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The Impact of Real Estate Market in the Albanian Economy

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Abstract: The real estate market has an important impact on social and economic development of a country, and it involves many aspects which increase the complexity of the impact analysis and often have opposite directions. This can be supported by the fact that real estate is one of the most important items in public spending³, but also in investment expenses in general (this is especially typical for Albania). These expenses are mainly related to infrastructure and accommodation of homeless people by the National Housing Entity. Researchers have studied the relation between the price of real estates with the GDP of a country, concluding that real estate prices and the government policies related to them, do impact the GDP growth, and movements in residential prices can be used to forecast GDP growth. On the other hand, when purchasing a home, individuals use all their savings, or take loans, which constantly cause the reduction of consumption and saving possibilities in order to afford the installments and other loan expenses. So, from this point of view, this investment may have an adverse effect, even on GDP. But, the question we raise in this study is: what impact has the real estate market in Albanian economy? We begin the study by emphasizing the importance of the real estate market, and then we identify key developments related to this market's financing, price developments and the construction activity, as an important part of the market itself. The study is concluded with a regression analysis on the role the real estate market plays in the Albanian economy.

Keywords: GDP; construction cost index; regression analysis

1. Introduction

Investment in real estates is and has always been one of the most controversial issues in the economic environment. This results mostly because of the complexity of this form of investment and the importance and close relations with several socio-economic aspects of a society. The claim that investment in real estate is one of the most profitable, sustainable and less risky investment is generally accepted, but we should expand the analysis on this issue.

The real estate market has a huge impact on social and economic development of a country, and it involves many aspects which increase the complexity of the impact analysis and often have opposite directions. This can be supported by the fact that real estate is one of the most important items in

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³ According to economic experts

public spending¹, but also in investment expenses in general (this is especially typical for Albania). These expenses are mainly related to infrastructure and accommodation of homeless people by the National Housing Entity.

On the other hand, it is a valuable source of income, primarily for the state, through tax on transactions related to real estate, tax on personal income for employed people in this sector, the tax on profit for enterprises of this sector, etc.

The development of this market increases employment and it is one of the most important sectors in this regard, because it has enabled the employment of a large number of people, from simple unskilled workers to individuals with high qualifications. The employment in this sector is also related to the one in other joint sectors, such as raw materials and inputs market, intermediary market (real estate agencies, etc.). Employment, consequently, increases the purchasing power of many families, which of course means an increased demand for many goods and other services produced in an economy. This is a multiplier effect, which leads the GDP growth, one of key indicators of a country's economic development.

In terms of investment, it is a very profitable investment for constructors and investors in this market by generating large amounts of money, which can then be channeled in many other branches of the economy through investments, or can be easily transferred to the banking sector, causing further immediate effects in economic growth. In addition, we should consider also the service centers (offices, shops, shopping centers, etc.) which bring new opportunities and incentives for businesses, employment and development.

Another element that explains the high importance of the real estate market is the financial crisis which affected almost the entire global economy, starting from the United States. The inhibition of the real estate prices increase and then the decline, and the deterioration of the quality of home mortgage for unqualified borrowers, the subprime loans, caused problems not only in this market but also in other financial markets, which due to the complexity and lack of transparency of new financial instruments, were closely related to the performance of loans in this sector.

Researchers² have studied the relation between the price of real estates with the GDP of a country, concluding that real estate prices and the government policies related to them, do impact the GDP growth, and movements in residential prices can be used to forecast GDP growth. On the other hand, when purchasing a home, individuals use all their savings, or take loans, which constantly cause the reduction of consumption and saving possibilities in order to afford the installments and other loan expenses. So, from this point of view, this investment may have an adverse effect, even on GDP.

A number of recent empirical studies identify strong relations between developments in housing markets and the real economy. For example, Claessens, Kose and Terrones (2010, 2012) show that declines in housing markets are highly synchronized across countries and the level of this positive covariance increases, especially during periods of synchronized recessions. Results determine that the recessions associated with the decline in the housing market tend to be longer and deeper than the other recessions. Also, the economic developments associated with booms in housing markets, are faster and stronger.

However, despite the consensus that movements in the housing market are very important for the real economy, the further level of study is complicated by many factors: the characteristics of the housing

¹ According to economic experts.

² LHT Chui and KW Chau (2005). *Surveying and Built Environment Vol 16(2)*.

market in a country; the nature and identification of economic shocks such as supply and demand shocks in housing markets, interest rates shocks on housing price movements.

Albanian researchers (Kripa & Kufo, 2013) have calculated a housing price index for Albania. They have also calculated an index for reference prices for the period 2007-2012, in order to understand if the trend of housing price index has any relation with the reference prices set by government. Thus, the authors concluded that market prices reflect only the market trend and the “bubble” phenomenon do still not exist in Albania.

