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the Built Environment**

Transaction cost and transparency on the owner-occupied housing market: An international comparison

Sylwia Lindqvist

Doctoral Thesis

Building and Real Estate Economics
Department of Real Estate and Construction Management
Royal Institute of Technology

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Royal Institute of Technology (KTH)
Building and Real Estate Economics
Department of Real Estate and Construction Management
SE – 100 44 Stockholm

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Abstract

This dissertation consists of four essays with specific objectives. The overall objective is, however, to seek a further understanding of the issue of cross-border residential transaction markets. While the first two essays focus specifically on transaction processes and costs in a number of selected countries, the two subsequent essays shift their attention towards the EU's Internal Market and the impact of differences between the countries, with relation to the transparency of transaction markets. The research is primary based on studies of written sources, subject-specific literature and legislation. The main message is that organization of the transaction process affects transaction costs in different ways. It can be argued that efficiency is associated with a lowering of transaction costs. The efficiency of different structures depends on our perspective. Transparency is associated with the organisation of transactions and their needs, though the term is somewhat unclear. Generally, the term may refer to the ability of transaction participants to observe information concerning the transacting process, thereby increasing their knowledge to make informed decisions. Thus it can be argued that a better basis for the decision-making process presupposes information disclosure, more standardized transaction practices, synchronized legal systems, and both legible and transparent regulations. This leads to the design of a transparency system, which is based on an understanding of the need for the system and its goal. Although reaching transparency will be both complex and time-consuming, this study draws attention to certain key aspect of the need to encourage transparency.

The first two essays focus on how residential transactions are organized in selected countries and on the costs for carrying out these transactions. Essay II works with two hypotheses concerning the relation between the organizational structure and the transaction costs. The study shows that transaction processes and costs differ considerably between the countries and as a result it is difficult to arrange the countries in a clear way according to their rules. Moreover, there is no clear connection between a broker's education level and how large a part in the process s/he plays. The total transaction costs excluding taxes vary from approximately 3 up to 8.5 percent. The costs are lower when the recording system is well arranged, when a broker has a bigger part in the process and when a conveyancer is impartial. In the countries where a broker has a higher education level and plays bigger part in the process, the broker's commission is not any higher when compared to other countries in the study. The study shows also that transaction costs are lower in the countries where the broker has a more neutral role and where fewer parties are involved in the process. Thus in order to avoid high transaction costs, it is important to avoid situations where both buyer and seller have their own agents. Furthermore, the availability of standardized information about properties may increase the efficiency of the market even though it increases the short run transaction cost.

Essay III provides a theoretical framework for an analysis of the concept of transparency in residential property transactions within the EU's internal market and tries to identify the essential factors that need to be addressed with respect to transparency of procedural, regulative and economic features. Essay IV seeks a further understanding of the issue of transparency in the residential property transaction market and attempts to define the state of transparency on the basis of selected EU-countries, in accord with five specific dimensions. The essential points are that an increase in cross-border transactions increases demand for easy access to information in other countries, and that the studied literature focuses on the coordination of legal systems, which produces systems that are more uniform and legally secured, and on broadening the mortgage market. Some of the aspects analysed in the study are far from transparent while others may be considered relatively transparent. The degree of transparency in the EU's internal market is determined by how transparency is defined, since something may be transparent based on a certain criteria but not on others, especially when the concept is a relative one and subject to changes. The study raises some key aspect as a basis for discussion about the encouragement of transparency.

Keywords: transaction process, transaction cost, real estate transaction, property transaction, residential transaction, cross-border transaction, transparency

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“We don’t see things as they are, we see them as we are.” ~ Anaïs Nin

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Dissertation overview

Transaction cost and transparency - some central issues

I Introduction

This dissertation consists of four essays on the residential transaction market. The first two essays concern comparative studies of transaction processes and costs in some selected countries, while the other two essays are about transparency in the EU's single transaction market. It can be argued that all the essays contribute to a study of structured and transparent unbounded transaction markets in a world of increasingly interlinked economies. Defining a well-functioning residential transaction market, both efficiently and effectively, is the core of the study.

