



**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS  
COMPETITION COMMITTEE**

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**Working Party No. 2 on Competition and Regulation**

**IMPROVING COMPETITION IN REAL ESTATE TRANSACTIONS**

**-- Lithuania --**

**19 February 2007**

*The attached document is submitted by the delegation of Lithuania to the Working Party No. 2 of the Competition Committee FOR DISCUSSION under item III of the agenda at its forthcoming meeting on 19 February 2007.*

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## **1. The residential housing market - an overview**

1. An especially rapid surge of the real estate (further RE) prices in Lithuania broke out in 2003 reflecting the overall favourable situation in the market: the national economy was growing at a pace of up to 10 percent per year, the unemployment levels dropped facilitating a general improvement in the population's expectations. In 2003, the expansive monetary policy pursued by the European Central Bank allowed the basic interest rate to drop to a 2 percent level. This enabled the commercial Lithuanian banks to increase their loan portfolios that were growing by as much as 52.3 percent per year. Furthermore, there was a popular belief that the introduction of the Euro will fuel the real estate prices, and many sought to acquire the new housing considering the timing to be most favourable. The ever more movement of the residential housing market was further heated by the tax relieves to housing loan holders, equally by psychological anticipation of price jumps as well as the herd instinct.

2. Despite an obviously insufficient supply of the RE the latter was growing quite slowly. This was caused by several reasons. First, the territorial planning (zoning) procedures in Lithuania are rather complicated and time-consuming. There are still some residual red tape barriers: the land restitution procedures have not been completed, in some individual regions the general territorial plans have not been drawn up and etc. Furthermore the construction companies are suffering from a insufficient capacity and an increasing labour force shortage.

3. It was imbalance between the supply and the demand that caused a soaring price increases. Even discounting influence of buyers expectations (anticipations of price increases), the overall conditions in the market were rather conducive to the price growth. During the last three years the prices were growing by 30-50 percent per year. A similar situation was observable in the markets of other Baltic States: the earlier launched crediting boom in Latvia and Estonia is not yet slowing down, rather it is still gaining momentum. The price dynamics in certain individual sectors of the real estate market is astonishing: over the year 2005 the prices in some old sections of Riga jumped by as much as 80 percent.

4. It has become a commonplace situation where about 90 percent of housings are purchased within less than two weeks from the announcement of the sale even before the foundation of the buildings is laid down or the necessary construction permits are obtained.

Fig. 1. Registered sold apartments in Lithuania: changes in average price (LTL/1 m<sup>2</sup>)<sup>1</sup>.

