CaixaBank Research

Artículo Sectorial

Real estate

# A severe blow for a well-

# positioned sector

It is inevitable that the property development and construction sectors, which are very sensitive to economic conditions and confidence levels, will contract significantly this year. We expect a notable decline in new building permits and a severe impact on employment in the construction industry. However, the nature of the shock and the state of the sector before the appearance of COVID-19, much more favourable than a decade ago, suggest it should be able to recover.

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# Impact on construction activity

Construction activity was directly affected throughout the state of emergency, especially during the two weeks when all non-essential work was restricted. The slump in cement consumption in April, –50% year-on-year, bears witness to this. However, as restrictions on economic activity have been lifted, construction work that was already underway has resumed relatively quickly and, despite some supply chain disruptions, no significant delays are expected in the delivery of new housing in 2020. The latest data available on completion certificates, for March, show that 81,700 homes were finished in the past 12 months (+17.6% year-on-year). Given that more than 100,000 homes were granted permits in 2019, we predict that between 80,000 and 100,000 could be completed this year.

## The uncertain climate will affect the rate at which new real estate projects are started

# Nueva edificación

On the other hand, it is very likely that the start of new building projects will slow down this year due to the uncertain climate and greater risk aversion, which would affect the number of homes completed in 2021. New building permits fell by 37% year–on–year in March compared to an increase of 5.5% in 2019. The impact COVID-19 may have on new construction will largely depend on expectations regarding the persistence of the economic shock. Real estate development is a long-term business and requires an environment of relative price stability to ensure the development returns a profit within two years. In this respect, the decrease in the construction sector's economic sentiment index to –32.4 points in May (compared to an average of –7 points in 2019) points to further declines in activity over the coming months.

We therefore expect the number of new building permits to fall significantly in 2020. Uncertainty is very high and this is reflected in a relatively wide range of forecasts: we predict a decline of between 40% and 20%; i.e. 65,000 to 85,000 new building permits. 2021 should see a gradual recovery in new building permits thanks to less economic uncertainty and developments in the pandemic (between 75,000 and 95,000 homes).

# Effects on the labor market

The labour market has been hard hit by the pandemic. Between 11 March and 31 May, the number of workers registered with Social Security as employed in the construction sector fell by 5.9% (–75,000).[1] In addition, 93,400 construction workers were affected by furlough measures and 168,647 self-employed persons had applied for the extraordinary allowance due to business interruption as of 31 May. Therefore, 26.4% of the sector's registered workers at 11 March were not working by the end of May. This high percentage, however, is lower than the average for the economy as a whole (29.1%), since there are sectors such as hospitality (79.7%) and retail (36%) that have been much harder hit by the crisis (see the following chart). Real estate activities, on the other hand, have suffered relatively less in terms of Social Security registered workers (-6,700 workers between 11 March and 31 May, –4.5%) although a large number of workers have been furloughed (16.7%) and 43% of self-employed workers in the sector have requested the extraordinary allowance for business interruption.

Over the coming months, the expected number of jobs to be created by firms in the construction industry is not encouraging. In May, the European Commission's indicator for the sector's recruitment prospects stood at –30 points, 10 points better than the minimum reached in April (–40 points) but well below the average of –7 points recorded in the 12 pre-crisis months.

The big job losses seen in construction are due to the sector's typical employment system and company structure. Specifically, the larger number of jobs lost in an economic shock can be partly explained by a high degree of temporary employment (40% of workers in the construction sector were on a temporary contract in 2019), by a high proportion of self-employed workers (30% of the total) and by small companies (55% of construction companies in Spain have no employees and an additional 40% have fewer than 10). This situation highlights the sector's structural problems, which become more visible at times of crisis. In this respect, the strategy followed to exit the recession should promote company growth and human capital management, for instance via measures to retain skilled labour and invest in personnel training and education.

1. Construction lost 157,000 registered workers in the second half of March, although the figures for April and May were more positive and showed a notable recovery in the jobs lost.

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The current economic shock is of a very different nature than the one causing the previous recession, as it has not originated in the real estate sector

The starting point for economic agents is much more solid than in 2008.

## Sector situation regarding the 2008 crisis

However, it is also very important to stress that the sector's starting point is much more solid than when the previous crisis erupted in 2008, suggesting it might recover more readily:

Construction companies and developers have significantly improved their financial position. The considerable reduction in the share of short-term debt on company balance sheets is a determining factor in preventing liquidity problems from leading to solvency problems.
The production of new builds does not seem excessive in relation to the structural need for housing. In 2019, new building permits totalled 106,266 homes (one eighth of the permits in 2006) compared to the 134,176 new homes created last

year according to the EAP. In addition, new homes are being built in areas with proven high demand and a more dynamic demographic profile.

Banks are less exposed to the development and construction sector. The share of credit for the real estate sector on bank balance sheets has been significantly reduced. Moreover, the non-performing loan ratio for bank loans to the sector has fallen dramatically since 2013 (the peak) and, in general, banking's solvency and liquidity situation is more robust and comfortable.


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