Real Estate

Sector Report

2nd Semester 2019

A more sustainable, longer-lasting expansion

The rise in house purchases by foreigners

Demand for rented accommodation is growing in Spain

The key aspects of the new Mortgage Act

CaixaBank Research

Real Estate

Spain's real estate sector: a more sustainable, longer-lasting expansion

2019 forecasts

Growth in prices slows down

+5.7%
Growth in house prices

Sales are still dynamic

542,000
House sales

The strong growth in the supply of new housing continues, particularly in areas of high demand

120,000
New building permits

Note: CaixaBank Research forecasts for 2019.

The rise in housing sales to foreigners

Housing demand by foreigners has increased non-stop since 2009

12.2%
House purchases by foreigners as share of total

Which nationalities buy the most?

- **15.5%** United Kingdom
- **7.5%** Germany
- **7.4%** France
- **6.3%** Belgium
- **5.8%** Sweden

Which zones have the greatest presence?

- **40.7%** Alicante
- **37.6%** Santa Cruz de Tenerife
- **30.5%** Malaga

Source: CaixaBank Research, based on 2018 data from the Spanish College of Registrars.

The rental market

More and more people are renting their home: supply will have to increase in line with this growing demand to avoid greater pressure on prices.

% of homes rented

16.1% (2013) → **17.8%** (2018)

The new Mortgage Act in detail

We analyse the key aspects of the new legislation governing real estate credit contracts.

Situation and outlook

A more sustainable, longer-lasting expansion

Spain's real estate sector is entering a more mature phase of the cycle characterised by a slowdown in growth in demand and prices. The factors supporting the property market boom (job creation, favourable financial conditions and high foreign demand) are still enjoying a positive trend but have eased slightly. The strong growth in the supply of housing persists, especially in areas with the highest demand. The sector will continue to expand over the next few quarters.

Spain's real estate sector ended 2018 with very good figures: house sales totalled 516,000, up 10% on 2017; new building permits broke through the 100,000 threshold, 25% more than the previous year, while growth in house prices speeded up to 6.7%. This upward trend in the real estate sector contrasted with economic conditions that are starting to show signs of peaking: Spain's GDP grew by 2.6% in 2018, still a high figure but below 3% for the first time in 3 years. This deceleration in the Spanish economy's growth rate is due to the weakening of some temporary factors that had boosted growth in previous years, such as lower interest rates, an expansionary fiscal stance and falling oil prices. In 2019 and 2020 we expect the economy to continue expanding but at a slightly slower rate: according to CaixaBank Research, Spain's GDP will grow by 2.3% and 1.9%, respectively.

Given this gradual slowdown in the Spanish economy, we believe that growth in the real estate sector will also moderate. This should not be interpreted as a sign of weakness for the sector, however, but rather a return to more normal and sustainable growth figures after the sharp rise observed during the recovery. In other words, **we expect the real estate sector to move down a gear but still perform well**, as we will explain in the rest of the Report.

House sales slow down their rate of growth. For 2019 we predict growth of around 5%

Looking first at the demand indicators, we can see that, since the end of 2018, **growth in sales has gradually lessened**. While sales rose by 11.2% between January and September last year, in 2018 Q4 their increase was lower (7.5%). This moderation continued in Q1 2019 with a more contained rise (3.7%). These data are in line with the information provided by Google Trends on the evolution of searches for housing on the internet, with the number of searches continuing to fall in April and May.

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The number of house purchases by foreigners is slowing down somewhat more sharply (–3% year-on-year in Q1 2019) although we should remember that this growth has been very strong over the past few years and purchases are therefore stabilising at a very high level. In fact, **the share of house sales to foreigners out of all sales has hardly fallen**: 12.2% in Q1 2019 compared with 12.6% in 2018 (for a detailed analysis of house sales to foreigners, see the article «The rise in house purchases by foreigners in Spain: together forever?» in this *Sector Report*).

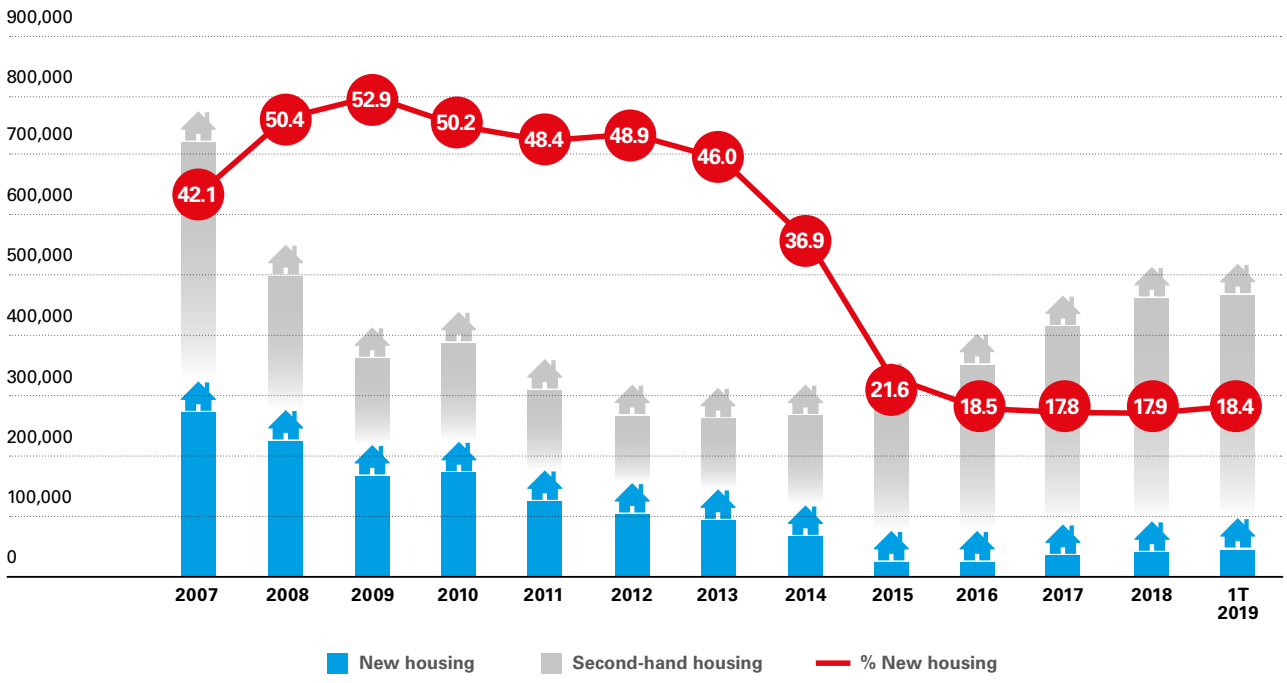
Sales of new housing are gaining ground but still represent a very small share compared with second-hand housing

Although total sales are slowing down, there is a notable difference between the sales of new and second-hand housing. In fact, as the property developments started in the past few years enter the market, **sales of new housing are increasing their share: in 2018, new housing sales grew more than second-hand sales for the first time in over 10 years.** This good performance by new housing sales continued in Q1 2019 with 14.4% growth compared with 1.4% for second-hand housing. Consequently, the relative weight of new housing is gaining ground (18.4% in Q1 2019) although still very close to the minimum level and very far from the average for the past decade (36%).[1]

(1) House sales according to the National Statistics Institute. According to the Ministry of Public Works, new house sales accounted for 9.7% of the total in 2018.

New housing sales are starting to pick up

Number of sales



Note: (*) Cumulative data for Q1 2019 over 4 quarters.
Source: CaixaBank Research, based on data from the Spanish Statistics Institute.

The factors supporting housing demand (essentially job creation, wage rises, low interest rates, mortgage activity and foreign demand) are helping the trend in the real estate market to remain positive. However, some of these factors such as job creation and foreign demand are expected to slow down slightly, while there is no increase in the rest of the factors. Specifically, CaixaBank Research expects the number of employees to increase substantially (by 400,000 in 2019 and 385,000 in 2020) but still below the average of 500,000 employees per year posted between 2015 and 2018. Nevertheless, wage increases, which are slightly above 2%, will boost growth in gross disposable household income over the coming quarters.

The accommodative financial conditions will also continue over the next few years as the ECB will normalise its monetary policy at a much slower rate than the one predicted a few months ago. According to CaixaBank Research forecasts, the 12-month Euribor rate will still be around 0.50% at the end of 2020.

The low interest rate environment and favourable economic climate will continue to support the flow of household credit. The volume of new credit to purchase housing rose by 8.7% in Q1 2019 (compared with 13.2% growth in 2018) while the number of mortgages increased by 11.2% year-on-year in February 2019 (cumulative over 12 months). It is worth noting that over 40% of these mortgages are fixed rate due to the protection afforded by this kind of contract against interest rates rising. Spain's new Mortgage Act, which came into force on 16 June, promotes fixed rate mortgages as well as the conversion of existing variable mortgages to fixed rate, so we can expect the proportion of this kind of mortgage to continue growing (see the article «The key aspects of the new Mortgage Act» in this *Sector Report*).

