



Colliers

2021

The residential sector in Spain

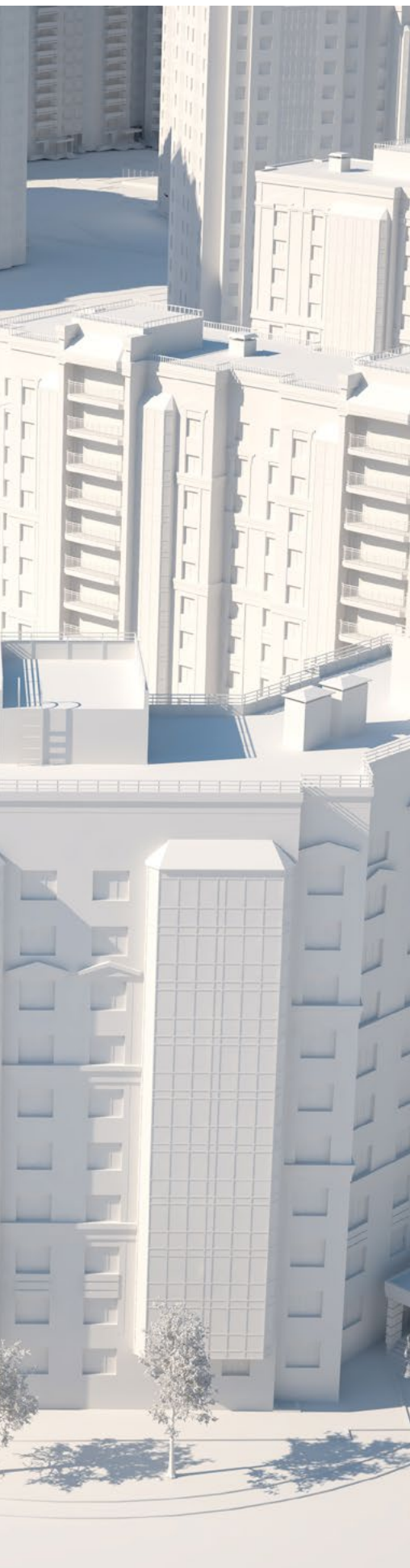
November



Copyright © 2021 Colliers International Spain. All rights reserved.

This document has been prepared by Colliers for general information only. The information in this document comes from reputable public real estate sources and portals. That information has not been verified. Colliers makes no warranty of any kind, express or implied, with respect to the information in this document, including, without limitation, any warranty as to content, accuracy or reliability. Interested parties must make their own inquiries as to the accuracy of the information. Colliers accepts no responsibility for any inferred or implied terms, conditions or warranties arising hereunder and disclaims all responsibility for any loss or damage arising therefrom. This document is copyrighted by Colliers.





The residential sector in Spain

Expert insight from the Colliers team



Mikel Echavarren

CEO

mikel.echavarren@colliers.com



Jorge Laguna

Business Intelligence Director

jorge.laguna@colliers.com



Antonio de la Fuente

*Managing Director | Corporate Finance
Residential - M&A*

antonio.delafuente@colliers.com



Luis Valdés

*Managing Director
Residential Sales Advisory*

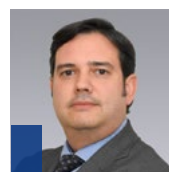
luis.valdes@colliers.com



Germán Fernández

Managing Director | Barcelona

german.fernandez@colliers.com



Rafael Paz

Director | Valencia

rafael.paz@colliers.com



Íñigo Molina

Director | Málaga

inigo.molina@colliers.com



After almost two years of pandemic, the residential sector has weathered what in mid-2020 seemed a complicated situation better than might have been expected.

Despite all the difficulties, the sector has shown itself to be resilient and capable of adapting to complex circumstances, working within the existing constraints to solve complicated problems. We see this response as evidence of the sector's maturity and the professionalism of the companies that have risen to the challenges they have encountered – in design, marketing, administrative management, financing, construction work, demand management, visits, contracts, works completion, deliveries and after-sales.