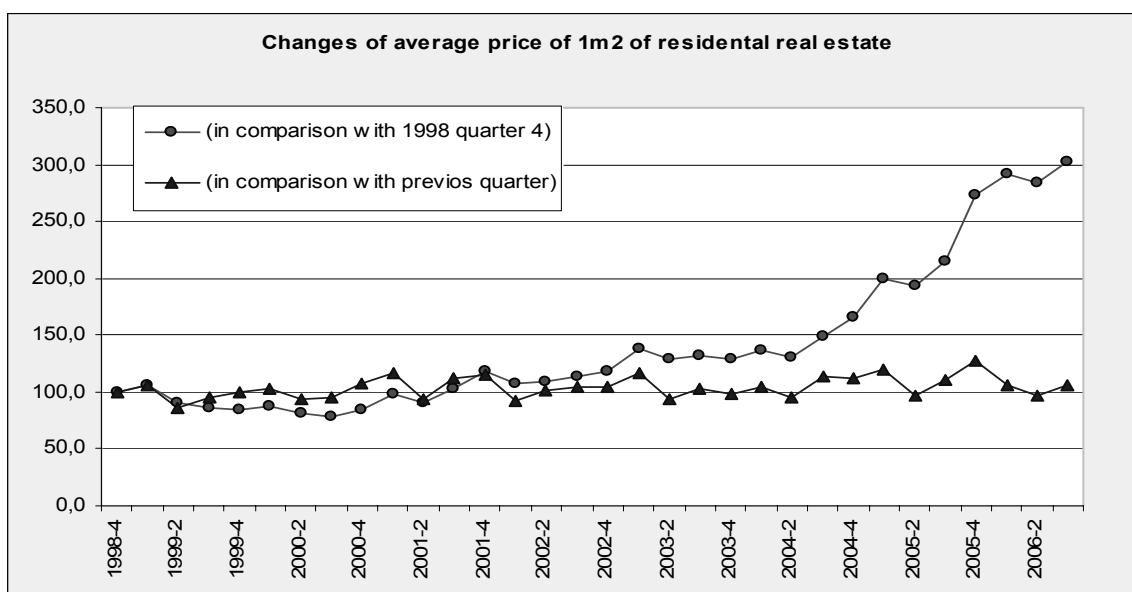
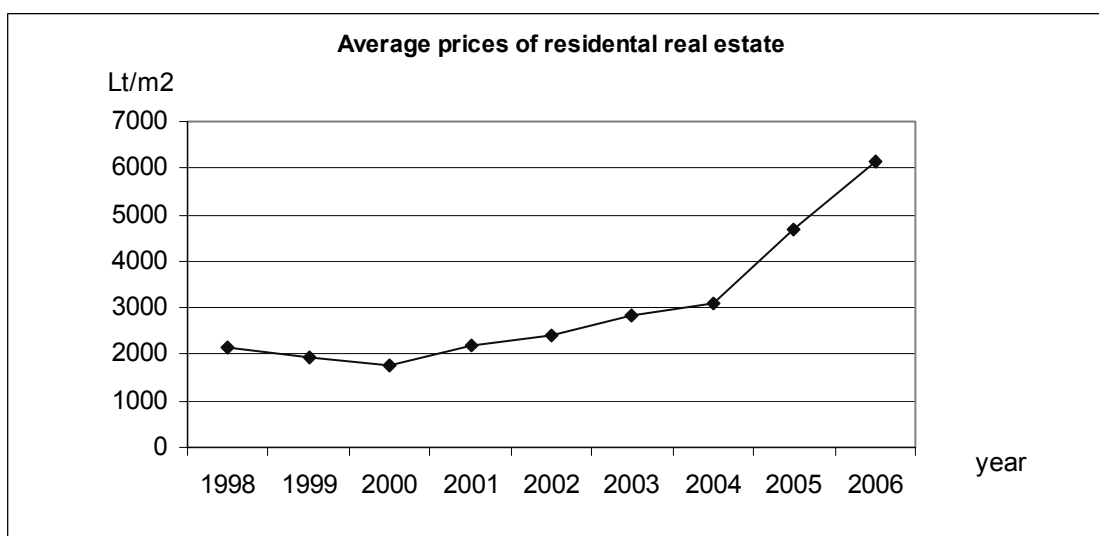


Fig. 2. Changes in the indicative prices of residential housing.



5. The rapid growth of the real estate market was favourable for the emergence and operations of the so-called speculators (or profiteers) who purchase housing in the hope to profit from the rapidly growing housing prices. The significant volumes of such profiteering resulted in even further distortion of the market. The findings of the market surveys conducted by some RE agencies suggest that speculators could account for as much as 15-30 percent of all buyers.

6. This overall dynamic market determined the peculiarities of competition in the RE intermediation market.

<sup>1</sup> Data source: Department of Statistics of Lithuania.

## 2. Activity of intermediaries operating in the real estate market

7. The RE (residential housing) market can be relatively distinguished into the primary and the secondary markets. The primary market covers the new construction housing. The absolute majority of these housing assets are marketed through the real estate intermediaries (agencies). The newly constructed housing sale is mostly limited to the three major cities of Lithuania. 90% of market transactions involve housing of old construction and only 10% - of newly constructed housing. In the view of the rapid growth of the primary market and virtually no regulation of the activities of the RE intermediaries, it is not an easy task to establish the percentage of the sellers in the secondary market referring to the services of the real estate agencies rather than relying on their own. This will be to a high degree determined by the market situation itself. During the high season where the search for a buyer was actually limited to a placement of advertisement, the importance of the intermediaries significantly decreased. With the markets maturing an increasing number of customers discover the advantages of intermediation even though so far intermediaries mainly work with the primary market.

