Spain´s real estate market: An incipient, gradual recovery

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The latest housing market indicators point to an incipient recovery in Spain´s real estate market. However, given the current level of unemployment, together with outstanding household debt, recovery should be moderate at best at least over the medium-term.

Most indicators suggest that the Spanish real estate market stabilized towards the end of 2014 and the beginning of 2015. After six years of adjustment, the peak-to-trough fall in house prices is estimated to be around 35%-40%, based on an average of leading sources. According to the index of the Ministry of Public Development (2005=100), house prices reached their peak in 2008Q1, at 124.7, and have steadily fallen to 87.3 in 2014Q3, albeit growing again in 2014Q4 to 87.6. The recovery is still incipient, but seems to be supported by some emerging improvements in transactions, as well as the growth in mortgage contracts, where the total amount loaned increased from 37.4 billion in 2013 to 41.2 billion in 2014. In any event, territorial disparity in Spain´s real estate market remains high. Moreover, although it is plausible to expect that house prices will increase during 2015 and beyond, growth will be moderate, given the level of unemployment and the amount of deleveraging that still needs to be done by households. Overall, an improvement in house price statistics in Spain –at least compared to those of other countries- would be a welcome development to better monitor this market.

Measuring house prices in Spain

While the financial crisis was the result of various factors, housing bubbles were a common feature among countries that suffered the most as a consequence of their imbalances. Spain is one of the most prominent examples. The fall in house prices had a significant negative impact on both the banking sector and the economy as a whole. This has given rise to several analyses and opinions suggesting, inter alia, that the Spanish economy should be more diversified and rely less on the construction sector. There have also been a number of voices criticizing the existence of legal incentives on housing and land prices and the need for more proactive and preventive regulations that avoid excessive speculation.

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In any event, regardless of the need for correction, the real estate and construction sectors are very relevant for economic growth in Spain. Now that the economy is recovering, the role of construction will sooner or later be a significant one. A recent example has been the registered unemployment figures of February 2015. There were 96,909 new jobs created -the best result for job creation in the month of February since 2007- and construction contributed the greatest number of jobs to the economy with 26,068.

Despite the importance of the construction and housing sectors, information quality for house price indicators is not comparable to those used in other countries, such as the United States. The Standard and Poor's Case-Shiller index in the US, or the HM Land Registry in the UK, are based on repeated sales. Therefore, they put the focus on specific transactions. Other indicators, such as the Census Bureau Constant Quality House Price Index in the US, take the hedonic approximation, thereby considering differences in the quality of the properties sold.

In Spain, the official price index published by the Ministry of Public Development is based on the appraisal price computed for the purposes of requesting a mortgage. This excludes purchases made in cash or other forms apart from mortgages. Additionally, it takes some time to make valuations and this causes a lag so prices do not reflect the current market evolution.

Valuation companies, such as Tinsa or Sociedad de Tasación, also publish their indices, but they are obviously based on valuations and, therefore, they have the same problems.

Spain's Statistical Office (INE) has recently started to publish a price index based on transactions registered on public deeds. The index uses a hedonic correction, which represents an improvement. However, there are a number of reasons –such as, for example, tax reporting– to believe that transactions in public registries do not reflect the true prices agreed by the parties in the agreement.

All the official indices have, therefore, a number of disadvantages preventing them from reflecting accurate transaction prices. In the absence of other official indicators, interesting complementary information is provided by buy-and-sell web pages, such as Idealista.com or Fotocasa. Their indices are built upon prices posted by sellers. Here the problem is the opposite to that of the public deeds: prices are usually discounted when the transaction is agreed and, therefore the estimated value could be overstated.

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As happened in the past –for example with the Spanish crisis of the 1970s– the adjustment of house prices after the bubble seems to take a longer time in Spain than in other countries, as is also the case for the adjustment of the economy itself. As shown in Table 1, a significant fall in house prices did not take place in Spain until 2011, when the annual decrease was 12.7%. However, other EU members that also experienced significant housing bubbles already suffered accumulated falls in house prices of around 40% from 2008 to 2010.

If we take the index of the Ministry of Public Development, as shown in Exhibit 1 (2005=100), house prices reached their peak in 2008Q1, when the index was 124.7 and have steadily fallen to 87.3 in 2014Q3, growing in 2014Q4 to 87.6.