Why Do We Study The Housing Market As Representative Of The Real Estate Market?

The real estate concept itself contains many elements such as: land, apartments, villas, industrial facilities, stores, etc., but in this study we are focused only on the apartment market, assuming that the other elements have the same characteristics and performance in this market.

In Albanian market, real estate market is classified as follows:¹

- ✓ Buildings;
- ✓ Residential buildings;
- ✓ Other buildings (hotels, commercial buildings, industrial buildings, other buildings);
- ✓ Engineering construction;
- ✓ Transport infrastructure;
- ✓ Roads and highways;
- ✓ Water, electricity and telecommunications lines;
- ✓ Complex constructions in industrial sites;
- ✓ Other engineering works.

If we refer to INSTAT data, residential buildings account for approximately 90% of the total constructions. This is another reason that justifies our choice to represent the Albanian real estate market with the residential buildings.

Chart 1 illustrates the share of the two main subcategories: buildings and engineering constructions, and the portion of the main item: residential buildings in construction sector.

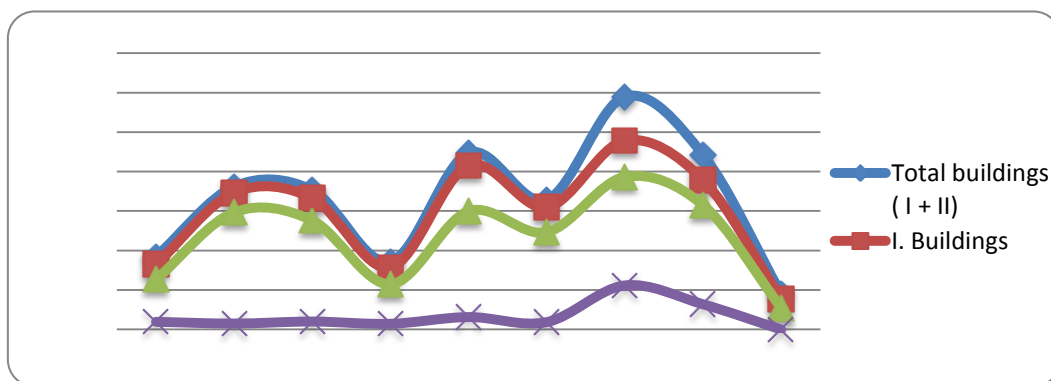


Chart 1. New constructions by type (in million ALL)

Source: INSTAT 2014

¹ The definition of Real Estates and their market can be found in the Civil Code of the Republic of Albania, Article 141, 142. But we are focused on the market classification reported by INSTAT, since we are mainly referred to this institution data.

Considering the above results, we will use the real estate term referring to apartments.

2. Price Performance in Albania

Studying the trend of prices in the housing market is a difficult work because of the high informality. We have gathered the data about real estate market from: partial studies from the real estate agencies, data from key institutions such as: INSTAT, Bank of Albania, Ministry of Finance; as well as studies from Albanian authors and researchers.

Based on the Real Estate Agencies

After the privatization process and reforms in 1991, the real estate market has experienced important changes. In 1993, the privatization of public housing was completed, by offering the opportunity for the apartment's trade. As a consequence, the apartment market, characterized by new and specific features, was born. Meanwhile, in 1994, began the construction of new apartments, especially in Tirana. In that period, the area in the center of Tirana was more favorable for construction than the former Block area, which was still unconstructed. The price of an apartment in the center of Tirana was approximately 70% higher than the price of an apartment in the periphery, such as Kinostudio or Lapraka. After 1996, together with the collapse of pyramid schemes, housing market experienced significant changes. The depreciation of the Albanian Lek resulted in impairment of the housing market. A significant drop in property sales transactions was identified and the main reason for this phenomenon was the political and economic collapse that the country was suffering by the failure of pyramid schemes. According to a study conducted by the real estate agency "Inf 93", an increase in prices by 190% was identified from 1996 to 2006, or an average of 19% each year. While the increase from 2002 to 2006 was 107%, representing the largest increase in prices by almost 26.7% annually.

