

# First Steps and Further Steps: Creation of Property Market Estonia Case Study

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**Key words:** land and ownership reform, property market

## SUMMARY

This paper describes the creation of property market in Estonia. During the Soviet occupation (1944-1991) the ownership rights of individuals were extremely limited and entrepreneurial freedom did not exist. Rights to the land were based on the long-term right of use only. There was no land market as the land use right was not transferable.

The necessary legislation for land reform was introduced in the beginning of 1990s. Adoption of legal acts and appropriate registers can still be considered as a pre-condition for well-functioning property markets. Systematic registration is a prerequisite because otherwise there will be nothing to sell and buy. The Land Register was (re)-established in 1993 enabling private land ownership and mortgaging. A few years later it was something, which allowed the number of property transfers to grow in a much more rapid way. It also contributed quite a lot to the market transparency as the sales partly financed by commercial banks were properly declared.

Despite of critics especially in the beginning of process, the land reform process in a wider context was rather successful. Experience and lessons learned in Estonia can be useful for some other countries, which are in the beginning of development.

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## 1. INTRODUCTION

The first signs of land tenure, which can be considered as the basis for the current system, date back to 1865, when the Russian Empire established the Baltic Private Law Code (*Liv-, Est- und Curländisches Privatrecht*) (Luts, M. 2000, p. 157). The Code included land regulation based on the Land Register and was similar to advanced systems in Continental Europe at this time. A radical land reform related to rural areas was introduced in the beginning of Estonian independence in 1920s. Almost all the land belonging to the big landlords was expropriated leaving them with relatively small land units. No compensation was paid for the expropriated land at first; later much lower value basis compared to the market value was used (Estonica, 2017). The expropriated land formed the state reserve and it was divided between new farms.

From legal point of view the system was still based on the Baltic Private Law Code until 1940, when Estonia was occupied by the Soviet Union. In 1940 all the land was nationalized. During the German occupation (1941-1944) the ownership rights were not officially restored, but the former owners were allowed to use their land again. When the Soviet occupation re-commenced in 1944, the former owners were not allowed to use their land, nationalization was followed by collectivization of the agriculture between 1947 and 1949 causing a new redistribution of the land. Actually, it was quite a lot based on the situation that existed before the redistribution of manor lands in 1920s (Estonica, 2017).

The changes in land tenure mainly focusing on agricultural sector started again in 1990s at the end of Soviet occupation before re-establishing independence. After Estonia regained independence in 1991, private land ownership was gradually restored. An ownership and land reform was initiated: the legal owners or their heirs were to regain ownership or be compensated for the land illegally expropriated after 16 June 1940. The principles of land reform were stipulated in the Land Reform Act that entered into force on 1 November 1991. The goal of land reform was to transform relations based on state ownership into relations primarily based on private ownership of land. The land reform was a compromise between the rights of former land owners and the interests of current land users.

Land restitution was a key component of the Estonian land reform. Due to physical changes mainly caused by new construction during the previous ca 50-year period, quite often the owners were opted to accept compensation instead of the physical restitution of their land. Restitution in its different forms was followed by privatization, which together formed basis for the creation of property market. Land reform in Estonia had a significant impact on the economic use of land, and thus to the whole economy.

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## 2. METHODS

The aim of current paper is to describe the creation of property market in Estonia. It is limited to studies in the field of land and ownership reform processes. It is based on the analysis of existing quantitative data about property registration, sales, mortgages and construction. All quantitative data have been obtained from public sources, no special data collection was carried out.

The current paper focuses only on Estonia. Land reforms are always complex including legal, economic and technical aspects, which are highly influenced by social agreement and political decisions. The current paper is focused only on the economic view.

The aims of this study are to provide a brief overview about land reform and to describe the features of development in the context of the property market.

