

Housing Situation in the Czech Republic and Housing Construction: Current Situation and Challenges

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State of Issue

Housing is one of the basic needs of people's lives. Its availability and quality in terms of its various characteristics represents also an important factor in family planning. Changes in the housing situation can occur throughout life. Housing is dealt with by young people leaving their parents, couples after starting a family, etc. A change of housing occurs when the family breaks down because of aging/illness, when, e.g., health problems require different housing.

Due to the exceptionally favorable weather, construction work could start much earlier this year. This advance was reflected in the fact that the work increased by a fifth year-on-year (y-o-y). The construction sector grew by 3.6%, y-o-y, in February 2024. The start of projects is often postponed due to costly financing. However, this problem is being alleviated due to the gradual decline in interest rates. As these rates fall, households' demand for mortgaged property is increasing. This leads to an increase in the prices of apartments/houses, which can stimulate construction. The 4Q 2023 was marked by a turnaround, with apartment prices rising after a year of declining apartment prices. In every second district, prices were higher than they had been a year earlier. A further decline is therefore not expected. Prague remains the most expensive location. One of the reasons is the mismatch between rising demand and lower supply. Mortgage interest rates are gradually falling, so demand cannot be expected to decline but rather to increase. Real estate is taxed minimally, which is why some entities invest in the purchase of real estate, even in a situation where they do not rent it out.

Causes and Analysis

Investment projects in the Czech construction industry almost came to a standstill in 2023. Due to high-interest rates, developers have scaled back their plans and construction has been significantly weakened. The lowest number of people took out a mortgage in the last three years happened in 2023. The total volume of new mortgages in 2022 exceeded 162 bn. CZK, which is only 42.7% of the volume from 2021 (379 bn. CZK). This figure was even lower for 2023 (124 bn. CZK). However, after the Czech National Bank lowered interest rates, mortgages are becoming cheaper and the market is starting to revive again. The volume of new loans provided in the period March 2023-February 2024 reached 136 bn. CZK. In the same previous period, it was only 127 bn. CZK. People expect rates to fall even more, which is why they tend to conclude shorter fixations. Banks should strive for the state to start subsidizing mortgages more again to revive the market. However, some experts reject this, saying that state subsidies would distort the price of real estate and lead to a further increase in demand. Rather, the state should strive to speed up construction. Interest rates and mortgages could fall lower than expected and could fall below 4% by the end of 2024. Last year's volume of mortgages could grow by one third this year.

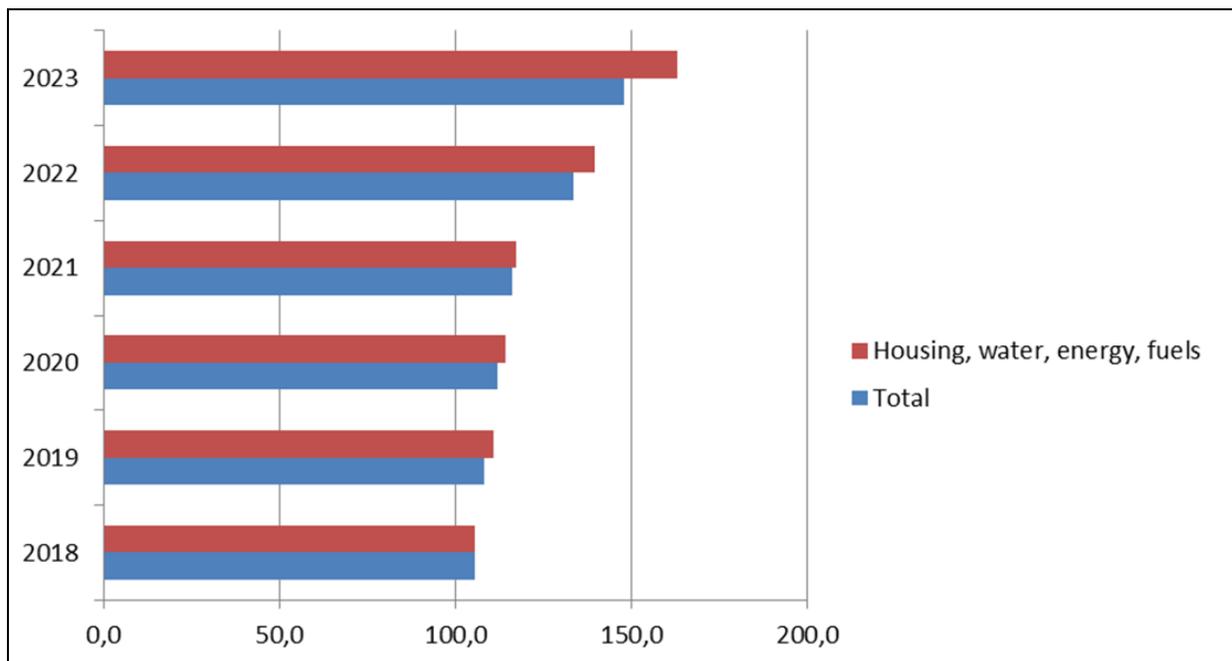
In the structure of housing in the Czech Republic (CR), own housing has long prevailed. The CR is one of those European countries where owner-occupied housing prevails over rental housing. In 2021,