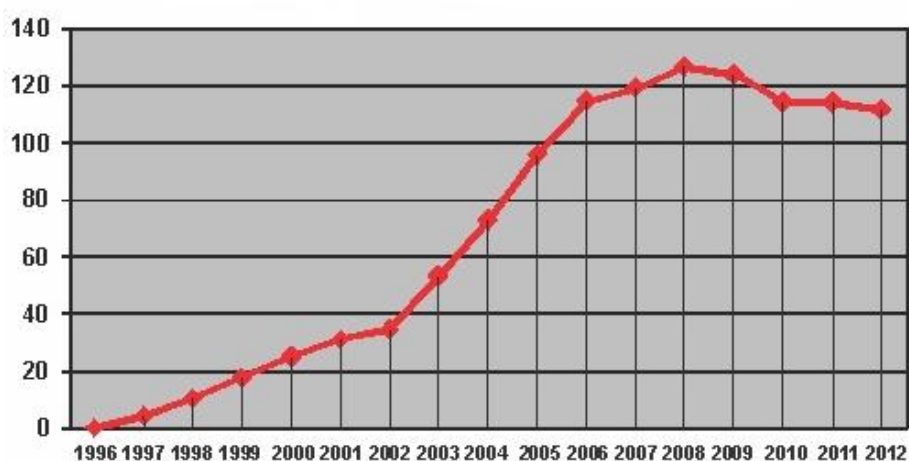


Chart 2. The increase in prices during 1996-2012 (in percentage)

Source: Real Estate Agency Inf '93

Given the above chart, we can see that from 2002 to 2008, the apartment prices have increased with positive trend. Besides the high demand for housing benefits, this growth has resulted from the high confidence that individuals had in this market during this period, considering the purchase of a house/apartment as a very good investment alternative. Starting from 2008 and the following years, it

was seen a downward trend in prices. This coincides with the consequences of the global crisis (the main cause of this crisis was the real estate market) in our country, where people lost confidence that the investment in real estates was the best investment alternative.

Another analysis done by the real estate agency “Green Hours ltd” on the performance of the real estate value for the years 2008-2009, emphasized that there have been various factors which have influenced the developments in the market and the increased prices, such as:

- ✓ Increased demand for housing, especially in big cities;
- ✓ Constructions in city centers, through infrastructure and services;
- ✓ Use of new buildings especially for apartments, shops and parking areas;
- ✓ Increased portion that landowner benefits from total construction area (above 35% of the construction value);
- ✓ Increased quality of construction materials;
- ✓ Implementation of fiscal policy and reduction of the informal economy;
- ✓ Improvement on the property legalization, restitution and compensation process by the government authorities;
- ✓ Increased sales index.

Based on Bank of Albania and INSTAT data

The performance of the real estate market is evaluated through the housing and rental price index, but these calculations are performed only for Tirana (without including its periphery areas). In the below chart it is given the performance of the housing price index and the rental price index during years. Generally, the trend of housing price index is progressive till 2012, but we see slower growth trends (especially in 2011). In 2012 the housing price index increased by 3.6%, achieving a higher level than the 2011 year-end. After that the trend was regressive in June 2013 by 10.8% and increased by 4.9% in second semester of 2013. In June 2014, the housing price index decreased by 1%, compared to 2013.

Meanwhile the rental price index had a downward trend over the years. Thus, in 2012 the index decreased by 6.3% to a lower level than the end of 2011. The first semester of 2013 the rental index decreased by 9%, and the second semester increased by 7%. In June 2014, the rental price index increased by 11%, compared to 2013.

We should also consider the ratio between the housing price index and the rental price index, which in 2014 reached 2 compared with 2.2 at 2013.