## 3. LEGAL MILESTONES

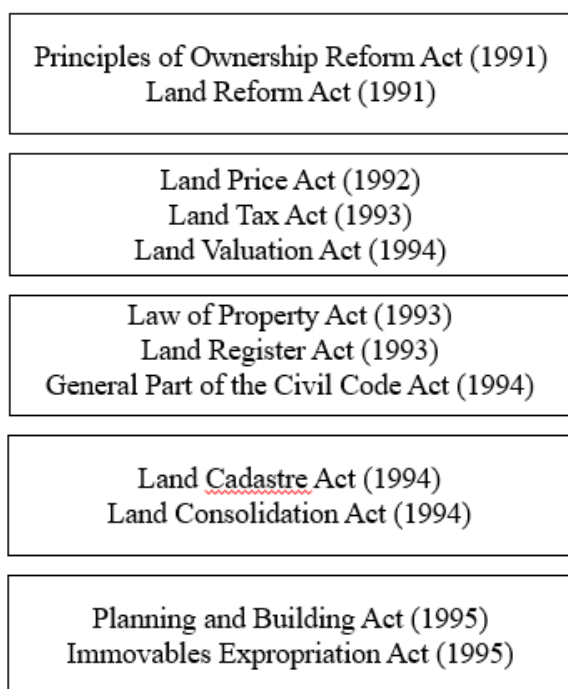


Figure 1: Legal acts regulating land relations

The first legal acts enabling private ownership were so called reform laws that came into force in 1991. A year later the Land Price Act stipulated the first principles of compensation, but because of its impractical nature including compensation based on 1940 values, etc., it was replaced with the Land Valuation Act in 1994. The land tax was introduced in 1993 and it attracted international attention because of its unusual approach as only the land was taxed and a value-based property tax was implemented in circumstances of nearly non-existing land markets. The laws enabling the functioning of property market were adopted in the same period: the Law of Property Act and the Land Register Act providing legal environment for ensuring property rights in 1993, and the General Part of Civil Code Act regulating property transfers in 1994.

These laws were followed by the Land Cadastre Act and the Land Consolidation Act in 1994. Despite of its introduction in the beginning of the land reform process, land consolidation stayed out of focus of the reform process. The Planning and Building Act and the Immovable Expropriation Act were approved in 1995. This way all regulation necessary for ensuring the property rights and public interests were simultaneously adopted within a four-year period.

Legislation adopted in this period included also regulations on conducting of notarial acts, pre-emption right, different types of condominiums, taxation of property transfers and capital gains, etc. The only bigger area that remained without appropriate new regulation was rental relations, as the Law of Obligations Act was adopted in 2001. Many laws went through numerous changes because of the impracticability the first solutions, or the changing environment.