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The construction industry looks very dynamic

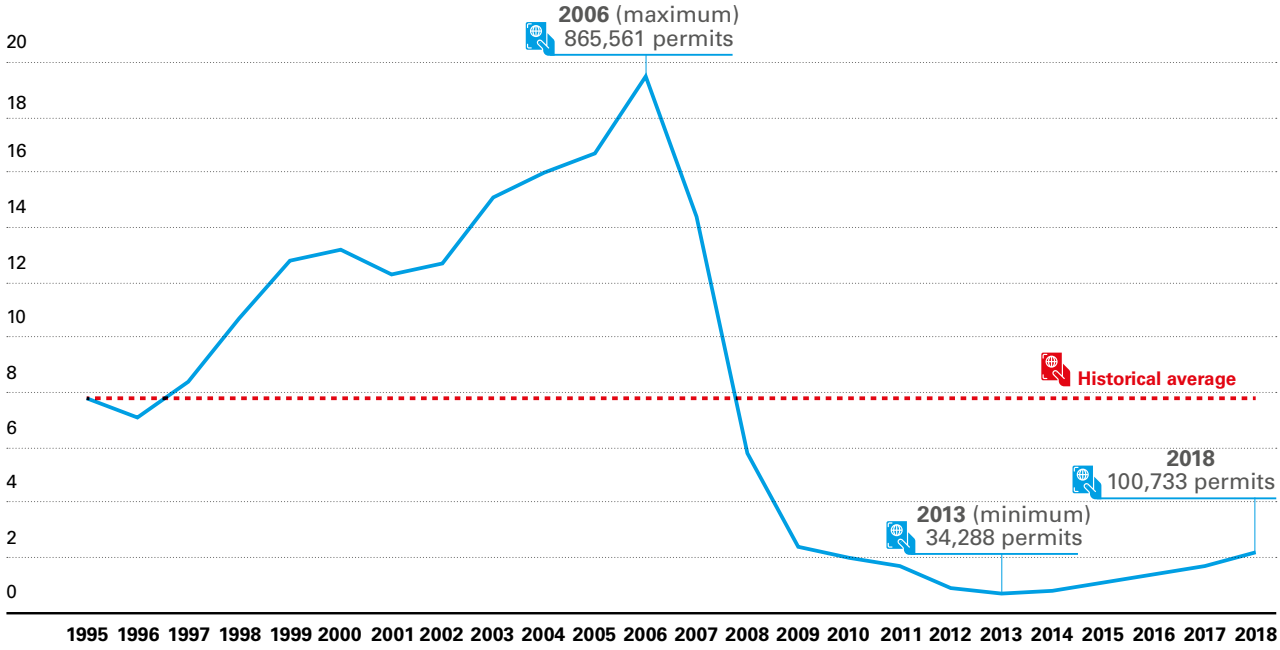
Supply indicators point to Spain's construction industry growing more quickly than the economy as a whole and its share is therefore increasing, although this is still far from the figure achieved in the property boom of 2000-2007. Specifically, the gross value added for construction accounted for 5.9% of GDP in 2018 compared with 5.1% in 2014 (minimum) and 10.4% in 2006 (maximum). The figures are similar in employment terms: employment in construction accounted for 6.3% of the total in 2018, compared with 5.7% in 2014 (minimum) and 13.3% in 2007 (maximum).

Supply indicators for the real estate sector

Source: CaixaBank Research, based on data from the Spanish Statistics Institute.

In 2018, 100,733 new building permits were granted, 24.7% more than in 2017, a positive trend that consolidated further in the first few months of 2019 (+25.5% year-on-year cumulative over 12 months up to February). In spite of this strong growth, it should be noted that the current level of production for new housing is still below the net creation of homes projected by the National Statistics Institute (around 135,000 homes every year on average during the period 2019-2025).
A close correlation can also be seen between demand and supply; i.e. more construction **is taking place in zones where there is more demand**. Another way to check whether the supply of new housing is excessive is by comparing this to the population. The following chart shows that the number of new building permits per 1,000 inhabitants in 2018 was 2.2, much lower than the historical average of 7.8.

New building permits per 1,000 inhabitants



Source: CaixaBank Research, based on data from the Spanish Statistics Institute and the Ministry of Public Works.

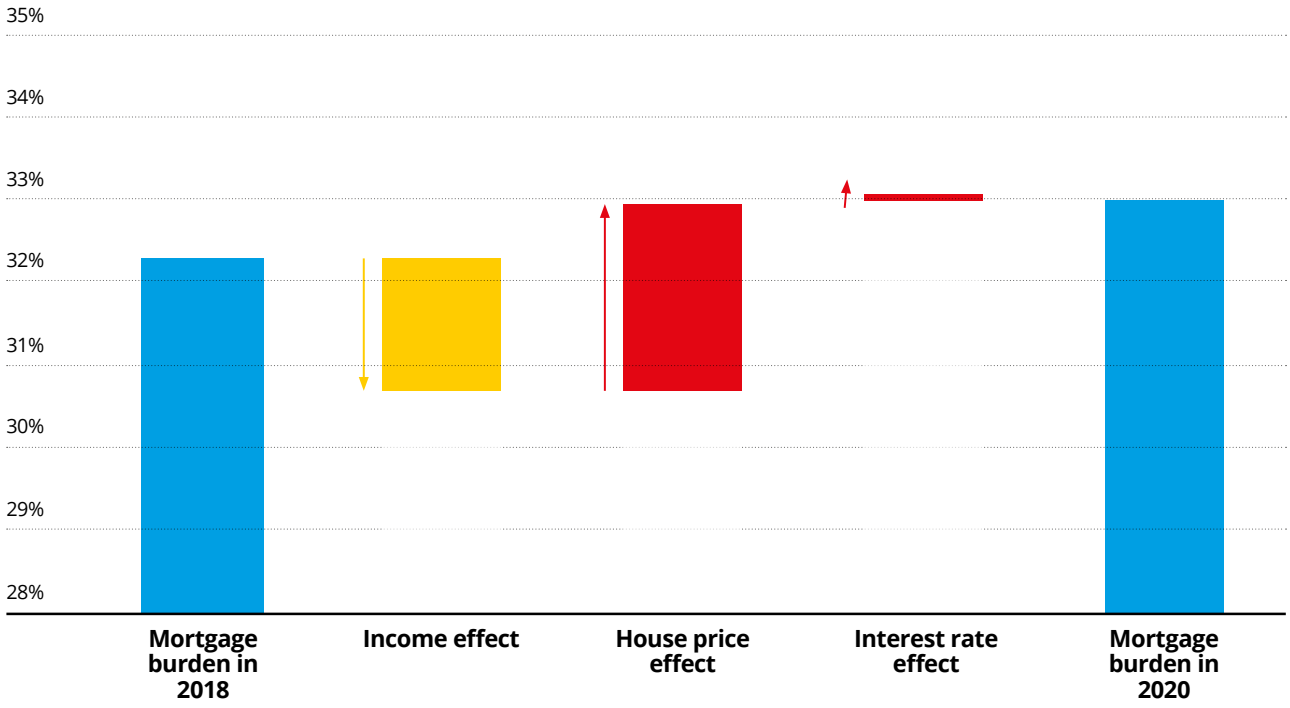
Given the real estate sector's current status, with strong growth in the supply of new housing and demand slowing down slightly, we can expect **prices to moderate their growth over the coming quarters**. Nevertheless, the rise in Q1 2019 was a notable 6.8% year-on-year according to the National Statistics Institute (based on transaction prices). This significant growth will continue over the next few months, around 5% on average during the period 2019-2020 according to CaixaBank Research.

House prices will continue to rise but at a slower pace

The expected moderation in the growth rate for house prices, together with the rise in disposable household income, will help to contain the increase in the affordability ratio and mortgage burden observed during the real estate sector's recovery. In fact, according to the Bank of Spain, in 2018 households needed 7.4 years of their entire income to buy a home, one year more than in 2013. The mortgage burden[2] also increased to 32.3% in 2018 compared with 30.5% in 2015. **CaixaBank Research forecasts point to a possible slight increase in the mortgage burden** up to 33% by the end of 2020 due to house prices rising faster than gross disposable household income and a slight increase in interest rates.

(2) Percentage of the gross disposable income required by an average household to meet its mortgage payments over the first year.

Mortgage burden: predicted trend between 2018 and 2020



Source: CaixaBank Research, based on data from the Bank of Spain.

In short, Spain's real estate sector is entering a more mature phase of the cycle when the growth rates observed in the past will tend to moderate. This slowdown should be seen as positive, however, as it will help the sector's expansion to become more sustainable and longer lasting.

Together forever?

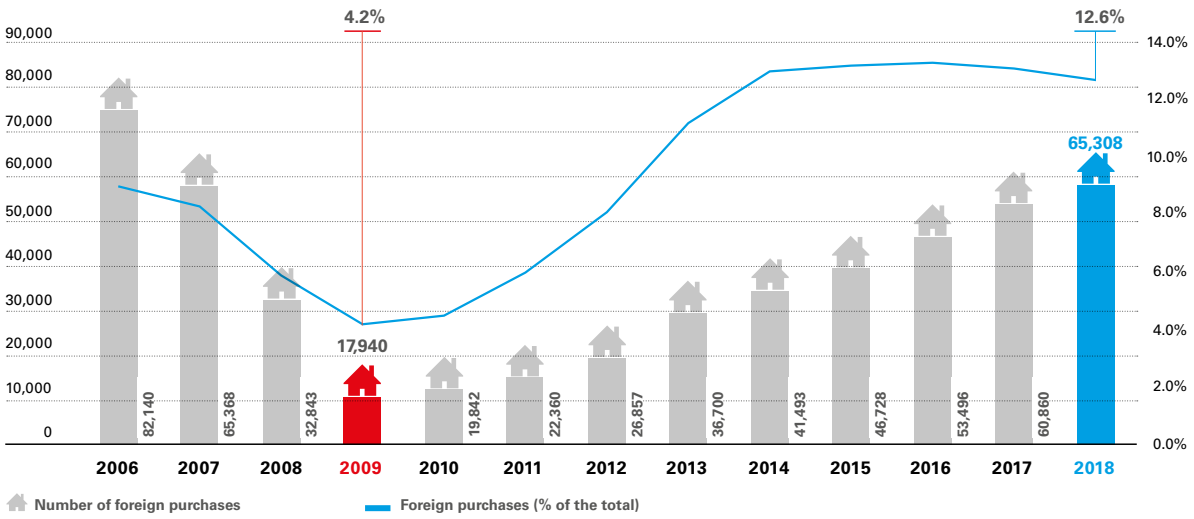
The rise in house purchases by foreigners in Spain

Foreign demand has been one of the factors supporting Spain's real estate sector throughout its recovery. House purchases by foreigners have tripled in just 10 years, reaching the substantial figure of 65,300 homes in 2018, 12.6% of the total. This article looks at the foreign demand for housing in Spain as well as factors that will affect the trend over the coming quarters.