8. Under the existing regulation in Lithuania neither RE agencies, agents nor brokers need to obtain any license to engage in the intermediation activities. The area is regulated only by general legislation such as the Law on Companies<sup>2</sup> or tax legislation<sup>3</sup>. The situation has both its advantages and shortcomings. On the one hand the entry into the market for such agencies is sufficiently easy. According to the recent statistics there are about 400 real estate and property development agencies in Lithuania. Given that the largest number of transactions concentrates in the major Lithuanian cities, the number is quite significant. It would be reasonably expect an intense competition, high quality of the services and relatively low charges. But it is exactly the absence of any licensing or any legal regulatory basis that was conducive to the emergence and operation in the market of numerous small real estate agents and brokers who provide services of inferior quality. Furthermore, the market is flooded with the so called „black brokers“ or “outside brokers” – quite a common phenomenon in an active and not yet matured RE market. These are persons illegally engaging in the intermediation services who avoid paying any taxes to the State from their illegitimate proceeds. Such minor intermediaries, often do not provide services professionally, fail to provide accurate data or documents, rather they considerably create the confusion in the market. Not infrequently such agents engage in small profit making by selling a real estate items for a price much higher than has been agreed with the seller and, having found an interested buyer purchases the item from the seller at a lower price and resells it to an interested buyer.

9. The activities of the illegal and non professional intermediaries not restricted by any liability or obligations significantly impair the image of all professional real estate companies legally operating in the market. Upon a negative experience of doing business with the such agencies or agents customers tend to avoid having business even with the legal and professional agents which eventually prevents the market from maturing, conducting any more detailed market analysis or the provision to the market of any higher certainty or information. Since in Lithuania the real estate agents do not need to obtain any licences, any market stabilisation may be expected only when customers refer to and rely exclusively upon the honestly working and professional real estate intermediaries.

10. The services of the Lithuanian real estate agents are much more often relied upon by those who seek to sell any housing rather than by potential buyers. An RE agency and a customer conclude a contract normally specifying the service that the customer seeks to be provided, other terms, such as the charges for the services to be offered. A generally accepted seller's fee (the customer's success fee) amounts to 3-3.5

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<sup>2</sup> The Law on Companies (13 July 2000, No. VIII-1835, Official Gazette, No. 64-1914)

<sup>3</sup> The Law on Corporate Income Tax (20 December 2001, No. IX-675, Official Gazette, 2001, No. 110-3992), the Law on Value Added Tax (5 March 2002, No. IX-751, Official Gazette, 2002, No. 35-1271) etc.

percent of the sale price. The fee is charged to the seller. The amount of the fee depends on a number of factors, i.e. the location of the housing, its size, the desirable term of the sale, and the customer's willingness to negotiate the price. In the course of the last several years the fee was steadily growing: from 1-1.5 percent during the „hot season“ of 2003-2004, to 3-3.5 percent in 2006. This growth in the fee clearly demonstrates the growing number of customers who prefer to pay a fee in return of being assured that they sell for a fair price. The real estate agencies not only search for the customers, they assess the housing at market prices.