**4. DYNAMICS OF LAND REFORM**

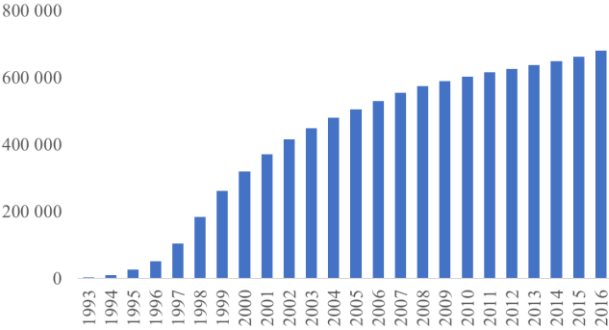


Figure 2: Number of parcels  
Source: Land Board

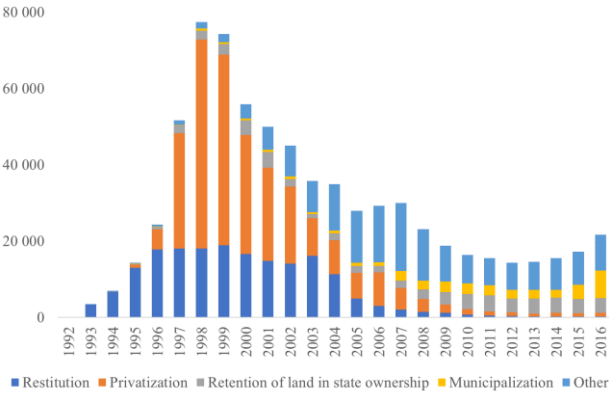


Figure 3: Formation of parcels annually  
Source: Land Board

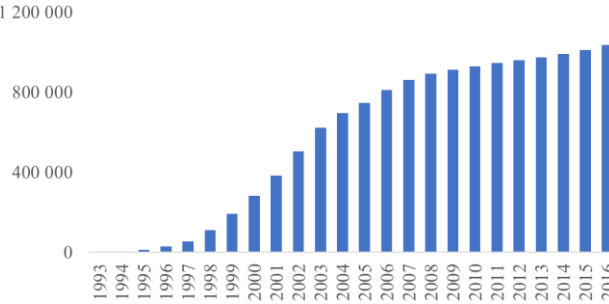


Figure 4: Number of Land Register units  
Source: Land Register

In the beginning of the process, the Estonian land reform was mainly focused on restitution and especially on rural areas. The Estonian Land Board (hereinafter Land Board) reports on its web-site that as of 1 October 2011, 20 years after introduction of the land reform, in total about 10% of the Estonian territory was not reformed (Land Board, 2011). Currently there is still ca 2% of the Estonian territory which is not reformed. This percentage has no harmful effect on the Estonian economy. There are still cases, which have not been solved because of the lack of interest among the parties, or legal problems. Currently, the target of completing the land reform is 2019.

Formation of cadastral parcels and that of Land Register units have mainly been similar in their dynamics, but at a certain stage the formation of Land Register units grew more rapidly. This was mainly caused by the formation of apartment units, as condominiums consist typically of a big number of apartment units locating on the same parcel. The land units in the Land Register may consist of more than one parcel. Registration of land in the Land Register is compulsory for all private owners, but it is still voluntary for the public sector with the exception of these units that are to be transferred.

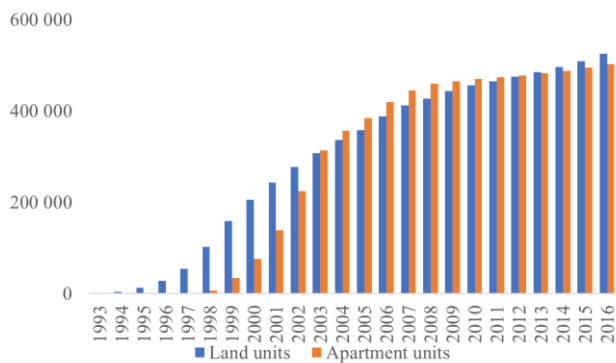


Figure 5: Number of Land Register units by their nature

Source: Land Register

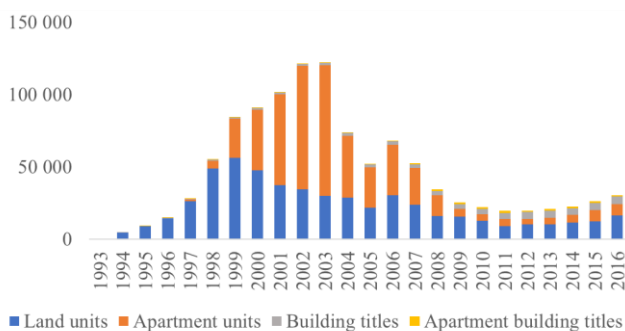


Figure 6: Formation of Land Register units

Source: Land Register

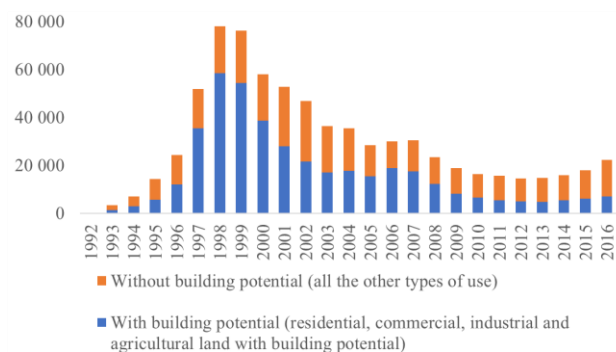


Figure 7: Formation of parcels based on their building potential

Source: Land Board

Formation of apartment units started several years later. If the formation of land units started in 1993, the first apartment units were formed in 1998. It should be considered that the formation of land units was based to a large extent on restitution, but apartments were mainly privatized.