Foreign house purchases played an important role at the start of Spain's real estate recovery. From the minimum levels recorded in 2009, in the midst of the global financial crisis, with just 17,940 homes purchased by foreigners (4.2% of all purchases made that year)[1], foreign demand soon picked up, enjoying double-digit growth between 2010 and 2017 to more than 13% of all purchases. Meanwhile, domestic demand remained sluggish until well into 2014.

(1) This article is based on purchase data provided by the Spanish College of Registrars. Other available sources, such as the data provided by the Ministry of Public Works based on Public Notary figures, suggest a much larger share of purchases by foreigners, namely 5.8% in 2009 and 15.8% in 2018.

Property purchases by foreigners have grown non-stop since 2009



Source: CaixaBank Research, based on data from the Spanish College of Registrars.

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In spite of Brexit, the British continue to lead the field in buying a second home in Spain

The most recent data confirm this strong performance by foreign demand: **in 2018, foreigners bought 65,300 homes in Spain**, 7.3% more than in 2017 and a very similar figure to the one recorded in 2007, before the property bubble burst. This confirms that the number of purchases by foreigners is now at a high level and, consequently, the growth rate is likely to ease off. A slight moderation could already be observed in the second half of 2018 and, as we will see in this article, the slowdown is likely to continue during 2019 and 2020.

Which nationalities buy the most housing in Spain?

The British lead the ranking of nationalities buying residential property in Spain in 2018 with over 10,000 units, 15.5% of all foreign demand. The Germans and French complete the podium with almost 5,000 homes each (7.5% and 7.4% of the total, respectively), with the Belgians (6.3%) and Swedes (5.8%) close on their heels. Although purchases by UK citizens remained at around 10,000 homes per year in the period 2016-2018, we can assume that this figure would have been even higher without the uncertainty caused by Brexit, since the purchases made by the rest of the nationalities grew considerably compared with 2016 levels.

The citizens from these countries tend to buy property in Spain for holiday use and there is a notable coincidence between the countries leading the

Why do foreigners choose Spain?

ranking for Spain's inbound tourism and the nationalities buying housing. This correlation suggests that such tourists, many of them retired, after repeatedly coming to Spain on holiday, have decided to buy a second home here. **The main reasons for choosing Spain are the climate and quality of life, the perceived level of safety and good flight connections with their home countries**. In addition to these factors, in the past decade Spanish property has also become more attractive as an investment, due to the slump in house prices during the most severe years of the recession. In other words, Spanish property became more affordable and a good investment opportunity for citizens of economies less badly hit by the crisis.

Where is foreign housing demand concentrated?

It is vitally important to know the detailed geographical distribution of different nationalities throughout Spain in order to anticipate the impact

Romania, Morocco and China lead the field of nationalities settling in Spain for work

of possible political or economic events on the Spanish residential market, such as identifying those zones that could be most affected by Brexit. It is interesting to note that each nationality has its own favourite destinations: the British prefer the Alicante and Andalusian coastline while the Germans like the Balearics, although many also choose the Canary Islands. The French and Portuguese like Catalonia and Galicia, respectively, because of their close proximity. The Italians prefer the Canary Islands while Scandinavians tend to choose the Community of Valencia and Andalusia.

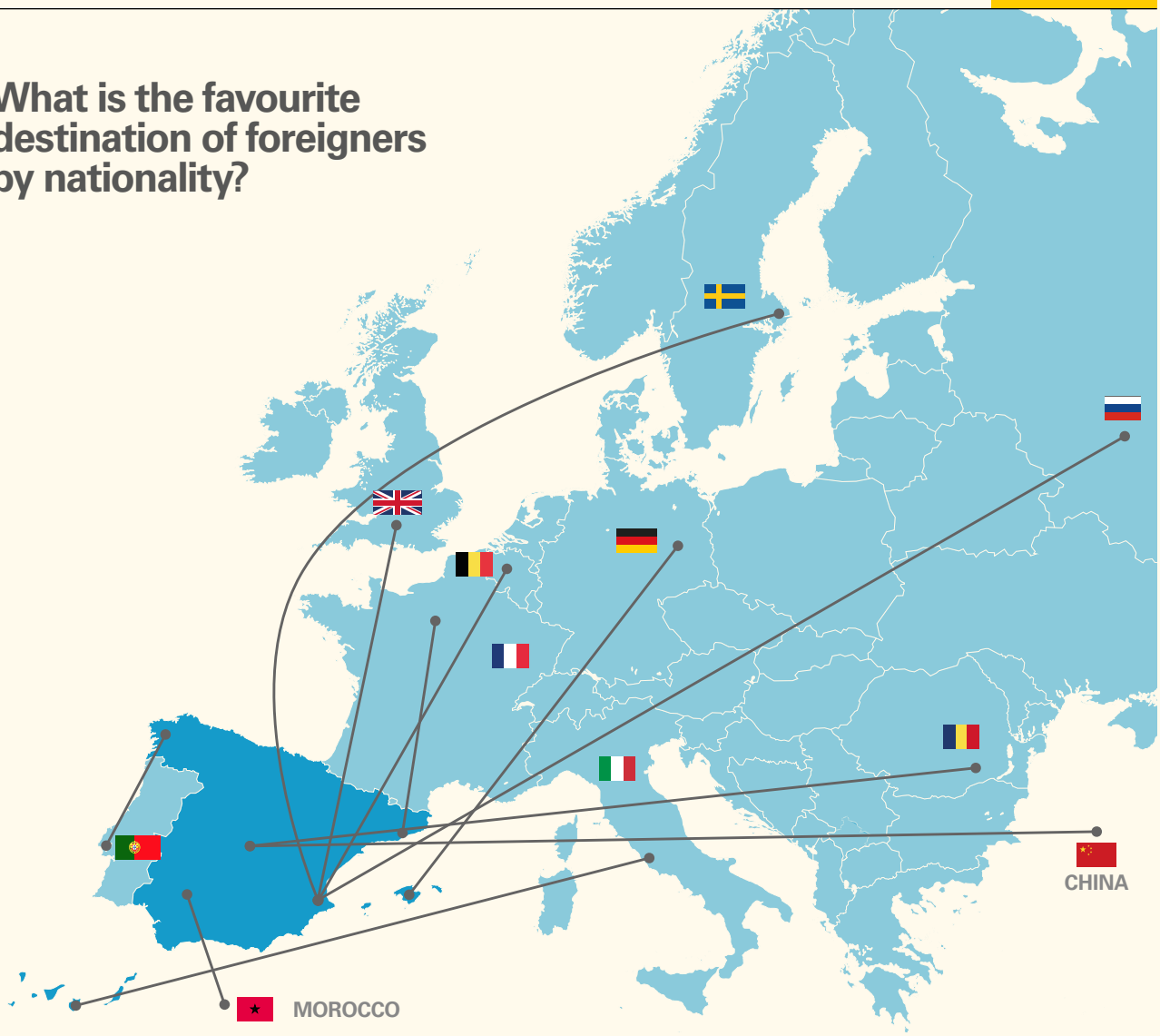
But apart from buying property for tourism purposes, **recently there has also been a rise in purchases made by foreigners settling in Spain for work.** This demand tends to be much more closely related to economic conditions in Spain and it is therefore not surprising that such purchases have picked up in line with the strong recovery in the Spanish economy, which started in 2014. Within this group, the ranking of nationalities is led by Romanians (3,553 purchases in 2018) followed by Moroccans (3,141 purchases) and the Chinese (2,573 purchases)[2]. Purchases made by these nationalities tend to be spread more across Spain's different autonomous regions, although they are particularly prevalent in large cities (Barcelona and Madrid) and agricultural areas with a demand for certain types of labour (such as Murcia, in the case of the Moroccans).

What are the projections for foreign demand over the next few quarters?

At CaixaBank Research we have thoroughly analysed the factors that help to predict the trends in foreign demand for residential property over the coming

(2) Purchases by these nationalities are closely related to the migratory flows from these countries, which have been increasing since 2014, totalling approximately 48,200 Moroccans, 30,400 Romanians and 11,700 Chinese between the second semester of 2017 and the first of 2018.

What is the favourite destination of foreigners by nationality?



UNITED KINGDOM	FRANCE	GERMANY	BELGIUM	SWEDEN
COMM. OF VALENCIA 34.9%	CATALONIA 40.5%	BALEARICS 37.0%	COMM. OF VALENCIA 40.7%	COMM. OF VALENCIA 48.4%
ANDALUSIA 29.3%	COMM. OF VALENCIA 27.2%	COMM. OF VALENCIA 19.7%	ANDALUSIA 26.1%	ANDALUSIA 35.4%
MURCIA 12.5%	ANDALUSIA 12.9%	CANARY ISLANDS 19.3%	CANARY ISLANDS 18.5%	BALEARICS 6.8%

ITALY	ROMANIA	CHINA	MOROCCO	RUSSIA
CANARY ISLANDS 42.9%	MADRID 23.8%	MADRID 32.1%	ANDALUCÍA 24.6%	COMM. OF VALENCIA 54.7%
CATALONIA 14.8%	COMM. OF VALENCIA 22.4%	CATALONIA 28.6%	CATALONIA 20.9%	CATALONIA 20.0%
ANDALUSIA 9.2%	CATALONIA 13.3%	ARAGÓN 2.6%	MURCIA 16.1%	CANARY ISLANDS 6.3%

Example: 34.9% of British citizens buying property in Spain bought a home in the Community of Valencia.
Source: CaixaBank Research, based on data from the Spanish College of Registrars. Note: Data from 2018.

