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Analysis of the market confidence in the housing sector

Spain is on the move after a three-year real estate crisis

This example is a modern day scenario for Spanish banks selling the existing stock of housing; reverse auctions, dump-prices, cheap housing grants, 100 percent mortgages with amortization periods of fifty years. Where it concerns buildings, the asking prices are often not even mentioned. For example, there's a completely vacant building in the very centre of the city of Madrid: every bid between 1 and 20 million Euro is considered very seriously. In order to break through the negative tendency in the market confidence after an 'acquisitions restraint' of three years, and to create recovery prospects, the financial policy of the banks and the measures to be taken in the residential sector must be highlighted. The following three parameters are also of importance when analysing the market fluctuations over the past period. Which scenario lies ahead for the real estate sector in the coming time: a) the factor of mortgage versus disposable annual income; b) the amount of new housing that's been initiated; and c) the tendency of the number of realised sales over the past few months.

Policy of the banks

With effect from 1 October the Bank of Spain will tighten its policy to stimulate the sales of real estate products. One of the measures that will be taken is to increase the normative provision on real estate products which are sold under execution by the bank. For property that has been repossessed a provision of 10 percent currently applies from the time of execution. One year after repossession this provision is 20 percent, and for property that is held for longer than 24 months on the balance sheet, the provision is 30 percent. In other words, for a building

A couple of investors visiting Spain are on the brink of leaving by bus from Madrid airport. The passengers take their seats with cameras at the ready. The city tour begins. As they're driving along the tour guide addresses them. The subject matter is not about the Prado Museum or the Retiro Park. The speaker, who is a professional broker, conducts the tour passing 600 newly completed homes which are up for sale under execution by the bank and being offered at discounts of 30, 40 and even 50 percent off the assessed value. Is this a doomsday-scenario or realistic practice? It is obvious that Spain is on the move after an unrelenting real estate crisis over the past three years. However, there's no optimism as yet. Eurostate conducted an investigation of influential factors for the market confidence in the Spanish real estate sector. The conclusion is that potential buyers should prepare themselves for a new real estate cycle.

that has an assessed value of € 30 million, after two years a provision of 9 million must be included. Looking at the totals, the bank already has € 60 billion worth of property value under execution, of which a total amount of € 13 billion is included as a provision. These provisions are eventually reflected in the financial statements of the bank and apply as a reserve to compensate for the loss of interest and devaluations. The purpose of this measure is also to put the banks under pressure to sell their real estate portfolios sooner.

Government policy

The Spanish government now mainly directs its policy on two main points: the social rentals market and renovations of the existing real estate. The social owner-occupied market – which was spearheaded by the current government until two years ago – has taken a back-seat. The current subsidies in the social owner-occupied segment will be abolished with effect from 1 January 2011. In 2009 the expenditure on subsidies amounted to some € 300 million. The fact that there is a

dire shortage of owner-occupied homes in the social and low-income sector is evident from the long waiting lists in the social new housing allocation procedure. Various parties also advocate tackling the current oversupply in the non-subsidized sector by means of the demand for social owner-occupied homes. However, the price differences between the non-subsidized and the social owner-occupied sector is still too big, which likewise cannot be bridged with subsidies or fiscal benefits.

Mortgage versus income

When the mortgage obligations are compared to the average gross disposable income, then it seems that this factor has dropped over the past two years from 7.7 to 6.8. This reduction, amongst other things, is due to the lower Euribor rate compared to two years ago and the lower housing prices. A risk which should not be underestimated is the Euribor's tendency to rise, which is the decisive factor for 95 percent of the mortgages in Spain, the recent increase in the tax rates and the ever-present structurally high rate

of unemployment, despite the decreasing trend over the past four months.

New housing

The number of newly built houses of which building has commenced, reduced over the past three years to an eighth of what the volume was in 2006; which was more than 760,000. In the past year 160,000 residences have been built. For the year 2010 the volume is not expected to rise above 100,000 residences. This stagnation in building production is extremely negative for the building sector and for em-

ployment opportunities. On the other hand it is estimated that in a 'healthy market situation', Spain can fulfil a demand of 350,000 to 400,000 residences per annum. Here a positive development is that in certain regions of Spain there is an accumulative demand for new housing, in combination with a decrease in the surplus supply. See Figure 1.