The reform process speeded up in a short time. Formation of land units reached its peak in 1999, which was approximately six years after the introduction of the Land Register. Despite all problems related to the land reform it is clear that from the point of view of market development, registration was not an obstacle for a too long time period. As the Estonian property system handles apartments as separate property units, it was at least partly one of the reasons which made the reform process more complicated and time-consuming. It is still difficult to say what is the best solution for condominiums, but it is necessary to point out that the Estonian system has at least some advantages, because in Estonia, there have never been problems with illegal construction and illegal property transfers unlike in many other countries in Europe that also started their reforms in early 1990s. The apartments were first privatized as movables with no rights to the land, the land units were privatized later.

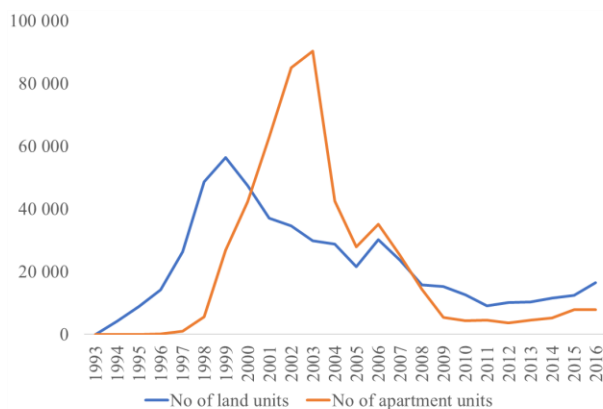


Figure 8: Formation of land and apartment units  
Source: Land Register

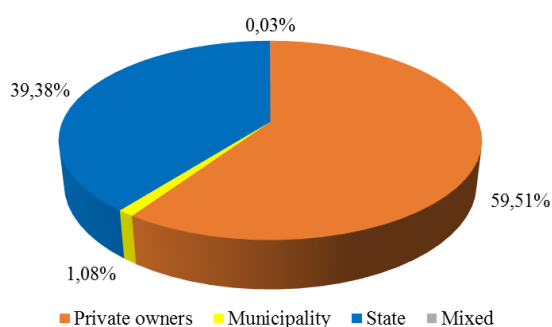


Figure 9: Ownership distribution of land parcels (01.01.2017)  
Source: Land Board, Land Register

It was possible to privatize apartments with vouchers, which were granted based on the length of employment and for illegally expropriated properties. As prices were much lower compared to the market value, these conditions were favorable for the most part of population. However, people living in the houses that were restituted could not use this opportunity. Their rights were protected by rent control in several years after restitution.

Looking at the share of different owners (figure 9), the land reform has fulfilled its main task, as almost 60% of land is owned by private owners. Municipalities own a limited part of land, but the share of the state is still close to 40%. It is mostly due to the fact that forest land constitutes ca 50% of the territory and 44% of the forest land is owned by the state. The remaining part of the land owned by the state covers various land use types and the state is still a relatively active purchaser in the market, the share of municipal land is also growing fast, as the state is transferring their rights to municipalities.