The overall market situation is good, although we must not overlook the challenges the sector will have to face in the short term, including the rise in construction costs, the lack

of fully developed land in some locations, the decarbonisation of buildings, the shortage of skilled labour and the new Housing Bill, which is expected to be passed next year.

Generally speaking, the existing demand from private individuals is solvent and has been affected very little, if at all (except in certain locations), by the pandemic. The price trend is positive, especially in the areas with more vigorous growth and a smaller supply of available land.

Right now, the residential sector is in a good place, as are the other real estate sectors. In the absence of investment alternatives and the presence of surplus liquidity, many institutional investors have chosen to double down on their real estate bets. The residential sector has also been targeted by Build-to-Rent investors, providing an added incentive and driver for investment in some areas and locations.

DEMAND

As it turned out, 2020 ended better than expected, with a decline of only 14.5% in the number of housing transactions compared to the previous year. The new build market performed very well compared to the second-hand market. While sales of existing homes fell by 16.9%, sales of new build property performed excellently, especially in the second half, ending the year with 7.2% growth, improving even on the figures for 2019.

It is worth noting that the strength of the demand for new housing was attributable largely to the sector's own inertia, as a substantial proportion of the transactions recorded in 2020 were arranged one or two years earlier, during the planning or construction phase, and have only now become effective, once the work was completed. Performance in the first half of 2020 was frankly poor, especially in the second quarter, which was severely affected by the strict lockdown, resulting in sharp contractions in both existing (-34.2%) and new housing (-14%). But this was followed by a very good second half, which saw a release of pent-up demand, improving even on the 2019 figures: new housing transactions grew 26.9% and second-hand housing, 1.0%.

In 2021, housing demand began very strongly. The first half was the best in the entire historical series since 2008.

The number of transactions was up 63.7% compared to 2020, or up 10.67% compared to the first half of 2019.

The performance in terms of number of transactions was very good, both in new housing (+44.9% vs 2020 and +23.9% vs 2019) and in existing stock (+66.2% vs 2020 and +9.3% vs 2019). The current level of demand is expected to continue in the second half, with a projected 640,000 housing transactions by the end of 2021, of which 75,000 units in the new build market and 565,000 units in the second-hand market.

Madrid continues to lead the demand in the new build market, with a 21% share, followed in second place by Malaga (8.9%), which in 2021 has overtaken Barcelona (8.3%), now lying in third place. In fourth and fifth position are Alicante (7.2%) and Valencia (6.1%). In the second-hand residential market, Madrid province also leads in number of transactions (12.9%), followed by Barcelona (10.7%), Alicante (6.4%), Valencia (6.3%) and Malaga (4.8%).

As regards foreign demand, the first half of 2021 brought a marked revival, with the number of homes purchased by foreigners almost reaching pre-Covid levels. Alicante remains the most popular province among foreign buyers, accounting for 17.6% of house purchases in this category. In second place was Malaga, with a 11.4% share, followed by Barcelona (8.7%), Madrid (7.7%), the two Canary Islands provinces (7.6%), Valencia (6.3%) and the Balearic Islands (6.2%).

