

International Journal of Law in the Built Environment, 2012, Volume 4, Issue 2,  
Pages 99-115

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# The Concept of Transparency in the European Union's Residential Housing Market: A Theoretical Framework

## ABSTRACT

**Purpose** – The purpose of this paper is to provide a theoretical framework for the subsequent analysis of the European Union internal market's concept of transparency in residential real estate transactions. Specifically, it seeks to identify the essential factors that should be addressed within any such analysis.

**Design/methodology/approach** – The study is based on a review of the literature on the general concept of transparency, and on other related aspects.

**Findings** – Based on this study, five dimensions of transparency are identified, namely transparency in transaction procedure, legal information, financing, taxation and transaction costs. The essential points are that an increase in cross-border transactions increases demand for easy access to information held in other countries. The studied literature focuses on the coordination of legal systems, making systems more uniform and legally secured, and on broadening of the mortgage market. The study highlights the complexities involved in achieving transparency, as well as the length of time that this will take to achieve in practice.

**Originality/value** – The paper identifies different dimensions of transparency in residential real estate transactions. There is little prior research in the area which focuses specifically on residential transactions. The study therefore draws upon work in other areas, including financial markets and taxation, and places this within a residential housing context.

**Keywords** - Residential housing market, property transaction real estate, real, transparency

**Paper type** - Conceptual paper

## 1. INTRODUCTION

Cross-border transactions are an important part of the European Union's (EU) real estate market, and as Ploeger and Van Loenen (2007) remark, the EU's "four freedoms" seem to provide a sound basis for expanding the property transaction market, including the opening up of the mortgage market. Those four freedoms encapsulate the principle of the free movement of the EU's fundamental production factors, i.e. free movement of *goods*, *services*, *persons* and *capital* (Bernitz & Kjellgren 2007). With the exception of goods, these freedoms are all directly linked to property purchase issues.

The effective and secure operation of cross-border transactions has been described as requiring 'transparency' (see e.g. Stubkjær, Frank & Zevenbergen 2007; Tiwari & White 2010). Clarification of the structure of the transaction market and real estate services is of decisive importance, since despite the expanding cross-border transaction market, there remain structural differences between markets and different regulatory systems. Furthermore, the differences can be found in agent and client relations, in the transaction process and costs,

as well as in approaches to mortgage design (see e.g Lindqvist 2006; 2008; ZERP et al. 2007; EUI & DNotI 2005).

The aim of this paper is to explore the concept of transparency in relation to residential housing issues within the EU's internal market, and to identify the essential factors that need to be addressed when considering it. The paper begins with a theoretical discussion on what should be included within the concept of transparency, and with a general discussion on the nature of the concept itself. The main thesis then follows, arguing that increasing transparency is a complex issue, and that it will take time to achieve.

The methodology consists of a literature review on the theory of transparency, globalisation and market operation. This framework is used as a background against which to identify the dimensions of transparency in relation to real estate transactions. Since there is little research in the area of transparency in relation to residential transactions, this study looks at other related sectors – for example financial markets, and taxation.

Section 2 of the paper defines the general concept of transparency and gives a broad overview of concept of transparency. Section 3 then outlines the concept of transparency in real estate markets, and section 4 then identifies five dimensions of transparency. Finally, conclusions are drawn in section 5.

## **2. THE CONCEPT OF TRANSPARENCY**

### **2.1. Definition and the origin of the term**

Transparency is a qualitative concept that is difficult to measure (Gnabo & Lecourt 2005; Eijffinger & Geraats 2006). The concept is often unclear and has different meanings, and various aspects of transparency can be found in different areas. As Williams (2003) argues, the precise definition on transparency can be somewhat illusive. Florini (2007) also remarks that the reason for lack of consensus on how to define and measure transparency can be referred to the broad use of the term. It is however generally associated with openness, communication and accountability. In the physical science, transparency is defined as something that can be seen through (NE 2008). However, this description can be used metaphorically in other areas, where seeing through means to reveal how something really is or works.