Realized sales

As was reported in Vastgoedmarkt of August 2010, the number of residential sales in June 2010 rose slightly by 7 percent to 37,297, when compared with the same monthly sales in 2009. Of the total amount, 48 percent is newly built housing and 52 percent is made up of existing housing. 90 percent of the total amount is in the non-subsidized sector and 10 percent is in the social sector. The increase is caused by the new role being played by the bank in the real estate sector as well as a more aggressive sales policy. Other causes are the lower housing prices and the consequences of a fiscal increase in the duties from 7 percent to 8 percent as from 1 July 2010. Hence potential housing buyers have been convinced sooner or have brought their acquisition plans forward somewhat. See Figure 2.

Conclusion

There is very little reason for optimism because of a possible reduction in the disposable income caused by a higher tax burden, interest rate increases and a structurally high unemployment rate. Stimulation of the social rentals market and renovation plans will not be enough to counteract the stagnation in new construction projects in the social housing sector and to provide job opportunities in the building sector. Yet a reduction in the real estate values over the past three years have led to the belief that the financial possibilities for potential buyers should be increased. Especially now that banks, which are good for a total of € 60 billion of repossessed properties, are being 'penalized' for their real estate assets. Although there's not a structural improvement as yet, potential buyers must start preparing themselves for a new real estate cycle, whether it be via organised city tours, reverse auctions, or via much more selective acquisition procedures. As Wim van Dijk, my business partner who recently passed away, once eloquently put it: 'When things are going well you must be careful, when they're going badly, trust your instincts.'

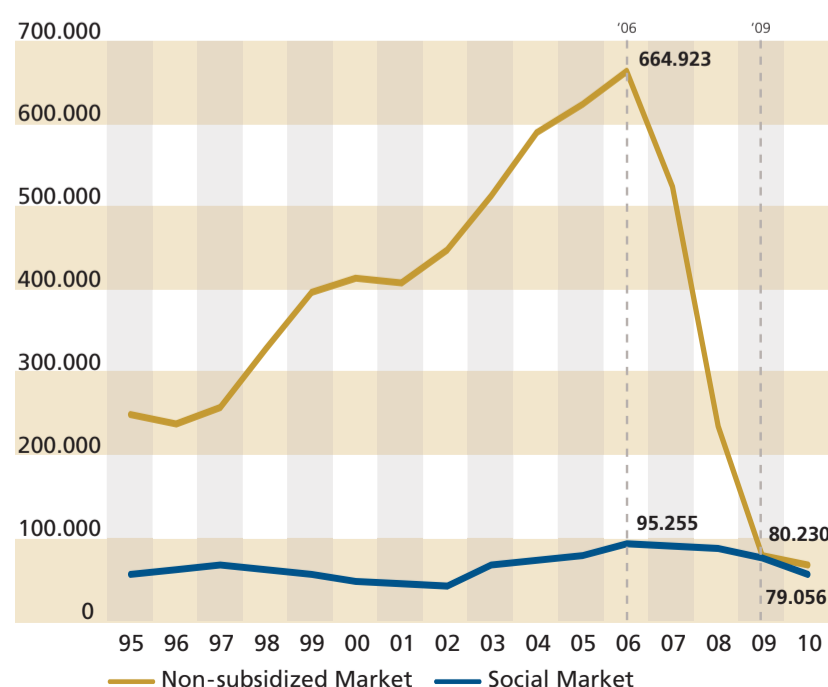
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Amount of new housing initiated in non-subsidized and social housing sector - Figure 1

Source: Ministry of Public Housing, The Bank of Spain and Mortgage Association of Spain



Number of realised sales of both newly built houses as well as existing housing - Figure 2

Source: Ministry of Public Housing, Tinsa (Assessors) and INE (National Statistics Agency)