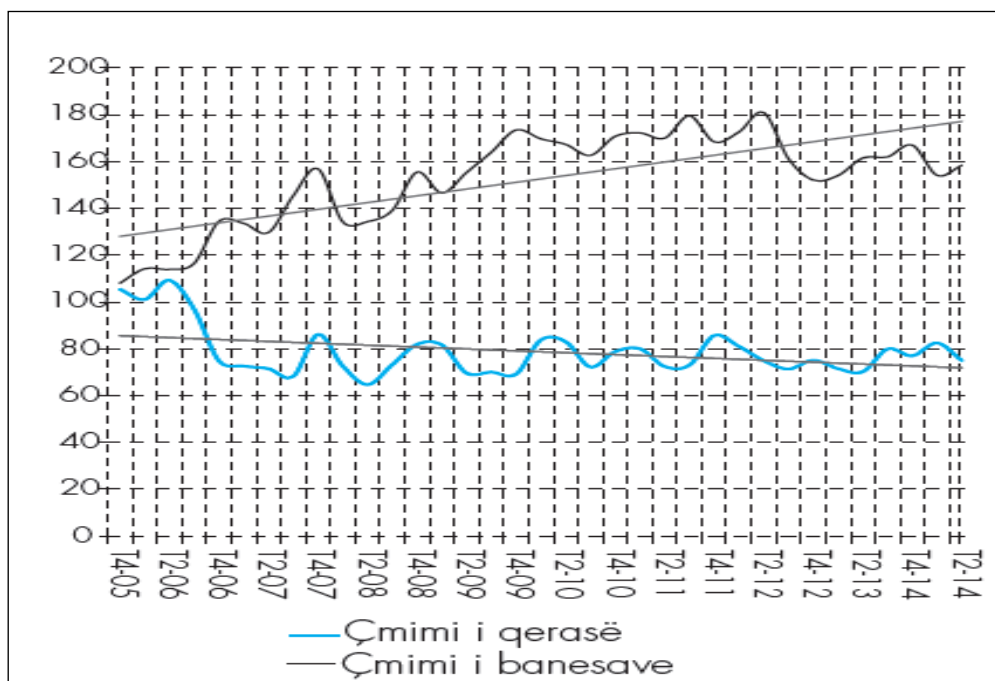


Chart 3. The performance of the housing price index in Tirana¹

Source: Financial Stability Report, 2014, Bank of Albania

Based on Different Studies in Albania

Regarding the price performance in our country, the housing price index is built by the authors Kripa and Kufo (2013). The data to build this index are obtained by independent appraisers of a financial institution. The population of the study includes 99 houses around the country according to regions share. It is calculated the average price in euro as an average of the total price divided by the total surface (in cases we identify more than one house). This price in index is multiplied by the specific weight of houses number in the total number of data by determining a new price for the index. If we consider the year 2007 as the basis for the index and we evaluate its performance in percentage, we note a slight increase for the first two years (2008-2009) and a decline for the last three years (2010-2012), which is pretty logical. This index expresses the demand in the housing market, which is affected by: the global crisis, bank lending policies, the lack of liquidity in the construction sector, and the lack of individual's liquidity. Therefore, the tendency of this index is considered as a normal market behavior.

¹ Black line: housing price index in Tirana
Blue line: rental price index in Tirana

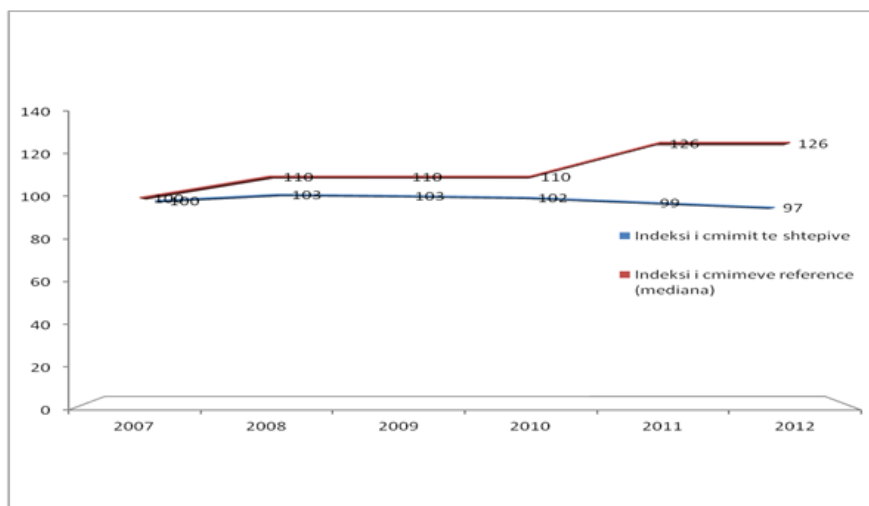


Chart 4. House price index

Source: Kripa and Kufo's calculations

On the other hand, the authors have also calculated an index for reference prices from 2007 to 2012 (Chart 5), in order to understand if the trend of housing price index has any connection with the reference prices set by the government. If we study the charts, we can note that, while market prices have a downward trend, the reference prices are in upward trend. This is because the reference prices are much lower than those of the market. However, the differences between them have been reduced over the years. Thus, the authors conclude that market prices reflect only the market trend and the “bubble” phenomenon can still not be considered in Albania.

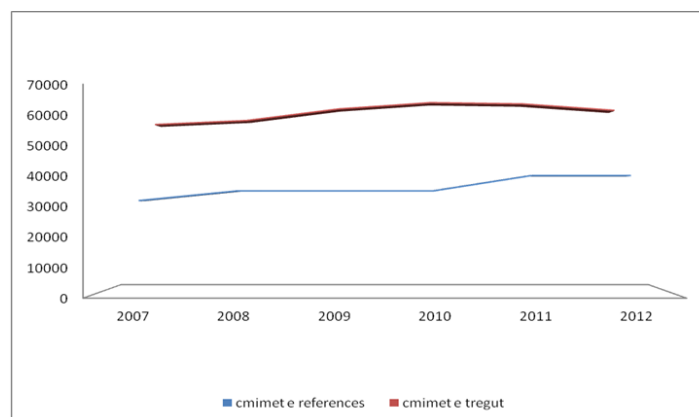


Chart 5. The difference between the market prices and the reference prices

Source: Kripa and Kufo's calculations

3. The Real Estate Financing System

The financial and banking system in Albania, compared with other countries in southeastern Europe, still appear weak. Its development over the years has not been significant, although this fact was turned into an advantage that “rescued” Albania by the Russian and Turkish crisis, in 1998 and 2001 respectively. The same we can say about the crisis in 2008.