According to Florini (1998), transparency is the opposite of secrecy and is consistent with intentionally revealing actions, which means opening up decision-making processes. She writes: “Transparency refers to the degree to which information is available to outsiders that enables them to have an informed voice in decisions and/or to assess the decisions made by insiders” (Florini 2007, p. 5). A similar definition is given by the Working Group on Transparency and Accountability (WGTA) (1998). In this way, people from the outside can assess inside information and become a part of relevant actions and decisions. Affected people are thus enabled to evaluate the impact of performance (Nelson 2001). Transparency is used to hold others accountable for their policies and performance (Williams 2003; Florini 2003). Sharing of information can be, according to Williams (2003), a way of fostering empowerment, and responsible decision-making.

Opacity - according to Schulte et al. (2005) - is the opposite of transparency, and can be related to the information asymmetry of market participants, therefore preventing them from observing information about the trading process (Madhavan et al. 2005). Thus, according to Nijhof et al. (2009), transparency should be understood “as a means to build trust between market parties and improve the efficiency of the market operation” (p. 254). Market transparency can for example increase buyers’ knowledge of supply pricing, though it has different implications for society’s well-being. While some believe that price transparency leads to price competition - resulting in higher efficiency, others found that price transparency under some conditions can actually increase prices, for example by making prices more uniform (Kyle & Ridley 2007).

## **2.2. Transparency and global integration**

The term transparency is often associated with democratization and globalization (Florini 1998) and the transparency phenomenon is driven by social, political, technological and economic forces. Interdependence among the World’s societies forced by globalization is often seen as creating a need for transparency and such interdependence as being a defining feature of cross-border transactions and social exchanges (Williams 2003). According to Williams (ibid), global production, trade and finance are three interlinked processes which stimulate a demand for transparency. Gelos and Wei (2005) argue that transparency is the way for countries to attract capital, reduce capital market volatility and lessen the severity of financial crises.

## **2.3. The need for transparency, and associated problems**

According to the WGTA (1998), transparency helps to improve economic performance by contributing to the efficient allocation of resources and reducing uncertainty. Nijhof et al. (2009) also remark that the availability of information can be used to limit risks, create trust between the parties to a transaction, and to allow the parties to make optimal choices, thereby yielding benefits for all.

According to the WGTA disclosure does however need to be comprehensive, timely and accurate so as to facilitate identification of appropriate information, and to enable the market participants to compare performance. The information should be made available on a periodic and timely basis using acceptable standards, and the disclosure should cover all relevant information and be consistent over time (WGTA 1998). According to Fung et al. (2007), accuracy of disclosure requires an understanding of the priorities and capacities of a diverse audience. However an alert and engaged public, ready to participate, is also required. Another key dimension mentioned by Nelson (2001) is accessibility. This focuses on the place where the information is made available, the languages in which it is available, and the costs of obtaining it. The cost of acquiring and using the information must also justify users’ efforts in relation to the expected benefits (Fung et al. 2007). In this context a greater amount of information requires a greater effort to check it or make it controllable (Nijhof et al 2009).

More information is not always positive; in some circumstances confidentiality may be warranted (WGTA 1998; Florini 1998). According to Florini (1998), even if all the conditions of transparency are right, there is no guarantee that it will work, as the information can easily be misused or misinterpreted. Even small imperfections in information can have behavioural consequences, which can lead to misallocation of resources (Fung et al. 2007).

## **2.4. Three generations of transparency**

According to Fung et al. (2007), three generations of transparency policies can be discerned: right-to-know, targeted transparency, and collaborative transparency. The right-to-know transparency is described in Florini (2007) where the goal is to create a more informed public by making information more available. In targeted transparency the information is required to be standardized and comparable, and is aimed at allowing informed choices (Fung et al. 2007). Hence, Fung et al. (2007) argue that policies should focus on the needs and interests of both users and disclosers as well as the comprehension ability of users and capacities of disclosers. In the third generation transparency “users become more active, initiating searches for customized information and often becoming information disclosers themselves, empowered by technology” (ibid., p. 166).

## **2.5 Summary**

The need for transparency is therefore a product of global interdependence. The demand for it can be seen to be stimulated by the interlinked processes of global production, trade and finance and the concept to be regarded as central to the effectiveness of cross-borders transactions. The concept itself is however somewhat elusive since different aspects of transparency exist. In general, transparency refers to the degree to which the information that allows informed choices is available. In the context of the property transaction market with which this paper is concerned, the term can be described as referring to the ability of transaction participants to observe information concerning the transacting process, increasing their knowledge to make informed decisions.