Table 1

Year-on-year change in house prices in the EU

(2014 as of Q3)

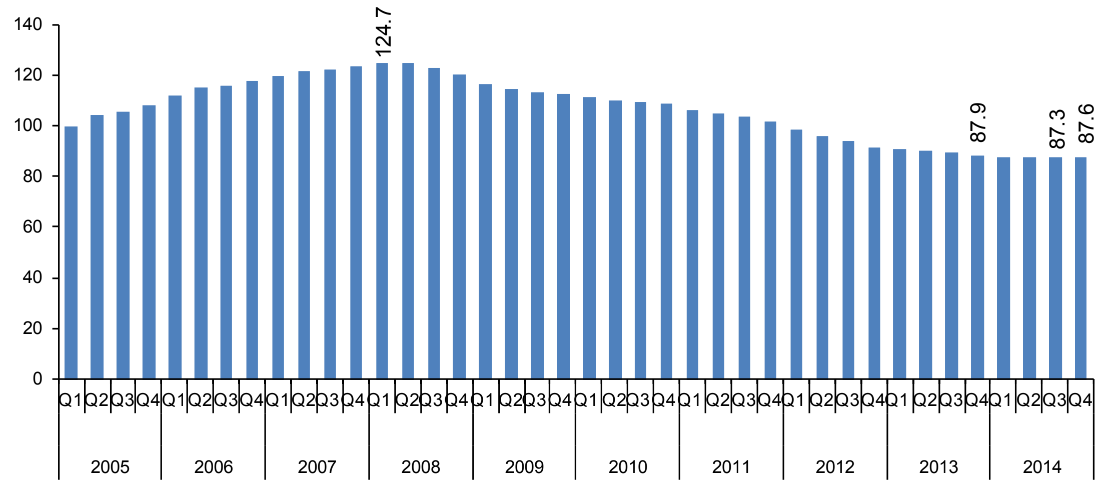
	2008	2009	2010	2011	2012	2013	2014
Euro Area	-1.1	-1.1	1.1	-0.2	-2.1	-1.8	0.5
European Union	-2.5	-1.8	1.1	-0.7	-1.4	-0.4	2.3
Belgium	3.3	-0.9	4.6	3.5	1.1	1.1	-0.8
Bulgaria	11.7	-25.7	-5.0	-5.8	-1.3	-1.2	1.8
Czech Republic	--	-6.7	-0.1	-0.9	-0.7	0.2	2.9
Denmark	-11.0	-4.8	2.5	-5.6	1.3	3.6	3.3
Germany	0.3	2.9	-0.5	4.2	5.0	1.5	--
Estonia	-19.6	-33.6	12.9	11.8	5.8	15.6	13.2
Ireland	-12.4	-18.6	-10.5	-16.7	-4.5	6.4	15.0
Greece	7.4	-0.9	-3.6	--	--	--	--
Spain	**-5.2**	**-4.4**	**-1.4**	**-12.7**	**-12.8**	**-6.3**	**0.3**
France	-3.4	-3.3	7.0	3.7	-2.0	-1.6	-1.2
Croatia	1.9	-4.3	-8.9	-1.6	-4.4	-14.4	2.6
Italy	--	--	--	0.3	-5.2	-5.3	-3.8
Cyprus	-0.9	-6.2	-5.1	-8.3	6.4	-8.5	-1.7
Latvia	-17.8	-29.3	-2.4	3.6	7.4	8.2	11.7
Lithuania	-2.5	-31.1	1.4	5.6	-1.2	3.0	10.1
Luxembourg	2.3	-0.4	5.4	5.4	3.8	4.2	4.9
Hungary	-1.7	-7.9	-0.5	-2.9	-5.2	-0.6	3.8
Malta	9.3	-7.7	-0.5	1.5	6.1	-2.5	3.9
Netherlands	-0.6	-4.8	-0.9	-3.4	-7.0	-4.4	1.2
Austria	--	--	--	6.4	6.5	3.3	0.7
Poland	--	--	--	--	--	--	--
Portugal	--	2.3	-0.9	-7.5	-4.0	0.6	4.9
Romania	--	--	-13.4	-17.1	-1.3	0.2	-2.3
Slovenia	-0.2	-8.1	-0.2	1.4	-8.8	-4.4	-5.4
Slovakia	1.0	-11.2	-1.8	-2.3	-2.9	2.2	1.2
Finland	-3.2	7.7	4.4	1.9	3.1	0.5	-0.3
Sweden	-3.8	11.4	6.1	-1.3	3.8	7.0	10.3
United Kingdom	-8.7	0.3	3.9	-0.5	2.3	5.4	11.7
Iceland	-1.9	-8.5	-1.5	7.2	4.7	7.8	7.6
Norway	-6.9	11.6	6.6	8.0	7.4	0.5	3.4

Source: Eurostat.