## 5. LAND REFORM AND MARKET INDICATORS

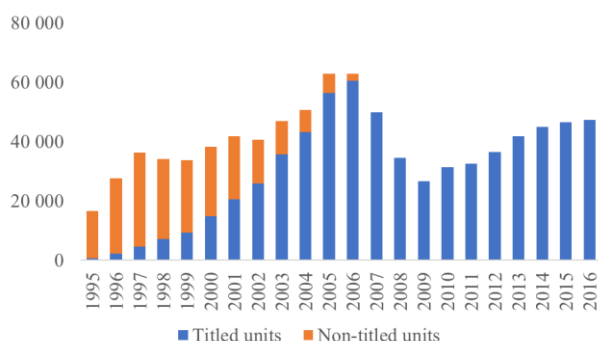


Figure 10: Number of sales annually  
Source: Statistics Estonia

There are no precise data about the sales in 1993-1994. Starting from 1995 data about the sales have been available, and up to 2001 the market was dominated by the sales of movables (non-titled units). As the biggest part of market was, and still is, related to apartments, it seems natural that due to different legal environment the majority of sales were made with movables. The situation changed year by year and starting from March 1, 2006 the transfers of movables were not allowed any more.

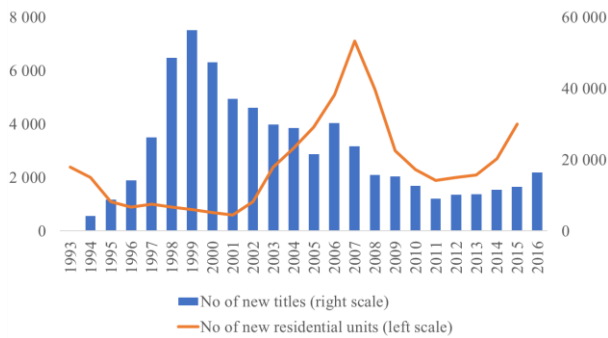


Figure 11: Formation of Land Register units and new construction

Source: Land Register, Statistics Estonia

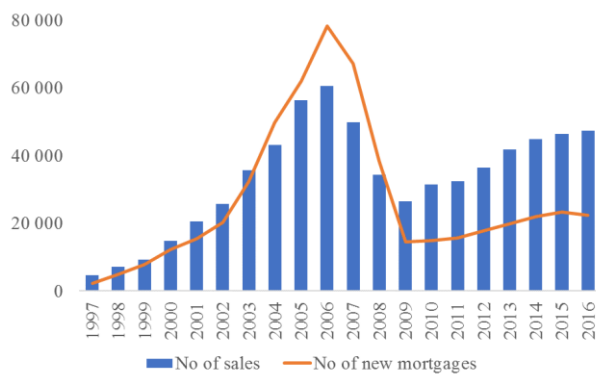


Figure 12: Dynamics of property sales and new mortgages

Source: Land Board, Land Register



Figure 13: Dynamics of property index compared to consumer price index

Source: Land Board, Statistics Estonia

The beginning of 2000s can be considered as the formation of property market. There was only a limited amount of new construction ongoing. The land reform cannot be considered as a cause, it was probably more related to funding abilities and market uncertainty. Construction started to grow in the beginning of 2000s and a few years later the market was booming and reached its peak in 2007.

Formation of property units made mortgage loans available. The number of mortgages was limited in 1990s and started to grow rapidly in the beginning of 2000s. There were both positive and negative aspects. Mortgages were one of the most important preconditions to speed up development. However, only a few years later Estonia stood in front of an overheated property market which led to the collapse. It was at least one of the reasons why recovering from the influences of global crisis in Estonia was much more complicated.

Based on overall property index the prices increased approximately three(!) times between 2003-2007. A new price level was still a bubble and the following two-year period (2007-2009) can be characterized by a rapid decline. The prices decreased for approximately 50% and remained still a little higher compared to 2003. The following 7-8 years (2009-2017) the prices have increased again and have enabled the price levels similar to the peak in 2007. The property market reached its typical cyclical development in the beginning of 2000s.