# **3. TRANSPARENCY AND THE REAL ESTATE MARKET**

## **3.1. Market transparency**

Transparency in the context of the real estate market is not clearly defined. According to Schulte et al. (2005), who studied the real estate market in Germany, transparency is essential for successful investment to take place. Transparency also matters to occupiers and tenants since it provides certainty and risk reduction (Hagkull in BI-ME et al. 2008). The working definition of market transparency that Schulte et al. (2005) establishes is as follows: “Real estate markets can be described as transparent when it becomes clear how the market mechanisms and the variables behind these mechanisms work, i.e. when there is as much information as possible available at any point in time” (p. 91).

A transparent market supplies as much information as possible to all market participants, and thus, the information advantages of other market participants are minimized. According to Schulte et al., transparency in the real estate market requires access to such variables as: the rental market with average and top rents, lease rents and demand and supply of space; the investment market with property rents and yields, purchase and selling prices; the property and construction market with building costs; and the capital market with lending conditions. Other variables of interest are, for example, financial information from central banks, transparency on valuation statements and transactions costs.

## **3.2 Measuring transparency**

Jones Lang LaSalle's five transparency sub-indices in Real Estate Transparency Index (RETI) 2008 are as follows: Performance Measurement, Market Fundamentals, Listed Vehicles, Legal and Regulatory Environment and Transaction Process. Their research considers, inter alia, consistency in the application and interpretation of laws and regulations, respect for private property rights, access to investment performance indices and market fundamentals data, and ethical standards of professionals in the commercial real estate market.

The highest score reached by European markets, based on the index, concerns the transaction process, which is related to the high levels of cross-border transactions, the presence of multinational advisors and consistent professional standards. However, the degree of transaction process transparency is high around the world. The variables considered in this case are: the availability of asset-specific information for properties on the market for sale or lease, the enforcement of professional standards for agents and real estate advisors, facilities and project management service and fees, occupier service charges, and debt financing commitments, terms and fees. The results imply that the information on the transaction - for example, the specifications of buildings for sale, service providers' charges and financing terms - can also be obtained in low transparency markets with less complete information about the broader market. It should, however, be noted that it is not entirely clear how Jones Lang LaSalle measure the concept of transparency.

### **3.3 Summary**

Summing up, the importance of transparency is clearly emphasized by different actors in the real estate market. However, in the context of the real estate market, there is no clear definition of transparency and no clear way of measuring it either.

## **4. TRANSPARENCY AND RESIDENTIAL REAL ESTATE TRANSACTIONS: THE FIVE DIMENSIONS**

### **4.1. Transparency in residential real estate**

As a consequence of globalisation, more interrelated markets and rising mobility, transparency has become an important issue in residential real estate. Efforts are now being taken to make global real estate transactions more transparent and less complicated, with more standardized transaction practices as well as clearer and more transparent regulations. Higher transparency and the disclosure of information on the transaction market can thus contribute to a better basis for decision-making by market participants. It can lead to higher awareness among market participants of market supply, issues connected to purchase or sale decisions, as well as the different challenges the market players are confronted with, including risks. It can also lead to a better understanding of the range of services available on the market and the costs connected to the transactions and cross-border investment. According to Nijhof et al. (2009), transparency in transactions can be associated both with openness about risks and costs of the transaction, and with providing insights into matters that are relevant for the parties involved.

### **4.2. Hindrances**

However, unification and comparability across countries also requires any obstacles to this to be identified. Although the internal market offers consumers the possibility of buying

properties in other EU-countries without major legal constraints, there are still some hindrances which need to be eliminated. A number of direct barriers operate in the form of transitional periods and exceptions negotiated by some countries when entering the EU - for example, relating to the purchase of holiday homes or secondary residencies (EUROPA 2007). In addition, significant differences in transaction procedures, legal formalities, regulation levels, ways of financing, and taxation, as well as different conditions, unexpected costs, also provide a number of indirect barriers. Country of origin principle, ownership attitudes, land registration systems, tax structure and rates, and financing can also be identified (beside nationalism, regionalism and ethnic claims of supremacy) as some of the barriers to unification (NAR, CIPS Europe 2006).

