

Demand for second homes in Spain

María Romero¹

The Spanish housing sector has been one of the hardest hit since the economic crisis first erupted. After seven years of contraction, the latest figures released point to an uptick in this sector of vital importance to the Spanish economy.

Holiday home purchases are increasingly important in Spain. This article provides a brief overview of the trend in this segment in recent months: who is buying, which are the most attractive markets and what measures may be fuelling the current momentum. The potential elimination of the “amortisation coefficient” in 2015, the chance to obtain a long-stay visa or residence permit by acquiring a home for over 500,000 euros and, above all, the improvement in the economic climate coupled with intense price corrections in the coastal markets, could continue to prop up second home transaction volumes in the months to come. If this forecast proves accurate, this development could help absorb the huge overhang of unsold housing in these markets, while contributing to the financial stability of the key players in the sector, the banks supporting these entities and markets, as well as the economy in general.

Introduction

The Spanish housing sector has unquestionably been one of the hardest hit since the economic crisis first erupted. After seven years of contraction, the latest figures released point to an uptick in this sector of vital importance to the Spanish economy. The most important indicator, the one with the ability to kick-start the entire process, relates to housing demand. Although real estate transactions remain far below pre-crisis levels, it is worth highlighting the upward trend witnessed in recent months. Within this general improvement, the recovery in and growing importance of second home purchases by both Spanish residents and buyers whose main residence is not Spain stands out. The purpose of this article

is to identify: (i) the trend in transactions of this nature in recent months; (ii) the second home buyer profile; (iii) the geographic markets proving most attractive to second home buyers; and (iv) the measures recently passed, (including the potential elimination of the so-called ‘amortisation coefficient’ [the coeficiente de abatamiento, a tax break for the capital gains generated by selling your house] in 2015 for home sellers and the granting of long-stay or residence permits to non-EC investors since September 2013) which may be fuelling recent momentum.

Demand for housing and drivers

Before turning to the trend in demand for second homes in Spain, it is worth pausing to define what

¹ A.F.I. - Analistas Financieros Internacionales, S.A.

is meant by demand for housing and identify what is driving it.

Potential demand for housing refers to all the people who intend to purchase or change homes over a defined period of time. This potential demand becomes effective demand when a house is actually purchased. There are many ways to group or split demand but they all result, albeit with nuances, from the following drivers:

- **New household formation:** this is the result of adult children leaving home and couples setting up households, as well as the division of existing households following divorce or separation.
- **Second homes:** demand for a non-primary residence used during the weekends or holidays from local and foreign residents.
- **Replacement, refurbishment, upgrade or change of location of an existing home:** this category encompasses demand pursued with the aim of enhancing or modifying housing conditions, such as conditions corresponding to the house itself or its neighbourhood, the cost of housing (rent or mortgage payment), the rent vs. ownership equation, etc.
- **Investment:** demand for houses for investment purposes in order to obtain financial returns as a result of their revaluation, rental or via tax breaks, as the case may be.

In a balanced residential market, the majority of demand for housing will be driven by demographics in general and new household formation in particular. The economic and financial crisis has prompted a decrease in the number of new

households from an average of 425,000 between 2002 and 2007 to a scant 84,000 in 2014. This level, according to the estimates for household formation recently published by Spain's statistics bureau, the INE,² is likely to hover at around 60,000 units in the years to come.

The drop in demand for primary residences, coupled with a significant house price correction, most notably along the Mediterranean coast and the two archipelago systems (the Canary and Balearic islands),³ has had the effect of increasing

Demand for second homes is growing in importance in Spain. In the first half of 2014, this segment accounted for 17.3% of all real estate transactions.

the weight of demand for second homes or investment housing in Spain.⁴ Specifically in the first half of 2014, second home transactions accounted for 17.3% of the total. This is why it is worth analysing the trend in this segment of demand in recent months in greater depth – who is buying these houses and what are the reasons behind this phenomenon?