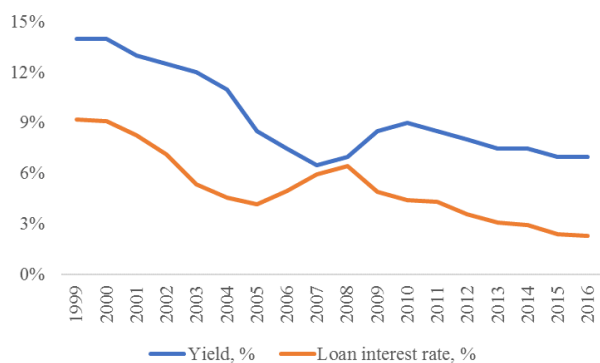


Figure 14: Commercial market yields and long term loan interest rates for enterprises  
Source: DTZ Kinnisvaraekspert, Bank of Estonia

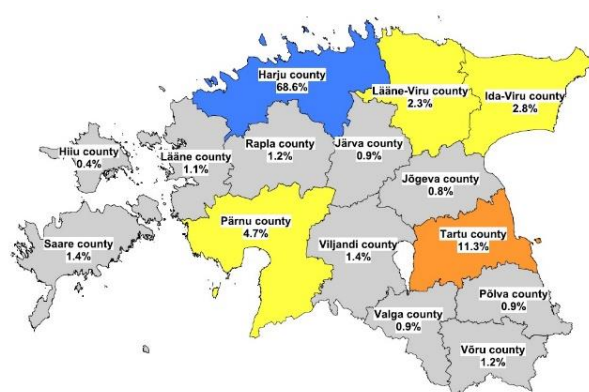


Figure 15: Property sales volume by counties (2016)  
Source: Land Board

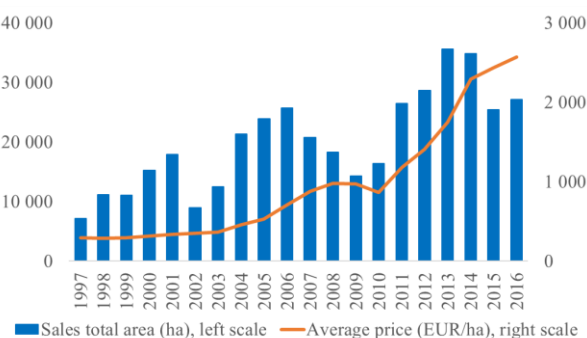


Figure 16: Arable land sales  
Source: Land Board

There have not been principal differences in the development of residential and commercial property markets. The yield curve (figure 14) of commercial properties has followed general dynamics. The period 2006-2007 was exceptional with extremely low yields, very high inflation and high interest rates of long term commercial loans.

Regional distribution of property sales has been influenced by population density and economic development. Significance of the capital city Tallinn and its surroundings (Harju County) has been rather high extending to ca 70% of the market volume. Another remarkable pole of attraction is Tartu County with the market share above 10%. The remaining part of Estonia amounts to less than 20% of the property market.

The property market cycle in general has been quite the same for different types of properties. There are still exceptions related to the forest and arable land. If the price level of forest land has been highly influenced by the prices of timber, which makes this market different compared to any other segments of the property market, then the market of arable land has been highly influenced by the EU subsidies. The price level of agricultural land remained very low in 1990s and started to grow in the beginning of 2000s. However, the prices were still low even in 2006-2007 when the most part of property market was booming. Rapid price increase started in 2010 which was a direct influence of the EU subsidies. During next 6-7-years the prices increased ca 2,5 times.