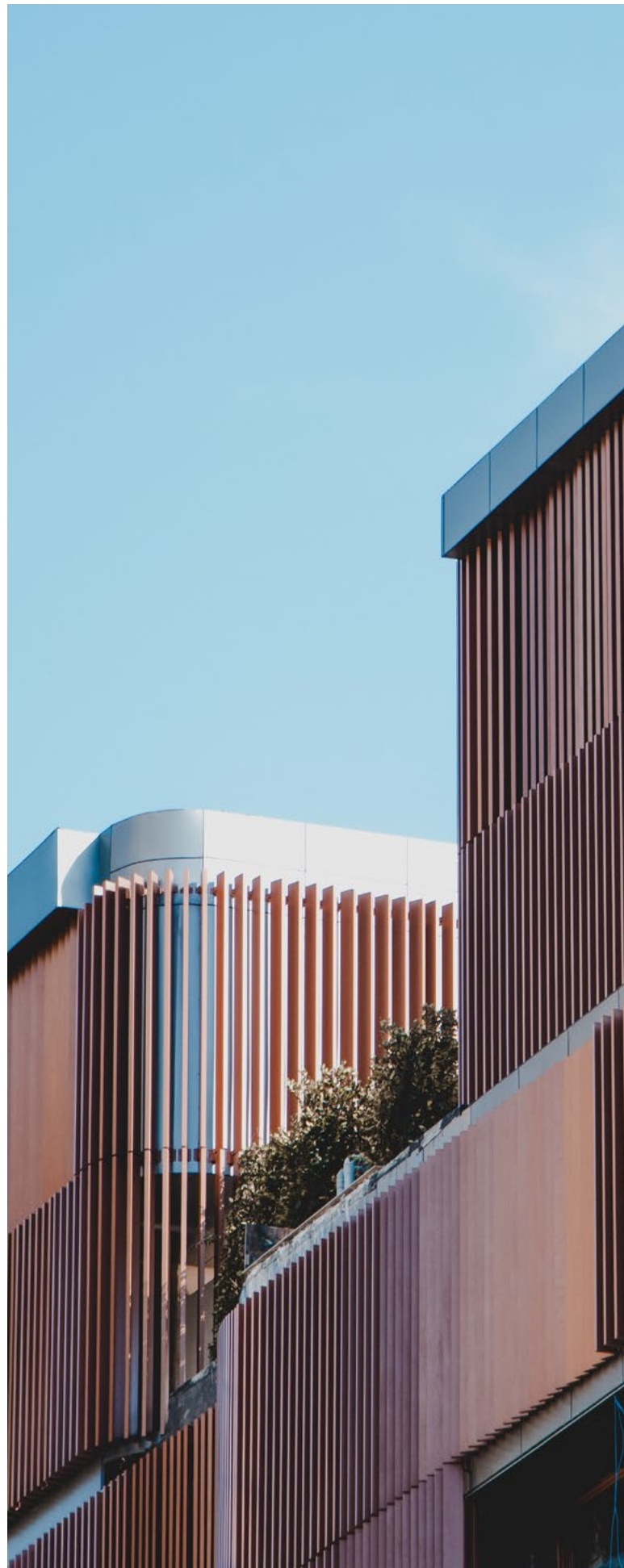


HOUSING PRODUCTION

In 2020, production contracted significantly as a result of the mobility restrictions and economic uncertainty that came with the pandemic. The contraction took the form of a decrease in the number of planning approvals (-19.6%) and new housing starts (-21.1%), although developments in progress were not halted and the pace of housing delivery continued in line with the previous year (-6.7%). Developers have shown great caution and professionalism throughout the pandemic; faced with the new situation, they decided to postpone some of their projects and delay the start of any building work that involved major commercial risk.

In the first half of 2021, however, coinciding with the economic upturn, developer activity took off strongly, as projects put on hold the previous year were resumed and new projects were started. The number of housing approvals has increased by 18.9% compared to the prior year average and is expected to reach 101,000 by the end of the year, a figure not too different from that recorded in 2019. Meanwhile, housing starts have grown 25.8% and are likewise expected, by the end of the year, to reach levels similar to those achieved in 2019. This gives us an idea of how strong the recovery has been and the level of caution and professionalism with which the players currently operating in this sector have acted. It should be pointed out that the projected number of housing approvals for 2021 (101,000) is not high, given that it is only 12% of the number recorded in 2006, at the height of the property bubble, when a total of 865,000 homes were approved.

After a 2020 full of uncertainty, developer activity this year has returned to the levels of 2019 (pre-pandemic). With growing demand the absorption rate is set to improve.





ABSORPTION

During 2017 and 2018, the new build market presented excellent absorption rates of 103% and 96%, respectively. Everything that was built was quickly absorbed by the demand. In 2019, however, the absorption rate fell to 79% because, although demand was similar to the previous year, housing production increased considerably. The situation worsened during the first half of 2020: while houses were still being delivered at the expected rate, demand fell dramatically because of the pandemic, so that the absorption rate dropped to 67%. Subsequent strong growth in demand during the second half of 2020, with an absorption rate of more than 86%, redressed the situation, so that the year ended with absorption of 78%.

