Overview For many years Spain has been the number one choice for British buyers looking for holiday homes abroad. The year-round sun and relaxed lifestyle attracted thousands, leading to a building boom all along the coastlines. However, with the economic downturn, the country has been hit hard and the property bubble has burst. How serious is the effect on the Spanish property market? And when will there be a recovery?

{embedscript}http://stage.guidesandbrochures.co.uk:8080/js/textlink/18945{/embedscript}

Introduction

“Spain is going to face the very direst of economic circumstances: a cycle of recession, deflation and widespread private sector default - a depression in fact” (Bernard Connolly, Banque AIG, 2007). With an area of 504,030 km2, Spain is the second largest country in the European Union (CIA,World Factbook, 2009). Spain is located on the Iberian Peninsula in south-western Europe, bordered to the south and east by the Mediterranean Sea, to the north by France and Andorra, and to the west by the Atlantic Ocean and Portugal.

A member of the UN,World Trade Organisation, NATO, OECD and many more international agreements, Spainis embedded as a pre-eminent force on the global stage, with the fifth-largest economy in the European Union and, in absolute terms, the twelfth largest in the world (CIA,World Factbook, 2009). After a peaceful transition to democracy following the death of dictator Francisco Franco in 1975, Spain began a process of economic modernisation. By joining the EU in 1986, the economy began to experience rapid growth. The attractive climate and the easy access led to a huge boom. The number of people, especially the British, buying property in the country, either as an investment, or for holiday home orretirement purposes increased significantly. For a number of years it was ranked as the world’s most popular location to purchase property. In a country of just over 40million people, four million of these are foreigners, which translates to a massive 9.3% of the resident population (Kyero, 2007).

The country’s intense growth and huge anforeign investment led to a bust (as many analysts predicted) was inevitable, leaving many buyers in negative equity and struggling to meet mortgage repayments. The pound weakening against the euro further devalued foreign investments. The severity of the downturn in Spain remains to be seen. Property owners and investors alike are now waiting until property in the country is worth purchasing again and is capable of being sold.

The economy

Spain’s accession to the EU in January 1986 resulted in the country opening its economy, modernising its industrial base and revising important economic legislation. Liberalised and encouraged foreign trade and investment. The EU, with funds from the European Regional

Development Fund, ploughed money into Spain. This greatly improved infrastructure, increased the level of GDP growth, reduced the public debt to GDP ratio and unemployment from 23% to 10%, and even brought inflation down to under 3% (OECD,May 2009). The country also began to see a massive rise in tourism. The growth of the industry led to it becoming a major sector in the country and by 2003, 66.5% of Spain’s GDP was contributed to by the service sector.

Spain is ranked second in the world for both tourist arrivals and income from tourism. In 2006 alone, the country received US$51.1 billion from its visitors (World Tourism Organisation, 2007).

Spain continued the path of economic growth after its 2004 general elections, with robust GDP growth despite fundamental problems in the economy becoming evident. In particular Spain’s huge trade deficit which was a staggering 10% of the country’s GDP by the summer of 2008 (El Pais, August 2008). It was also losing competitiveness against its main trading partners, and had a high inflation rate and a high family indebtedness chiefly related to the Spanish real estate boom and rocketing oil prices. The Spanish government’s official GDP growth forecast for 2008 was 2.3% in April. This was hastily revised by the Spanish Ministry of Economy down to 1.6%, and independent forecasters instead estimated around 0.8%, a huge GDP growth - drop on previous years. Like most of the globe, 2009 brought recession to the country, with projections showing GDP growth at -3.3% for the year and it is not expected to recover until 2011, even at a modest growth rate of 0.9% (Ministry of Economy, April 2008; Economist Intelligence Unit, 2008).

Due to its lack of resources, Spain has to import all of its fossil fuels, which, in a scenario of record prices added pressure to the inflation rate and in June 2008 inflation reached a 13 year high of 5%. Then, with the shift in oil prices and the bursting of the property bubble in the second half of 2008, Spain registered a negative inflation rate in March 2009 for the first time on record, raising concerns over the effects of deflation (Forbes, 2009).

In the period October 2007 to October 2008, Spain saw its unemployment rate climbing by 37%, the worst in history.With a current rate projected to reach 15.9% in 2009, Spain is suffering Europe’s biggest unemployment crisis (Spain Finance Ministry, January 2009).

