RESIDENTIAL SPAIN 2019

Real Estate for a changing world

BNP PARIBAS REAL ESTATE

Real Estate for a changing world
¿CYCLE CHANGE AHEAD?
THE PRESENT AND FUTURE OF THE RESIDENTIAL MARKET IN SPAIN

Price stabilisation underpinned by an increase in supply with demand remaining robust.

LOWER GENERAL GROWTH

Having experienced continuous growth since 2014, the Spanish residential market is entering a maturity phase, with lower price growth and more stable demand.

The entry into law of the new mortgage act, plus political and economic worries, slowed down the market over the summer months before regaining traction in October and November.

The increase in supply, particularly of new-build properties, into a market with stable demand, eased price growth. The pace of development sales is also slower.

The institutionalisation of the sector and the strength of demand for rental property have attracted new investors to the market.

RESIDENTIAL PROPERTY: KEY DATA

MACROECONOMIC INDICATORS

Investment funds and insurance companies are making their first acquisitions of land and property. Demand is showing greater scrutiny on issues such as specifications, design and energy efficiency.

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SUPPLY ANALYSIS

AVAILABLE STOCK

The available stock of unsold new housing in Spain at the end of 2018 stood at 459,876 units, a drop of 3.58% from 2017, continuing a downward trend that has now gone on for 9 years. Availability represents 1.79% of the total housing stock, compared to 1.86% in 2017. Madrid, Alicante and Barcelona are the three provinces that make up the highest number of properties, with 25.6% of the total between them.

The provinces where the stock decreased most, and with the highest demand, were Guipúzcoa (-43.62%), Málaga (-23.86%), Huelva (-21.23%) and Lugo (-16.28%). The stock in Madrid decreased by -2.67%, whereas in Barcelona it went down by -3.62%.

-3.58%
AVAILABLE STOCK IN 2018

An important indicator of developer activity and for future deliveries are the residential new building permits. Up to November 2019, permits had increased by 5.4% compared to 2018 with 98,194 proposed properties, indicating developer activity remains solid. It is estimated that in 2020 the supply of completed new housing will be in the region of 100,000 properties.

The permits granted in Madrid declined by -4.8% and increased by 0.1% in Barcelona. However, in Valencia the number of building permits granted increased significantly, going up by 50.3%. Madrid, Barcelona and Valencia made up 35% of the total number of permits granted up to November 2019.
SUPPLY ANALYSIS

ANALYSIS BY PROVINCE

The criteria used to identify the most dynamic areas in the residential market and potential areas for the development of new projects, include the following:

- Increase of population
- Increase of housing transactions
- Available stock reduction

The map below shows the provinces where these three requirements are met, suggesting that they are the most favourable locations to invest.

The available stock of 2014 has been completely absorbed.

The decrease in the available supply in recent years is widespread in most Spanish regions. Coupled with the increase in demand, declining availability is generating price rises.

Less established secondary markets such as Murcia, the Canary Islands and Álava, also performed well. This is especially the case with Navarra, where the available stock of 2014 has been completely absorbed.

Factors such as the scarcity of labour and the increase in construction material prices have affected developer activity over the last few years.

These increases are reflected in construction company fees, which went up by around 9% from 2017 to 2018. This had little effect on the end price of housing, since the main indicator, the HPA (house price appreciation) also increased by around 4-5%. Its growth absorbed the increase in general construction costs, which represent around 50% of the end price of housing.

Construction costs eased over 2019, growing by around 3%, which is in line with HPA increases, thus normalising the situation. No price gap with construction is expected for 2020, with the HPA estimated at about 3-4% according to leading Spanish developers.

As shown in the table below, the future supply of new housing is promising, although it will slow price rises if it materialises.

The deliveries forecast for the next few years exceed those of the recent past, particularly in 2021, the year in which the most important developers will bring the largest number of properties to market.

