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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 increases in the prices of all types of real estate as changes are expected to differ across the segments of the national real estate market. Real estate 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, demand from retail sector will strengthen the market for urban development sites, provision of infrastructure will importantly influence prices in holiday resorts and industrial estates, and agricultural land prices will initially upsurge.

**Key words:** Real estate market, real property, EU accession, Bulgaria

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**THE PRICE OF EU ACCESSION:  
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**1 Introduction**

A number of recent studies on the determinants of price dynamics in Central and Eastern Europe (Baldwin et al., 1997; 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 countries due to become members of the European Union (EU). A basic proposition 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.<sup>1</sup> In a similar vein, transition will still impact price dynamics in accession countries, but only for a limited period of time, especially, in the advanced transition economies. Catching-up, in turn, is a long-term 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 the EU 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 real estate markets in Central and Eastern Europe, there are only a few published studies related to factors and trends of price dynamics. D'Arcy and Keogh (1998) emphasise the importance of property markets to competition and factor price determination. In this respect property led urban regeneration and real estate development form the focus for stimulating economic growth and capturing international capital investment. With particular reference to Central and Eastern Europe, in spite of still maturing process, the real estate market has played an important role in the competitive position and price levels in the cities of the advanced transition economies, such as Hungary, the Czech Republic and Poland (Keivani et al., 2001; Keivani et al., 2002; Parsa et al., 2000). More specifically, real estate markets play a two-fold role. First, these markets have to offer an adequate mix of appropriate floor space for supporting economic activity thereby overcoming the physical constraints imposed by the existing built environment. Second, the real estate market process in terms of patterns of ownership, legal arrangements and other market institutions determines the range and possibilities of property use, investment and development, and thus the relative prices of production factors.

Systematic analyses of the Bulgarian real estate market are scarce; the few examples are Andonov and Rizov (1999), Home et al. (1996), Munro-Faure and Evtimov (2000), and Rizov (1994). The existing studies and the analysis in this paper point out to three important characteristics of the Bulgarian real estate market. First, property prices are influenced primarily by demand, which depends largely on the nation's standard of living and the expectations of the population. Second, the government plays 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 services, taxation, and security of property rights. Third, it should be pointed out that in most market sectors EU accession, although it is not likely to increase demand substantially, would promote a greater general spirit of investment.

The current analysis shows that accession of Bulgaria to the EU is expected to result in an increase and differentiation in the prices of flats, a boom and later stabilization in the market for office space, an increasing demand for urban development sites by the retail industry, an improvement in the position of industrial real estate conditional on infrastructure availability 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 the 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 in the Bulgarian real estate market. Further, in turn, the likely developments in four important segments of the real estate market, specifically, residential properties, offices and shops, resorts and industrial estates, and agricultural land, are discussed. Finally, a brief conclusion is offered.

## **2 Driving forces in the Bulgarian real estate 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 a location offering space for

living and production but not 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 over the last ten years. Privatization and reintroduction of real estate market have 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 post-communist Bulgarian cities are related to: (i) sub-division 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 areas, and (iv) expansion of cities beyond the periphery, i.e., suburbanization (Rizov, 1994).

Five main driving forces affecting the real estate market and property development in Bulgarian context can be identified: (i) demand for land and property, (ii) striving for development gains, (iii) financial institutions' investment decisions, (iv) dynamics of economic restructuring, and (v) international property interests. Distinguishing these driving forces can help understanding the dynamics of property development, enable the categorisation of development processes, and thus provide a framework for analysing the temporal and spatial variations in functioning of the Bulgarian real estate market.

The first driving force – demand for land and property, from both the production and consumption sectors – is, to a large extent, responsible for development processes and for market operations observed. Demand is a result of political and economic factors, leading to economic growth and technological change as well as changes in the location and organisation of firms. Two steps in the locational choice of firms can be distinguished: the selection of a region and the

selection of a location within this region. The development, taking place on a regional scale can be explained by the fluctuations in the demand for new buildings by the production sector. With respect to selection of a location within a region, however, other factors are more important. In the industrial sector, the availability of business sites, in combination with the level of land prices and the accessibility of the location (including availability of infrastructure) are of decisive significance. In the office market, the location of firms is also dependant on these factors, but is in addition defined by the strategies and interests of the property sector and the stock of properties appropriate for conversion.