In the first half of 2021, the absorption rate has been 80%, slightly above the levels reached in the previous two years. Demand has increased by 10% during this half-year, with a total of 33,167 new housing transactions; but so has the number of homes delivered (41,360 units), stalling any further improvement in the absorption rate.

Among the larger markets, the provinces of Madrid (90%), Valencia (105%) and Malaga (88.5%) had very good absorption rates. Absorption was lower in the new build markets in Barcelona (69%) and Seville (73%), but this was due more to excess production than to lack of demand: in both these cities the demand increased, but not enough to absorb all the homes delivered.

Over these last two and a half years, a theoretical difference of 40,000 units has arisen between the number of homes delivered and the number sold. This is a high figure, but the real number is lower, due to the lag between the delivery date and the date a sale is registered and reported to the Ministry of Public Works, so part of these homes will be registered as sold and included in the statistics over the next two months. Given the strong growth in demand, this accumulated stock is not a concern, as it is attributable more to the inertia of a sector that has been growing continuously since 2017 than to any lack of demand. We expect this stock to be absorbed without difficulty during 2022 and part of 2023.

PRICE TRENDS

The health crisis naturally affected the upward trend in the price curves in 2020. That year saw a very slight, almost negligible contraction in the prices of new homes, but a somewhat more pronounced decline in the selling prices of existing housing (around -5%). In the rental market, however, prices were much harder hit, showing a clear yield compression trend. We saw significant widespread falls of more than 10% in rental prices, even exceeding 15% and 20% in some areas. This happened mainly in cities with a significant presence of properties used for tourist rental. It is worth highlighting the fact that in some places, such as the Madrid and Barcelona city centres, the rental supply increased by up to 70%.

In 2021 sales prices started to rise again, especially during the second quarter. The strong demand seen in the second half of 2020 continued, though moderating slightly, through the first half of 2021. As a result, the selling prices of new homes increased by an average of around 5% compared to the previous year and are already slightly above pre-Covid levels. Second-hand housing prices increased at similar rates, approaching but still below pre-Covid levels, as the increase was preceded by a sharper contraction.

Based on Colliers' predictive models, we estimate an additional price increase of 1% to 2% by year-end 2021 in

both new and existing housing. For 2022, we anticipate some stability in prices overall, although increases of 5% to 10% are on the cards (more in new build than in existing stock) in some of the areas in which demand has been growing strongly. Specifically, we have identified six markets in which this could occur, first and foremost being Madrid and Barcelona. Madrid province has had a population growth of +1.7%, with more than 116,000 new inhabitants registered in 2020, of which 68,600 in Madrid capital. In Barcelona province, the growth has been 1.4%, with almost 80,000 new inhabitants registered in 2020 (27,420 in the capital). Both Madrid autonomous community and Barcelona province will continue to experience price growth, most markedly in the capitals and metropolitan areas.

Other areas with high demand include the Balearic Islands, which, with a population growth of 1.9% and 23,100 new inhabitants registered in 2020, will continue to see an upward trend in prices. The Balearics are also one of the autonomous communities that suffered most, during the health crisis, from the mobility restrictions and the near closure of the foreign market. So now, with the foreign market reopening and the number of residents increasing, demand growth will put upward pressure on prices.



The picture is similar in the provinces of Valencia (population +1%), with 46,000 new inhabitants; Alicante (+1.1%), with 21,000 new inhabitants; Malaga (+1.5%), with 24,500 new inhabitants; and Murcia (+1.2%), with almost 17,500 new inhabitants. In these four provinces only 15% of the population growth has been in the capital, the bulk of the new inhabitants being concentrated in the main coastal towns, with a strong tourism component.

Over the last four years, the trend in selling prices has been different in Madrid compared to Barcelona. In Madrid, in 2021, prices rose above pre-Covid levels and, except for the slight contraction in 2020, have been on a steady upward trend since 2014, with somewhat steeper rises during 2018 and 2019. In Barcelona capital the trend has been very different. From 2014 to 2017-2018, prices grew markedly faster in Barcelona than in Madrid. After that, the trends diverge: whereas in Madrid prices continued their steady climb, in Barcelona they declined from year to year. As of June 2021, house prices in Barcelona were down 4.2%, whereas in Madrid they had risen. One of the factors driving this decline is the Barcelona City Council's housing regulations. Coupled with the economic uncertainty households are facing because

of the health crisis and the high prices reached in 2018, the regulations have prompted many owners to take their apartment out of the rental market and put it up for sale, sharply increasing the supply of homes for sale in Barcelona. However, given the strong demand for housing in Barcelona capital, this trend is expected to change within the next few months, as prices start to increase faster than they have been.