DEVELOPER ACTIVITY - CONSTRUCTION COSTS

DEVELOPER ACTIVITY - INDUSTRIALISATION

Industrialised construction is gaining traction in the residential market through the launch of new developments, emerging as an alternative to traditional construction.

By carrying out a majority of the processes in the factory, and choosing simultaneous construction over sequential construction, execution times are cut by 30% from 18-20 months to 13-14 months, although at their optimum can reduce by half to 9 months. Despite having a slightly higher construction cost (4-5% more) according to the area in question, the time saved more than makes up for this, without any effect on the quality of the end product.

The potential customers for this type of housing are trading up from their old property to a new one and need to have higher purchasing power. As the delivery times are reduced, the buyers have to pay 20% - 30% of the total property price over a shorter period of time.

Aedas Homes is one of the leading developers committed to industrialised construction, and has several projects of this type. Other developers such as Via Célebre and Metrovacesa are also starting to implement this model.
DEMAND BEHAVIOUR

The number of transactions carried out in Spain over 2019 reached 501,085 according to the National Statistics Institute (INE). This represents a minimal decrease of 3.3% compared to 2018. New-build property transactions grew by 1.2%, whereas the second-hand market saw an annual fall of 4.2%.

At provincial level, Madrid (-7.5%), Barcelona (-3.4%), Valencia (-3.9%), Alicante (-6.5%), Málaga (7.8%) and Vizcaya (-7.7%) saw a reduction in the number of property sale transactions.

At municipal level, Madrid and Barcelona continue to be the most important areas, although their transactions went down by -10.7% and –1.1%, respectively, compared to September 2018. Alicante (-12.8%), Valencia (-13.9%) and Málaga (-17.1%), were next by the number of transactions seeing reductions due to the lower level of activity in the second-hand market.

The sale of second-hand properties continues to dominate the market, making up more than three quarters of the transactions carried out in all the autonomous regions. In the city of Madrid they increased by 5.9% through to Q3 2019, whereas in Barcelona they decreased by 10.3%. The demand for new-build in the city of Valencia was very high, with sales increasing by 190% through to September.
PRICE PERFORMANCE

Analysis of prices shown in chart, show growth rates are unchanged, although development activity is likely to slow this down in the future. It is unlikely that the situation of oversupply seen in the past will recur due to the stability of demand.

The average price per square metre of private housing stood at 1,638.30 euros in the third quarter of 2019, representing an increase of 3.07% compared to the same quarter in 2018.

There is still room for a rise in prices, as the historic high (€2,101/sqm) achieved in the first quarter of 2008, has yet to be regained.

For municipalities with more than 50,000 inhabitants, the highest private housing prices were found in San Sebastián (€3,887.80/sqm), Ibiza (€3,505.90/sqm), Barcelona (€3,412.20/sqm), Sant Cugat del Vallés (€3,403.10/sqm), Madrid (€3,227.40/sqm) and Pozuelo de Alarcón (€3,186.80/sqm).

Provinces with prices over €2,000/sqm were Madrid, Barcelona, Guipúzcoa, Vizcaya and the Balearic Islands. The provinces with the cheapest €/sqm price were Ciudad Real, Teruel and Cuenca. Annual growth in prices was strongest in Zaragoza (5.6%), Málaga (5.3%), Valencia (5.3%), the Balearic Islands (4.8%), Madrid (4.6%) and Navarra (4.6%).
The number of mortgages granted in the eleven months of 2019 was 327,435, an increase of 0.1% over the same period in 2018.

The new mortgage law that requires a longer process to register temporarily reduced the number granted when it came into force in June. Great impact occurred in August (20,385), a figure that improved by 45.7% in November with 29,691 mortgages, back to normal. The average mortgage granted in November was €125,763, 1.2% more than the average in 2018.

According to the Registrars Association, 42.76% of all of the mortgages in Q3 were at a fixed interest rate, representing an increase of 0.6% compared to the second quarter.