more than 3/4 of the population in the country lived in own dwelling and 1/5 of the population lived in rental housing (in EU countries it was 70% in the own housing). Other Central European countries had an even higher share of owner-occupied housing. On the other hand, many Western European countries were at the level of the average.

In terms of the legal form, 2/3 of Czech households live in their own flats/family houses, one fifth in rented flats. Other households live in a cooperative apartment or live elsewhere. Households differ greatly in this respect; however, owner-occupied housing prevails for all of them. During life, there is usually a transition to owner-occupied housing. Lower-income households are more likely to live in rental housing. Rental housing is more typical for large cities, in the smallest municipalities living in family houses prevails. More than one-fifth of households live in rented apartments in Prague and in five other regions. Qualitative housing indicators in terms of housing area per capita also differ between types of households. In terms of area, the largest apartments are occupied by complete families with children, followed by childless families, single-parent households, and individuals. The quality of housing and the satisfaction of its users are influenced by the parameters of the dwelling and external conditions. Satisfaction with both parameters is high among Czech households. Of the most problematic negative phenomena, they consider noise, and polluted surrounding environment. Residents of larger cities are more likely to struggle with these negatives.

The average cost of housing expenditure in the CR is rising. Until 2021, the level of excessive burden of housing expenditure was still decreasing, but 2022 brought a ten percent increase in average housing costs, partly in response to the rise in gas and electricity prices. However, the CR is one of the European countries with a below-average level of burden. Due to faster growth in household incomes than growth in housing costs, the share of net income spent by households on housing declined for several years until 2021. The reversal came in 2022, when this share increased to about 15% and in 2023 to 17%. The decline in real estate prices that the economy has experienced over the past two years is unlikely to return soon. Housing costs vary according to household composition. Families with multiple children pay the most for housing. The most burdensome for families are food and housing expenses (less than a quarter of the average household's housing expenditure in 2022 was represented by rent, followed by electricity/gas). The state can help households cover housing costs by providing benefits (housing allowance and housing benefit). The rise in housing costs caused by the energy crisis, and with changed conditions for entitlement to the allowance, was reflected in an increased number of beneficiaries. Graph 1 shows that over the years the consumption index for the "housing, water, energy, fuels" group (ECOICOP classification) has been increasing, and for this group the index is also increasing compared to the average for all twelve ECOICOP groups (transport, education, food and accommodation, clothing, and footwear, etc.).

Graph 1: Consumer price index (CPI) – the Czech Republic (in %, 2018-2023)



Notes: CPI - base index (2015 average=100, ECOICOP classification).
Source: CSO database.