Turning to the rental market, in 2021 average rents performed worse than house prices and there is evidence of a slight yield compression in the market. Low interest rates, low selling prices and the high savings rates achieved over the past year by households not affected by the health crisis have encouraged home buying more than renting. Although from the second quarter of 2021 rents started to recover some of the ground lost the previous year, they are still almost 10% below pre-Covid levels. Even so, if the housing bill allows, rents are expected to reach pre-Covid levels by the end of 2022, at least in the cities that are currently experiencing strong demand for rental housing, notably Madrid and Barcelona.



The demographic growth seen over the last four years (+900,000 inhabitants) will continue to push up the demand for housing, especially in markets such as Madrid and Barcelona, but also in Malaga, the Balearic Islands, Valencia, Alicante and Murcia, partly driven by foreign demand

IS ANOTHER REAL ESTATE BUBBLE BREWING?

'Bubble' is a very emotive term; it evokes a past event that we all remember vividly. At present, we do not believe anything like that is going to happen in the residential sector in Spain and rule it out completely. Our reasons for taking this position are as follows:

- Current production levels are reasonable. Housing approvals in 2021 are forecast to reach 101,000, which is only 12% of the figure recorded in 2006, at the height of the property bubble, when 865,000 homes were approved.
- Housing demand is increasing strongly. After four years of population loss (from 2012 to 2015) and two years of stagnation (2016 and 2017), the last three years have seen accelerating population growth (+150,000 inhabitants in 2018, + 300,000 in 2019 and +425,000 in 2020), so that the population has increased by almost 900,000 in just three years.
- Absorption rates in the new housing market are above 80% and are expected to improve as demand increases.
- The housing mortgage market has an average LTV ratio of 64.8%. Only 8.8% of mortgages have an LTV above 80%, compared to 17% of mortgages at the height of the 2007 property bubble.
- Average mortgage-to-income ratios are below 35% (except for San Sebastián, with 40%) and prices are reasonably contained.
- No rise in interest rates that might lead to a significant increase in debt service costs is expected in the near term.

All this is reason enough to categorically deny that we are currently facing another real estate bubble like that of 2007.







RESIDENTIAL SECTOR CHALLENGES IN SPAIN FOR 2022

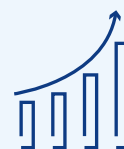
The challenge of increased construction costs

In 2021 the cost of construction materials has rocketed as a result of a sharp rise in electricity, fuel and commodity prices. Commodity prices, which had been stagnant until 2016, rose slightly during 2017, 2018 and 2019, when they stood 7.5% above the level recorded in 2016. During 2020, with the health crisis, prices fell slightly. In June 2021, however, the construction materials cost index was up 10% year-on-year and 17% above the 2016 level. Yet despite the recent hike in the price of construction materials, we remain optimistic and anticipate an easing of prices in the second half of 2022.

Labour costs, meanwhile, have been more stable. During the second quarter of 2020, the labour cost index fell 5.8% as a result of job losses due to the health crisis. Since then, however, it has recovered all the lost ground and by June 2021 was up 1.1% compared to the previous year. The main problem, in our view, is the shortage of skilled labour to meet the ongoing increase in activity and the new requirements for decarbonisation of buildings. The coming months are therefore likely to see increases in labour costs.

Another determining factor for production costs is the cost of the raw material: land. According to data published by the Ministry of Public Works, the average price paid for land fell by a substantial 17% in 2020. Since the second quarter of 2021, however, average prices have recovered rapidly, reaching an average of €162/m² in June 2021. This is very close to pre-Covid levels (164 €/m²). One of the main problems facing developers is the shortage of high quality fully developed land at reasonable prices in certain locations. This shortage is likely to continue to push up the price of land in those locations over the next few months.