The number of mortgages taken out at a variable rate continued to go down, although they still made up 57.24% of the total.

The autonomous regions with the highest average mortgages in Q3 were Madrid (€202,426), the Balearic Islands (€180,503), Catalonia (€149,185) and the Basque Country (€143,246). The finance charge for mortgages is highest in Catalonia (2.66%), the Canary Islands (2.64%) and Galicia (2.54%), followed by Madrid (2.31%) and Navarra (2.26%). The lowest rate was in the Basque Country (1.85%).

Two indicators measure the affordability of a property purchase by families.

The first is the percentage of disposable income taken up by the mortgage repayment. According to Bank of Spain figures, this was 31.6% in Q3, down from the second quarter. Despite the percentage having gone up in recent years, it is still below the recommended limit of 33%.

The other indicator is the ratio of entire annual gross disposable income required to buy the property as measured in years. According to Bank of Spain figures for the third quarter, it would take 7.3 years to cover the full amount. This figure is above the recommended 5-6 years, which is the European average.

Whilst affordability is not an immediate issue, price rises are making property increasing expensive for families as costs eat into household income.
RENTAL MARKET

Although less established compared to markets in other countries, the Spanish rental market is on an upward trend and is gaining share nationally.

RENTED HOMES (%) - 2018

The percentage of rented homes in Spain in 2018 was 23.7% according to Eurostat figures, 3.5% more than in 2017 and up 11.8% since 2014, reaching a historic high.

FACTORS BEHIND THE RENTAL BOOM

- Professionalization of the sector with the entry of major corporations and funds that have increased their investments and are raising their profile. The sector was previously the domain of private investors.
- Geographical mobility, so commonplace in today’s society, means that it is not cost-effective for many people to buy a property.
- In the case of the groups with the lowest incomes, primarily young people, high property purchase prices mean that they are forced to turn to the rental market.

PRICE AND YIELD

Strong demand led to a year-on-year increase of 4.8% in 2019 with the average national rent standing at €10.90/sqm a month. Prices rose in the two biggest Spanish cities: Madrid (€16.10/sqm) and Barcelona (€16.50/sqm) recorded a year-on-year increase of 3.9% and 1.9%, respectively. The city of Pamplona was particularly notable for its year-on-year growth of 10.4%.

The rental yield remained stable in 2019, standing at 7.4% according to the figures published by the Idealista real estate website. The yield in Madrid was 5.2%, compared to 4.8% in Barcelona. Murcia and Lérida (7.5%) had the highest yield, whereas San Sebastian (3.9%) had the lowest.

THE BUILD TO RENT PHENOMENON

In a context of high liquidity in the market and low interest rates, the residential sector has emerged as an attractive alternative market for companies to invest in. This has led major international funds (primarily insurance companies and pension funds) to commit to rental.

There are two methods for financing projects:

- Through forward purchase contracts, developers arrange the finance for construction of the properties, subsequently delivering them to the relevant fund who then market and operate them on completion.
- Forward funding is the preferred approach of investors especially those with “value-add” strategies. Here the fund itself finances construction in return for discounts on the end price.

The major investment organisations have sufficient resources to hold assets over the medium to long term, receiving regular income whilst waiting for the right time to sell and maximise their profit.

Investment focuses on growth markets, where the yields are in the region of 3.5%-4.0%, although sometimes locations with yields of 5.0% are considered. This means transactions tend to look at Madrid and its metropolitan area. However, projects also go forward in Barcelona, Valencia, Seville, Malaga and Palma de Mallorca.