The meaning of the second driving force – striving for development gains that define the strategies of landowners, developers and financial institutions - is affected by the institutional context of Bulgarian cities. Specifically, substantial share of urban land is owned by municipalities, which do not necessarily strive for development gains in the first place but rather pursue certain public interests. Developers are not always interested in land development, because it seems to be almost impossible to make a profit (development gains) on it; rather they operate in the construction market where large fluctuations in market prices and rents occur. As a consequence, the development gains or losses on property development in Bulgaria are high.

The third driving force - financial institutions' investment decisions affecting flows of capital into different investment projects, different property sectors and different locations – has been importantly influencing the functioning of the Bulgarian real estate market and also transmitting the fluctuations in monetary policies and financial regime.<sup>2</sup> Investments in projects, including property development have not been stable over the period of transition; until recently, they have been declining, and continuously shifting from one sector of the real estate market to another, in particular, from housing and heavy industry to infrastructure and light industry.

Furthermore, financial institutions (mainly banks) prefer the role of financier of property development rather than acting as commissioners. In this way, they are able to minimise their risk. Risk minimisation by financial institutions is also one of the reasons for their participation in public-private partnerships.

The fourth driving force - dynamics of the economic restructuring at both national and regional level that affects spatial structures and property development in both urban and rural areas - plays the most significant role at the moment, in Bulgaria. This implies that regions show differential spatial and property development processes, due to variations in the regional production structure. In the same time, the existing spatial structure also affects the dynamics of the economic restructuring of the regions; shortcomings in the factory stock affect regional industrial growth and efficiency, for example.

Finally, it is believed that the fifth driving force - interaction between local, national and international financial and property interests for control over property and investment opportunities - plays a role in the Bulgarian real estate market. Investments by western companies and institutions in Bulgaria illustrate the growing importance of international competition in the Bulgarian real estate market with the rising expectations for EU accession.<sup>3</sup>

The relative weight of these driving forces depends on the type of development (new construction or restructuring), the sector of the real estate market in which transactions take place and the quality of the location (e.g. land prices, rental levels, the proximity of the market, etc.). Further, the institutional context, together with the government's position in the real estate market, institutional changes and changes in the organisation of firms and markets (e.g. the increasing importance of financial capital, the dominant position of Sofia as economic centre, etc.) as well as the pace of economic growth also affect the price dynamics in the Bulgarian real estate market.

### **3 Real estate market sectors: Overview and forecasts**

#### **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 in line with west European price levels, this will not happen overnight but will be a long-term process. This corresponds to the expectations of the market players themselves (Aristo Ltd., 2003; Bulgarski Imoty, 2002; Yavlana 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 west 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; in fact this process has already begun even before the signing of the accession treaty. Thus, membership will result only in moderate price increases.

- Figure 1 -

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 main regional towns and cities in Bulgaria reveals that prices and expectations of market players differ significantly (see figure 1). Until now the housing market outside Sofia has been more or less in a state of equilibrium, but in the future a slight oversupply is expected. Postponing the decision regarding possibility of 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 the larger towns and cities.

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**

Sofia, with population of over a million inhabitants, is by far the largest city in the country and represents the focus of the office market.<sup>4</sup> The next largest city, Plovdiv, represents only around a third of the capital's size and economic importance. The stock of existing offices in Sofia as well as in other Bulgarian cities still consists mainly of older, renovated pre-1980's buildings or converted residential premises. The oversupply of such low quality offices does not match the demand for modern, prime location office space. As a response to this and as a result of expectations for forthcoming EU accession, since 2001 there has been an increasing interest of

developers in constructing new office buildings or business complexes. According to the National Statistical Institute, only for the first half of 2003, 136 planning permissions for new office development have been issued.