Nevertheless, several professional networks now exist which promote standards for real estate professions on an international basis. These include CEPI (European Council of Real Estate Professions), CEN (European Committee for Standardization), a European project on standardization of real estate broker services as well as EULIS (European Land Information Service) which provides access to land registers in Europe and with the aim of providing European property information to the whole world. TEGoVA (European Group of Valuers' Associations) also promotes the harmonisation of European valuation standards, whilst RICS (Royal Institution of Chartered Surveyors) brings together professionals from different spheres of the property sector and maintains and regulates professional standards. Finally, FIABCI (International Real Estate Federation) operates as a business club of real estate professional in 60 countries, helping to provide businesses with an international dimension.

### **4.3. Dimension of transparency**

Against this backdrop the paper now attempts to identify dimensions that should be included in defining the concept of transparency in residential property transactions. This will then be used to identify the degree of transparency in EU countries. Five aspects are distinguished: (1) Transparency in transaction procedure (including access to information and assistance in the process), (2) Transparency in legal information (including national legislation on ownerships forms, permissions and land registry), (3) Transparency in financing, (4) Transparency in taxation, and (5) Transparency in transaction costs.

### **4.4. Dimension 1 - transparency in transaction procedure**

#### ***4.4.1. Openness and design***

As Lisec et al. (2007) remark, demand for a secure, transparent and efficient real estate market raises an issue related to the optimization of transaction procedures. Transparency in transaction procedures concerns openness about regulatory systems and models in the respective countries. Furthermore, the design of the models affects the timescale of transactions and the variation in legal fees between different countries, and consequently, this affects the cost of transactions (Griffiths 2007). Variations across countries can, for instance, be found in the content of professional services, terms and conditions for market access and in the degree of regulation for real estate professionals. The role that the real estate professional plays in the process of a transaction differs across countries. Lawyers, notaries, conveyancers, banks, title registrars and real estate brokers/agents are some of the actors with different roles and levels of importance in the process.

#### ***4.4.2. Procedural differences***

Focusing on the broker/agent, it can be established that there is no existing EU standard for real estate broker services. The nature of broker commission also varies. In some of the member states, such as Ireland or England, the broker acts as a representative, while in others, like Sweden, as an impartial middleman. However, many other models can be found too. In Germany and Poland the professional can choose to work either as representative for one party or as impartial middleman for both, while in Denmark and Finland, the broker/agent looks out for his/her client's needs and interest, but with consideration for the other party in the transaction.

The other aspect is differences in requirements in the process. The majority of countries require mandatory participation of a notarius publicus (e.g. Germany, Poland), while in other countries buyers and sellers are able to carry out the transaction by themselves (e.g. Sweden, Norway). Additionally, the role of conveyancers and the extent of their tasks differ between the countries. Furthermore, in some countries permission to be involved in real estate transactions can also be given to banks, building companies, solicitors or other lawyers. To what extent national legislation is applicable at cross-border activity is often unclear. However, this should be an important issue, bearing in mind the interest in consumer protection.

#### ***4.4.3. Harmonization attempts***

As stated above, CEN is one of the attempts for convergence between the European countries. All national standardization institutes within the EU have been invited to the project on harmonisation of real estate broker/agent services, with the European Commission (EC) as observers. Decisions made by CEN on harmonisation can thereafter be binding through EU-directive, although only after it has been taken up by the national governments (SOU 2008:6).

### **4.5. Dimension 2 - transparency in legal information**

#### ***4.5.1. Openness and certainty***

Transparency on legal information refers to openness of information from national land registries, openness on rights and interests in real property, forms of ownership and other relevant information on national legislation. At the same time, it refers to a level of certainty in those rights and interests. Reliability and accessibility of the information affects the functionality of the real estate market (Nummelin 2003). According to Ploeger and Van Loenen (2007), transparency of information from national land registrations and uniform levels of certainty concerning rights and interests in real property are necessary for a common European housing market. It can, however, be observed that national systems of land registration in member states provide different levels of legal certainty (Van Loenen et al. 2005) and have reached different stages of development (Ollén 2002). This is due to a combination of historical influences, organizational differences, as well as legal and technical points of view (Ploeger & Van Loenen 2007).

In general, the fields of land registration law, contract law and obligations, as well as the law relating to rights in land are considered to be difficult to harmonize (Van Loenen et al. 2005). Ollén (2002) argues that despite the fact that "land law is, and will for a foreseeable future remain, a national issue, there is good reason for improving the availability of and access to



information in order to, among others things, take away obstacles that might exist for financial institutions” (p. 214).

