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Market Overview

HOUSING REPORT SPAIN

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INTRODUCTION

After nearly seven years of decline that have seen nominal prices fall by an average of 40%, the residential property market in Spain is now beginning a cycle of recovery. Economic growth, low interest rates, and improved affordability are among the factors contributing to increased optimism in the housing market. These indicators explain the increasing appetite among foreign investment funds which over the last 24 months have acquired servicing platforms and have been active in purchasing large volume NPL's portfolios. In addition, improved demand for new residential projects in cities like Madrid and Barcelona, as well as in some coastal regions, means the beginning of increased stability in the sector. High unemployment levels, the decline of population and an oversized stock of unsold houses are elements however that may mean a slow recovery.

In Spain, the ratio of ownership versus rental housing is equal to approximately 83:17, which is far above European average. One of the consequences of the crisis is that the subsidies for acquiring owner-occupied apartments have been reduced and taxes increased. On the other hand, regulation of the Spanish rental property market has been modified to provide more protection for property owners and increasing incentives are being offered to invest in apartments for rent. International investment Funds have taken advantage of these changed conditions and a significant increase in cross-border investment in residential real estate over the past 18 months has been witnessed.

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EXECUTIVE SUMMARY

1. PRICE ADJUSTMENTS

Since the beginning of the crisis, the residential prices have plunged approximately 40% to 50% on average from the peak values in 2007. Biggest losses have been taken by Spanish banks due to high discounted values of foreclosed properties. It is forecast that price adjustments will moderate this year and rebound in the bigger cities, like Madrid and Barcelona.

2. HOUSES SOLD

According to the National Institute for Statistics, approximately 320.000 houses, both new built as well as existing, were sold during 2014, 3% higher than 2013. Sales increased amongst foreigners, representing 21% of total sales. Due to wage moderation and high unemployment rate, the average purchase cost still equals to 5.9 times the yearly average family income, twice as much as in the US.

3. POPULATION DEMOGRAPHY

The Spanish population is forecast to shrink by 10%, from 46 million residents to 41.5 million by 2050. Estimates published by the National Institute for Statistics foresee that the principle target group of potential home buyers, aged between 25 and 49, will fall by more than 4 million people in the coming 10 years due to emigration and gradual aging.

4. MORTGAGE LENDING

95% of mortgage lending in Spain is linked to the Euribor. This means that if ECB starts to raise rates, the market's overexposure to variable interest rates could have serious financial impact for many property owners and financial institutions. During 2014, the total number of mortgages - currently 20.000 per month - increased by 28.5% with respect to 2013, the highest growth in the last five years.

5. FORECLOSURE PROCEDURES

Default on mortgages as a part of total bank lending increased up to 6.3%, an all-time high. As regard the number of foreclosure procedures, BANKIA dominates the list of 13 Spanish bank entities, followed by BBVA and Caixa Bank. According to the Ministry of Employment, the improving macro-economic conditions and labor market will reduce the unemployment rates in the short term.

6. EXISTING STOCK

At the height of the housing boom more than 800.000 houses were built on a yearly basis, more than the UK, Germany and France together. This massive oversupply was translated into near 700.000 unsold houses by 2010, currently reduced to less than 500.000. According to the Institute of Statistics less than 50.000 new houses were initiated in 2014, an all-time low.

7. RENTAL MARKET

Spain's rental market is underdeveloped and, in terms of legal protection, used to be extremely pro-tenant. As a result, the proportion of ownership versus rental is one of the highest in Europe, 83:17. In order to stimulate the rental market, several fiscal benefits and new regulations were introduced during 2013 to give property owners more legal protection by law in default situations.

8. INVESTMENT MARKET

Average yields on residential investment used to be no higher than 2.5% to 3.5%. Since the beginning of the crisis yields are inching up as sale prices have dropped more rapidly than rental prices. The actual rental yield ranges from 4% to 5%. Banks, Spanish largest property owners, are currently renting out a significant part of their immense stock of foreclosed real estate properties.

9. BAD BANK

Sareb was created as one of the conditions of the €100bn bailout plan agreed with EU lenders. Sareb was launched at the end of 2013 with an estimated €50bn of assets and non performing loans. The assets will be gradually sold off to the market over 15 year life of the Sareb. The international investment market has become one of the main targets for large debt / asset portfolio sales.

10. MARKET OPPORTUNITIES

Strategic purchases of land in good urban locations has great potential. Value added opportunities offering good returns over the medium term as key economic drivers improve and consumer confidence returns. Sourcing assets through SAREB, banks and public entities as well as through private landowners with planning initiatives in need of capital to unlock development potential.