Background

It is important to determine and to understand the role of the transaction market in the European, and global, transformation. Residential transaction markets around the world undergo rapid changes. Tiwari and White (2010) observe that the past 60 years have witnessed the growth of significant economic integration across the globe, most significantly growth in the real estate industry during the past 30 years. The last two decades have witnessed the establishment of an international real estate market. Globalisation in a transaction market involves internationalisation of foreign investment, including capital flows as well as internationalisation of real estate companies and their services – boundless investment and service exchanges associated with the free movement of capital and services.

In turn, free movement of capital is associated with overall efficiency and safety with regard to property rights, since capital flows will not occur if the legal and institutional environment does not comply with international standards (see e.g. Brzeski, Dobrowolski & Sędek, eds. 2004). The legal and institutional environment is also associated with professional service in the market. Knowledge of the legal and institutional arrangements of the market is required, moreover, not only by professionals, but also, to some extent, by the main transaction parties or decision makers. Internationalisation requires therefore more organized cooperation within the real estate sector, and more interaction to make the market attractive in the long-term.

As mentioned in Brzeski, Dobrowolski and Sędek (2004), real estate markets do not operate independently, but are highly conditioned by the socio-economic environment. The characteristics of real estate and the real estate market (e.g. high values, illiquidity, heterogeneity, lack of portability, participation on an irregular basis, limited information, difficulty to test and change etc.) may lead to inefficiency in resources allocation (see e.g. Tiwari & White 2010, Lind & Lundström 2007). The market is often beset by problems of principal-agent, information asymmetries and transaction costs.

Brzeski, Dobrowolski and Sędek (2004) discuss five essential functions of the real estate sector (with particular reference to the residential sector) which contribute to economic stability and the formation of growth factors: (a) real estate as a capital base for the production of goods and services; (b) real estate as providing space for living and leisure; (c) real estate as an option for

long-term capital investment (by those having accumulated capital, making it available to others); (d) real estate as having market equity value, which allows the monetization through sale or the use of property as collateral for the funding of other economic enterprises; and (e) the activity of the real estate sector in generating significant multiplier effects in the economy thanks to numerous substantive and financial linkages which create demand for consumer goods and services. Furthermore, the capital invested in real estate is the capital invested not only in the real estate itself, but also in the economy of the country, region, city and district (Ibid.).

As is remarked in Lind and Lundström (2007), a well-functioning housing market makes individual household choice possible and allows individual households to enter the market. Furthermore, globalisation imposes an additional level of adaptation to international conditions. Lind and Lundström emphasise that both the individuals and the society at large benefit from the simple and transparent systems, since simplicity creates less vulnerability and more endurance against internal and external disturbances and transparency creates a basis for efficiency.

Thus, in a well-functioning transaction market it should be easy for consumers to inform themselves about the range of residencies and services available in the market and about how the processes work. The lack of such information contributes to the emergence of a consultant market where the commodity is information that is differently structured and processed (see Lind & Lundström 2009). This requires, however, that the regulations are continuously changed according to an assessment of the impact of existing regulations and the adjustment of the new international developments. Moreover, insights into other countries' systems provide suggestions for national changes. Even though there may be a desire to retain national sovereignty, it is more desirable to have rules consistent with the rest of Europe. Thus the national perspective must be in keeping with the external world perspective.

There seems to be willingness among the trade associations across Europe to increase regulation of the professions involved in the sale of property. On the other hand the EU pursues deregulation since its goal is to increase mobility. Countries with deregulated markets where anyone may be engaged in property brokering face competition in their domestic markets from other countries, while they are hindered from entering foreign markets. The question is how far the EU should go to ensure competition and efficiency in the transaction market including capital market. The issue is whether it is deregulation or reregulation that is needed.

All the European countries face the challenge of internationalisation, though they may respond differently, providing, according to Tiwari and White (2010), the possibility for differences in outcomes among the various countries. The integration process has a strong influence on the functioning of domestic markets. Transparency ought to be seen from the perspective of all the parties. It is essential not to divert actors from already transparent markets (see Lund & Lundström 2009). There is a difference of opinion about whether residencies generally should be considered as consumption or as a financial investment (see Lind & Lundström 2007), and this is also relevant in the context of cross-border market activity. According to Kälin (2005), though quality of life and personal use are dominant motives for purchase of residential properties, the acquisition is always a capital investment and the value of the asset can change.