In reaction to this, ratings agency Standard & Poor’s cut Spain’s credit rating from AA+ to AAA. The lower rating means the cost of public borrowing will rise just as the nation is likely to mount new public spending efforts to boost its deteriorating economy (Standard & Poor’s, January 2009).

Property market boom

Powered by the property boom and a strong tourism sector, the Spanish economy grew to be the fifth biggest in Europe. In the 1960s and 1970s the government began to embed the opportunity for home ownership across Spain, with a number of policy changes to encourage growth. Tax regulation meant that 15% of mortgage payments became deductible from income taxes, a benefit which did not apply to renters.Mortgage levels grew with this, and banks began to offer up to 40 or in some cases 50-year mortgages (El Pais, 2009).

Further structural reforms pursued since the mid-1990s, and a surge in immigration boosted growth, construction activity and job creation. The difference in the standard of living within the euro area shrunk from an average of 20% to less than 13% between 1995 and 2003 (OECD, Spain Economic Survey, 2005). From 1988 to 2003, the average return on property investment was 13.5%, significantly beating stock market returns in the region in the same period (OECD; Banco de Espana, 2005).

This led to a huge boom in home ownership. In 2005 the OECD highlighted that 65% of Spaniards own their principal property outright, compared to just 38.6% as a European average, leading to a ‘wealth effect’ which in turn led to a boost in confidence and consumer spending (OECD, Spain Economic Survey, 2005).

In 2004, 509,293 new properties were built on Spain, growing to 528,754 in 2005 (Ministry of Housing, 2005). From this it was estimated that 300,000 were covered by demand from Spanish people, 100,000 from foreign investors, and 100,000 for foreigners living in Spain. By 2006 the Spanish were building 620,000 homes a year – a massive four times more than the UK – despite Spain having 20 million fewer people. At the peak of the bubble, the number eventually reached a massive 800,000 in 2007.

This extra speculative construction meant that from houses built over the period 2001 to 2007, about 28% were vacant as of late 2008 (Información Comercial Española, 2008). The knock-on effect of this meant that the economy as well as a large proportion of the workforce of Spain became hugely dependant on the property industry.

By 2005 there were two million people directly employed by the building sector, and approximately another three million in businesses related to it (La Caxia, 2005). Companies carrying out property valuations experienced a tripling in the number of employees in the three years to 2007 alone (El Mercado Inmobiliaro en Malaga, 2007). The result of all this was real estate prices rising by an incredible 201% from 1995 to 2007 (Ministry of Housing, 2008). Mortgage debt was growing at 25% a year, reaching ?651.168bn towards the peak of the bubble. 97% of these mortgages were at a variable interest rate, leaving them hugely susceptible to changing market conditions (Ministry of Housing, 2008).

Up until the first three months of 2007, Spanish house prices were still rising by 7.2% year-on-year, despite worries beginning to form. It wasn’t until the collapse of the US housing market that Spain began to suffer the after effects.

Property market bust

The soaring effects of the boom eventually meant that when the bust arrived it had a huge impact. As with most rapid price falls in global housing markets, the beginning of the downturn was when supply significantly overtook demand. According to the Ministry of Housing, 745,000 new homes were finished in Spain in 2008, but less than 300,000 were sold (Ministry of Housing, 2009).

Then, higher mortgage interest rates in the euro zone, doubling from 2.5% to 5%, a fall in the value of the pound, and the general effects of a recession meant that many foreigners with homes in Spain were unable to make mortgage repayments on their properties, leading to an effect similar to that of the sub-prime crisis in the US. After the bubble burst in late 2007, average house prices in the capital,Madrid, had fallen to £2,895 per square meter in Q3 2008, down 3.7% from Q4 2007. The average price of houses across Spain was ?2,069 per square meter in Q3 2008, down 1.6% from its peak level in Q1 2008. The price falls in 2008 were in sharp contrast to the double digit price increases from 2001 to 2006 (Bank of Spain, 2008).

The most recent Knight Frank Global House Price Index, released in March 2009, showed that Spain was still showing year-on-year decreases of 3.2%, and the falls were not slowing (Knight Frank, Global House Price Index,March 2009). It may take some time for the economy to recover, and for the oversupply of homes to be absorbed into the market before any real recovery is seen. It may take some time for the economy to recover
New households and housing starts - Spain

Focus on Property

The future for Spain Whatever the economic condition in Spain, the fact remains that tourists (especially UK residents) will always be attracted to the country for the same reasons.
The year-round sunshine, easy going lifestyle, and the comparatively lower cost of living are still strong factors which will continue to attract foreign investors.
Experts believe that as interest rates in the UK and euro area stay low throughout the first half of 2009, both markets will be stimulated. As lower interest rates and greater governmental pressure on the banks increases lending, the markets will eventually slowly turn in favour of investors (Nubricks, 2009). There are reports emerging of agents in Spain with large numbers of clients who wish to purchase, but are waiting to sell their homes in the UK. Therefore if the domestic property market begins its upswing, the Spanish one will follow suit.