The following table shows the main build to rent transactions recorded in 2019 and to date in 2020:

<table>
<thead>
<tr>
<th>DATE</th>
<th>SELLER / DEVELOPER</th>
<th>BUYER</th>
<th>LOCATION</th>
<th>N°HOUSING UNITS</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>AMENABAR</td>
<td>ARES</td>
<td>MADRID (VALDEBEBAS)</td>
<td>400</td>
</tr>
<tr>
<td>2020</td>
<td>ACCIONA</td>
<td>HINES</td>
<td>MADRID (VALDEBEBAS)</td>
<td>400</td>
</tr>
<tr>
<td>2019</td>
<td>STONEWEYG</td>
<td>M&amp;G</td>
<td>MADRID (SKYLINE)</td>
<td>300</td>
</tr>
<tr>
<td>2019</td>
<td>ACCIONA</td>
<td>AXA</td>
<td>MADRID (MENDEJ AUJARO)</td>
<td>135</td>
</tr>
<tr>
<td>2019</td>
<td>STONEWEYG</td>
<td>AXA</td>
<td>LA MARINA BADALONA</td>
<td>216</td>
</tr>
<tr>
<td>2019</td>
<td>METROVACESA</td>
<td>ARES</td>
<td>ARANDA DEL REY Y MADRID CAPITAL</td>
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</tr>
<tr>
<td>2019</td>
<td>AEDAS</td>
<td>ARES</td>
<td>TORREJÓN DE ARDOZ,ナルCA y CAÑAVERAL</td>
<td>500</td>
</tr>
<tr>
<td>2019</td>
<td>-</td>
<td>ASG</td>
<td>SAN SEBASTÍAN DE LOS REYES</td>
<td>300</td>
</tr>
</tbody>
</table>

“Build to rent developments offers attractive yields to investors in a market with a positive growth trend”
INVESTMENT MARKET

INCREASED ACTIVITY

Investment in rental property portfolios and build to rent developments stood at approximately 2 billion euros in 2019. Investment in the residential market is increasing with the entry of investors that specialise in this sector and in Spain. However, most transactions are still carried out between private buyers.

Players with active residential development strategies include Grupo Lar, which has a pipeline of 5,000 rental properties on a time horizon through to the end of 2025 and is a clear example of the commitment made to the rental market. The Spanish/Swiss fund Stoneweg recently sold the residential project it was running in Badalona to AXA and sold the “Skyline” project in Madrid to the M&G fund. AXA has been one of the most active companies in residential investment over recent months, having formed an agreement with Acciona to develop 135 properties in Mendez Álvaro.

Aedas Homes, through the Ares Management fund, will build 500 properties in Torrejón de Ardoz, Alcalá de Henares and El Cañaveral. This same fund has entered into an agreement with Metrovacesa for the construction of 120 properties in Madrid and Arganda del Rey. One of the latest BTR transactions carried out this year is the purchase by Ares of a proposed residential complex in Valdebebas with more than 400 properties for €110 million that Amenabar will develop. Hines also recently purchased a development with nearly 400 properties from Acciona.

Other notable investment transactions in residential property include the purchase by Azora of more than 500 properties from Sabadell for a total of €150 million, and the acquisition of properties in Madrid by Greystar, a leading US company in the student residence business in Spain, from the Carlyle Group.

Purchase of property portfolios

Portfolio disposals, mainly by banks, are also a market feature. Divestment of real estate portfolios is part of a strategy to reduce exposure to real estate and improve capital ratios as required by regulators.

Banco Sabadell, one of the most active companies in the sale of real estate portfolios, completed the sale of its property-marketing platform, Solvia Servicios Inmobiliarios, to the Stockholm-based company, Intrum, for 241.4 million euros. The US fund Oaktree Capital Management took over the developer Solvia Desarrollos Inmobiliarios for approximately 882 million euros in the summer.

In October 2018, BBVA completed the sale of its real estate business Anida to the Cerberus fund. Banco Santander sold its residential property portfolio to the same fund for 1.54 billion, as did Banco Sabadell, who sold two portfolios to Cerberus with a gross book value of 9.1 billion euros.
LAND MARKET

Around 13,290 land sale transactions took place in Spain through to September 2019, 17% less than the same period in the previous year. The supply of land has shrunk since the pre-crisis years, as there has been no expansion in land with planning permission to add to the supply. In addition, a large part of the available land that does have planning permission is already absorbed. Faced with limited choice, especially in major capitals such as Madrid and Barcelona, investors have consequently turned attention to alternative markets such as Palma de Mallorca, Málaga, Seville and Valencia.