Accession can offer a real chance of salvation for the office market in Bulgaria, often described by Sofia brokers as fragile and haphazard. It is argued that the dominant oversupply of low quality premises has been determined, to a large extent, by the repeated postponement of the date for accession; table 1 shows a general trend of increasing office prices across Central and Eastern Europe in correlation with closing up EU accession. However, it is uncertain how far EU membership, for which investors have waited so long, will solve office market problems. Evidence from property development practices (Bulgarski Imoti, 2002; Aristo Ltd., 2003) shows that it is the real estate market that is most interested in the Bulgarian government attracting as many EU institutions and businesses as possible.

- Table 1 -

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.

Concerning the retail market, the domestic demand and purchasing power of local population is the major determinant of price dynamics. Tourist spending apparently also plays a

role and its importance is reflected in variation of prices across locations within cities and across regions (see figure 2). Price levels fall dramatically away from the main business and tourist areas. There is, however, an important new player that is likely to soon start dominating the retail industry – a rise of supermarket chains is observed in Bulgaria, following similar developments in other accession countries. Commonly, supermarkets create their own retail space often beyond city centres, across the residential areas. This trend already drives upwards the prices of appropriate development sites and is likely to suppress or negatively affect prices of small shops in marginal locations.

- Figure 2 -

### **Resorts and industrial estates**

The process aiming at eliminating large price differences between Bulgarian and west European holiday resorts is in an advance stage of development. Numerous hotels and restaurants have been privatized and western tour-operators are present in all major Bulgarian resorts. Today international prices for plots of land are not much higher than those in some Black Sea coast resort areas around the city of Varna and towns along the southern Black Sea coast. However, important differences in the averages still remain. Expectations are that in a longer run, EU accession will lead to tourists looking beyond the established resorts and discovering the Black Sea coast as well as inland picturesque mountain towns, which may well become a popular holiday destination among foreigners.

Structural transformation and privatization of Bulgarian industry is also close to completion. However, existing industrial buildings are largely outdated, of substandard quality and often are allocated in polluted and unattractive sites. There is growing demand for modern

well-located warehousing and distribution facilities as well as for light industrial accommodation. This demand is driven both by domestic and foreign companies, although newcomer foreign businesses usually create their own premises. The supply of modern flexible-use facilities remains limited and sale market prices are far from established; market transactions are rare and prices vary widely and unsystematically across locations and regions (see figure 3).

- Figure 3 -

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 in 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 agricultural land as a factor of production 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 (Rizov and Andonov, 2000). To achieve equilibrium there must be an effective land (lease) market since without it realistic land prices

cannot be established. Speculation has already begun in Bulgaria: many of the interested parties think that with the approaching EU accession the price of agricultural land will rise. They have therefore started buying land, which is both suitable for agricultural use and is conveniently located to markets (see table 2 and table 3). 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.

- Table 2 -

Such expectations are 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. This is so because farmers from the EU who are already operating in Bulgaria will be entitled to buy land. Even if there is a limit per farmer of land owned, 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.

- Table 3 -

In the case of Bulgaria, it is likely that prices at the southern border with Greece and in good quality agricultural areas around the city of Plovdiv, south-central Bulgaria, as well as around seaside towns, specifically in south-eastern Bulgaria, will deviate upwards from those in other parts of the country due to the proximity of main markets (see table 3). 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, specifically the Dobrudja region, which is characterized by high quality soil and vast fields appropriate for large scale mechanized farming.

#### **4 Conclusion**

Accession of Bulgaria to the EU is expected to result in increases 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. Real estate prices have been influenced primarily by local demand, government policies and legal framework in place as well as 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, expansion of supermarket chains will positively affect demand for development sites, 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.

## Notes

<sup>1</sup> In fact, already now, EU accession countries are exposed to policies of harmonisation and monitoring.

<sup>2</sup> In 1997 a currency board was introduced in Bulgaria which led to stabilization of the financial system and hardening of budget constraints (see Rizov, 2002).