Exhibit 1

House price index in Spain (2005-2014)

(2005=100)



Source: Spain's Ministry of Public Development and own elaboration.

If the inflection point is confirmed, it has taken six years for the market to adjust in Spain. Similarly, the information recently released by the INE suggests that house prices have risen 1.8% in 2014.

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Is the market really recovering?

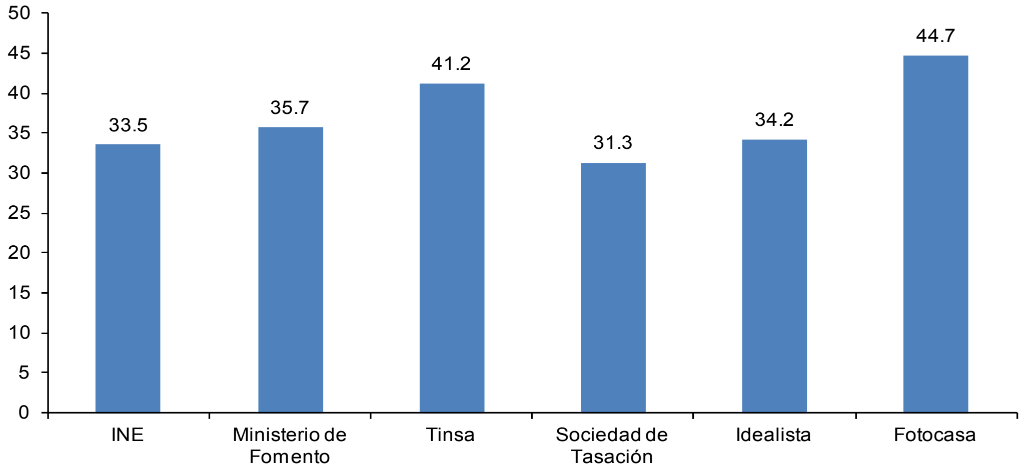
The latest figures from different public and private sources suggest that the adjustment in house prices was completed by the end of 2014. At least where average prices are concerned. However, there are significant divergences in the estimation of the fall peak-to-trough. Exhibit 2 shows the accumulated decrease in prices. The official figures (Ministry of Public Works/Ministerio de Fomento, and INE) suggest the peak was reached by 2008Q1 and those of private sources may slightly vary but are overall comparable. The total fall ranges from the 44.7% estimated by Fotocasa to the 31.3% by Sociedad de Tasación.

No matter the source, the figures are in line with the expectation of a 35%-40% adjustment needed to start the recovery in the real estate market. In this vein, the *Global Housing and Mortgage Outlook – 2015* published by Fitch Ratings on January 14th, 2015, states, "economic growth, low interest rates, and improved affordability are among the supporting factors for mortgage and housing markets in some Eurozone peripheral markets. In Spain, for example, we expect house prices to stabilize this year after nearly seven years of declines that have seen nominal prices fall 40%. We expect housing NPLs in both Spain and Portugal to stabilize in 2015 and fall next year."

Economic recovery appears to be a stabilizing factor, although the rating agency also suggest there are some threats to the completion of the adjustment in the housing market, such as