The scarcity of land has pushed up prices, particularly in the growth markets. Developers have seen their margins squeezed to levels of 8-10% in some cases, mainly due to the high construction and land costs. Coupled with delays in the granting of permits (up to 18-20 months in Madrid), developers are adopting less conventional strategies to guarantee project feasibility, such as acquiring land parcels with outstanding planning permission.

WHERE ARE THE TRANSACTIONS CONCENTRATED?

Developers are setting their sights on the metropolitan areas of cities where there is still an available stock of land. In Madrid, land transactions occur outside the M30 ring road, in neighbourhoods such as Cañaveral and Valdebebas. In the city of Barcelona, apart from the occasional transaction carried out in districts such as Sagrera, Gracia or the area around Meridiana, a majority of the transactions are concentrated in the Zona Franca and L’Hospitalet de Llobregat.

Nevertheless, there is an increasingly scarce supply of land with planning permission, which led to its price increasing by 10.1% over the last year in municipalities with more than 50,000 inhabitants. The outcome is the buying of more and more cheap land with outstanding planning permission elsewhere.

Land with the option to re-parcel is in demand from the most important developers. They prefer the attractive price of these land parcels as they give the option of capital gains from resale without needing to build. A profit is realised instead of waiting for final approval for permits, demarcation of plots by the Compensation Board, or other administrative procedures which may take as long as two or three years.

Chart “price performance of urban land with outstanding planning permission” shows the appreciation of managed land in two of the main areas of metropolitan Madrid where the transactions are concentrated. It enabled owners to obtain capital gains of over 100% in three years in the case of El Cañaveral, compared to approximately 67% in Valdebebas.
2020 OUTLOOK

• The residential market continues to display the strength seen in recent years, although it appears to be entering a maturity phase. Forecast price growth for 2020 stands at approximately 3% for the whole market. There is an excess of demand for new-build property which exceeds the current supply provided by developers and must be met. The increase in the price of new-build properties could therefore be more than 3%.

• In secondary areas and on the coast, prices will tend more towards stabilisation, and in areas where the absorption of housing is slowing down, there could even be small price decreases. The most popular markets, where we forecast bigger increases, remain Madrid and Barcelona, though cities such as Málaga, Valencia and Palma de Mallorca will join them.

• Balanced demand in the sector is a big factor behind price stabilisation. It will remain robust but less speculative demand. 2019 is likely to close with property sales of over 510,000 when final data is assembled. Taking into account the lower economic growth expected over the upcoming year with global and domestic uncertainty, the volume of sales in 2020 will be approximately 500,000 units.

• The rental market will continue on its upward trend in 2020, particularly in large cities and towns where there is a high concentration of economic activity and labour. It will play a leading role in the market, with a rising supply that will ease rents. The entry of important international players making considerable investments through build to rent projects has restructured the rental market, which is being “professionalised”. As has been seen in recent years, the percentage of properties for rent in Spain will increasingly match levels recorded in neighbouring countries.

• In the land market, the shortage of land with planning permission has placed a great deal of pressure on prices over the last year. We believe that rises in land prices will ease over 2020, as a result of the lower price rise forecast for finished product. There are markets where demand is more active: Madrid, Barcelona, Málaga, Valencia and the Balearic Islands; and others where the recovery is slower: Castilla La Mancha, Extremadura and Castilla León.

• The scarcity of land with planning permission has resulted in demand directed towards land under development where construction stalled. We will therefore see investors and developers taking positions in the largest land developments to minimise the risks involved. It is also a way of stimulating land development, thus helping to complete the production process that was at a standstill from 2008 to 2014.
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