#### ***4.5.2. Coordination efforts***

Among the attempts to create a more transparent system of real estate transactions is the establishment of the Permanent Committee on Cadastre in the European Union (PCC) in 2002 which aims to coordinate the cadastres in Europe and their users (Ploeger & Van Loenen 2005). Another project, EULIS, brings together several European land registries in one internal portal, providing access to the information in the computerised databases of the participating organisations. An extensive presentation can be found on their website or in Ploeger and Van Loenen (2004; 2005; 2007). As a further attempt towards harmonising the information and description of legal issues, Paasch (2005) mentions UNECE’s guidelines (United Nations Economic Commission for Europe) on real property units and identifiers which focus on land registration systems.

#### ***4.5.3. Legal, organisational and technical issues***

The next step in the process can be, according to Ploeger and Van Loenen (2005), the harmonization of land registries. They emphasise that decisions about technical standards and the legal basis of the registration system are actually of greater importance than differences in land law. Conversely, in Ploeger and Van Loenen (2007), integration of legal and organisational issues is considered to be the greater challenge compared to technical issues. European uniformity, in the respect of the divergences between the systems (as the classification of national systems from a comparative point of view can be difficult), is believed by Remien (2005) to be somewhat utopian. One possible solution for a common method of land registration is, according to Ploeger and Van Loenen (2005), the EuroTitle system: a standard for land registration, which would be complementary to existing national systems, on voluntary basis, but would not replace them (Ploeger & Van Loenen 2005, p. 9; Van Loenen et al. 2005). Another direction may be a guarantee of title based on the concept of private title insurance (Ploeger & Van Loenen 2007).

#### ***4.5.4. Property legislation***

When discussing possible solutions for a common land registry in Europe, issues relating to real property legislation naturally arise. Legal aspects of real property transaction are of significance for the transaction procedure, for example, in the validity, smoothness and costs of the transaction. Paasch (2005) writes: “The internationalisation (i.e. standardization or harmonisation) of law is an old dream, leading to visions of legal integration or even unification of legal systems” (p. 2). According to Paasch, the real property domain can be introduced to the methodology of comparative law by the use of standardized terms and definitions describing the legal content of national real property legislations and the use of a classification model. Furthermore, a better understanding of legal issues through a standardized approach makes it possible to reduce real property transaction costs (ibid.).

### **4.6 Dimension 3 - transparency in financing**

#### ***4.6.1. Accessibility of financial products***

Transparency in financing focuses on the accessibility of information for a wide range of mortgage products, both national and cross-border, as well as the costs associated with them. The full liberalisation of capital movement for most member states came into effect in 1990 by the Directive 88/361/EEC, and later by the Maastricht Treaty in 1993. Countries joining the EU progressively removed barriers, although some exceptions and transitional periods with regard to the right to purchase second homes or agricultural land can still be found (EC 2009). In some areas, free movement of capital is working smoothly and efficiently, but there is still much development needed in other areas, such as financial services. The vision of the European Single Market is to offer consumers a wide choice of financial products, such as loans, with the possibility of purchasing products anywhere in the EU, consequently making transactions easier and cheaper (EC 2009).

#### ***4.6.2. Uncertainty over legal information***

According to Ploeger and Van Loenen (2005), despite the Second Banking Directive 89/646/EEG, which established the EU's single market for banking, the realities of a single European mortgage market is still remote, and Nasarre-Aznar (2004) remarks that transnational mortgage lending represents only one percent of the whole mortgage business. As discussed earlier in this paper, difficulties in exporting national mortgage products are linked to uncertainties over legal information about the property to be mortgaged. Van Loenen et al. (2005) remark: "Mortgage banks have difficulties in assessing the value of the information they receive and so do not risk supporting a loan for property in another member state" (p. 1). Nasarre-Aznar (2004) states that the legal difficulties which foreign lenders experience leads to a lack of concurrence among European lending institutions, and as a result, two essential objectives of the EU are not accomplished: "free movement of capital – because lenders behave according to a national-based market – and free movement of workers – because borrowers need to refer to local lending institutions to finance their homes instead of continuing using their own" (p. 2). Even though a home bank has a partner bank or a representative office in another country, the local home office cannot help with the transaction as usually a particular department needs to be contacted separately. Furthermore, the costs are usually higher when taking a loan for a property in another country. For instance, a person in Sweden wishing to take a loan in Sweden for a property in Spain must pay an arrangement fee of €1000 (October 2008), whereas no such fee is charged for loans concerning properties in Sweden (April 2009).

