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Spanish property market struggling amidst stringent austerity measures

BARCELONA – The interest rate for Spanish bonds fell back to 4-5 percent after reaching a speculative 7 percent last summer and seems to have stabilized over the last months. Despite numerous political reforms and stringent austerity measures, the real problem remains unsolved such as a growing unemployment rate of 26%. But also the Spanish real estate sector, after five years of crisis, still causes a negative impact on the local economy. In the following a summary of the ten most dominant issues in the Spanish residential market.

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1. Sale prices
Since the beginning of the crisis, the residential prices have plunged by an average of 40 to 50 percent, returning to the levels of 2004. An additional fall of 20 to 30 percent is expected. Areas with a large oversupply of new built houses, such as coastal regions and large urban expansion areas close to major cities, will suffer the most significant downfalls.

2. Demand
According to the Ministry of Public Works, 300.000 houses were sold during 2012 against 350.000 in the year before. Approximately 50 percent are new built houses and the other half existing. Banks have become the largest property investors due to the enormous amount of foreclosures and liquidations. Amidst the downfall in sales to Spanish residents, the number of units sold to foreigners increased by 6 percent. Sales are expected to slide in the forthcoming months due to weaker demand. Also, VAT on property transactions increased last month from 4 percent up to 10 percent. In addition, Spain has to battle against the negative effect of population shrinkage. The Spanish population is forecast to shrink by 10 percent from 46 million residents to 41,5 million by 2050.

Property transactions increased by foreigners

3. Supply
At the height of the housing boom 800.000 houses were built on a yearly base. Spain developed more houses then the UK, Germany and France together. Pre-sale was banished. After all, during many years prices used to increase during construction. The residential market took an enormous risk that was translated into a massive oversupply of more than 1 million new built houses. Possible solutions that are currently being suggested are substantial price discounts, conversion to rental market, social absorption for property owners being evicted and even demolition is mentioned.

4. New development
According to the National Statistics Institute in 2012 there were just over 50.000 houses started. This volume has never been so low since the '60. Demand and supply varies a lot per region as a result of which some regions are completely paralyzed in the construction sector. The government is actually preparing a new law to stimulate refurbishment and renovation of existing properties to recover part of the significant unemployment rates in the field of construction and its subsectors.

5. Rental market
Spain's rental market used to be extremely pro-tenant. As a result, the proportion in Spain of sale versus the rental market is 83/17, one of the highest in Europe. Recently, several new regulations were introduced in order to stimulate the rental market. In addition, a new law was created that will give property lenders more legal protection by law in default situations and will also provide fiscal benefits.

6. Rental investment market
Average yields on residential investment used to be no higher than 4 percent. Since the beginning of the crisis residential yields are inching up as sale prices have dropped more

rapidly than rental prices. The actual rental yield is ranging from 4 to 6 percent. Spanish banks, the largest property investors, are renting out a significant part of their immense stock of foreclosed real estate properties. In order to stimulate the private investment market for rental properties, the fiscal law has recently been modified for so called SOCIMI's, the Spanish variant of REIT. Due to these modifications the government expects growing interest for the creation of investment vehicles dedicated to the investment and management of residential portfolios.

7. Bad bank

The creation of Sareb, the Spanish bad bank, has created many expectations for this year. Its main target is to relieve the banks of their accumulated real estate portfolio and free up capital. Spanish banks are now able to transfer their properties to the bad bank at an average price reduction of 70 percent. Nevertheless, direct effect of these devaluations won't be seen on a short term as properties will be resold to the private market spread over 15 years. In first instance the institutional investment market will be targeted with larger packages. Subsequently, these investors will sell to individuals once the market enters into a phase of growth.

Expected IRR Spanish Bad Bank is 15%

8. Interest rates

95 percent of the Spanish residential mortgages is referenced to the Euribor plus an additional fixed market spread applied by the credit providers. The actual level of the Euribor is 0,6 percent. The spread which used to be 0,5 percent during the housing boom, actually reaches up to 3% due to the stringent measures to reduce real estate risks. On the contrary, the market's overexposure to adjustable interest rates could still have serious financial consequences for many property owners and credit providers if ECB rates start to rise.

9. Finance

Banks are obliged to make provisions on their real estate portfolio in order to protect the downside and withstand possible risks. Hereto, banks have drastically cut available credit facilities for the private sector. Finance for land acquisition has dried up entirely, unless a project is completely preleased or presold. Furthermore, a project developer has to battle against a crooked market situation. In this sense, banks that decide to develop their illiquid land assets into more liquid residential dwellings are actually offering credit facilities up to 100 percent to their customers.

10. Opportunities

In summary, recovery on the short term of the Spanish real estate sector is not expected to happen. The market offers interesting residential investment opportunities mainly in areas with a large oversupply. There are opportunities for the creation of investment vehicles with potential fiscal benefits. By speculating on future growth, the investment yield that is being expected by the Spanish bad bank is 15 percent IRR. However, prior to start with reconstruction and growth, the market has to clear its rubble before evaluating the real damage of the Spanish real estate problem.