As remarked by Brzeski, Dobrowolski and Sędek (2004), among others, informational and organisational globalisation may have different effects on different actors. For the transaction

parties, buyer and seller, it can mean lowering the costs, but for the professionals, it can mean losing the benefit of the information service component and a weakening of the traditional roles.

Thus the level of the market integration and the speed with which it can proceed, depends on the level of adaptation within the legal and institutional environment. It is important to facilitate the turnover on the market and to insure that transactions are not inhibited by legal and tax obstacles, in order to promote the economic growth of the integrated market. Market integration will most likely have an impact on the further development of different transaction professionals. For example, the broker/agent profession may require more flexibility and a capacity of adjustment to changing conditions. As a consequence brokers/agents will need to have greater knowledge about the different environments affecting their customers' decision making. It can be argued that professionalism and transaction development cannot co-exist without a necessary level of standardisation.

Research questions

The main research questions in this study are:

- How do the organisation of the transaction process and the broker's role affect the transaction costs?
- Are some organisational structures more efficient than others?
- Why is transparency needed?
- What are the essential measures for achieving a more efficient and transparent market?

The actual research in the field focuses mostly on transparency, harmonisation and standardisation of land registers and the capital market, but there are also other dimensions to explore. Comparative law studies provide legal perspectives from the lawyers' point of view while law and economic studies or economic studies focus on measuring the costs. Since I have a background in real estate brokerage within the multidisciplinary/interdisciplinary academic field of real estate science, in a country where the broker is expected to have knowledge of the whole transaction process, I see the individual parts and perspectives differently than other researchers. I am especially aware of how complex the issue is, how everything is connected and how the many elements must inter-relate for everything to work.

The study begins with the broker's role in the process as seen from the broker's perspective. In the second part of the study this perspective has been sharpened with the focus on transparency not seen from some particular perspective but in general terms.

II Research method

Traditionally, as explained in Alvesson & Sköldbberg (2008), research is perceived as dealing with the creation of more or less objective knowledge using scientific methods. An impression of reality leads to generalization and theory building. However, the researcher not only depicts the social reality, but also reconstructs it, interacting with the researched objects. Thus, also this study is focused on researching the "objective reality" (and not people's subjective experience), while recognizing that data and facts are to some extent subjective constructions and interpretations.

The research strategy in this study is based on qualitatively investigating multicase studies with multilateral comparisons. The cases correspond to different countries, selected on the basis of specific factors. In the first part of the study, which deals with transaction processes and costs, the six countries are: Sweden, Finland, Norway, Poland, England and the USA. In the second part of the study, which focuses on transparency issues within the European Union, seven member states are studied: Sweden, Denmark, England, Germany, Poland, France and Spain. Only the residential market and privately own properties are treated with no focus on the specific forms of ownership. The theoretical framework for essay I and II is based on transaction costs theory, while for essay III and IV the concepts of transparency, globalisation and market operation are considered.

The research tools used in this study derive from a combination of various sources. They include studies of primary sources such as legislation (though the primary purpose is not juridical), and secondary sources, such as property-related literature and research studies, both general and specific, relating to comparative aspects of individual countries. The research includes studies of available Internet resources, additional interviews and other contacts with experts. Over the years I have also participated in various real estate trade fairs, branch conferences and meetings of the European Council of Real Estate Professions, which has contributed to my establishing fruitful contacts and inputs from professionals, both practitioners and academics.

As with any research, this study has encountered a number of challenges. Among these are the danger of imposing comparable descriptions and terms on the study of foreign texts and legislations, as well as problems relating to the reliability of the information sources discussed both in essay I and IV. These include, for example, the assumption that the some concepts are viable from country to country. In fact a concept in the language of one country may have no parallel in the language of another country. It can be argued that translations are almost always imperfect. Barriers to intercultural communications are additional dimensions. A word does not always mean exactly the same thing or is not directly translatable (see e.g. Jandt 2007, Bogdan 2003). In essay IV there is also a discussion of the case study's validity and its contribution in the research field generally, since the strategy used in the study is considered by some researchers to be controversial.