## 6. SALES PRICE REGISTER

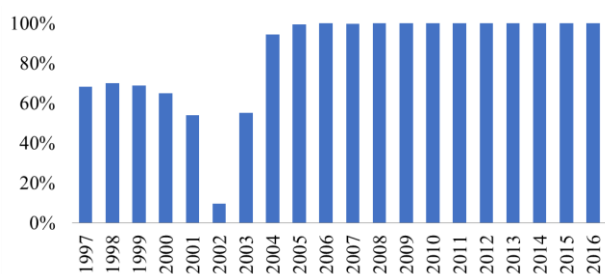


Figure 17: Coverage of the Database of Transactions

Source: Land Board

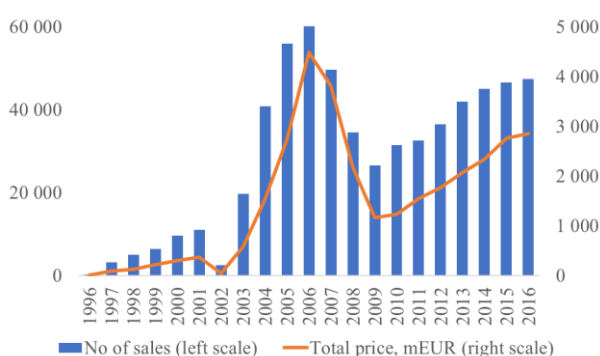


Figure 18: Number of sales and total price in the Database of Transactions

Source: Land Board

The sales data cover the main characteristics of property transfers. Land Board is responsible for the administration and supervision. The system has a direct link to the Land Cadastre and cadastral map (GIS), which enables the use of queries and statistical tools based on location.

The Database of Transactions was introduced by Land Board in 1996. Its early development (1997-2000) can be characterized by sales data coverage of around 65-70%, which was mainly affected by the weaknesses of the legal background. Sales data were submitted from notaries to local municipalities according to their right of pre-emption to all sales in their territory and local municipalities were obliged to provide Land Board the same data. Due to a long chain and clumsy data submission and the lack of electronic solutions the situation changed dramatically when data collection this way ended. It took only around one year to reach a completely different quality level with the coverage of nearly 100%. Since 2005 all sales data are collected electronically using the e-Notary system.

A simple fee system based on units (transactions) is used; there are no discounts for corporate clients. The users having access to the sales data are strictly limited: only certified valuers with a special license from Land Board are entitled to obtain the data. The quality of the data has improved year by year, with the changes being more rapid during the early part of development.

The biggest change was a result of the dramatic increase in mortgage lending in the late 1990s. As commercial banks were strict in fixing their rights, there was no longer any room for underdeclared prices. However, not all transactions correspond to free market conditions, and in certain cases over- or under-declared prices remain. Sales data have been used by both the public and private sectors. They are not available to everybody, which means that only private valuers have used them for market analysis and valuation. Land Board has used the data for

market analysis; the periodically published market overviews are freely accessible on the Land Board website. First Steps and Further Steps: Creation of Property Market Estonia Case Study (8907)  
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Board website. Land Board has developed a query of real property price statistics, which allows basic statistics based on type of use, location, etc. to be compiled. This is available to anyone interested on the Land Board website. Property indices have also been produced by Land Board, which form a product based on Database of Transactions. Land Board does not produce individual valuation reports itself, but market data are used for procedures related to state assets, e.g. the estimation of initial prices when state land is being sold at auctions. The sales data are also used by other public authorities like Statistics Estonia and the Bank of Estonia. The data have also been used in mass valuation, but the last revaluation was in 2001 and there has been no further use in this context in the past 16 years.

## **7. CONCLUSIONS**

Despite slow implementation, the land reform in Estonia in the context of market development has been rather successful. It should be highlighted that the introduction of systematic registration, which allowed development of a mortgage system, was one of the key elements of the new system. Looking at the number of mortgages that in a certain period even exceeded the number of sales, the rapid development of the property market was to a large extent based on it. Approximately the first 10 years of development were rather out of the classical market cycles, as the main emphasis was on securing private ownership. Looking at the period starting from the beginning of 2000s, cyclical development of the property market can be followed. At least two more conclusions could be drawn and these are related to the market transparency. The Database of Transactions was introduced at an early stage of the land reform. Despite different problems with coverage and reliability, it was still a good solution because it supported the market transparency quite a lot. The influence of mass valuation in the earlier stage of reforms was also very positive as it provided a clear basis for compensation and privatization.

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