<sup>3</sup> Indirect investment in specialized property investment companies offers a more suitable method of gaining exposure to international real estate markets (MacAllister, 2000). This is so because indirect markets are more transparent, information costs are lower, liquidity is higher, and performance measurement is less problematic. These characteristics are of even greater importance in the economies in transition such as Bulgaria.

<sup>4</sup> The population of Sofia represents about 15% of total population, about 17% of total labour force; the GDP per capita is highest and the level of unemployment, compared with other cities and main regional towns, lowest in the country.

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**Table 1 Office market prices in EU accession countries, 2001**

Country	Sale price, €/m <sup>2</sup>				Rent, €/m <sup>2</sup>			
	Capital city		Other cities		Capital city		Other cities	
	min	max	min	max	min	max	min	max
Bulgaria	350.0	1000.0	200.0	800.0	40.0	265.0	25.0	120.0
Romania	600.0	1000.0	300.0	500.0	120.0	360.0	35.0	85.0
Czech Rep.	700.0	1500.0	300.0	800.0	75.0	300.0	50.0	180.0
Hungary	940.0	1415.0	470.0	710.0	200.0	255.0	85.0	115.0
Poland	1000.0	4000.0	600.0	3000.0	275.0	340.0	85.0	115.0
Slovakia	420.0	750.0	355.0	525.0	55.0	140.0	30.0	55.0

Source: CEREAN (2001)

**Table 2 Agricultural land market characteristics, 1999-2002**

<b>Years</b>	<b>Number of transactions</b>	<b>Total amount of land sold, ha</b>	<b>Average sale price, €/ha</b>	<b>Average amount per transaction, ha</b>
2001/2002	35450	35273	705.0	1.0
2000/2001	31324	59306	705.0	1.9
1999/2000	10710	18293	685.0	1.7

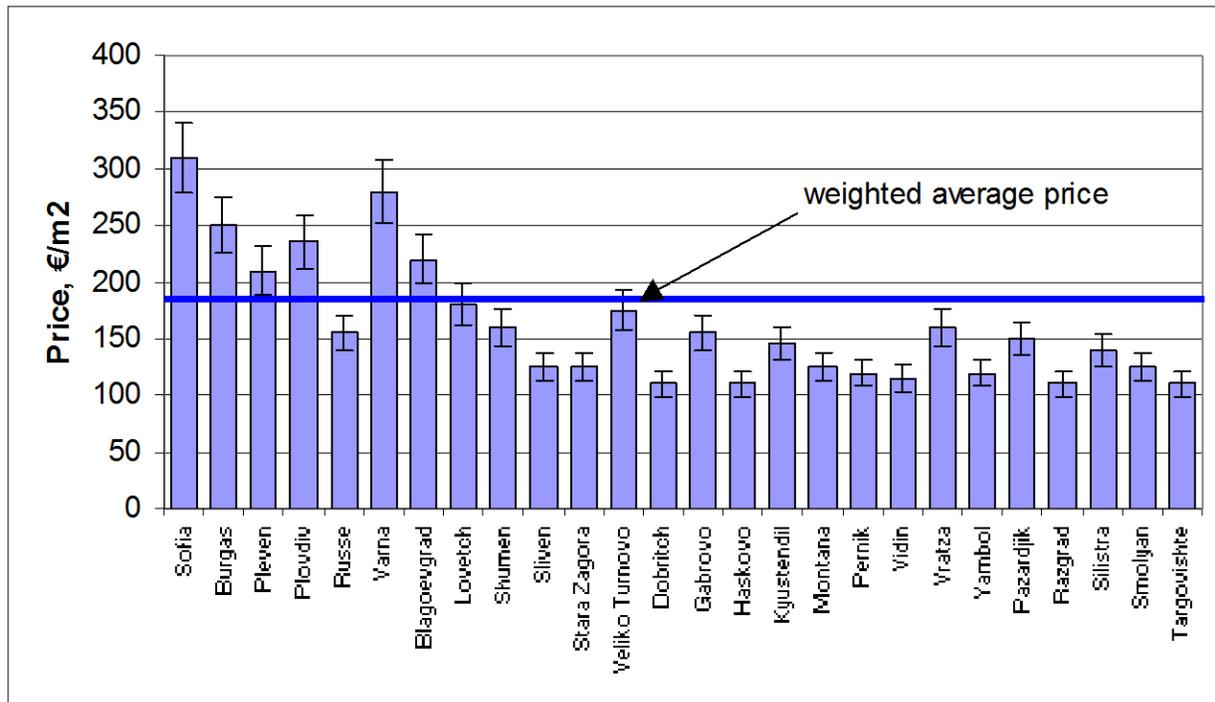
Sources: Ministry of Agriculture and Forestry (2002) and Aristo Ltd. (2003)