#### ***4.6.3 Towards integration of the mortgage market***

Among attempts to move towards an integrated mortgage market, the report by the Forum Group on Mortgage Credit (a group created by the EC in 2003) should be noted. This resulted in the EC's Green Paper on Mortgage Credit in the EU (COM (2005) 327) and White Paper on the Integration of EU Mortgage Credit Markets (COM (2007) 807). As the Forum Group's mandate was to identify and assess the impact of the barriers to the smooth functioning of the internal market for mortgage credit, the report consists of the recommendations for tackling these barriers (EU 2004). The Green Paper brings up the possible benefits of and obstacles to the further integration of European mortgage markets (see COM (2005) 327) while the White Paper is a summary of the review on the functioning and level of integration in credit mortgage markets, identifying a package of proportionate measures designed to improve the competitiveness and efficiency of cross-border lending (see COM (2007) 807). All documents address the issues of land register transparency. The discussion of the report and papers can be found in Ploeger and Van Loenen (2007; 2008).

#### ***4.6.4. A common mortgage for Europe***

Project Eurohypotheq is suggested, amongst others, by Nasarre-Aznar (2004) as a way to achieve a common mortgage market for Europe that is beneficial for both consumers and lenders. The model, which can be found on [www.eurohypotheq.com](http://www.eurohypotheq.com), is proposed by the Eurohypotheq Research Group (a group of experts launched in Spain with members from Spain, the United Kingdom, Sweden, Germany and Poland), but the project is the result of long discussions and has its origin in the 1966 report, “The Development of a European Capital Market”, for the EC. The model is intended to be an alternative tool to facilitate the transfer of mortgages without substantial changes to existing legal systems of the member states, and would operate under the principle of *lex rei sitae* (the law where the property is situated) (MCF 2005).

But as Ploeger and Van Loenen (2005) remark, the Eurohypotheq does not resolve the problems of diversity between the national systems of land law and land registry. In 2005, the Mortgage Credit Foundation (MCF) - a Polish foundation with representatives from the Ministry of Finance, Ministry of Justice, the National Bank of Poland, research institutions and banks - published “Basic Guidelines for a Eurohypotheq”. One of the outcomes states that “The transferability and the economic value not only of the Eurohypotheq, but of all mortgages, depends on its legal environment, in particular a transparent land registration system, where all relevant charges on the land can be checked by the prospective creditor, and effective enforcement procedures” (p. 8).

Some descriptions of the function of the Eurohypotheq - advantages and disadvantages of the model as well as basic configuration - can be found in Nasarre-Azar (2004). Information on the subject can also be found in Van Loenen et al. (2005), Ploeger and Van Loenen (2005; 2007). According to Nasarre-Aznar (2004), the main implications of a common mortgage for Europe, which the Eurohypotheq represents, would be: “easier access to a dwelling, better land development, more concurrence among lending institutions, better mortgage funding, allowance of more and more diversified types of trans-national businesses and, generally speaking, a wider and more open housing and mortgage markets in Europe” (p. 2).

### **4.7. Dimension 4 - transparency in taxation**

#### ***4.7.1. National tax sovereignty versus coordination and harmonisation needs***

Cnossen (2002) and Joumard (2001) state that, together with the progress of integration within the EU, international taxation issues (including interactions between the tax systems of the member states, and the harmonisation or coordination of member states’ tax policies) has been brought up for discussion. The design of the taxation system is of decisive importance as it can either stimulate the purchase of goods and services or prevent consumption by making products or services more expensive (Bernitz & Kjellgren 2007).

According to Bernitz and Kjellgren (2007), there is a clear conflict between the member states’ desire to keep national tax sovereignty and the requirement for coordination and harmonisation at EU-level in the interests of continued economic integration. Sørensen (2001) remarks: “Although the ‘Europe-builders’ in the European Commission have presented numerous proposals for tax coordination and tax harmonisation over the years, member states

have jealously guarded their sovereignty in matters of tax policy, and so far only a limited amount of coordination has been achieved” (p. 2).