Recent trends in demand for second homes

In the first half of 2014, demand for housing amounted to just shy of 173,000 units, year-on-year growth of 26.8%. This favourable trend is underpinned by the recovery underway in demand for second houses from foreigners

² For further information, please see the following press release: <http://www.ine.es/prensa/np871.pdf>

³ On average, housing prices were down 40% as of first half of 2014; however, along the Mediterranean coast and the two archipelagos, prices were down by more than half.

⁴ In the case of demand for houses for investment purposes, the amendment of the law regulating REITs in Spain (known by their Spanish acronym as SOCIMIs) (Law 16/2012 of December 27th, 2012) has also played a part, as it has not only resulted in an increase in the number of entities of this type in Spain (nine are currently traded on the continuous and alternative stock markets compared to just two one year ago), but has also meant that a substantial percentage of their leased assets are residential assets (houses).

not resident in Spain. Although second home purchases by residents⁵ outweighed purchases by non-residents (accounting for 93.1% of the total in the first half of 2014), they registered a decline in year-on-year terms (of 2.8%). At any rate, it is worth noting that some 30,000 houses bought in the first half were purchased with the purpose of turning them into second homes. As noted earlier, this figure accounted for 17.3% of all first-half home purchases.

Demand from residents

Although the upward trend in second home purchases by Spanish residents was interrupted in the first half of 2014, it is worth emphasising the fact that resident buyers remain a significant source of demand. Ownership of one's primary residence has become an identity badge in Spanish culture⁶ (despite the fact that in the middle of the last century the percentage of households renting their homes was far more significant) and it is possible that the same can be increasingly said of having a second home which the family can enjoy on the weekend or during the holidays.

This cultural driver has been shored up by a sharp housing price correction which has grabbed the attention of the segment of potential second homebuyers with enough savings or credit standing –a virtual must in the prevailing credit climate– to make an investment of this nature.

In addition, albeit still at the drafting stage, the potential elimination of the amortisation coefficient contemplated in the draft amendments to Spain's Personal Income Tax Act (Law 35/2006 of November 28th, 2006), the consolidated text of the Non-Resident Income Tax Act (enacted by

Legislative Royal Decree 5/2004, of March 5th, 2004) and other tax legislation⁷ could boost house

Second home purchases by residents, which are concentrated in coastal areas, remain in line with 2013 averages. Residents of Madrid and Catalonia account for two-thirds of these buyers and are also more inclined to invest beyond their region of residence.

purchases towards the end of this year, as the legislative changes will imply substantially lower tax bills for the seller if the sale goes through before the end of 2014. We would not rule out additional price cuts, including on second homes, in order to attract potential buyers in an attempt to speed up sales.

According to the data of the first half of 2014, house purchases by residents totalled 27,700. Despite the dip in year-on-year terms, this level is in line with the semi-annual average observed throughout 2013 and even 2011.

Residents of Madrid and Catalonia are the most active in this segment of the market, in keeping with their relatively higher purchasing power and GDP per capita and, probably, their lower initial indebtedness levels. In the first half of 2014, these regions accounted for almost 66% of second homes purchased by Spanish residents. These buyers are also more likely to invest outside their region of residence. In the first half of 2014, two out of every 10 real estate transactions were inter-regional purchases, i.e., the purchase of houses in other regions of Spain.

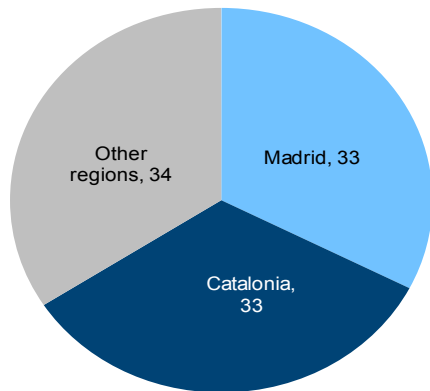
⁵ For the purpose of defining second-home transactions, it was assumed that all houses purchased outside of the province in which the buyer is resident were second-home purchases.

⁶ According to the INE, 77.7% of Spanish households owned their homes in 2013.