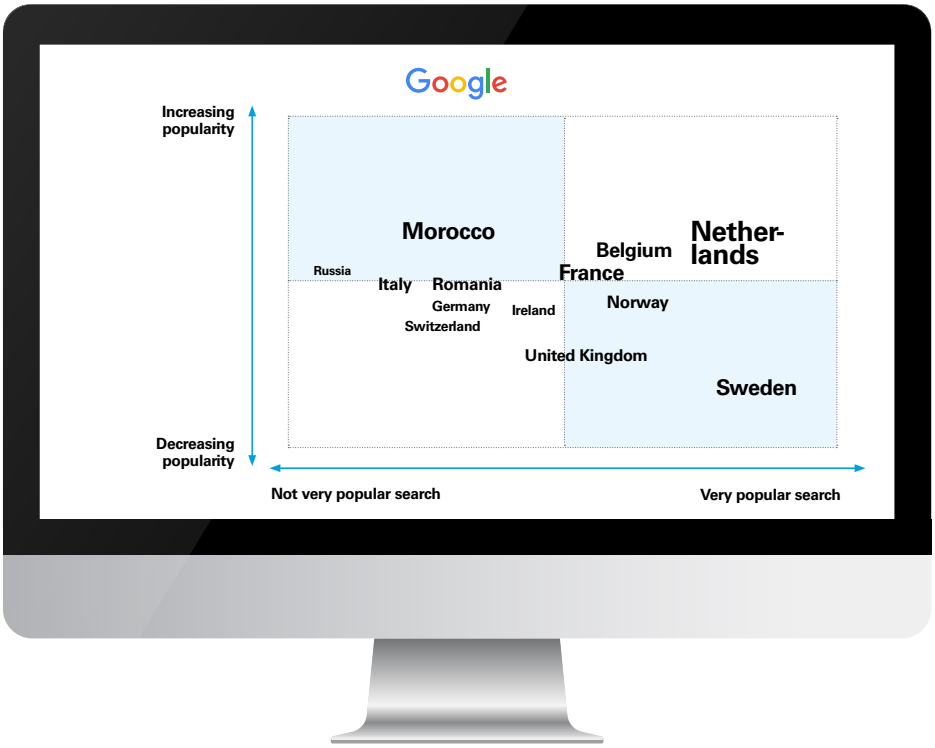
Economic growth in the countries of origin, inbound tourism, immigration and the exchange rate are all key to predicting foreign demand for housing

quarters. For instance, we have taken into account the economic conditions in the countries of origin (GDP growth and exchange rate), inbound tourism rates by country and immigration towards Spain by nationality[3]. Another very useful instrument for predicting the intention to buy on the part of foreigners is the number of Google searches to buy housing in Spain made from other countries.

Google Trends show that buying an apartment in Spain is still a very popular search in the main purchasing countries. In the past few months, however, this kind of search has become less popular in northern European countries. On the other hand, Google searches by the Dutch, French, Belgians and especially Moroccans are still very strong, suggesting that purchases by these nationalities could gain share. The combination of information from Google Trends with the key economic variable forecasts suggests that housing purchases by the main purchasing countries (United Kingdom, Germany and France) will grow more

③ Specifically, a time series regression analysis is carried out for each of the main nationalities purchasing residential property in Spain: the United Kingdom, Germany, France, Italy, Netherlands and Sweden, accounting for 44% of the foreign demand in 2018.

Popularity of searches cor "Buy apartment in Spain" according to Google Trends



Example: Sweden is the country where the Google Trends index is highest between January and May 2019, indicating that buying an apartment in Spain is a very popular search in Sweden (horizontal axis). However, the Google Trends index is lower compared with the same period in 2018, suggesting it has become slightly less popular (vertical axis).
Note: Data from January to May 2018 and 2019. Source: CaixaBank Research, based on data from Google Trends.

moderately in 2019 (by around 2%). The main reasons are that economic growth is slowing down in these countries and inbound tourism by these nationalities has almost stalled. Regarding the United Kingdom, it is also important to note that the exchange rate plays a vital role in predicting house sales given that depreciation in the pound sterling makes purchases in euros in Spain more expensive. As the uncertainty surrounding Brexit dissipates, we expect the pound to appreciate slightly, which should improve the purchasing power of the British and, consequently, boost their purchases.[4]

In conclusion, foreign demand provided fundamental support for revitalising the residential market when it was at its lowest ebb.[5] Over the longer term, the key question is whether this increase in foreign demand is a temporary phenomenon or has the potential for sustained growth. The answer to this question will depend, on the one hand, on the health of the economy and its

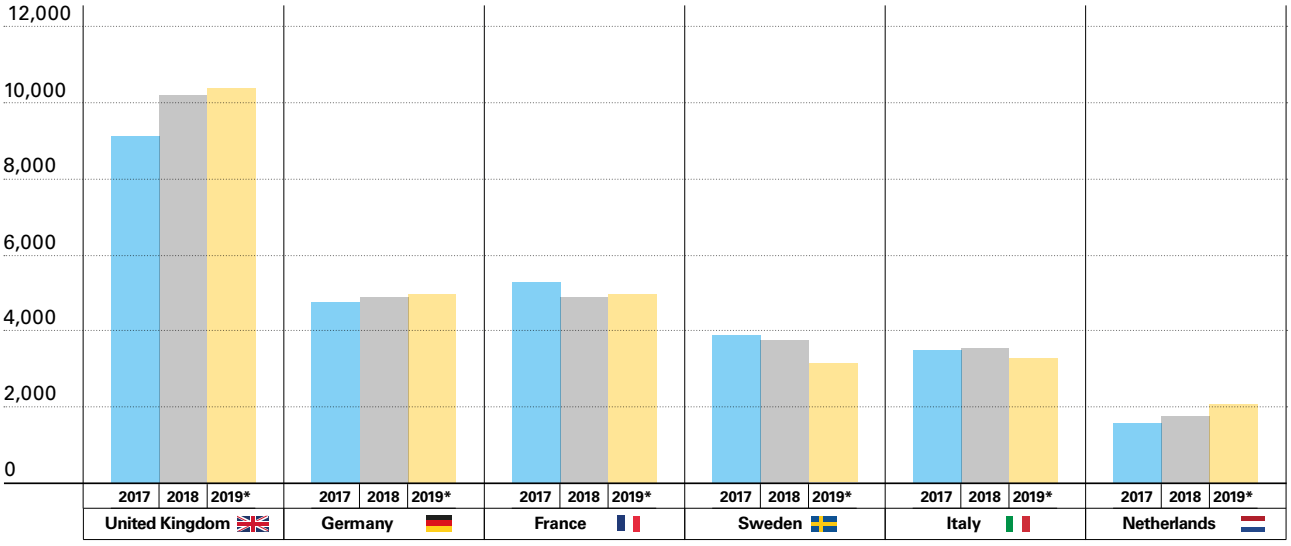
Over the next few quarters, we expect foreign demand for housing to moderate given the slowdown in European economies, although there is great potential for growth in the medium term

④ Should the pound sterling depreciate by 10% annually (similar to the depreciation occurring after the Brexit referendum), growth in housing purchases by the British would fall by 9.3 pp. At current levels, this is equivalent to approximately 1,000 fewer homes.

⑤ Although foreign demand has had a positive effect overall, it is also true that, in certain areas such as large city centres and tourist resorts, the pressure of tourism-related purchases has affected the local residential market to some extent. This aspect is addressed by the next article which looks at the rental market.

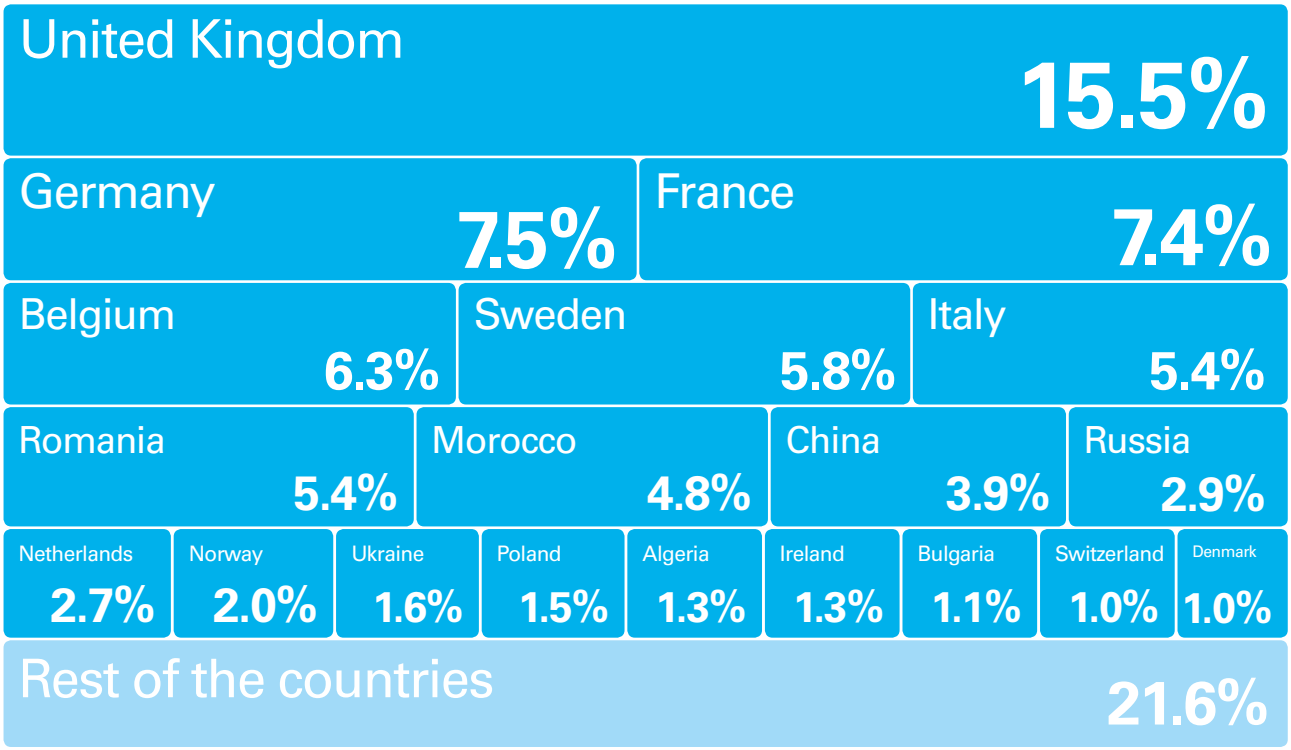
Which nationalities buy the most housing in Spain?