The challenge for developers, however, is to deal with rising materials and labour costs, so if there are no increases in the price of the finished product (which presumably will rise at least in line with inflation), they will have to cut their coat according to their cloth and look for lower prices when buying land for new developments.



INCREASE IN COST OF CONSTRUCTION MATERIALS



SHORTAGE OF SKILLED LABOUR



SHORTAGE OF FULLY DEVELOPED LAND

The challenge of financing

As expected, access to credit has deteriorated significantly, despite coordinated efforts by governments and the ECB to provide liquidity to the financial system. Doubts about the Spanish economy and the solvency of some companies, households and key sectors have naturally affected the financing of debt-intensive sectors such as real estate. It is fair to say that, although the flow has not been stopped completely, bank financing generally has been more restricted for all real estate products across the board, and the financing of real estate developments is no exception.

Banks have started to require a higher percentage of pre-sales and have cut the level of financing (including for land) and increased their spreads, in anticipation of a higher risk of subrogation in favour of future customers. The forecast is that the current attitude of caution will not dissipate until the economic recovery materialises. As a result, rather than traditional financing, in 2021 some of the large real estate firms (such as Vía Célere, Neinor Homes, Aedas Homes and Metrovacesa) have opted for new financing formulas, consisting mainly of bond issues, so as to continue to meet their business plans.

The financing of land purchases for residential development has been a proscribed activity for banks since the previous financial crisis.

Nevertheless, where a development was demonstrably viable, both commercially (a specified level of sales) and technically (the necessary building permit), financial institutions were sometimes open to allowing the developer to recover part of the land price via the construction loan.

As a general rule, therefore, before Covid-19 came onto the scene, no financing was available for land purchase, except for one-off projects with a reasonably low LTV carried out by a very select group of financially sound developers whose balance sheet was sufficient to secure the loan regardless of whether the development was a success or not. In response to this situation, since the end of 2017 various alternative financing funds had been trying to bridge the gap between the land purchase and the construction loan from the bank, when part of the amount paid for the land could be recovered.

The new situation post-Covid directly affects the use of such alternative financing, as the means of paying off many of these loans has been withdrawn insofar as banks have tightened the conditions for financing land. Faced with the challenge of obtaining funds when traditional credit is restricted, developers who need such alternative financing will have to be willing to hold the loans throughout much of the life of the development, with all that this entails in terms of use of funds and reduced profitability, given the high cost of this type of loan.







The challenge of new regulations

During 2022, the Spanish government is expected to pass two bills affecting the residential property market: the Architecture and Quality of the Built Environment Act and the Housing Act.

The Housing Act is the one that will have the greatest impact on the ordinary functioning of the residential market. The act is intended to facilitate access to housing by putting a cap on rents in “stressed areas”, so as to ensure affordable prices. It is also intended to promote public housing and improve the housing situation for young people and vulnerable groups.

The bill defines stressed areas as locations where average rents have risen five points above the CPI in the last five years and, at the same time, the average rent plus the cost of utilities exceeds 30% of household disposable income. Once approved, the act gives the central government 18 months to implement a system of benchmarks for setting the rent cap in stressed areas.



Moreover, to lower rents and increase the supply of rental housing, the act provides for tax relief as an incentive for new rental agreements. In general outline, the landlord will be able to deduct 50% of rental revenue from tax, although in stressed areas the deduction could be up to 90% if the landlord chooses to lower the rent by 5% compared to the previous contract, or 70% if the tenant is a young person between the ages of 18 and 35. The Housing Act will also authorise city and town councils to establish a property tax (IBI) surcharge of up to 150% for homes left empty when the owner owns three or more other homes.

The Spanish government's obsession with regulating the rental housing market adds high uncertainty to the investment market. Nevertheless, we do not expect to see any real measures that would damage market expectations in the municipalities and autonomous communities not controlled by the governing coalition or the parties that offer it conditional support. Even so, the threat of regulation sends a deplorable signal as regards the legal certainty every investor requires and is underscored by the empty gesture of increasing the taxation of Spanish REITs. All these measures and pressures are counterproductive and undermine efforts to develop a modern, efficient rental housing stock in Spain.