Exhibit 2

Peak-to-trough fall in house prices

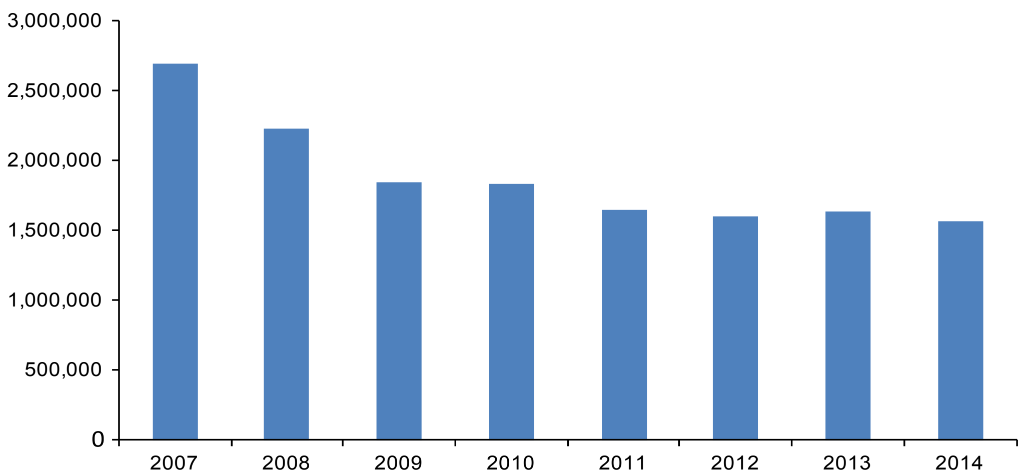


Sources: Computed from INE, Ministerio de Fomento, Tinsa, Sociedad de Tasación, Idealista and Fotocasa data.

the possible underperformance of mortgages. Specifically, Fitch suggests that "a persistently weak labor market and return to recession could see Italian arrears rise modestly this year and house prices continue to fall. Long-term joblessness presents a risk to recovering mortgage performance in Spain and Portugal. A new risk to Eurozone mortgage markets is the possibility of persisting deflation. Spain and the Netherlands are the most exposed markets due to high household debt in the former and the number of interest only mortgages in the latter."

Exhibit 3

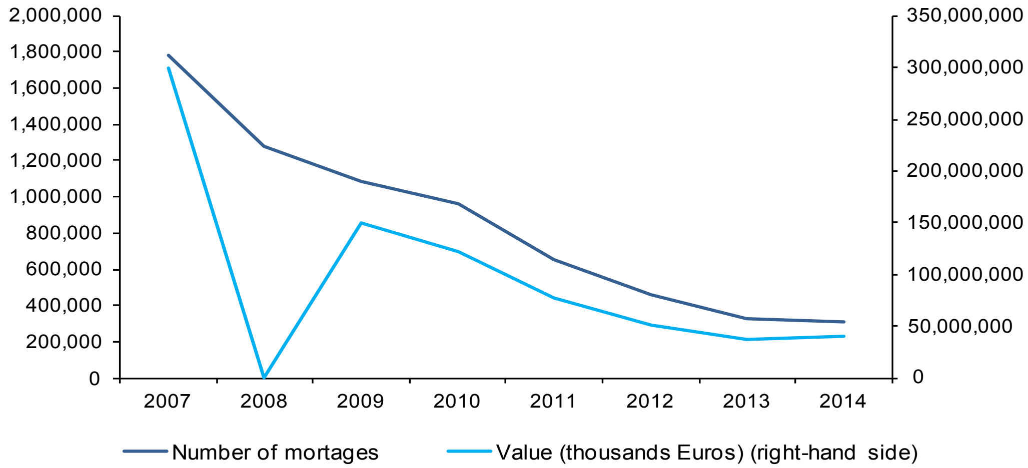
Transfers of property rights



Source: Spain's Statistical Office (INE) and own elaboration.

Exhibit 4

Mortgages constituted: Amount and value



Source: Spain's Statistical Office (INE) and own elaboration.

If one looks at the transactions in the real estate market, as well as at mortgage funding, the recovery seems to be confirmed, but is incipient and weak. In particular, the provisional INE figures suggest the transfers of property rights (as a proxy of real estate transactions) increased from 1,602,633 in 2012 to 1,636,496 in 2013, but fell to 1,561,287 in 2014 (Exhibit 3). This does not necessarily mean demand fell in 2014 as the increase in 2013 may have been driven by the end of a more favorable tax treatment on house purchase transactions.

Actually, according to the latest monthly data published by INE, the number of property transfers registered in January 2015 was 140,904 properties. This is 2% less than in January 2014. However, if we focus on dwellings, the registered transfers increased by 9.6% in the same period.

As for mortgages, the total number of mortgages fell from 326,978 in 2013 to 314,018 in 2014. However, the total amount loaned increased from 37.4 billion euros to 41.2 billion euros in the same period. Consequently, the average mortgage amount has increased from 114,637 euros in 2013 to 131,127 euros in 2014.

Taking the most recent monthly data, the total number of mortgages constituted on dwellings recorded in the land registries was 15,962 in December 2014, 28.9% more than in December 2013.

Unequal stabilization

Even if an overall stabilization of the real estate market seems to be in place, there are significant differences across markets.