Residents of the CR prefer to live in their own apartment. Despite the high initial investment, it is usually accompanied by relatively lower monthly costs, without mortgage payments. The affordability of housing is influenced by several factors. First, the supply of housing stock and the demand for certain forms of housing, which reflects the preferences of citizens, the level of interest rates on mortgage loans and regional differences. The high demand for real estate due to such factors causes an increase in prices and thus lower affordability of housing.

The deteriorating affordability of housing since 2021 is evidenced by the *Housing Affordability Index (HAI)*. In response to stagnating mortgage interest rates and falling apartment prices, recent months indicate a slight turnaround and improvement from the 2H of 2022. The HAI expresses how much of a household's net monthly income is needed to pay a mortgage on an apartment. In February 2023, this figure was about two-thirds of the average household's income. Apartments in Prague remain the least affordable. In European comparison, the CR is among the countries with the least affordable owner-occupied housing. In Germany or Poland, the situation is much better. According to Eurostat, 24% of the population in the CR lived in rented apartments in 2023, a bit higher figure than two years ago. The situation is thus below the average value of the EU countries. In neighboring Germany and Austria, the proportion is higher, reaching around 50%.

In recent years, developments on the real estate market have also been influenced by the CNB's measures regulating various limits for the provision of mortgage loans and, e.g., by the abolition of the real estate acquisition tax. The high growth in owner-occupied housing prices increased the demand for rental apartments. In 2021/2022, rental prices also rose with varying dynamics in Czech cities and regions. *Deloitte Property Index* (August 2023) compares the prices in capital (Prague) and big cities (Brno, Ostrava) to the country average (country average = 100%). Prague has this indicator 131.7%, Brno 108.5%, and Ostrava 65.6%. This shows that there are also expensive cities that are not capital

(Brno), but this is not true for the other big city (Ostrava). Annual change of average transaction price for a new dwelling (computation based on local currency) is for the CR 7.4%. This may also have been partly due to the influx of refugees from Ukraine who were looking for suitable housing. Space is now being created to support various forms of housing. To this end, the state can adopt legislation that would enable municipalities to provide affordable and high-quality housing. Support from the state/local governments in providing affordable housing for people at risk of housing shortage in the form of social or start-up apartments persists. Due to the increase in energy costs, there are several grant programs that the government has introduced to increase energy self-sufficiency in the household sector. Due to the declining affordability of owning an apartment, many households have turned to the rental segment and banks were preparing housing programs for specific profession groups such as doctors. These programs were also prepared in cooperation with the public sector. The European Commission recently praised the support of affordable housing in the CR from public sources. The state will thus be able to finance the creation of rental apartments with below-market rents for young people or beneficial professions. The 2022 census showed that more than 270,000 people need housing. Inappropriate housing (small area, overcrowding, frequent moving) also negatively affects children's development.

Future Expectations and Implication

The downward trend, caused by high inflation and rising energy, interest rates and construction prices, is over. The Czech economy is returning to growth this year, which, according to the Ministry of Finance, should amount to 1.4%. In 2025, economic growth is estimated at 2.6%. This could also be reflected in the overall recovery of the economy and housing construction. The approval of support for affordable housing in the CR from public sources will enable the state to finance the creation of rental apartments with lower-than-market rents. Approximately 2 bn CZK should be allocated for these activities this year. Developers are optimistic and expect clients with mortgages to return. According to them, the prices of apartments could rise again due to the growing demand. This year's increase in real estate prices can be expected in the lower single digits as people are investing in real estate. In the coming years, the construction of large residential districts will begin. In the construction process, the state and companies will have to monitor not only deadlines and total costs but also environmental criteria. State support for families should take a comprehensive form, from support to the labor market, through the benefit/tax system, services for parents to affordable housing. The housing situation of people in difficult situations should also be improved by the Housing Support Act. According to experts, the law is better prepared than have been the similar laws in the past. The basic principles of the law were already presented last year with the then expected time for the law to be discussed by the government was the end 2023. This has not happened and is now expected to happen in June. While this is not a fundamental housing reform, the changes represent a more systemic approach to the current housing challenges. Contact centers for housing should be established in every municipality with extended administrative powers, and through them stakeholders should have the opportunity to address the issue of housing.

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