects, which may include the following (Kucharska-Stasiak 2016, p. 27-31):

- it is possible to tax property and to enforce obligations it is burdened with, even if it requires selling the property,
- local character of the real estate market – property “is waiting” to be in demand; the demand called for in one city cannot be met by property located in another city, which means that the property value will be the outcome of interactions between demand and supply on the local market,
- property value which is very vulnerable to changes in the surrounding environment, e.g. a single family house situated in a quiet area will decline in value if a highway is built in its vicinity,

- it is possible to secure loans granted; a form of securing loans is to mortgage property.

4. Factors influencing the functioning of real estate market (the Polish determinants)

The Polish real estate market is quite frequently referred to as inflexible and imperfect. This is determined by both the general features characteristic for the entire real estate market across the world, which arise from the specificity of the goods offered on the market - especially the attributes of place and time, price movements, their variation, consequences of interventionism, different concentration of transaction in time intervals and market areas, unpredictable behavior of contracting parties and variations in supply and demand. The features characteristic for the Polish market for real estate, on the other hand, include the difficulty in accessing information and no possibility of verifying its credibility, no reliable staff servicing the market, the interruption for over a half of a century of the tradition of the free real estate market as an element of economy and, as its consequence, no fully-fledged routine mechanisms facilitating operations, and most importantly – a lack of harmonized legal provisions.

The shaping of the market is affected by factors which eliminate barriers to its development and help create favorable conditions. These include the following:

- free inflow of investment capital (through favorable legislation, favorable financial provisions, easier access to capital, efficient investment service),
- efficient construction industry (through implementing reforms in the industry, trade and services relating to the construction business, educating staff, improving tender procedures, generating information about construction),
- increased society's wealth (improving measures and efforts aimed at burdening expenditures so as to make the goods, it being a property, increasingly accessible to the most diverse strata of society) (Pawlikowska-Piechotka 1996, pp. 9-10).

The functioning and development of the real estate market requires the existence of specific resources in terms of buildings, structures and land plots. These resources are local in their character and cannot be moved through space and time. For properties recognized as goods, the supply in the aggregated form is the result of the interaction between the three primary factors: the structure of existing resource, and increase and losses in terms of new substance. The overall

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potential supply of land plots is constant. The earth is not created by human labor and so its spatial resources cannot be increased by production. In the socio-economic development, rational management of land (including the protection of land against its being excluded from agricultural and forestry production) is a paramount issue. The decline in agricultural and forestry areas is alarming, being a clear indication of the need to stop the transfer of land for purposes other than those related to agriculture and forestry (Cymerman et al. 2001, p. 23).

What does not foster the development of a real estate market is in particular: economic downturn and poor creditworthiness of entities interested in purchasing property. Moreover, failing to regulate the legal state of property ownership along with a lack of credible information in this respect lead to a situation where potential buyers are at risk of losing a portion or all their funds invested in the purchase. So, economic and legal determinants are affecting supply and demand of properties intended for sale or rent. The determinants surrounding the development of the real estate market refer to the economic, legal and institutional environment, in its broader sense, as well as attractiveness of properties with their value varying through time and space.

The markets for real estate do not function autonomously as they are highly dependent on the socio-economic setting. The challenges facing the Polish real estate market are strongly linked to those facing the economy and the socio-political system (Brzeski 1994). There are many factors which exist and influence the market making up the quality of the market's economic situation. They include: demographic characteristics of society, affluence of citizens and enterprises, the system of legal regulations and legal acts, and economic instruments that are in widespread use. It is hard not to recognize the role exercised by these factors, since many of them either accelerate the decision-making process in terms of investments or impede the movement on the real estate market.

The main factor which contributes to economic growth is certainly investing in properties, which, among all the goods subject to economic and legal trade, are of key importance for the development of a country's economy. They represent the essential element in terms of the exchange of goods in the area of socio-economic relations, which, in turn, constitute the basis for various legal relationships, mainly in the notary and judicial practice, such as, for example, contracts for sale, donation, exchange, mortgage, etc. Property investment requires substantial capital which only rarely is owned in its entirety by investors. On a developed real estate market, property developers and investors finance their undertakings with their own capital and the

capital borrowed for this purpose. Credit institutions have to be satisfied that there is a good prospect that borrowers will pay back their loans. This depends on the productivity of the property concerned generating profit or the borrowers' income. In Poland, the real estate financing has not been functioning sufficiently with this situation being additionally exacerbated by high mortgage interest rates.

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