Albanian financial market lacks trading stocks and bonds. The only developed market is the primary government securities market, while their secondary market is less developed. Derivatives have never been used, unless they appear in the section of foreign currency in commercial banks' balance sheets.

But we can surely take into consideration the financing opportunity for the real estates through real estate loans. Loans for individuals have marked the highest levels in 2005-2007. Further in 2008, the growth rate of these individual loans dropped to 30%, compared with 62% at the end of 2007. This decrease was observed in home loans and consumer loans as well. Individual loan portfolio is dominated by the real estate loans up to 66%.

Loans for real estate has experienced significant growth, but they have started from a very low or not existing basis. At the end of 2001, this loan was less than 10% of the GDP¹.

Meanwhile, if we refer to the property loans granted by banks, there is an increasing trend (but with a downward tendency). But, during 2012, while in the first quarter we have an increase in this loan by 6.3%, in the second quarter we have a drop by 0.6% of the outstanding loans for real estate purchase in annual terms. In the end of 2013, we have a drop of 1.26% in annual terms, compared to the positive trend by 3.5% in the previous semester. In 2014 the decline continues by 9.6%.

This loan has dropped, according to the Bank of Albania, also due to a lower demand from individuals, while its quality is getting worse². This means that the relation between the real estate prices and the loans for them is not so easy to be explained, but while analyzing these figures³, we should consider the complexity of factors that influence the demand for real estate, the level of their influence in a certain period and also the need to improve the index calculation methods.

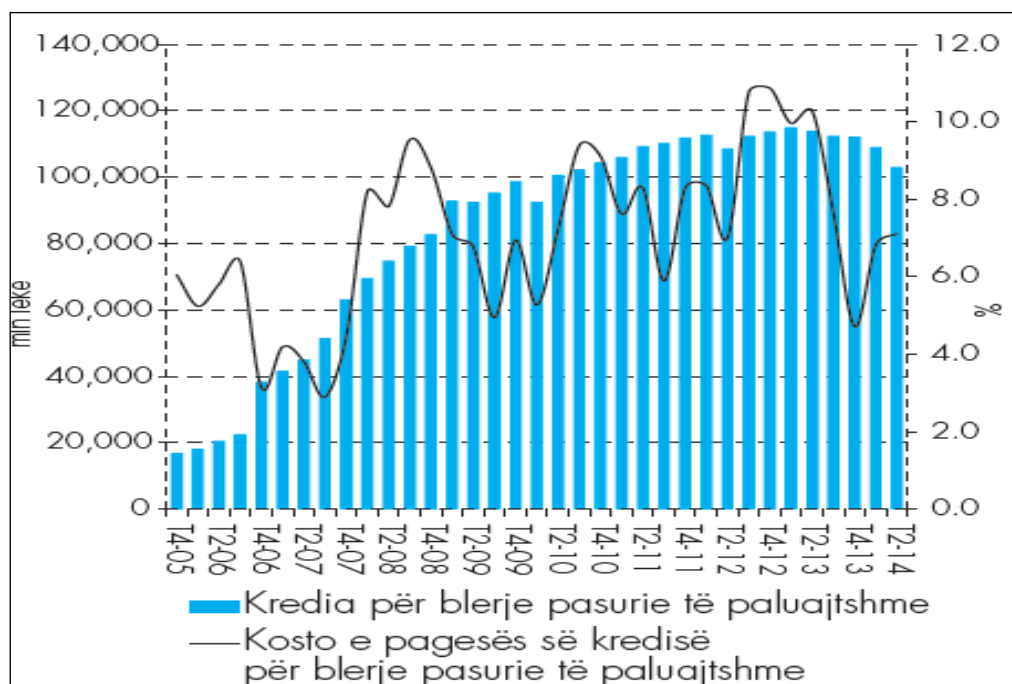


Chart 6. Performance of the real estate loan⁴

Source: Financial Stability Report, 2014, Bank of Albania

¹ According to the Financial Stability Report, the first six months of 2012, dated in June 2012, the ratio of nonperforming loans for real estate was 13.9% compared to 12.55% in December 2011.

² Values refer to the Bank of Albania data

³ In comparison with the housing price index chart.