III Discussion of key issues (research questions)

As mentioned above, this study's central questions concern the organisation of the transaction process and its impact on the transaction costs, as well as the issues of transparency within the EU's internal market and the measures that are necessary to increase transparency. The first topic is mainly discussed in Essay I and Essay II, and the second is discussed in Essay III and Essay IV.

Organisation of transaction process and its impact on transaction costs

How the organisation of transaction process affects the transaction costs and whether some structures are more efficient than others are discussed in Essay I and Essay II and to some extent also in Essay IV. Essay I, a monograph, provides the basis for Essay II, which presents two hypotheses, on the relation between the organizational structure and the transaction costs: (1) the

first hypothesis concerns the role of the broker and the thesis that the involvement of a “neutral” broker will reduce the total transaction cost when compared to a system where the broker is an agent for one of the parties; (2) the second hypothesis is that a more secure and stable property registration system will lower the transaction costs.

Based on the study, it can be argued that the organisation of the transaction process affects transaction costs in different ways. The costs are lower, for example, if the recording system is well arranged, if fewer parties are involved in the process, if a neutral broker has more of a part in the process and if a conveyancer is impartial. The study shows, moreover, that in the countries where a broker has a higher level of education and plays a greater part in the process, the broker commission is not higher compared to the other studied countries.

Thus in order to avoid high transaction costs it is important to avoid situations where both buyer and seller have their own agent. Though it can be argued, that having their own legal adviser may in some cases (particularly in more complex cases), help to reduce future conflict costs and minimize the risk of transaction failure. Furthermore, a system of standardized information about properties can increase the efficiency of the market even though it increases the transaction costs in the short run.

A possible learning outcome of the study is that by studying other systems, one gains new perspectives on one’s own system with the possibility that the optimal solutions can be found. The question is whether efficiency and low transaction costs are related, even though efficiency does not necessarily mean minimizing the total cost. Deciding which structures are more effective will depend on which perspective we are looking from. Furthermore, when comparing costs, the quality of the services must be taken into account.

When fewer actors are involved in the process, the transaction costs seem to be lower. Though, when there is some kind of arrangement where all the actors cooperate, the difference may not be so great. Thus the cost can, but not always, be lower if only one broker is commissioned and if the broker is impartial. One can imagine various solutions, for example, a single broker handling simple cases while more actors are engaged in more complex cases. If the parties hire one broker each, it means higher costs, but on the other hand, division of labour becomes clearer, which may avoid future conflict costs. One intermediary with clearly defined role in the process potentially lowers the cost. The question is, whether brokers can be as effective if they work for both parties and if this role can be combined with the commission depending on price. Thus the correlation between an incentive agreement and broker’s role needs to be studied carefully, since it is important to have contracts that reduce the risk of asymmetric information and protect against opportunistic behaviour.

Other learning outcomes relate to cooperation between brokers, negotiations, property surveying and the bidding process. Cooperation between brokers reduces competition, but when a buyer is found more quickly, the cost will be lower. Moreover, cooperation raises the quality and quantity of matches, resulting in higher match probability and lower search cost. Cooperation also eliminates the need for buyers and sellers to visit several brokers in order to ensure adequate market surveillance and market exposure. At the same time, with increasing cooperation, there is the possibility of reduced price competition.

Negotiations on commission size can lead to price discrimination, where different actors pay different amount for the same service. A uniform commission policy where different companies adopt a common rate, can lead to monopoly pricing. A fixed commission, on the other hand, eliminates the costs associated with the sellers looking for cheaper service providers. Price coordination of this type conflicts with competition law. Some components of the marketing expenses may or may not be related to the sale price, such as travel expenses to the object, costs of showing or use of the broker's equipment. On the other hand, some people set a higher value on a broker's services, since time has a higher value for them and they are willing to pay for it.

It may be beneficial to make a survey before the property is put on the market, especially if additional surveys, undertaken, for example, by the lender, thereby can be avoided. An improved basis for decision-making helps in negotiations. Many people today participate in the bidding without having surveyed the property. There is a risk that the seller pays for a survey even though the property does not get sold, but without an inspection, a buyer may realize afterwards, that s/he has made a wrong decision.