Number of homes



Note: (*) Forecast.
Source: CaixaBank Research, based on data from the Spanish College of Registrars.

The British top the ranking of purchases by foreigners



Note: Data from 2018. Source: CaixaBank Research, based on data from the Spanish College of Registrars.

capacity to attract foreign workers. Regarding tourism-related demand, its growth potential will largely depend on the implementation of polices aimed at positioning Spain not only as a holiday destination but also as a residential destination for retired Europeans. Ultimately, the progressive ageing of Europe's population and Spain's attractive climate, culture, level of safety and quality of life have given us a competitive edge. Are we capable of becoming Europe's Florida?

The rental market

Rent is on the rise in Spain

More and more people are renting their home. In the past 5 years, the percentage of households renting their main home has increased significantly: from 16.1% in 2013 to 17.8% in 2018. This strong demand for rental property has pushed up prices, especially in large cities and tourist resorts, although in the past few quarters there has been a slight moderation. With a view to the future, the demand for rented accommodation is expected to remain strong and, to avoid more pressure on prices, supply will have to grow in line with this demand.

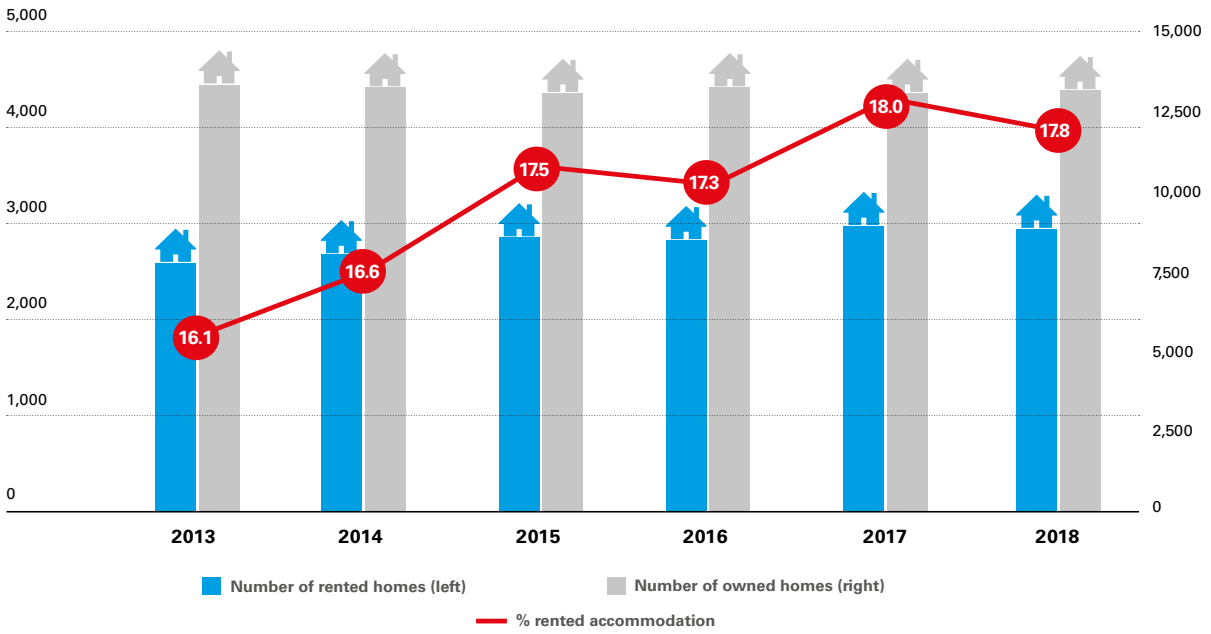
Traditionally, Spanish households have preferred to buy their home rather than rent it. However, the relative share of rented accommodation has been rising year after year: while fewer than 10% of Spanish households rented their home in 2001, this percentage reached 17.8% in 2018.[1] If, in addition to rented accommodation, we also include other types of ownership of the main residence, such as that provided free of charge by a relative, then this figure rises to 23% (the remaining 77% corresponds to households that own their own home). In spite of this considerable increase in renting, its share is still small compared with other European countries. The euro area average is about 30% while Germany, where renting is the most popular, it reaches almost 50%.[2]

① Data from 2001 according to the Bank of Spain and from 2018 according to the Encuesta Continua de Hogares (ECH) by the National Statistics Institute. Including rented accommodation at market and below-market prices.

② These percentages include accommodation provided rent-free (as well as rents at market and below-market prices) and are taken from the European Union Statistics on Income and Living Conditions (EU-SILC) by Eurostat (data from 2017).

Renting is becoming more popular

Thousand households



Source: CaixaBank Research, based on data from the Spanish Statistics Institute (ECH).

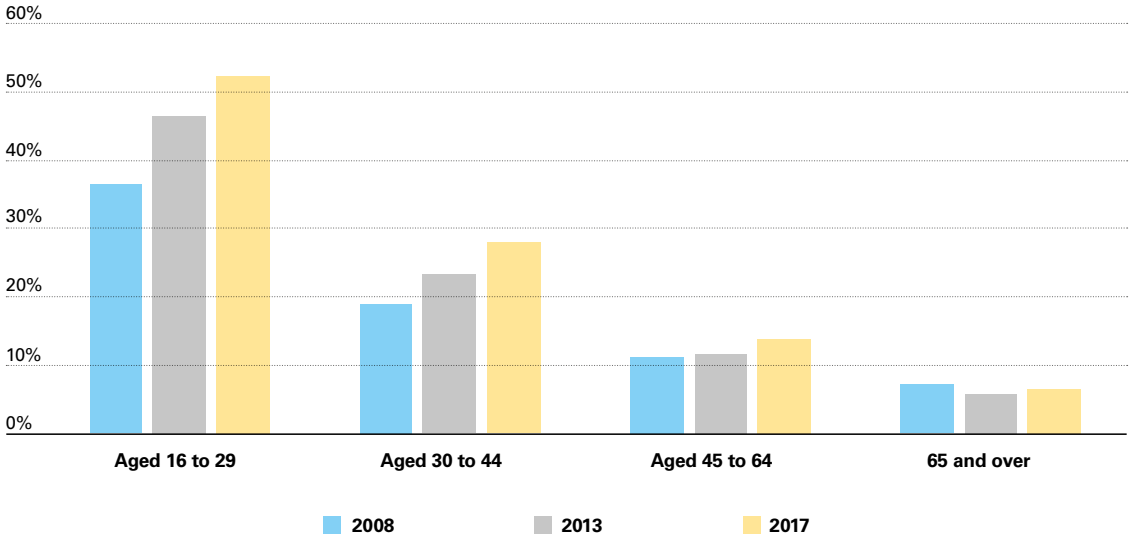
The rise in renting is even more evident if we focus on the most recent period, between 2013 and 2018: over these 5 years the increase in the number of rented homes reached 70,400 per year, a higher figure than the net creation of households (63,700 per year) due to the drop in owned property (–31,000 per year).[3] Nevertheless, it should be noted that, in 2018, the demand for rented accommodation stalled, a phenomenon which, as we will see below, is partly due to the sharp rise in rents in the preceding years.

③ The households living in a home provided rent-free or at a reduced price by another household or company increased by 24,300 on average between 2013 and 2018 according to the ECH.

The proportion of young Spaniards living in rented accommodation has risen considerably over the past decade, partly because their employment conditions are not favourable for buying their own home

Young people rent the most

% of renting households



Source: CaixaBank Research, based on data from the Spanish Statistics Institute (ECV).

Although the tendency to rent is widespread across all age groups, it has become most prevalent among young people. As can be seen in the chart, 52.2% of young people aged 16 to 29 were renting their accommodation in 2017 compared with 36.5% in 2008. In fact, young people leaving their parents' home[4] tend to rent accommodation mainly because their employment conditions are not favourable for buying their own property. All labour market indicators point to young people being the hardest hit by the economic crisis and, although their situation has improved since 2014, the repercussions can still be perceived in the form of a very high temporary employment rate among young people (56.3% in 2018), twice as high as that for the population as a whole; a higher unemployment rate (29.3%) and more long-term unemployment (35.8%), as well as slower growth in wages among young people.

④ According to the Consejo de la Juventud de España (CJE), fewer than 25% of young people under 30 have left their parents' home.

This trend in renting among the new generations has also been reinforced by a shift in preferences from ownership to use and greater geographical mobility. The fiscal changes introduced in 2013, eliminating income tax deductions for investment in the main residence, also mean that there are now fewer tax benefits to owning your own home.

Factors supporting the demand in rented accommodation

The boom in tourism and sharing platforms have also pushed up demand for rented tourist accommodation

The main reason why people rent a property is to live in it. However, the past few years have seen an increase in short-stay rentals for tourism purposes, related to the expansion in the sharing economy and tourism boom. In fact, the number of international tourists visiting Spain has doubled in the past decade and the country is now the world's second most popular tourist destination, only behind France and ahead of the United States. Most of Spain's foreign tourists stay in hotels but an increasing number opt for rented accommodation. Specifically, 11.8% of international tourists rented their accommodation in 2018 compared with 10.7% in 2016, an increase of 1.7 million people in just 2 years (up to 9.7 million).