11. The buyer will be normally charged a notary's (registration) fee. The Law on the Notariate<sup>4</sup> stipulates that notaries charge a fee for the any notaries' actions, drafting of transaction documents, consultations and technical services. The amount of the fee is established by the Ministry of Justice of the Republic of Lithuania upon an agreement with the Ministry of Finance. The Order of the Minister of Justice<sup>5</sup> approved the provisional amounts of fees to be charged for the notary services. The fee for the confirmation of the transfer of an immovable asset was established at 0.5 percent of the value of the item in any case not less than LTL 100. Confirmation of a loan or credit agreement – 0.3 percent of the amount of the loan but in any case not less than LTL 50. The notary services market is virtually free of any competition. The Orders of the Minister of Justice establish not only the fixed rates for the notary fees, but also the fixed number of notaries in the Republic and their working hours. Besides, the Law on the Notariate provides for a prohibition of the advertising of notary services. Certain services are virtually tied up to specific notaries with the client left with no possibility to apply to another notary (e.g., in cases of property inheritance, the customer is obligated to apply to the notary in whose territory the property to be inherited is located). Furthermore, the Code of Honour (Ethics) of Notaries<sup>6</sup> recognises such actions of notaries as „attracting the customers by one-off or regular lower fees than those offered by other notaries“ as actions of unfair competition. In accordance with the Law on the Notariate for any infringement of the Notaries' Code of Ethics the notary may be subjected to a disciplinary proceedings, a sanction (warning, reprimand, removal from the position). Thus, this chain of circumstances and regulations directly related to the housing acquisition transactions presents a number of hard anticompetitive restrictions.

12. In Lithuania normally larger real estate agencies would offer a number of auxiliary services: real estate management and strategy services, geodesic and cadastre measurements, property lease and evaluation. The latter service is especially often offered by RE agencies. This market however is subjected to a much more stringent regulation than that of the intermediation. The activities of the asset valuers are being regulated by the Law on the Principles of the Asset Valuation<sup>7</sup>. The State supervision of the activities of assets valuers and entities engaged in asset valuation is being performed by the Auditing, Accounting and Assets Appraisal Institute of Lithuania. The Law also provides that the documents certifying the right to engage in the asset valuation activities are the qualification certificate of the asset valuator or the qualification certificate of the company; the Law also defines the restrictions imposed upon the rights of the asset valuers to assess any property. Asset valuers shall comply with the educational and professional experience requirements established by the Government of the Republic of Lithuania.<sup>8</sup>

<sup>4</sup> The Law on Notariate (Official Gazette, 1992, No. 28-810), No. I-2882

<sup>5</sup> Order No.57 of 12 September 199 of the Minister of Justice "On the approval of the provisional fees for the notarial actions, drafting of transaction documents, consultations and technical services“.

<sup>6</sup> Resolution of the Chamber of Notaries on the amendment of the Code of Honour (Ethics) of the Notaries of the Republic of Lithuania, 25 March 2000.

<sup>7</sup> The Law on the Principles of Asset Valuation (25 May 1999, No.VIII-1202; Official Gazette, 1999, No. 52-1672)

<sup>8</sup> Resolution No.1157 of 28 September 1998 of the Government of the Republic of Lithuania "On the approval of the qualification requirements of asset valuers“.

13. The Competition Council has received complain of individual asset valuator concerning the actions of commercial banks. Prior to granting a housing loan commercial banks require a report of the valutors of the property to be acquired as to its condition and the price. In certain cases it is the commercial banks that perform the asset valuation, although quite often the customers are offered a list of “acceptable asset valutors”. The list often includes 5-10 asset valuation companies. The applicant claimed that banks unreasonably refuse to include him into the lists even though he has acquired all the necessary qualification certificates. The applicant also claimed that the banks had concluded an agreement with the major asset valuation companies to prevent other asset valutors to enter this particular market segment. The close examination of the situation and the inquiries with the banks produced a finding that there are about 25 such companies of which about 10 are included into the list of the companies recommended by the banks. These asset valuation companies were most well known and with the best reputation. They also were in the market at least of 7-11 years, i.e. from the beginning of the market. Seeking to minimize the risk related to the asset valuation and accordingly the related crediting risk the banks have established sufficiently stringent additional criteria for the recommended asset valuation companies. Furthermore, the banks had provided for the customer’s discretion to acquire the asset valuation services at any asset valuator, in which case the Bank will be forced to perform some additional analysis and investigation. Finally, following a sufficiently critical inquiry many banks turned to much more flexible approach towards the customer's desire to choose an asset valuator.