The argument for oral bidding is that it attracts more prospective buyers but it is just as likely that it is faulty pricing that attracts many buyers. The bidders' time costs contribute to the inefficiency of the process. Prospective buyers may make an offer and then realize that they cannot afford the amount and so the transaction fails. It is not usually beneficial (though it can be beneficial from certain perspectives) when one is forced to sell a recently acquired property. It means beginning a new process with additional costs. Use of a written form and a well-organized process can reduce these risks.

The study results are meant to be a starting point for a normative discussion about what lessons countries can learn from each other's experience. The important aspects are: (a) reducing the number of professionals in the transaction process where one person is able to handle all the steps in the process; (b) balancing the interest of the transaction parties, buyer and seller, in order to avoid the costs of involving two representatives; (c) standardizing contract forms and presenting sufficient information about the (object) property in order to reduce the risk and future conflict costs for inexperienced buyers and sellers with asymmetric information, and (d) making the transaction process, as a whole, more transparent, by, for example, using more formal auctions with binding bids, and/or fixed price sales where the property is sold to the one who first accepts the terms.

It seems apparent that more detailed studies are needed within the field, since research points in different directions. As brought up in Essay III, while ZERP's study (2007a; 2007b) shows that, in terms of pricing, deregulated systems or systems with lower levels of restrictive regulations produce better outcomes for consumers, and that the Latin notary systems have generally higher levels of cost than the lawyer systems or the Scandinavian systems (particularly for higher value transactions). This is also, to some extent, confirmed by Mattsson (2008), showing that costs are lower in those countries where notaries are not involved in the process. Murray (2007; 2008) advocates providing separate legal advice for the transaction parties, especially for the buyers. He sees a bright future for public notaries, since he found no evidence that deregulation of conveyancing services leads to lower costs or higher efficiency among the countries he studied.

The need for transparency and the measures necessary to increase it

Why transparency is needed is discussed in Essay III, which gives a theoretical framework for analysing the concept of transparency. The measures necessary to achieve a more effective and transparent market are discussed in Essay IV.

The essential points in Essay III are that an increase in cross-border transactions increases demand for easy access to information in other countries. The studied literature focuses on the coordination of legal systems, on making systems more uniform and legally secured, and on broadening of the mortgage market. The concept of transparency is, however, somewhat elusive as different aspects of transparency exists. Though, the importance of transparency is emphasized by the different actors in the real estate market, there is no clear definition of it and no clear way of measuring it. The term could, however, refer to the ability of transaction participants to get information relevant for the transaction process, which would increase their knowledge and their ability to make informed decisions. It can be argued that a better basis for the decision-making process presupposes information disclosure, more standardized transaction practices, synchronized legal systems, and both legible and transparent regulations. This leads to the design of a transparency system, which is based on an understanding why the system is wanted and what its goal is. The study indicates that reaching transparency will be complex and will take time.

In order to identify the state of transparency and the essential factors that need to be addressed with respect to it, the study identifies five dimensions of transparency. These are: (1) transparency in the *transaction procedure*, concerning openness about regulatory systems and models since the design of the models affects transaction in different ways; (2) transparency in *legal information*, referring to openness about information from national land registries, as well as openness regarding rights and interests in real property and certainty regarding those rights and interests, forms of ownership and other relevant information on national legislations; (3) transparency in *financing*, allowing access to a wide range of information about mortgage products and the costs associated with them; (4) transparency in *taxation*, relating to the design of the tax systems, and (5) transparency in *transaction costs*, involving significant differences in both direct and indirect transaction costs.

It can be argued, that some of the aspects analysed in the study are far from transparent while others can be considered relatively transparent. How transparent an internal market is has, in some ways, to do with how transparency is defined, since something can be transparent based on certain criteria but not on others, particularly when the concept is a relative one and subject to changes. The study brings up some key aspect as a basis for discussion about encouraging transparency. For instance the study indicates that Denmark should remove its rules relating to the ownership of holiday homes, which make it difficult to acquire a secondary home in Denmark.