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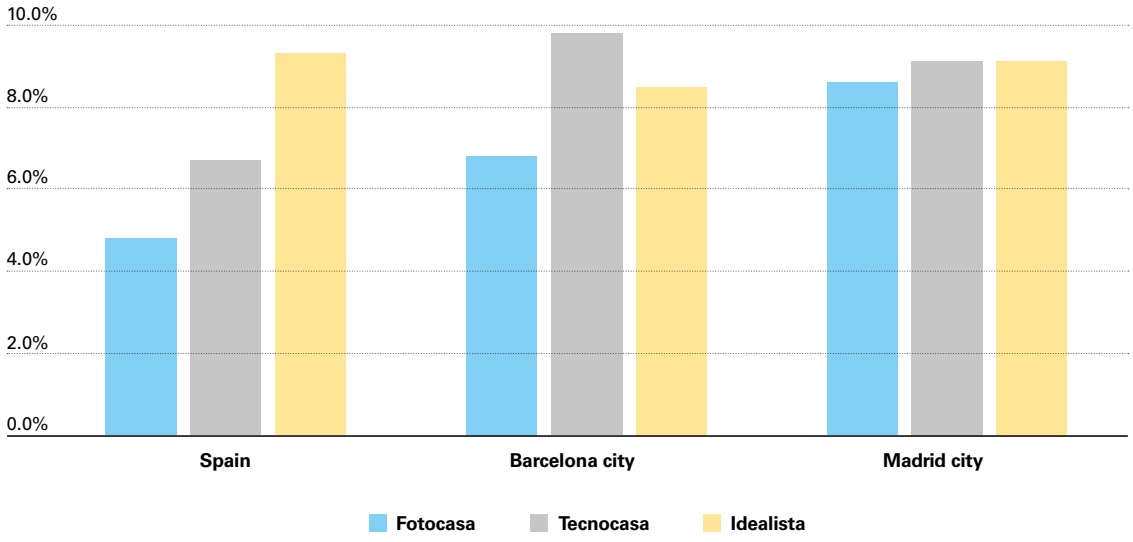
The boom in tourist apartments is considerably controversial, especially in those cities that receive a large number of tourists all year round, due to the effects in economic, social, environmental and town planning terms but also because of their impact on the residential market. For the moment, a lack of data means it is difficult to thoroughly analyse this issue in Spain[5] although the analyses available internationally can provide some pointers. Several studies carried out in the United States have found a limited but positive correlation between the proliferation of tourist apartments on the supply of residential housing and the cost of rent in the long term[6]. In any case, this factor is likely to become less important in Spain given the more restrictive legislation brought in for tourist apartments and the slowdown observed in the growth of inbound tourism.

(5) See Ortuño, Armando and Juan Luís Jiménez, "Las viviendas turísticas ofertadas por plataformas on-line: Estado de la cuestión" Documento de Trabajo 2019/04 FEDEA.

(6) Barron, K., Kung, E. and Proserpio, D. (2017), "The sharing economy and housing affordability: evidence from Airbnb" and Horn, K. and Merante, M. (2017). "Is home sharing driving up rents? Evidence from Airbnb in Boston." Journal of Housing Economics, 38, 14-24.

Rents are soaring

Annual average growth between 2014 and 2018 (%)



Source: CaixaBank Research, based on data from Fotocasa, Tecnocasa and Idealista.

In Barcelona and Madrid, rents increased by 40% between 2014 and 2018 according to real estate websites

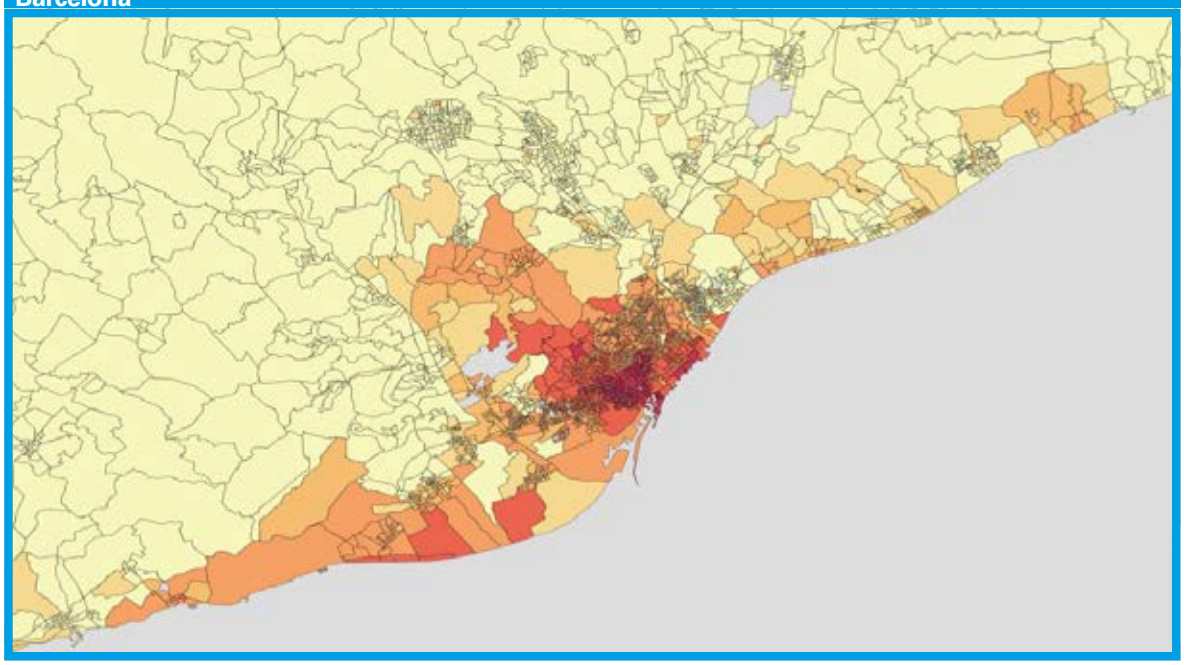
The sharp rise in demand for rented accommodation has driven up prices.[7] This is evident from the available indicators produced by various real estate websites: across Spain, rents rose by between 5% and 9% year-on-year on average from 2014 to 2018, with a cumulative increase of almost 40% in the cities of Barcelona and Madrid. Although this upward trend has eased since 2018, especially in Barcelona, this city has the highest rents (about 15-17 euros per square metre on average according to different sources) while in Madrid

(7) There is currently no official reference that helps to monitor the trend in the rental market. Recently, the government passed Royal Decree-Law 7/2019, creating a state system of benchmarks for rented accommodation prices.

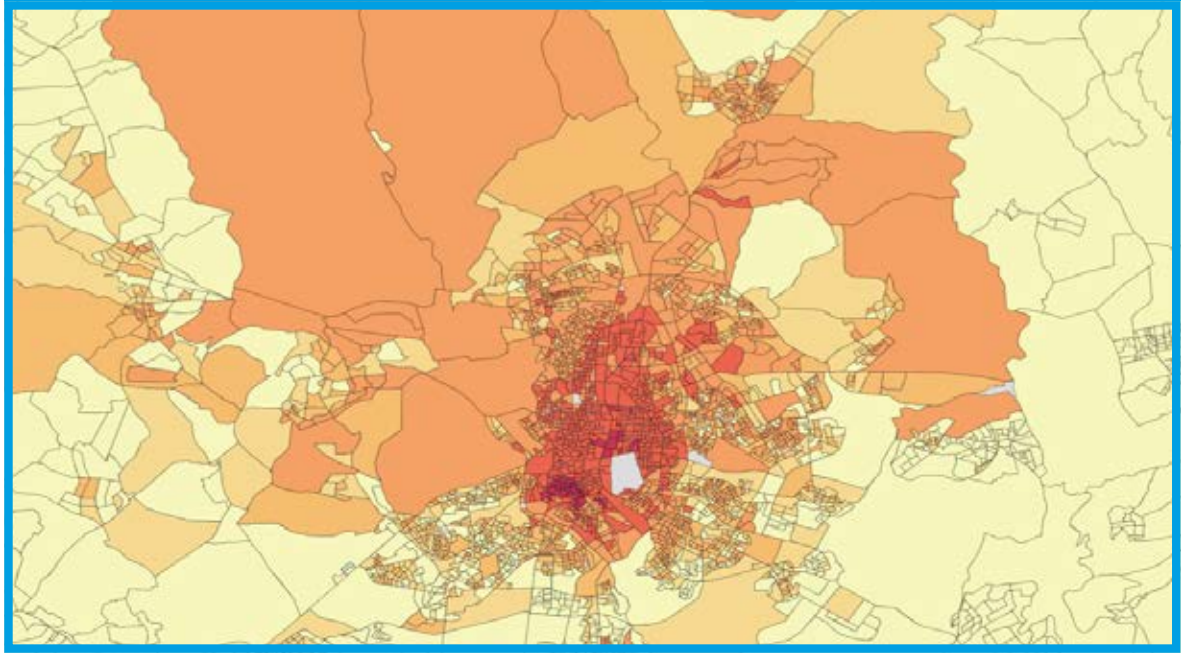
the price is around 14-17 euros per square metre on average. However, both cities have notable differences in rents depending on the district and neighbourhood, as can be seen in the maps below.

Rent per square metre

Barcelona



Madrid



Rent per square metre (index 100 = maximum)

Source: CaixaBank Research, based on data from AIS (2018).

Real Estate

The sharp rise in rent over the past few years has resulted in high prices in many zones. Consequently, the proportion of households with problems in paying their rent has remained high in spite of the economy recovery. According to Eurostat, 42.1% of households that rent their home at market price allocate over 40% of their disposable income to paying rent (compared with 24.9% in the euro area).