The treatment of different taxes in connection with property or property transactions varies considerably across the EU. National tax legislation has been brought down in a large number of EC-court settlements, on the basis that special treatment of people or companies is considered to be a discriminatory act in relation to other countries (Bernitz & Kjellgren 2007). In an example from Sweden (which has a clear limitation of free movement of both persons and capital), a person could be given the right (under some conditions) to defer payment of capital gains tax on the sale profit, favouring those buying or selling a property within Sweden. This limitation was however changed on 1 February 2007, and today, under the current Swedish rules, payment of tax can even be deferred when using the money to buy a home in another member state or other country included in the EES-agreement, without restrictions on ownership form.

#### ***4.7.2. National approaches to taxation***

Brown and Hepworth (2002) have undertaken research on property taxation systems in 42 European countries, albeit based on the situation in 1999/2000. The types of housing taxation they researched includes annual property taxes, income taxes, inheritance and gift taxes, capital gains taxes, value added taxes, and property transfer taxes. According to their report, the housing taxation policies have many variants, although a number of common structures for taxation can be found.

Some of the findings show that the treatment of capital gains tax from property varies considerably, and in some countries capital gains are not taxable at all being simply treated as part of the taxpayer’s normal income and assessed as part of their income tax liability. While some countries have adopted a specific capital gains tax approach, other countries tax it as part of a separate capital gains tax system or by income and corporation tax.

Income taxes are mainly levied by central government. However, a number of countries allow regional governments to levy their own income tax either as a separate tax or as an additional rate levied in addition to the national rate. Additionally, most countries levy some form of inheritance and gift taxes. In most cases, the property tax is a local one, but it can also be a central governmental tax. The tax burden on the transfer of property can be significant in some countries (ibid.). However, the important observation is that taxation on properties, in respect to forms and levels, can never be seen as isolated from each country’s tax system. This is why property taxation can never be evaluated independently of other tax forms, the structure for taxation and the total tax burden (Lind & Lundström 2007).

Despite the report being obsolete on some points today, as many changes have been introduced since then, it can be established that, there are still significant differences between the countries’ tax systems, which make it difficult for the European consumer to get an overview. Taxation as a component of the consumer’s housing costs may affect his or her capital allocation, and consequently, it may affect residential mobility across countries. In addition, the values of the properties can be affected.

### **4.8. Dimension 5 - transparency in transaction costs**

#### ***4.8.1. Variations in costs***

Transparency in transaction costs is an important objective within the transparency issue when the transaction process is considered. According to the Global Property Guide (GPG) (2009), the cost of buying and selling residential property varies considerably across EU-countries. Roundtrip transaction costs - i.e. the total cost of buying and selling a residential property (which includes legal fees, sales and transfer taxes, registration fees, and real estate agents' costs and fees) - ranges from as little as 3.35 percent of the property value in Lithuania to as much as 24.88 percent in Bulgaria.

#### ***4.8.2. Difficulties in comparison***

The comparison between countries is, however, based on some assumptions concerning the property value, type of property and location. It should also be taken into consideration that price levels vary significantly between the countries, as do incomes. In addition, different forms of ownership for apartments exist in different countries, which can make the comparison difficult and can affect prices and transaction taxes. It can be argued that this kind of comparison should rather be done on comparable objects with prices corresponding to price levels for respectively countries. However, significant differences in transfer taxes, registration fees, agents' fees, notaries' fees and other direct and indirect costs can be established. It must also be noted that some costs can vary depending on the complexity of the transaction or negotiations between the parties, and furthermore, the costs of both energy labelling and property condition surveying can be added as well. It is also hard to decide which party is a cost bearer as what the law states is not always what is common in practice: even if, according to law, there is an equitable tax duty, in practice only one of the parties bears the cost.

#### **4.9. Summary**

Transparency is considered to be an important issue in residential real estate transactions. A better basis for decision-making presupposes information disclosure, more standardized transaction practices and both clear and transparent regulations. This section has identified the five aspects – or *dimensions* - which could be used to measure the degree of transparency through the European countries.