As mentioned in the study those aspects requiring more discussion in relation to the enhancement of transparency are: a common marketplace for residencies with the total supply collected in one place; clear information regarding mandatory professionals and the involvement of mandatory professionals; clear definition of the terms “agent” and “broker”; conveyancing open to professionals other than notaries with no restrictions on nationality or locality; creation of a new profession specialising in European cross-border transactions; a reliable system of title/deed

registration; e-conveyancing; further development of EULIS; clear information about different ownership forms; a review on all limitations in acquisitions; the establishment of the same financing limits for foreigners and domestic purchasers using the criterion of credibility rather than nationality; the creation of European mortgage brokers; a general policy on primary residencies with regard to the tax on capital gains; the regulation of the fees of energy labelling or clear guidelines on pricing; a review of transaction costs; the elimination of high price variances in services; and establishing contact points for the information necessary to property transactions driven by independent actors.

These are only some examples to encourage transparency. Some of these aspects have been pointed out by other researchers in the field. There is no doubt that transparency is associated with how the transactions are organized and how efficient they are.

Concluding remarks

The research has showed that although there are significant differences between countries, it seems that countries more and more look across borders when developing transaction systems. Since it is impossible to standardize and harmonise all the transaction aspects, it comes down to finding ways to overcome significant differences. A single market cannot exist if all participating nations only pursue their own interests. The transaction market, moreover, consists of overlapping submarkets, such as the financing market, the service market etc. The development of a structure needs a common focus, with the consumer at the centre.

Although much has been done, much remains. Integrating the European aspects into the national system must be a natural process and an obvious need, if a single market is desired. A single market may have negative consequences, which we are witnessing in recent times. Integration is complex and results in many conflicts. New technology facilitating information flows reduces transaction costs for some actors in the market, but, on the other hand, it may have negative consequences for service providers and the labour market. Though some forums for the market development can be identified, the active role of the market players may be questioned. In general terms it is all about improving the allocation of resources.

In summary, the study's main contribution is a discussion of the organisational structure of residential property transactions, bringing into focus the concept of transparency, associated with information disclosure and synchronized systems and regulations.

IV Future research

There is no research that leaves all questions answered; it is more likely that new questions are raised. The next step would seem to be to identify the priority areas of transparency and the cross-border transaction market.

It could, for example, be interesting to look closely at the proposed European professional card, a new approach for recognition of professional qualifications, which is fully supported by the CEPI. According to Timo Multanen, the President of CEPI (see Multanen in CEPI's Annual Report 2010), the card will potentially strengthen both temporary and occasional mobility, limit

administrative burdens and ensure quality of services to the clients. The card's role in simplifying mobility in Europe is also emphasized by Michel Barnier, European Commissioner (see Barnier in CEPI's Annual Report 2010), who talks about the usefulness of the card for service recipients, since it shows that the professional is fully qualified to carry on the business. It may be that the role of the card in strengthening mobility is quite obvious; however, it is not clear how the quality of services can be ensured as a result. Much depends on the requirements that are put in place to obtain such a card. The gap between the countries with high professional requirements and those with no requirements remains, not to mention the differences between the countries in the broad aspects of their systems. Education in the European platform, based on practical cases, proposed also by CEPI seems to offer a better potential opportunity, but, once again, this reflects the conflict between the ambitions of the European Commission and the European trade organisations – is it to be deregulation, or more regulation?

Other issues might lead to deeper studies of different residential ownership forms across Europe, since, as the research shows, there are questions about the comparisons of forms across Europe. Focus is particularly drawn to the Swedish tenant-ownership, which is considered by many in Sweden not to have an equivalent in other countries, although the studies show that quite similar forms can be found in other countries. Further studies could therefore contribute to the development of the form and a better understanding how the form can maintain itself in comparison to owner-occupied apartments. This could also contribute to clarification of the different terms used across countries.

It would also be interesting to look outside of Europe, since European residential property buyers does not limit their home searches to Europe. The Asian market is of particular interest. It could also be interesting to look at how limitations in foreign ownership are getting around company forms and what consequences this has on the exploitation of the market and the local population.

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