Furthermore, 2021 also saw the enactment of Law 7/2021 of 20 May on Climate Change and Energy Transition, which is intended to facilitate the decarbonisation of the Spanish economy and the transition to a circular model that will ensure rational use of resources, as well as adaptation to climate change and the implementation of a sustainable development model. In March 2021, the Technical Building Code (CTE) was amended to comply with Directive 2010/31/EU of the European Parliament and of the Council of 19 May 2010 on the energy efficiency of buildings, which establishes the obligation to review and update minimum energy efficiency requirements to adapt them to technical advances in the construction sector.

The purpose of this act is to decarbonise both new buildings and existing stock through rehabilitation. This will lead to increased construction costs. The introduction of these measures to improve the energy efficiency of buildings and the carbon footprint of the construction process is a European requirement which we believe should be postponed until the market has fully recovered. Other proposed legislative measures in relation to a new architecture act should likewise take the impact on construction costs very carefully into account.

RENTAL MARKET - BTR

In 2020, multi-family (residential rental and student housing) was the sector that attracted the largest volume of investment in Spain, overtaking the office market for the first time, with more than 2.6 billion euros invested, representing nearly 30% of the total investment market in Spain. Within that total, the residential rental segment accounted for an investment of 1.7 billion euros.

An important distinction within the multi-family residential rental market is between Private Rented Sector (PRS), made up of existing rental housing, and Build to Rent (BTR). In 2020, PRS accounted for only 18% of the total investment volume in residential rental, with approximately 300 million euros invested in the construction of some 3,000 rental homes. BTR thus accounted for 82% of the investment in that year, with a total volume of 1.4 billion for the construction of around 6,000 rental homes. It should be noted, at this point, that in 2019 the share of investment was 60% PRS and 40% BTR. The fact that BTR investment is already almost five times the investment in PRS testifies to the major shortage of finished product to meet the demand for this institutional capital.

In an environment of low interest rates, high medium-term inflation expectations and near-zero government bond spreads, BTR investment remains an attractive alternative for investors with a low cost of capital, mainly because it generates attractive yields with limited risks, given the clear social and demographic trend shift towards renting in a country that historically has favoured owner-occupancy.

Moreover, credit restrictions and tighter lending conditions, job insecurity, the proliferation of part-time contracts and a long list of other factors have generated a need for flexible housing solutions with no entry barriers—a need this sector is able to meet.

The cities of Madrid and Barcelona and their metropolitan areas have been, and continue to be, the locations that attract the most investor appetite. They are, respectively, Spain's largest and second largest city, not only in population but also as drivers of the country's economy, which is why their workforce is swollen by 100,000 (Madrid) and 70,000 (Barcelona) new arrivals each year. Investors are well aware of this trend and recognise the need to provide housing solutions for users who, in most cases, lack the savings required to buy their own home. While the attractiveness of these two main hubs is undeniable, a growing number of investors feel able, and have shown themselves willing, to expand BTR investment to other parts of Spain, focusing on provincial capitals with a large urban core, medium or high per capita income, significant economic activity and good amenities and connections. Cities that meet these criteria and in which BTR deals have started to take place include Malaga, Valencia, Alicante, Bilbao, Pamplona, Palma de Mallorca, Tarragona, Murcia, Zaragoza, Córdoba, Granada and Seville. The list does not stop there, though, as the trend is spreading and investors are already turning their attention to locations such as San Sebastián, Santander, Valladolid, Las Palmas de Gran Canaria and Santa Cruz de Tenerife



Rental market expansion is continuing. Madrid and Barcelona and their metropolitan areas are where demand is highest



CONTACT

MADRID

Paseo de la Castellana, 141
Edificio Cuzco IV - 14th Floor · 28046
T. +34 91 579 84 00

BARCELONA

Avenida Diagonal, 618
7th Floor · 08021
T. +34 93 410 26 80

VALENCIA

Avenida de Aragón, 30
46021
T. +34 93 410 26 80

MÁLAGA

Plaza de la Solidaridad, 12
29006
T. +34 607 73 48 25



colliers.spain@colliers.com