14. The less frequently offered by the real estate agents geodesic and cadastre measurement services are equally strictly regulated by the Law on Geodesy and Cartography<sup>9</sup>. The geodetic operations include the formation of geodetic networks, surveying to determine setting and inclinations of buildings and structures, cadastre measurements of immovable property objects and marking of buildings and equipment on sites. The rules applicable to licensing concerning the performance of such operations, and the rules on the accounting of validity of surveyor certificates are approved by the Government<sup>10</sup>. The rules provide for a strict education, experience and other criteria applicable to applicant for the necessary licence.

15. In summary it could be drawn a conclusion that the regulation of the activities of some entities operating in the real estate market (including other agencies providing other services) is not sufficiently balanced. The oversight of the real estate agencies is not clearly defined and creates possibilities for numerous fraudulent activities in the RE market. On the other hand, the activities of notaries is subjected to such stringent regulation that the customer is left without any possibility to look for better or less expensive services.

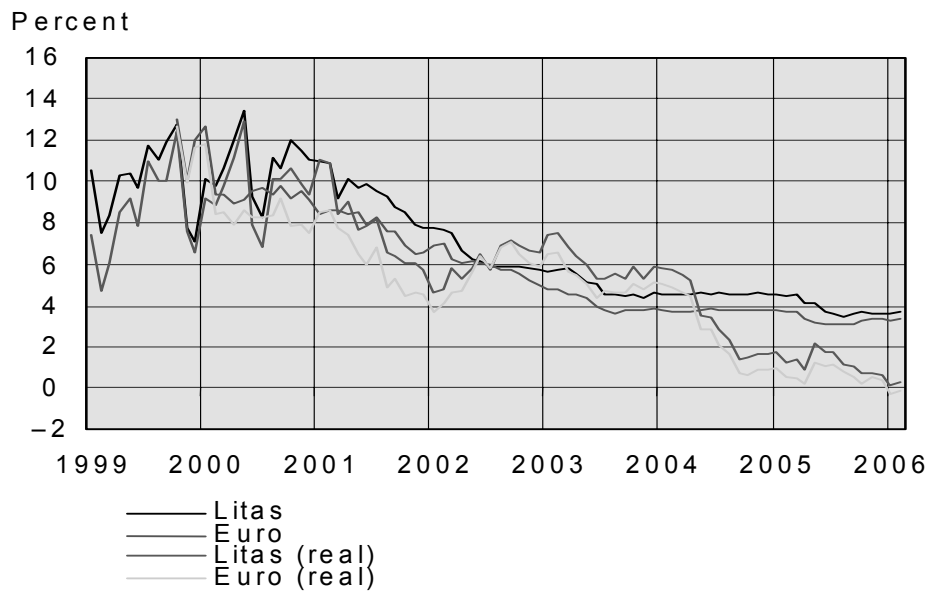
### **3. Housing loan market**

16. Another important reason that had to a significant extent heated the prices in the real estate market was the improving terms for obtaining housing loans. The banks had extended the loan repayment term from 25 to 40 years, reduced the required initial instalment and the interest rates, – both in the view of the falling basic interest rates and on the account of the banks' margin. The development of the average housing loan interest rate is shown in Fig.3.

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<sup>9</sup> The Law on Geodesy and Cartography (Official Gazette, 2001, No. 62-2226)

<sup>10</sup> Resolution No. 1805 of 19 November 2002 of the Government of the Republic of Lithuania "On the approval of the regulations on the licesing of geodetic, topography and cartography works“