**Table 3 Agricultural land market characteristics by region, 2001/2002**

<b>Region</b>	<b>Number of transactions</b>	<b>Total amount of land sold, ha</b>	<b>Average sale price, €/ha</b>	<b>Average amount per transaction, ha</b>
North-western	2823	3077	575.0	1.1
North-central	6949	7328	600.0	1.0
North-eastern	13510	17319	535.0	1.3
Northern Bulgaria	23282	27724		1.2
South-eastern	4676	3351	820.0	0.7
South-central	5353	3280	1405.0	0.6
South-western	2139	919	2190.0	0.4
Southern Bulgaria	12168	7550		0.6

Sources: Ministry of Agriculture and Forestry (2002) and Aristo Ltd. (2003)

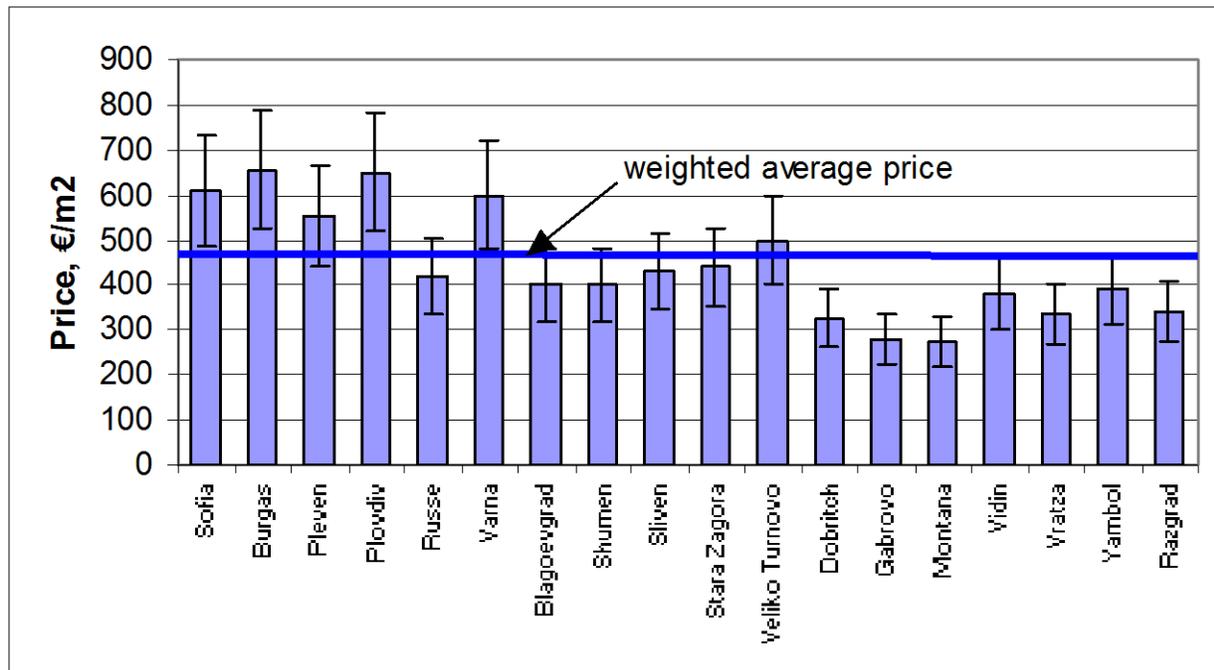
**Figure 1 Average sale prices of residential property, Q3, 2002 - Q2, 2003**



Note: The prices of residential property shown, mainly reflect the offer prices for flats.

