

Spanish Property Market – Boom or Bust?

By Peter Fitzgerald FIAVI, Managing Director of Lindsay Estates

The Irish property investor's love affair with Spanish property appears to be in decline. Widespread media reporting of planning corruption scandals, land expropriation and product oversupply, added to the emergence of alternative investment markets, have all contributed to a major fall-off in Irish activity in this market in the past 18 months. Where the micro-markets of the Costa del Sol and Costa Blanca were being driven to an unprecedented level by Irish investors between 1998 and 2005, they are now suffering a severe reduction in demand against a large supply overhang.

Accurate statistics of Irish ownership in Spain are difficult to obtain, but it is generally thought that somewhere in the region of 150,000 residential properties may belong to Irish investors. Part of the difficulty here is that there has been quite a large level of speculative off-plan investment with a view to selling on prior to completion and as such it is impossible to accurately estimate the number of

end user or lifestyle buyers. It is, however, essential in any analysis of the market to distinguish between these two sectors. Clearly, speculative investors who entered the market between the late 1990's and 2003, will have benefited from the extraordinary growth levels of that period and will most probably have moved on to new market opportunities elsewhere. Those investors who entered the market, particularly in the past two years, are now finding that selling on in a declining market is impossible and are faced with the prospect of completing the purchase with the assistance of a mortgage, which it may not be possible to repay through rental income. Lifestyle buyers, on the other hand, will generally be pleased that nominal values have increased by 197% over a ten year period.

The Irish investment frenzy in Spain was fuelled by the Celtic Tiger economy and the spiralling property values associated with it. Similarly the Spanish economy began to grow impressively, albeit with a

large dependence on the construction industry. By 2003, Spain was producing 900,000 new properties a year, more than the combined output of France, Germany and Italy. Indeed Spain produces a quarter of all new homes built in the E.U. The factors driving this included a growing demand from foreign buyers of vacation homes, increasing numbers of affluent immigrants and the low interest rate environment. Residential construction now represents around 11% of Spain's GDP.

By 2005, many experts were already predicting that the market would overheat, but nevertheless it remained remarkably resilient and in 2006 prices rose overall by 9.1%, although this was considerably down from the 2005 growth figure of 18.5%. The slowdown had clearly begun due to two main factors, the oversupply of product and the prevailing financial conditions as a result of rising interest rates. In December 2005, the European Central Bank began to increase interest



rates, resulting eventually in a series of seven increases, which drove the Euribor index on which Spanish mortgages are based to as much as 4.75%, and creating serious fears of mortgage arrears affecting the main Spanish banks such as Santander, its specialist mortgage subsidiary UCI, and BBVA. More recently the global credit crisis arising from the sub-prime products has further exacerbated the problem, with the banks suffering liquidity problems and the full extent of their exposure to the crisis as yet uncertain. This has resulted in a virtual shutdown of credit for property related investment or speculative purposes. This has serious implications for the estimated 1 million unsold properties in Spain at present, 500,000 newly-built and 500,000 resales.

A further difficulty is the growing indebtedness of the Spanish property-owning population. Recent figures indicated that millions of Spaniards are now spending about 55% of their wages on principal or secondary loan repayments, double the percentage considered healthy by many banks. Spain's household debt is running at record levels approaching 600 billion euro. Already there have been documented cases where people have simply handed in the keys of their property to the bank rather than continue to battle with increased repayment costs. This trend, heretofore unheard of in Spain, looks likely to continue, at least until there is some easing of interest rates and stabilisation of prices.

It should, of course, be stressed that the Spanish property market is made up of many different regional and diverse micro-markets, and that different areas and types of property will perform differently in any market downturn. The main problem is likely to be in over-developed coastal areas, where inadequate planning controls have resulted in large scale developments of average or below average quality in secondary locations, most of which were acquired by overseas clients at pre-construction stage, many of whom are now not in a position to finance completion. Quality properties in prime locations will continue to be in demand from a more discerning client base, while banks will increasingly scrutinise the credentials of non-resident applicants for finance. Clearly the days of presenting minimal documentation for mortgage purposes have passed and extensive credit checking and risk analysis will now become the norm in this sector.

The issues surrounding planning corruption are likely to result in a much improved system for the future. The well reported scandal of Marbella Town Hall, where unlawful building licenses were issued for many years in return for bribes consisting of large sums of money, and as a result of which two former Mayors, a chief planning official and other staff members are currently in prison on corruption charges, has led to a major review of the planning process involving local Town Halls and the Autonomous Regional Governments, which will hopefully prevent future instances of such scandalous proportions. A new era of transparent property transaction, backed up by proper judicial resources will bring renewed confidence to a market that, despite its recent setbacks, has a lot to offer to investors going forward.

So is the boom over? If so, is the market to have a soft or hard landing? Although prices overall in Spain grew by an estimated 4.8% in 2007, the situation has clearly deteriorated in recent months. A glance at the IBEX35 index on the Spanish Stock Exchange will show that since Spring 2007, most of Spain's top quoted construction companies are down by up to 40%, indicating that many investors fear the worst. Most experts are now predicting minimal or zero growth in 2008. While certain coastal and tourist oriented locations are showing definite signs of price falls, for reasons outlined earlier, the overall market, including the major cities of Madrid and Barcelona, looks like having a soft landing, after a decade long boom. The primary concerns will be the supply overhang, bad debts, and future interest rate trends. Current estimates put future annual demand in the region of 450,000 units, well short of the 2007 output of 800,000.

This has, of course, serious implications for the construction industry, where it has been suggested there have already been 40,000 workers laid off in both construction and real estate firms. However, the withdrawal of the speculative investor from the market for now should assist in achieving equilibrium between supply and demand going forward. Other factors such as an increase in immigrants seeking to enter the housing market, the outcome of the forthcoming elections in Spain and a possible early resolution of the problems in the banking sector may all be positive in terms of achieving the soft landing. Indeed the OECD, although previously critical of overpricing in the Spanish market, has forecast a soft landing, coupled with a slight slowdown in economic growth from 3.3% in 2007 to 3.1% in 2008, still well above the average economic growth rate for the Eurozone.

As always in times of market downturn, opportunities arise for the astute investor. The current situation in Spain is no different. Distressed vendors, bank repossessions, and under-pressure developers offer a buying opportunity. Spain has a lot of positives for investors, easy access and communications, excellent climate and lifestyle, sound economic, social and political background, secure legal and judicial system and probably most important of all it is the desired retirement and vacation choice of millions of Europeans, something to which the new emerging markets can only aspire. With proper due diligence and caution, and remembering the oft-quoted real estate dictum 'location, location, location', the shrewd Irish investor can look forward to a bright future in Spain.