Transparency on *transaction procedure* concerns openness about regulatory systems and models since the design of the models affects transactions in many different ways. Transparency on *legal information* refers to openness about information from national land registries, openness on rights and interests in real property, forms of ownership and other relevant information on national legislations. At the same time, it also refers to a level of certainty on those rights and interests as reliability and accessibility of the information affects the functionality of the transaction.

The free movement of capital is another essential condition for the proper functioning of the Internal Market and cross-border transactions. Transparency on *financing* concerns access to a wide range of mortgage products, both national and cross-border ones, as well as costs associated with them. The *taxation system* as a component of consumers' housing costs has a significant role in the property market. The way the system is designed can have crucial importance for transactions as it can either stimulate or prevent them, and this results in residential mobility across the countries being affected. It is, however, a problematic issue since economical integration creates a conflict between the European countries' desire to keep

national tax sovereignty and the need for coordination and harmonisation. The final aspect is that of *transaction cost* transparency, which involves significant differences in both direct and indirect costs, and this can be of decisive importance for the transaction.

## 5. CONCLUSION

The effectiveness of the real estate market - and transparency, as one of the factors that are important for efficiency - are considered to be essential aspects of the global competitive market. The effective operation of the real estate market is believed to be associated with a carefully synchronized legal system that provides transparency, simplicity and legal security. The importance of the real estate market is linked with key investments such as saving and consumption choices of households and businesses, as well as banking and equity market performance. However, the state of the housing market, and the effects of foreign investment, cannot be measured without comprehensive information on transactions within the market. In addition, foreign investment in the housing market can be associated with benefits, even if the costs of adjustment are high.

The EU's "free movement" is not only a basic principle, but also a fundamental right linked with European identity, the core of the EU and a starting point for the other rights. Thus, limiting this right could have a significant impact on the functioning of the EU. Examples of this limitation can be seen in the European court's settlements in cases such as the case C-370/05 on the restrictions on the acquisition of agricultural property, where they required that the acquirer take up fixed residence on the agricultural property.

An increase in cross-border transactions brings demands for easy accesses to information, for uniform systems and broader mortgage markets. Despite more developed technology, and the growing importance of the internet, the help of local experts who are familiar with local systems is still inevitable in many countries as the mortgage market is still considered to be local. In Ploeger and Van Loenen (2007), a picture of a current transaction process can be found that highlights a potential buyer hiring a local advisor to clarify the foreign legal terminology and provide a sufficient and reliable overview of the legal status of a property. This process is both time and money consuming, and moreover, uncertainty of the legal situation affects the range of the mortgage products. Hence, improving the legislative framework and administrative procedures would lead to clean titles and more efficient cadastres, which could bring many new buyers to the market.

As illustrated earlier in this paper, a new generation of transparency can be both beneficial but is also associated with risks. Effective policies are not about an increase of information, but about an increase of knowledge for more informed choices. In the housing market, safe choices (on the basis of e.g. comparable information) are particularly important, as out-of-date or incomplete information can confuse or mislead potential buyers, who, without data for decision-making, can refrain from purchase or risk a complex and problematic transaction. Transparent and neutral legislation and procedures could contribute to an increase in cross-border home ownership.

Transparency is, however, difficult to measure. Three dimensions, identified by Fung et al. (2007), which characterise a sustainable system with lasting changes are: expanding scope of information relative to the scope of the problem addressed, increasing accuracy and quality of information, and increasing use of information by the involved parties. Despite advanced

communication technology and the information age we live in at present, Fung et al. remarks that there is still much to do to reduce serious risks or improve important services, and nonetheless, “those who benefit from transparency – whether investors, consumers, or employees – remain separated by language, location, and cultural traditions” (p. 134). Hence, the design of a transparent system is of decisive importance. Since disclosures are associated with improved decision making and enable actors to coordinate their action, in order to design a good system it is important to understand why the system is wanted and what its goal is, and subsequently, the assessment of those goals can suggest what changes are needed.

This paper presents a theoretical framework on the issues of transparency in the residential real estate market where the following dimensions are identified:

- transparency in transaction procedure
- transparency in legal information
- transparency in financing
- transparency in taxation, and
- transparency in transaction costs

The next step is more detailed empirical studies on transparency and neutrality between citizens in different countries within the EU when they want to carry out cross-border housing transactions. The hypothesis is that the EU is far from transparent in this respect, and that the road to transparency will be long and winding.

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