Source: National Bulletin for Real Estate (2003), Bulgarski Imoty (2002) and own calculations

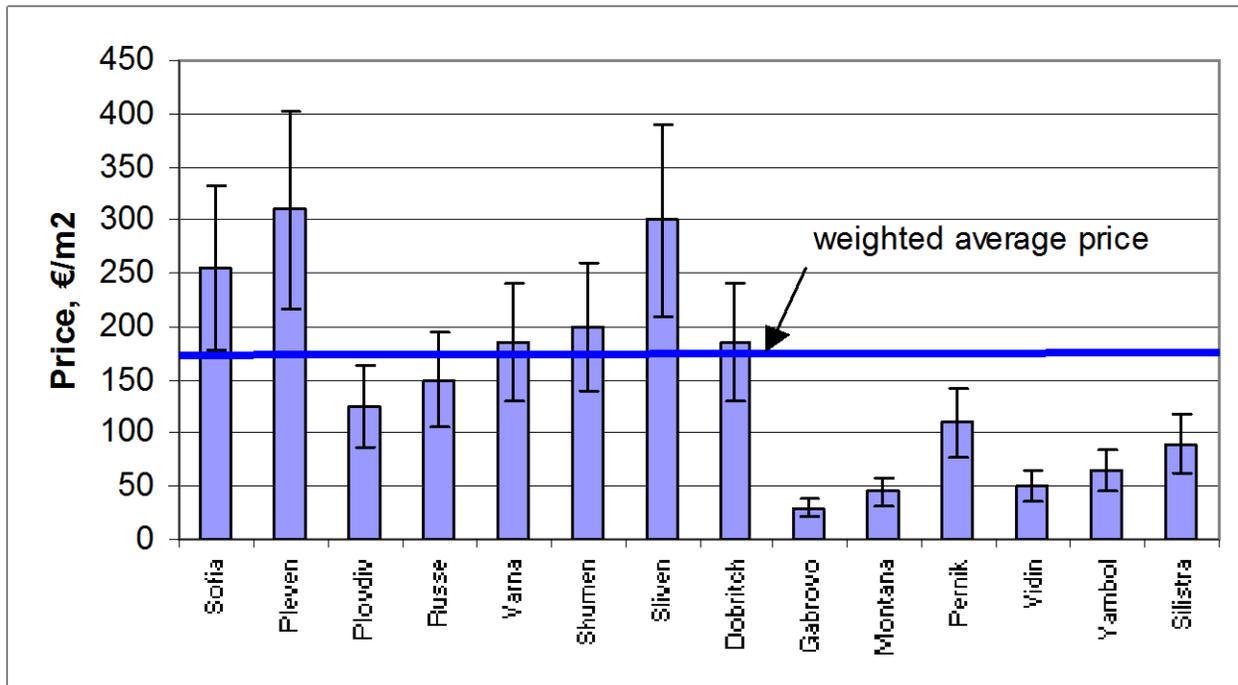
**Figure 2 Average sale prices of retail property, Q3, 2002 - Q2, 2003**



Note: The prices of retail property shown, mainly reflect the offer prices for centrally located small to medium sized premises.

Source: National Bulletin for Real Estate (2003), Bulgarski Imoty (2002) and own calculations

**Figure 3 Average sale prices of industrial property, Q3, 2002 - Q2, 2003**



Note: The prices of industrial property shown, reflect the offer prices for existing premises clear from production equipment and machinery.

Source: National Bulletin for Real Estate (2003), Bulgarski Imoty (2002) and own calculations