Proof of Spain’s continuing popularity is shown in tourism figures, which remain strong. The 2009 Easter holiday period saw the Costa del Sol region experience record figures, with 75% occupancy in hotels along the coast, almost eight points higher than the same period in 2008. Along with this, bars and restaurants reported a 15% increase in their takings compared to last year (Costa del Sol Tourism Board, April 2009).

There is also a new terminal under construction at Malaga airport, costing ?300m, doubling the airport’s capacity to 9,000 passengers an hour.

Additions to hotels include a luxury Mandarin Oriental hotel due to open in Benahavis in 2010, and the luxury five-star Vincci Selection hotel recently opened in Marbella, proving that not only are investments in the region ongoing; construction in planned projects is still taking place - despite the effects of the global recession.
The Spanish government is also responding to the crisis, recently announcing an £11bn stimulus package in a bid to create 300,000 jobs. This is further to the package previously announced including a ?40 package for mortgage relief, tax cuts, and credit lines for new business (Global Property Guide, December 2008).
The Spanish property market may well still have some way to fall, but recovery from 2011 onwards looks likely.Whether it will achieve the heights it did before the bust is uncertain.

Investors who look to Spain for a lifestyle choice or as an investment will be met with considerable reductions on already below market value properties. will find bargains in the country.

Those looking for capital gains and strong income returns would be better placed over the next few years to look for markets which have not experienced such a severe property market bust, such as Eastern Europe, Bulgaria, and other regions not as closely linked to the sub-prime crisis in the US and the UK

Spain buying guide Foreigners have a right to buy and re-sell all kinds of property (residential, commercial or land) with no legal limitations EU members have the right to live permanently in Spain10% of the purchase price for the property has to be paid as a deposit Investors pay the balance of the purchase price and all fees when the “Escritura de compraventa”, the definitive contract equivalent to the deeds of the property, is signed Roundtrip transaction costs are usually between 8.16%-11.24% for the buyer Capital gains tax in Spain for residents is a maximum of 15%, calculated as part of the investors’ Spanish income tax. For nonresidents it is 18%. From the declared value of the property, 3% will be retained at the Notary on the day contracts are signed. Any expenses incurred during the sale can be offset against this Residents who reinvest all of the proceeds of sale to purchase another principal residence can get capital gains tax relief, provided they have lived in the property for three years or more. (Global Property Guide, 2009)

The Spanish property market may well still have some way to fall,but recovery from 2011 onwards looks likely

Focus on Property

Aston Lloyd Research Ltd Phone: 020 7374 8988 Fax: 020 7374 6990 Email: info@astonlloyd.co.uk Website: www.astonlloyd.co.uk

Aston Lloyd Research Ltd is a leadingedge provider of impartial research materials for property investors. Aston Lloyd Research produces in-depth country profile reports, as well as emerging market news briefs and special feature reports on global markets.

For more information or for access to further research materials, please visit www.astonlloyd.co.uk

Every effort has been made to ensure that the data and other information in this report is accurate, however information within the property investment and real estate field is subject to change from time to time. The purpose of this report is to provide information, analysis and a background to emerging markets. It is not intended for use directly or indirectly in market forecasting or for making investment decisions.

Aston Lloyd Research Ltd accepts no responsibility or liability for any losses or damages incurred as a result of improper use of this report.

Did you know…

- The rain in Spain does not fall mainly on the plain. The wettest region is in the north-east. In April 2007 it rained almost every day.
- The capital, Madrid, is in the exact centre of the country.
- There is not a tooth fairy in Spain.
- Instead, there is a tooth mouse called Ratoncito Perez.
- The beret, which is associated with France, was actually invented in the north east of Spain.
- At Christmas time, presents are given after dinner on Christmas Eve. An American T-shirt maker printed shirts for Spain which promoted the Pope’s visit. However, instead of the “I saw the Pope” in Spanish, the shirts accidentally said “I saw the Potato.”
- The world’s largest food fight is the annual “La Tomatina” tomato throwing festival in Valencia.
- It is believed that mayonnaise was invented in Spain.