Supply is adjusting to the growing rental market with the Build to Rent model

On the supply side, higher rents are encouraging real estate firms to enter the market that specialise in managing buildings completely aimed at rental accommodation. The development of these "turnkey" or Build to Rent (B2R) projects means that the whole block is sold to a single owner who manages and monetises the building by renting out the apartments. This segment has aroused the interest of institutional investors (pension funds, real estate investment trusts, etc.) looking for long-term investments with much more attractive returns than those offered by government bonds, for instance. This new supply will help to professionalise a sector which, in Spain, is still highly atomised.[8]

(8) Although there are no official statistics, it is estimated that only between 2% and 4% of rented accommodation is owned by institutional investors.

What future awaits the rental market?

On the one hand, the factors that have boosted demand in rented accommodation will tend to dissipate as the economic situation improves. For example, young people forming a household in rented accommodation over the past few years should begin to buy their accommodation as their employment conditions improve. However, other forces are acting in the opposite direction, suggesting that demand for rented accommodation will continue to grow. The population projections produced by Spain's National Statistics Institute point to demographic growth over the next few years being primarily due to growth in the foreign population.[9] Given that households with members born abroad are more likely to rent (around 60% compared with 12% of households in which all the members are Spanish), the net inflows of immigrants expected over the coming years should continue to push up demand for rented accommodation. Specifically, we predict this could remain at around 70,000 homes per year, similar to the level observed between 2013 and 2018.

(9) According to the population projections produced by the National Statistics Institute, between 2019 and 2025 around 135,000 households per year will be created and the population will grow by 3%, reaching 48 million people. The population born in Spain will decrease (-1.2%) while that born abroad will pick up (+29.8%).

Should this scenario come about, it will be necessary for supply to increase to prevent the greater demand from driving up rents too far. The trend in the rental market will also be greatly affected by the public policies implemented to encourage affordable and social housing.

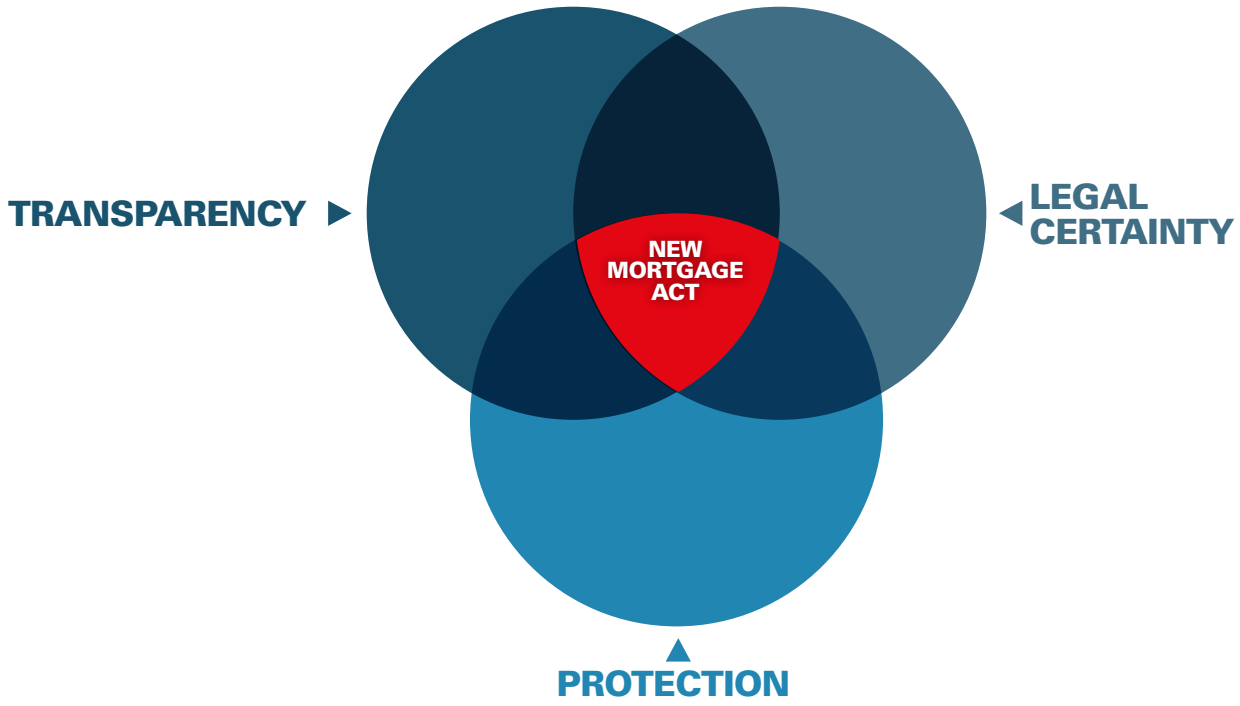
Regulation and legal certainty

The key aspects of the new Mortgage Act

The new Mortgage Act that governs real estate credit agreements has three main objectives: to provide more consumer protection, make mortgage contracts more transparent and improve legal certainty in the financial system. All three are vital to ensure the mortgage market functions appropriately and to improve financial stability.

Popularly known as the "Mortgage Act", Spain's new law governing real estate credit contracts came into force on 16 June 2019, going through a lot of stages, procedures and amendments before finally being published in the Spanish gazette (BOE) on 16 March this year.

We should note that the main aim of this law was to transpose Europe's Mortgage Credit Directive passed in 2014 into Spanish legislation. But the Act also introduces additional measures to protect consumers and improve legal certainty, as well as including measures specific to the Spanish economy.The main aspects of the latter include extending the legal regime to cover not only consumers but all natural persons; a clearer allocation of mortgage costs and the prohibition of minimum interest clauses, issues which have been controversial in the past few years, as well as specific measures to promote fixed interest mortgages.



What are the key changes in the new Mortgage Act?

The main changes introduced by this new legislation, which are crucial for the mortgage market to function correctly, can be grouped into five blocks: transparency measures, measures related to the conduct and organisation of credit institutions, measures to limit early repayment charges, measures to promote conversion to fixed interest mortgages and, finally, criteria for mortgage foreclosures.

1 | TRANSPARENCY

The first block aims **to make mortgage contracts more transparent**. Specifically, it focuses on establishing a greater degree of regulation for the pre-contract phase, with the lender (bank) being required to provide detailed and binding[1] information on the content of the contract, by means of:

- A European Standardised Information Sheet (ESIS) so that offers from different lenders and even from banks from different countries can be compared.
- A standardised warnings sheet (SWS) stating the clauses and reference interest rate used to establish the applicable interest rate, among other details.
- In the case of variable rate mortgages, an analysis of the evolution of the instalments under different interest rate scenarios.

It is also mandatory to visit a notary before the contract is signed to ensure the consumer (the buyer of the property) has received all the aforementioned information and understands the financial and legal obligations contained in the contract, this being recorded in a deed.

2 | CONDUCT OF THE BANK

The aim of the second block **is to improve the rules of conduct and internal organisation of credit institutions**. Specific training is required for personnel selling mortgages to ensure they have the necessary knowledge and skills, as well as setting limits regarding the remuneration policy for staff selling these credit agreements to avoid adverse incentives, and assessments are also required of the consumer's solvency before and over the lifetime of the credit to ensure their creditworthiness is assessed and not just the value of the property in question.

Tying practices (the obligation to take out other products as well as the mortgage)[2] are also prohibited, although bundling is allowed (without any obligation) provided the quotes for such products are presented separately so that the cost of each one can be duly evaluated.

Finally, a clear framework has been established regarding the allocation of the costs associated with taking out a mortgage. Consumers pay any agency, notary and land registry fees while the lender is responsible for appraisal costs and additional copies of notarised documents, if required. However, many credit institutions are already opting to meet all the costs involved in order to reduce the risk of future legal actions.

(1) During the period agreed until the contract is signed, which must be at least 10 days (in Catalonia 14 days).

(2) Except for insurance policies covering repayment of the loan or damages to the mortgaged property.

3 | BANKING FEES

Thirdly, the Act lowers the **mortgage fee for early repayment**[3] taken out after the Act came into force. One of the following options can be agreed for variable rate mortgages: a maximum charge[4] of 0.25% of the capital repaid early during the first 3 years, or a charge of 0.15% during the first 5 years. With fixed interest mortgages, the maximum charge will be 2% during the first 10 years and 1.5% after that. This represents a substantial change to previous regulations as there was no legal limit for fixed rate contracts.

③ This charge compensates the credit institution for any losses incurred due to early repayment.

④ In all cases, never exceeding the financial loss the credit institution may incur.

Maximum charges for early repayment of variable rate mortgages

		New Act	
Repayment period:	Previous regulations	Option 1	Option 2
Under 3 years	0.50	0.25	0.15
Between 3 and 5 years	0.50	0.00	0.15
Over 5 years	0.25	0.00	0.00

Source: CaixaBank Research.

Maximum charges for early repayment of fixed rate mortgages

	New Act
Under 10 years	2,0
Over 10 years	1,5

4 | CONVERSION TO FIXED RATE

The fourth pillar of the Act aims to encourage the conversion of variable rate mortgages to fixed rate in order to make households more financially stable in the face of potential interest rate hikes. Specifically, it establishes that, in such cases, the maximum charges for early repayment should be 0.15% of the outstanding capital during the first three years and 0% subsequently, significantly lower than the maximum charges in place before this legislative change.

One particularly relevant aspect of the new Act is that the **new charges for converting from a variable to a fixed rate mortgage should be backdated**; in other words, they apply to all existing mortgage contracts. In the current environment, with ultra-low interest rates, it is even more advantageous to incentivise this conversion in Spain since 87% of the mortgages are linked to the Euribor so that, in the expected scenario of higher interest rates, the financial burden of many Spanish households will increase. Fixed rate mortgages, which do not pass on the risk of interest rate variations to the borrower, keep mortgage instalments stable until the end of the contract and thereby help financial planning.