⁴ Black line: the cost of the payment to purchase real estate & the Blue columns: real estate loans

4. The Performance of Construction in Albania

After the fall of communism, several changes in the public and private construction sector occurred. Initially, the public housing areas were privatized. In the 1990s the government, through the National Housing Entity, took over the completion of the unfinished public housing and the construction of additional apartments for sale at lower prices than the market. In 1990, 10,193 apartments were built from this institution in 555 buildings. During 1995-1996 it was encouraged the construction through loan financing by the World Bank.

But the old system of public construction sector has been almost totally replaced by the private sector. The construction sector had a very large increase in Albania and it has been caused by several factors such as:

- ✓ inherited lack of housing;
- ✓ new generated request;
- ✓ inherited deficiencies in infrastructure and the need for investment in this sector;
- ✓ growth in the private sector, especially in trading and tourism sector;
- ✓ better economic conditions for business development, using cheaper construction materials and higher productive labor force.

In addition, the construction sector has always occupied a high weight in the GDP of Albania. Therefore we consider this sector of particular importance and perform analysis of the phases of its development over the years, including the recent situation as well.

Based on INSTAT data and calculations of the Bank of Albania, we have analyzed the construction sector progress compared to other sectors of the economy.

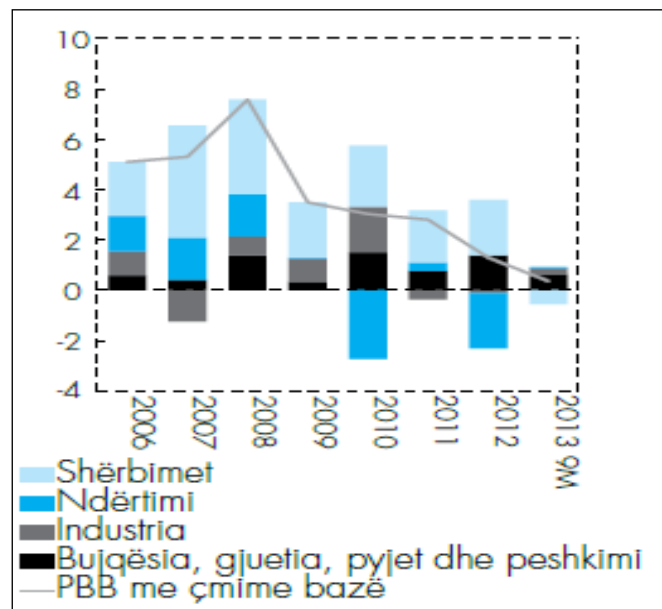


Chart 7. The real GDP structure and loan structure by economy's sectors¹

Source: Bank of Albania

¹ Blue section: Construction

In 2009, the construction activity began to shrink and this process continued till 2011, but still the construction value added in GDP continued to decline. Further in 2011, the generated value was 0.8% higher than in 2010, but remaining 9.4 percentage points below the average of 2005-2009. In the end of 2011, the dynamics of the construction sector still remained non-positive, reflecting a lack of confidence in the sector. The construction activity suffered a strong reduction in 2012, after that, it began increasing due to the public investments. Despite all the negative signs on the sector, it had not stopped moving. It continues to suffer the weakness of private investments in economy. This sector has played the role of locomotive in Albanian economic output matrix due to the strongest relation with the other sectors. Thus, the construction of new buildings or roads has stimulated the production or trading of inputs, cement, iron, bitumen, tiles, sanitary equipment, doors, windows, household equipment, furniture, etc. This stimulation constitutes direct impact of the construction sector in economic output matrix. But besides this, it has caused an indirect effect with a higher influence.

The constructors have experienced financial difficulties caused by the declining liquidity, and therefore they have tried to sell at lower prices in order to generate income. In addition, the construction cost index has increased, due to the increased input prices, reducing in this way the profit margin of construction companies.