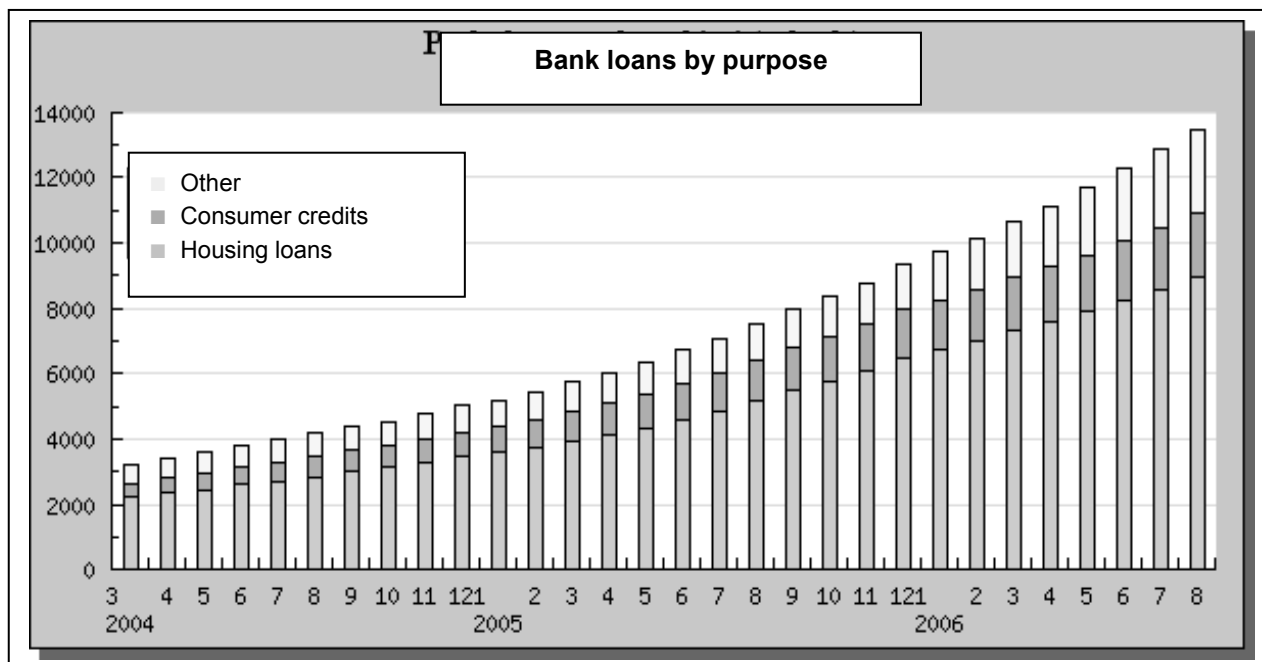
Fig.3. Housing loan interest rates in 2005-2006.<sup>11</sup>

17. Taking advantage of the improved terms in the loan market an increasing number of residents feel more willing to apply for the housing loans. The housing loan interest rates have been falling in the view of the growing demand for such funding facilities (although the main part of the interest rate is represented by the variable interest rate). The ever better crediting terms and the decreasing interest rates at the account of the bank's margin allows a conclusion of the growing competition in the loan market.

18. Loans granted by the banks in the course of the three years (2004-2006) nearly quadrupled (Fig.4).

<sup>11</sup> Data source: The Bank of Lithuania

Fig.4. Banks loan portfolio, 2004-2006<sup>12</sup>



19. Although the loan portfolio has been increasing at an extremely high rate, the housing crediting potential in Lithuania is still not fully utilised. The housing loan portfolio rate in 2003-2005 increased from 4 to 9 percent of GDP. In the meantime in the closest neighbouring Baltic States this rate accounts for 10 percent of the GDP in Latvia and 20 percent in Estonia. The Euro zone average rate is 38 percent.<sup>13</sup> The report of the Bank of Lithuania on the results of the survey concludes that out of 11 banks surveyed not a single bank indicated of any intention to liberalise any terms for granting the housing credits. 18 percent of the banks surveyed advocated an idea of slightly more stringent crediting terms (they together hold about one fifth of the banking market). This shows that the “softness” of the crediting terms has virtually reached the limit. Taking advantage of the high demand in housing credits and seeking to offer to a client a convenient “single window” service the banks offer or even tie up other services to the loan granting, such as property insurance, account opening, etc. The banks refer to such options for a number of reasons: they seek to assure the insurance of the mortgaged property and customer’s health at a reliable insurer, besides, each extra service is additionally chargeable.

<sup>12</sup> Data source: The Bank of Lithuania

<sup>13</sup> Data source: DNB Nord