⁷ At the time this article was written, the tax reforms presented by the Spanish government were still being processed by Parliament, specifically by the Senate. For further information, please visit the following link: http://www.senado.es/legis10/publicaciones/pdf/senado/bocg/BOCG_D_10_415_2810.PDF

Exhibit 1

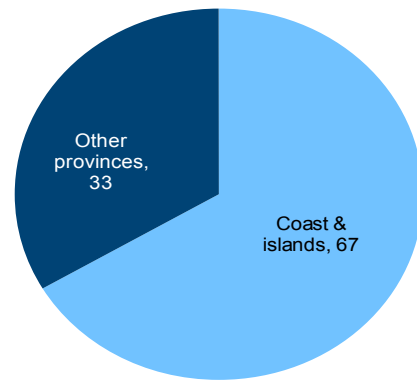
Source of second home purchases by Spanish residents by region of residence (% of total), H114



Sources: AFI, Ministry of Development.

Exhibit 2

Geographic location of second homes purchased by Spanish residents (% of total), H114



Sources: AFI, Ministry of Development.

As for the geographic markets receiving the bulk of this demand, as might be expected, the coastal provinces, particularly those along the Mediterranean coast and two main archipelagos, are the biggest recipients. Two out of every three second homes purchased by Spanish residents in the first half of 2014 were located in these tourist regions.

Demand from non-residents

The demand for housing from non-Spanish residents is hardly surprising considering that Spain is the third largest tourist destination according to the World Tourism Organisation (in 2013, 60 million foreign tourists visited Spain, while the government's estimates point to a new record of 63 million in 2014), coupled with the fact that, according to the Spanish Ministry for Industry, Energy and Tourism, one-third of incoming tourists lodge in houses, either owned or rented. The preference for this less conventional

form of tourist accommodation probably reflects enhanced satisfaction of these travellers' needs, particularly in the case of long or more frequent stays, which would otherwise push costs up significantly.

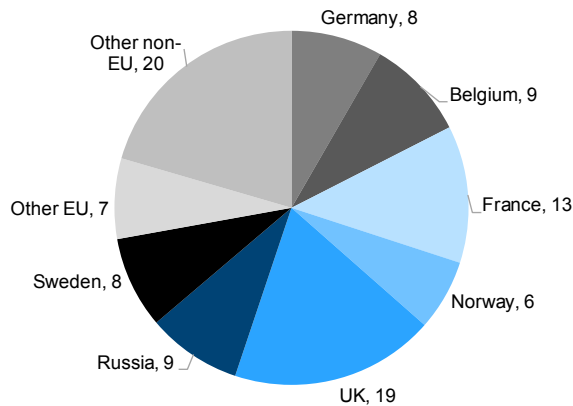
However, a legislative change may also be underpinning demand for housing by non-residents. Since September 2013, following implementation of Law 14/2013, of September 27th, 2013, on support for entrepreneurs and their international expansion,⁸ foreigners not resident in Spain⁹ who purchase a house for 500,000 euros or more can apply for a long-stay or residence permit for investors by virtue of the fact that they have made a significant capital investment in the country. Since an investment in real estate is less liquid than investments in other financial assets, it is assumed that the investor will stay in Spain for a relatively extended period of time. Nevertheless, the related long-stay or residence

⁸ For further information, go to the following link: <http://www.boe.es/boe/dias/2013/09/28/pdfs/BOE-A-2013-10074.pdf>

⁹ This measure is more attractive for citizens who are not residents in any European Union member state as, thanks to the freedom of movement for European citizens throughout the European Community, a visa is not required for such travel.

Exhibit 3

Nationality of non-resident foreigners purchasing homes in Spain (% of total), H114



Sources: Afi, CIEN-Notariado.

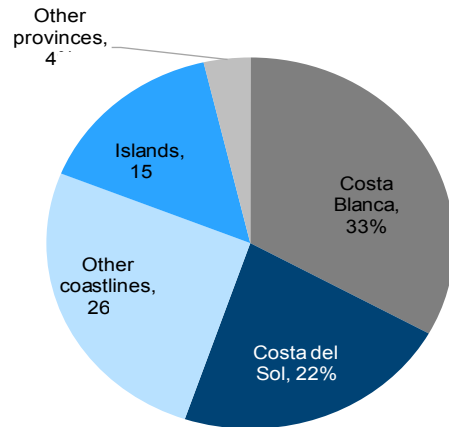
permits are not given on a permanent basis but rather for a maximum period of two years. This mismatch between the usual investment period and period of time for which the visa is granted suggests that these home-buyers are not looking to establish residence in Spain so much as to take advantage of the incipient recovery in the housing sector in Spain to generate returns on relatively high-ticket real estate investments within a short timeframe.