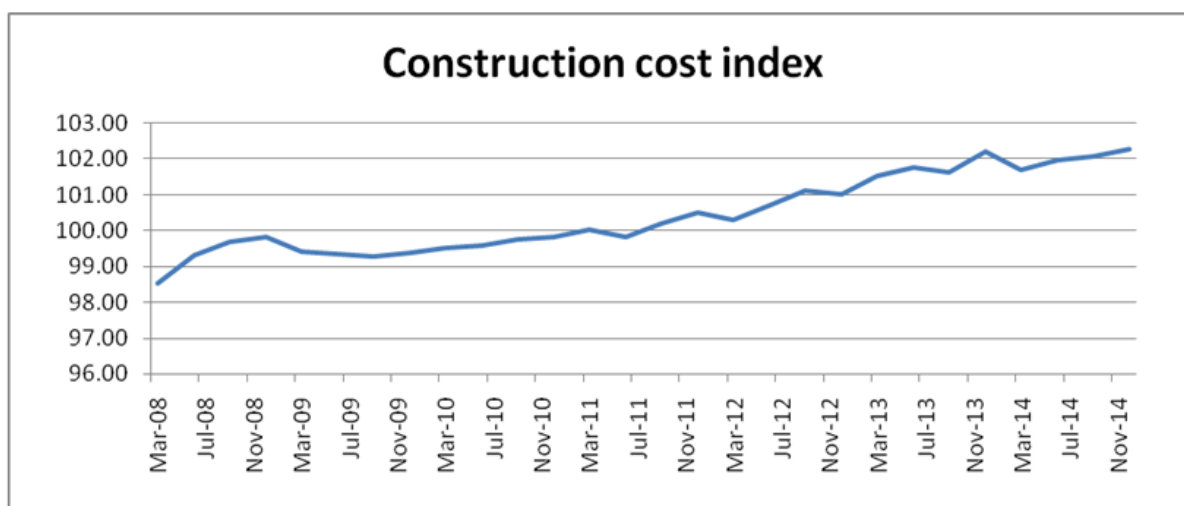


Chart 8. Construction cost index's trend

Source: INSTAT 2014

5. Analysis of the Impact of Real Estate Market in the Albanian Economy

The housing market and GDP exhibits an endogenous relationship, and hence, one cannot exogenously separate the effect of housing market on GDP and vice-versa. Previous studies suggest that real estate prices (mostly residential house prices) are the leading indicator of GDP (Chau, 2001; 2005). Other studies (Ganesan and Tse 1997, amongst others Hui and Yiu 2003) focus mainly on the dynamics of residential real estate on the economic performance of a country. Moreover, Englund and Ioannides (1997) estimate the abovementioned effect focusing mainly on the lagged impact of housing market on GDP. This is due to the lag information released from GDP and the housing price for market fundamentals (Chui and Chau 2005).

However, due to the lack of data in Albania, this study will make use of existing data such as the *Construction Cost Index* and/or *Housing Price Index*. The latter cannot be used for the purpose of this

study, because the data available does not allow having a long data span for econometrical use. In this context, this paper will only describe the data and statistically (not econometrically) describe their relationship. Therefore, the former (Construction Cost Index) is employed for the purpose of investigating the relationship between real estate investment and economic growth. An important limitation, hence, consist of proper data in order to estimate the effect of housing prices and GDP. As a result, the data series for investigating the relationship between economic growth and the real estate market, measured through the Construction Cost Index, were obtained from the Bank of Albania and INSTAT (Institute of Statistics) for the data interval from March 2008-December 2014. Economic growth was measured by a non-seasonalized GDP in real terms, whereas the Construction Cost Index was calculated through the transaction evidence. Both, the GDP and the indices are the composite quarterly index for a certain type of premises. In general, the literature of housing market suggests the use of the change of quarterly GDP and quarterly housing price index/ construction cost index. Therefore, this study has employed the quarterly GDP and the construction cost index instead of the quarterly housing price index.

In table 1-5 in Appendix, the outputs of the regression, and the normality of distribution using Shapiro Wilk Test and skeweness and kurtosis test are conducted. A probability scatter plot of Residuals is also provided in appendix. All the tests and diagnostics suggest the use of a larger data span and some of the failure of diagnostics, which from the other hand suggests the use of more appropriate data. However, in the case of Albania we are aware of such data limitations. This study tried the use of natural logarithm, which from the econometrical point of view and economical as well, did improve the statistics. The following hypothesis was pursued:

H₀: There is a significant relationship between the quarterly GDP and the quarterly construction cost index.

H_a: There is not a significant relationship between the quarterly GDP and the quarterly construction cost index.

Results

The regression results in Appendix 1-5, suggests the existence of a linear relationship between economic growth (measures as the natural logarithm and the construction cost index). This can be observed as well from the graphical presentation (Figure 1) of the relationship between economic performance (measured by ln GDP) and Construction Cost Index (CCI). The Figure 1 display the quarterly GDP and Construction Cost Index relationship, which suggests a positive relationship between these two variables, hence, suggesting for a positive contribution of construction in economic performance.