Free-market house prices actually showed their first quarterly increase in 2014Q4 (0.5%), according to the Public Development Ministry. The average price of a free-market house in the 2014Q4 was 1,463.10 euros a square meter. However, the General Price Index revealed some differences across regions. Prices increased in seven Spanish

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regions in 2014, including Cantabria (+3.6%), the Balearic Islands (+2.3%), the Canary Islands (+0.5%), Valencia (+0.5%), Madrid (+0.4%) and Andalusia (+0.1%). However, they fell in Asturias (-5.2%), Castile-Leon (-3.6%) and Castile-La Mancha (-3.2%).

Prices across provinces vary significantly ranging from 774.1 euros a square meter in Ciudad Real to 2,701.7 euros in Gipuzkoa by the end of 2014.

The adjustment is also unequal in terms of the effort necessary to acquire a house, measured by the number of wages required to pay the full price. Using average salary information from INE and the price of free housing provided by the Ministry of Public Development, the average number of salaries to acquire a house of 90 square meters was 6.1 in Spain in 2014, but ranges regionally from 4.1 in Castile-La Mancha to 8.8 in the Balearic Islands.

It is also important to note that, despite the economic recovery, the level of unemployment is still very high and it is having a persistent impact on foreclosures. The INE figures as of 2014Q4 (Table 2) reveal some interesting facts. Although the registration of certifications of foreclosures in the land registries was 30,677 in 2014Q4, this represents a 4.4% decrease in the annual rate, meaning that the reduction in foreclosures is still too nascent to be confirmed.

Table 2
Foreclosures in Spain
(2014Q4)

	Foreclosures in 2014Q4	Quarterly change %	Annual change %
Total properties	30,677	32.0	-4.4
Urban properties	29,354	32.6	-4.0
Urban properties -dwellings	18,211	32.5	-1.0
Solar	1,285	24.4	-36.9
Other	9,858	33.9	-2.7
Rustic properties	1,323	19.7	-12.8

Source: Spain's Statistical Office (INE) and own elaboration.

Interestingly, 61.6% of the certifications of foreclosures in 2014Q4 corresponded to mortgages set up between 2005 and 2008, suggesting that the years prior to the peak involved particularly high risk in house purchase transactions.

Recent regulatory measures affecting the housing sector

The impact of foreclosures and mortgage payments on a significant number of households is still noteworthy. Some measures recently approved by the government on the Council of Ministers held on February 27th are oriented to some extent to alleviate these problems. The Royal Decree Law on second chance mechanisms and the reduction in the financial burden, and other measures of a social nature was approved. A specific system is established to resolve the insolvency of individuals. Out-of-court payment agreements are extended and made more flexible, as is the possibility of making arrangements with creditors so that it becomes faster and simpler to restructure debts.

A judicial restructuring mechanism is also established that will allow individuals to be released from outstanding debts by employing assets they own at the time an agreement is reached, with the intervention of a judge. Additionally, prescription periods for personal debts are reduced from 15 to 5 years.

Another measure under this new legislation is related to the Code of Best Practices for mortgage debtors. The new criteria will now be made more flexible for accessing these properties and cases of particular vulnerability will be extended to include those over the age of 60. The new legislation also removes 'floor clauses' on mortgages for debtors below the new threshold established in the Code and extends the moratorium on evictions from primary residences of the most vulnerable groups until 2017.

Conclusions

Several indicators towards the end of 2014 and the beginning of 2015 suggest that the real estate market is completing its adjustment. However, some risk remains given the high level of unemployment and the overall downside risks that affect European economies.

The recovery has been unequal and, to some extent, a number of transactions still suggest that there are price adjustment in some territories, while increases in others.

It is plausible to expect that house prices will increase during 2015 and in subsequent years, but the growth will be moderate for various reasons. The most obvious one is that the level of unemployment prevents many Spaniards from access to housing. Even if foreigners represent around 13% of sales, most of the market depends on domestic conditions. Additionally, Spanish households still face a substantial deleveraging effort ahead and this imposes a limit on the new debt they can assume. It is also important to have in mind that the stock of empty houses is around 1 million –1.4 million, depending on different estimations, with new, unsold houses being more than 0.5 million.

In any event, even if the real estate and construction markets are still important for Spanish economic growth, a sustainable evolution should be achieved in order to avoid the recurrence of problems suffered during recent years.