Additionally, and in relation to mortgage conversion, the Act makes it easier to convert from credits denominated in a foreign currency to euros (or in the currency in which consumers receive most of their income), protecting them against exchange rate risk.

Maximum charges for early repayment when converting from a variable to a fixed interest mortgage

	Previous regulations	New Act
Under 3 years	0.50	0.15
Between 3 and 5 years	0.50	0.00
Over 5 years	0.25	0.00

Source: CaixaBank Research.

5 | MORTGAGE FORECLOSURE

The last pillar of the Act **establishes tougher criteria for creditors to begin foreclosure proceedings**. During the first half of a credit's lifetime, over 3% of the capital granted must be defaulted or more than 12 monthly instalments. During the second half of the credit's lifetime, this default must be over 7% or more than 15 instalments. This change in the law, applicable to both new and existing mortgages, establishes a single criterion that helps to strengthen the legal certainty of mortgage contracts. Additionally, late payment interest will be the rate agreed in the contract plus 3 points during the late payment period, calculated on the outstanding capital.

What impact will the new Act have on the mortgage market?
In general terms, **the new Act will have a positive effect** as it reinforces legal certainty and therefore helps the mortgage market to work properly.

The new Act will help the mortgage market to perform better

Specifically, the changes introduced by the Mortgage Act foster greater transparency and reduce the unequal balance of information between the different parties. They also clarify some issues that were either not covered by the previous law or ambiguous and that have resulted in conflict and numerous legal proceedings, such as the criteria for mortgage foreclosure and who is responsible for mortgage costs. Legal uncertainty is damaging for both banks and their customers as this makes it difficult to have a precise idea of the costs and risks involved in the operation and can end up limiting the supply or making transactions more expensive. Consequently, **the improved legal certainty and greater transparency help the mortgage market to perform better and promote credit activity**.

Standardising pre-contract documentation at a European level and greater transparency should also encourage competition. However, more competition between countries is unlikely because of the large number of different legal aspects and frameworks that make it difficult to achieve a truly pan-European mortgage market at present.

The Mortgage Act encourages people to take out or convert to fixed interest mortgages. As we have already noted, this kind of contract protects households from interest rate fluctuations and should therefore make the economy more financially stable. However, the limits established for charges on the early repayment of fixed rate mortgages might reduce the supply or end up making such contracts more expensive. Given that banks assume the interest rate risk, at times when interest rates are below the rate established in the contract, should some of the outstanding capital be repaid early the creditor would incur a financial loss since the funds repaid could not be reinvested in an asset providing a similar return. As can be seen in the next chart, **in most cases the bank's financial loss is much higher than the maximum charge established** by law of 2% of the repaid capital in the first 10 years and 1.5% subsequently.

The minimum requirements to be able to foreclose on a mortgage[5] also delay the recovery of the unpaid debt on a defaulted loan, increasing foreclosure costs. This could result in tougher credit conditions for those customers with a higher risk profile.

(5) Under the previous law, clauses tended to establish a period of three months.

In conclusion, the new Mortgage Act will clearly help the mortgage market to function better since it increases consumer protection, reinforces transparency and strengthens the legal certainty of the financial system. Nevertheless, in the short term some of the new measures may result in tougher criteria to grant credit to those people with a higher risk profile. Neither is it clear whether the measures favouring conversions from variable to fixed mortgages are attractive enough to promote this kind of contract.

In most situations, the charge is not enough to cover the bank's loss
(% of the repaid capital)

		Early repayment period					
		1 year	5 years	10 years	15 years	20 years	25 years
Spread between the contract and market interest rate (percentage points)	0.25	3.6	2.9	2.2	1.5	1.0	0.5
	0.50	7.3	6.0	4.5	3.2	2.0	1.0
	0.75	11.2	9.2	7.0	5.0	3.2	1.6
	1.00	15.2	12.6	9.6	7.0	4.5	2.3
	1.25	19.3	16.2	12.5	9.1	6.0	3.1
	1.50	23.7	19.9	15.6	11.4	7.6	4.0

Financial loss less than the maximum charge Financial loss more than the maximum charge

Example: If the capital is repaid 5 years after the mortgage is taken out and the market interest rate has fallen by 1 percentage point, the bank loses 12.6% of the repaid capital, much more than the maximum charge of 2% established by the Act. Note: Assuming a 30-year mortgage at a 2% interest rate. However, the differences with other interest rates are minimal. The relevant variables are the spread between the market interest rate and the point in the credit's lifetime that the early repayment takes place. Future losses are shown at their present value. Source: CaixaBank Research.

HOW TO BUY A HOME

The steps to taking out a mortgage

01

Analyse your budget and how much you can repay

02

Look for your property

03

Look for financing and compare Comparisons are now easier thanks to the standardised

04

The bank studies the operation Land registry checks, appraisal and assessment of the customer's solvency

05

Final approval

06

Reception and signing of the binding offer together with the mandatory documentation, sent to the notary

07

First visit to the notary A deed is drawn up stating that the customer understands the documentation

08

Cooling-off period of at least 10 days from the time the binding offer is received. In Catalonia this is 14 days

09

Signing before a notary

10

Adminis-tration and reception of the deed Pay-ment of the no-tary, registration, taxes, etc.

Indicators and forecasts

Annual change (%), unless otherwise specified

	Average 2000-2007	Average 2008-2014	Average 2015-2017	Data 2018	Forecast 2019[1]	Forecast 2020[1]	Trend[2]
Economic activity indicators							
GDP	3.8	-1.0	3.3	2.6	2.3	1.9	
GVA construction	2.7	-8.0	4.8	7.6	6.0	4.0	
Investment in construction	6.2	-8.6	3.1	6.2	3.6	2.9	
Residential investment	7.9	-9.1	5.0	6.9	3.6	3.0	
Investment in rest of construction	4.8	-7.6	1.4	5.5	3.6	2.8	
New building permits (thousands)	642	94	65	101	120	130	
New building permits	3.9	-30.5	32.5	24.7	19.1	8.3	
Certificates of final completion (thousands)	482	230	47	64	90	110	
Certificates of final completion	8.3	-31.2	5.3	17.8	39.9	22.2	
Synthetic indicator for construction	3.1	-8.4	6.2	7.9	-	-	
Confidence in the construction sector (level)	13.1	-41.8	-30.6	-4.6	-	-	
Labour market							
Total workers registered with Social Security	3.5	-2.1	3.3	3.1	2.8	2.2	
Registered workers in construction	6.1	-13.0	4.5	6.7	5.8	2.7	
Construction of buildings	-	-14.4	5.7	8.0	8.0	2.8	
Civil engineering	-	-16.4	0.5	2.7	3.6	2.1	
Specialised construction	-	-8.9	4.1	4.9	4.6	2.7	
Registered workers in real estate activities	10.3	2.1	7.0	6.2	5.8	2.5	
Total employees (LFS)	4.1	-2.4	2.8	2.7	2.4	1.9	
Employees in construction (LFS)	6.7	-13.5	4.3	8.3	7.4	3.1	
Temporary employment rate in construction (%)	57.3	39.6	42.0	40.5	40.0	40.0	
Unemployment rate in construction (%)	7.5	22.8	14.2	10.5	8.3	7.5	
Demand for housing							
Sales[3] (thousands)	886	388	410	516	542	561	
Sales[3]	-0.1	-11.9	13.6	10.3	5.0	3.5	
New housing[3]	12.1	-13.6	-10.9	-6.0	-	-	-
Second-hand housing[3]	-7.8	-10.8	24.1	-5.9	-	-	-
Foreign sales[4]	-22.1	-6.3	13.4	3.0	2.0	1.1	
Second home sales[5]	-7.6	-9.8	7.0	10.7	7.0	5.5	
Prices							
House prices (Min. Public Works)	12.9	-4.8	1.8	3.4	4.4	4.4	
House prices (INE)	-	-6.1	4.8	6.7	5.7	4.8	
Land prices	17.5	-8.8	3.4	-1.6	0.4	4.2	
CPI rent	3.2	1.8	0.4	1.7	-	-	-
Affordability ratios							
House prices (% gross disposable income)	6.5	7.4	6.7	7.4	7.5	7.6	
Theoretical burden (% gross disposable income)	35.1	37.5	30.5	32.3	32.4	33.0	
Return on rent (%)	4.5	3.5	4.4	4.1	-	-	
Financing[6]							
Number of mortgages	5.8	-22.7	15.3	10.6	16.0	-	
Outstanding balance of credit to purchase housing	23.0	-0.1	-3.7	-1.9	-1.2	-	
New loans housing	-3.0	-21.4	12.9	10.8	7.4	-	
Outstanding balance of credit for property development	37.3	-10.1	-11.1	-17.1	-	-	
NPL ratio of credit for housing (%)	0.5	3.5	4.9	4.4	-	-	
NPL ratio of credit for property development (%)	0.4	20.0	26.2	10.9	-	-	

Notes: 1. Forecasts at 31 May 2019. 2. A sun indicates growth above the 2015-2018 average less 1/4 standard deviation; a sun with a cloud indicates growth above the 2015-2018 average less a standard deviation; a cloud indicates negative growth or growth above the 2015-2018 average less 1.5 standard deviations; rain indicates growth below the 2015-2018 average less 1.5 standard deviations. 3. The 2000-2007 average for house sales corresponds to the period 2004-2007 and the data come from the Ministry of Public Works. National Statistics Institute's sales figures as from 2007. 4. Foreign sales according to the Ministry of Public Works. 5. Sales of second homes are estimated based on the sales carried out in a different province than the buyer's residence. 6. The Financing data in the column "Forecast 2019" correspond to cumulative data up to the latest data available for 2019.
Source: CaixaBank Research, based on data from the National Statistics Institute (INE), Ministry of Public Works, Ministry of Public Works, Ministry of Employment and Social Security and Bank of Spain.

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