Regardless of the reasons underpinning the intention to purchase a property in Spain, the fact is that the recent sector figures reveal that real estate transactions by non-resident foreigners have been growing consistently since 2009. In the first half of 2014, 2,000 such transactions were registered, marking year-on-year growth of 12.0% and twice the market trough level.

Buyers are mainly EU residents, mostly from the countries which generate the highest flows of tourism into Spain. In the first half of 2014, the English and French accounted for one-third

Exhibit 4

Geographic location of second homes purchased by non-residents (% of total), H114



Sources: AFI, Ministry of Development.

of the houses sold to non-resident foreigners. However, it is worth highlighting other countries such as Belgium, Sweden and Russia. Although they each account for roughly 8.7% of transaction volumes, investor appetite from these nations has risen the fastest in recent months.

Purchases by non-residents, which are concentrated along Spain's Costa Blanca and Costa del Sol, have doubled from the lows of 2009. English and French buyers account for one-third of the total but investor appetite is growing fastest among Belgian, Swedish and Russian buyers.

It is particularly worth flagging the growth in buying activity by Russians, which may well be related to the legislative reforms regarding long-stay or residence permits. According to the School of Property Registrars, 4.7% of homes purchased by foreigners in 2013 exceeded the 500,000 euros

mark and 42.1% of these were made by non-EC citizens. Although there are no official figures depicting the trend in house purchases in this price segment in 2014, several of the real estate portals are saying that Russians are dominating property purchases in the >500,000 euros price segment.

As might be expected, the markets proving most attractive to non-resident buyers are: (i) the coastlines with the most stable favourable weather conditions; (ii) the areas in which prices have corrected the most from their highs; and, (iii) the areas offering an abundant supply of unsold homes for every type of buyer, no matter their purchasing power. It is therefore not surprising to note that half of the sales registered in recent months are concentrated in Spain's Costa Blanca and Costa del Sol, i.e., in the provinces of Alicante and Malaga, respectively. These are the same markets that have seen the greatest growth in second home sales since 2009 and are likely to continue to do so in the months to come.

In the case of non-EU residents, the statistics published by the School of Property Registrars suggest that home purchases in the >500,000 euros price segment are concentrated in the Basque region, to the tune of 7% of sales in 2013. As well as being an attractive tourist destination for foreigners with high purchasing power, this region boasts the most expensive cities in Spain. Residential property prices per square meter are higher in San Sebastian, for example, than anywhere else in Spain. In the second quarter of 2014, the last figure available, this metric stood at around 3,300 euros, compared to an average of 2,000 euros across the major Spanish cities.

Conclusions

The modest pace of growth in household formation post-crisis, coupled with a sharp price correction, have put demand for second homes or investment homes in Spain somewhat back in the limelight. Of all house sales registered in the first half of 2014, 17.3% were second homes.

Although second home purchases by residents slowed somewhat year-on-year in the early part of 2014, residents continued to account for nearly all transactions in this segment. Purchases by non-resident foreigners, however, have been growing consistently and by the first half of 2014 had doubled the low registered in mid-2009.

The possible elimination of the amortisation coefficient in 2015, the chance to obtain a long-stay visa or residence permit by acquiring a home for over 500,000 euros and, above all, the improvement in the economic climate coupled with intense price corrections in the coastal markets, where investor appetite for second homes is concentrated, could continue to prop up holiday-home transaction volumes in the months to come.

Any recovery in housing demand should be welcomed, particularly if focused on the markets where the glut of unsold housing is highest, such as those proving attractive to the second home buyer. As a result, growth in transaction volumes in these markets would not only help absorb the huge overhang of unsold housing, it would also contribute to restoring the financial stability of the sector players, the banks operating in these markets and the economy in general.