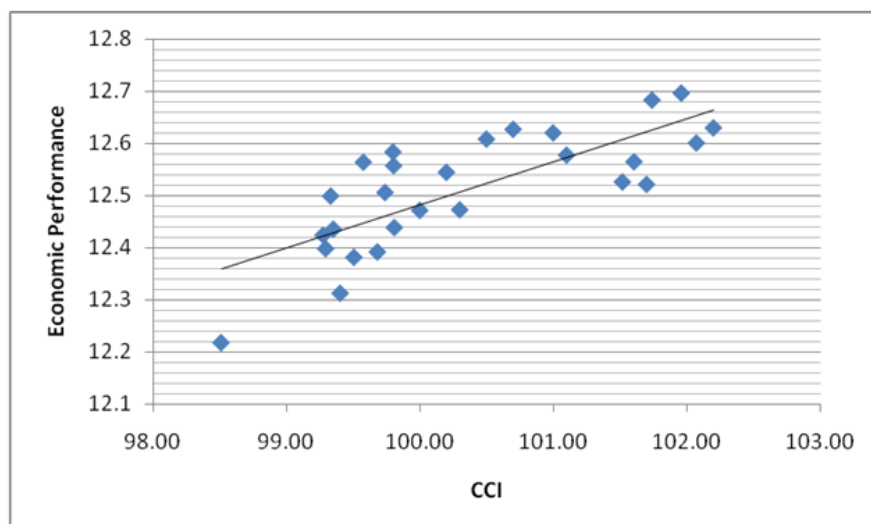


Chart 9. The relation between CCI and economic performance

Source: Authors' calculations, SPSS

However, one should take into consideration a statistically augmented investigation of the above mentioned relationship. Therefore, the regression between the dependent and the independent variable is conducted.

The equation suggested is as follows:

$$\text{Economic performance} = 4.244^* + 0.082 \text{ CCI}^{**} \quad (1)$$

(1.393) (0.014)

Two important tests were conducted related with the regression proposed: (i) the slope coefficient and (ii) the constant significance. For the abovementioned parameters, we rejected the null hypothesis of the zero slope and zero constant (intercept). The statistical p-value of 0.000 (see Appendix) suggests a significant relationship only. In this context, the increase of CCI by one percentage, may lead to an increase of the economic performance by 0.082 percentage points, which from an economical point of view is reasonable. Moreover, the significance of the intercept of equation (1) suggests for a positive effect of economic performance independently of the level of CCI (in this case, more specifically, if the level of CCI is 0). However, one should take into consideration the causality of this relationship (the endogeneity of this relationship) and the data limitation, and hence smooth the economic suggestion for the effect of housing prices on economic performance.

All the descriptive statistics are shown in Appendix too.

6. Conclusions and Recommendations

The real estate market has an important impact on the social and economic development of a country. It is related to many other sectors (banking, construction etc.) by causing mutual impact, especially in terms of employment, income, etc.

Studying the trend of prices in the housing market is a difficult work because of the high informality. However, by using several data sources for this market, we can conclude that the price performance has followed the same trend of world prices, with two years distance. But, the dynamics of prices in

Albania is more complex than that, and we should not concentrate only on the global crisis, but also on other internal factors, such as the cost and quality of construction, financing costs, and the legal and administrative framework of Albania.

Loans for real estate has experienced significant growth, but it has initiated from a low or not existing base. At the end of 2001, this loan was less than 10% of the GDP. According to the Bank of Albania, this loan has dropped, also due to a lower demand from individuals, while its quality has declined. Although we are used to consider a positive relation between housing price and the housing loan, data show the complexity of factors that influence the demand for real estate, the level of their influence in a certain period of time and the need to improve the index calculation methods.

Theoretically, the relation between housing prices and the real economy can be strengthened through financial accelerators and different mechanisms which operate between the balance sheets of firms, families and state. Through these mechanisms, an increase in the price of the asset, consequently improves the welfare of the unit (the entity), thus increasing its capacity to borrow, invest and consume. Further, this process leads to increases in housing prices, bringing the market to equilibrium. So, in other words, the fluctuations in the housing market mean larger cyclical fluctuations of the real economy.

Our statistical analysis confirmed the positive relation between the quarterly GDP and the Construction Cost Index, indicating a positive impact of the construction sector in the economy. However should also consider this relationship to be endogenous, which moderates the conclusion regarding house prices impact on economic performance.

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Appendix

Variables Entered/Removed^a

Model	Variables Entered	Variables Removed	Method
1	CCI ^b		. Enter

a. Dependent Variable: Inecoperformance

b. All requested variables entered.

Model Summary^b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.765 ^a	.585	.568	.07416

a. Predictors: (Constant), CCI

b. Dependent Variable: Inecoperformance

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	4.244	1.393		3.046	.005
	CCI	.082	.014	.765	5.936	.000

a. Dependent Variable: Inecoperformance

Residuals Statistics^a

	Minimum	Maximum	Mean	Std. Deviation	N
Predicted Value	12.3599	12.6639	12.5122	.08634	27
Residual	-.14325	.11642	.00000	.07272	27
Std. Predicted Value	-1.764	1.757	.000	1.000	27
Std. Residual	-1.931	1.570	.000	.981	27

a. Dependent Variable: Inecoperformance