# Real Estate

## Sector Report

2nd Semester 2021

## The real estate sector in the new normal

The crisis tiptoes through the real estate sector

How has the slump in foreign tourism affected the residential property market?

The impact of COVID-19 on commercial real estate investment in Spain

Are international housing markets at risk of overheating?

CaixaBank Research


**Sector Report**

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**CaixaBank Research**

**Enric Fernández** Chief Economist
**José Ramón Díez** Director of International Economies and Markets
**Oriol Aspachs** Director of the Spanish Economy
**Sandra Jódar** Director of Bank Strategy
**Judit Montoriol Garriga and Pedro Álvarez Ondina** Coordinators of the *Real Estate Sector Report*

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# Summary 2021









**«Architecture is the art of how to waste space».**
PHILIP JOHNSON

# Real Estate

## SPAIN'S REAL ESTATE SECTOR IS GRADUALLY RETURNING TO ITS PRE-PANDEMIC TRENDS:

- House sales picked up notably in the first few months of 2021.
- The trend in new building permits is one of gradual recovery.
- Adjustments in house prices have been very limited and we expect these to continue rising moderately but steadily.

## THE SLUMP IN INTERNATIONAL TOURISM AND ITS IMPACT ON THE REAL ESTATE MARKET

### CHANGE IN PURCHASES BY FOREIGNERS IN 2020

**24%**

**House** purchases by **foreigners fell in** 2020

The **Mediterranean coast** and **islands** have been hit the **hardest**


### THE TREND IN HOUSE PRICES

**Tourist municipalities**

+7.5% 2019 → -1.1% 2020 → FORECAST +0.5%

**Non-tourist municipalities**

+7.1% 2019 → +1.6% 2020 → FORECAST +0.9%

## THE PANDEMIC'S IMPACT ON COMMERCIAL REAL ESTATE INVESTMENT HAS BEEN UNEVEN ACROSS SEGMENTS:

**BENEFITTED**

- RESIDENTIAL PROPERTY
- RETAIL CHANNEL
- LOGISTICS SECTOR

**DISADVANTAGED**

- OFFICES — Due to the rise in teleworking
- COMMERCIAL PREMISES — Due to the rise in e-commerce
- HOTELS — Due to the slump in tourism

## ARE INTERNATIONAL HOUSING MARKETS AT RISK OF OVERHEATING?

Growth in house prices accelerated in 2020 in many advanced economies

**Factors supporting the rise in house prices:**

- Change in buyer preferences due to lockdowns and the **rise in teleworking.**
- **Limited supply** in some residential markets.
- **Low interest rates** encourage home purchases.
- **Forced savings** accumulated during the pandemic can be invested partly in real estate.

Executive summary

# The real estate sector in the new normal

The Spanish economy has now reached the turning point we have been waiting for. All the economic indicators for Q2 2021 show a notable recovery in economic activity as a large proportion of the restrictions on business and travel have been lifted thanks to the acceleration in the vaccination campaign. Although the main downside risks affecting the macroeconomic scenario remain contingent on developments in the health situation (such as the appearance of new variants of the virus and the effectiveness of vaccines against these), the fact is **Spain's good vaccination rate means we can be fairly optimistic about the outlook for its economy**. In particular, in 2021 we expect the economic recovery to gain traction in the second half of the year, helped by the return of international travel and tourists, as well as employment to continue improving and many of the furloughed employees to return to work.

In this context of economic recovery, we also expect the real estate sector to consolidate its upward trend. **Activity in the residential market is recovering reasonably well from last year's extraordinary downturn** (sales fell by 17.7% and new building permits by 19.5% in 2020). In the first few months of 2021, house sales rallied considerably and new building permits are gradually recovering. On the other hand, house prices have accentuated their downward trend observed in 2019. Nevertheless, their performance was surprisingly resilient during the pandemic, particularly the prices for new builds.

**The impact of the crisis on the sector has therefore been limited and much less than initially expected**. Among the factors behind this resilience are the solid starting position of households (i.e. low debt in general), a real estate market without excess supply and a decisive economic policy response, deployed through a wide range of instruments that have enabled households to maintain their income. Financing conditions for house purchase loans have also remained accommodative. Moreover, this resilience has not been exclusive to the Spanish real estate market but has also been observed in most real estate markets in advanced economies, an aspect that is presumably related to the expansionary fiscal and monetary policies implemented.

However, **one segment that has been hit especially hard by the pandemic has been foreign demand**. The most popular areas with tourists, namely the Mediterranean coastline and islands, saw a considerable drop in purchases by foreigners as a result of the restrictions on international travel. Nevertheless, in spite of this slump in demand, in the most popular municipalities the adjustment in prices has been slight and the outlook for the coming quarters is good, thanks to the revival in international tourism that is expected with the progress of vaccinations and, above all, for the coming year.

Looking at the trend in the commercial real estate market, we can also see that certain types of assets have performed less well, such as offices due to the rise in teleworking and hotel assets due to the slump in international tourist arrivals. On the positive side, the real estate assets that have benefited from the pandemic include residential property, as well as logistics assets and data centres.

In contrast to the previous crisis, **the construction industry could be a lever for growth in the current recovery thanks, in part, to the NGEU funds earmarked for the construction and renovation of housing and urban regeneration** (investments totalling 6,820 million euros are expected over the next few years). NGEU funding is not only a great step forward at a European level but is also a unique opportunity that must be maximised in order to strengthen Spain's economic recovery and transform and modernise its economy by promoting the country's ecological transition and digital transformation and improving its productivity, all sustainably.

Situation and outlook

# The crisis tiptoes through the real estate sector

Activity in the real estate market is recovering from the extraordinary slump experienced during the strictest months of lockdown. House sales picked up notably in the first few months of 2021 while new building permits continue to recover gradually. On the other hand, house prices have accentuated their downward trend observed since mid-2018. Nevertheless, their performance was surprisingly resilient during the pandemic, particularly the prices for new builds, and we expect house prices to continue posting moderate but steady gains in the coming quarters.

## The Spanish economy is on its way to recovery

Despite a very weak start to the year, marked by a complicated epidemiological situation and considerable restrictions on business, from April onwards and especially in May and June, a widespread recovery could be observed in the economic indicators, which we expect to continue and even intensify in the second half of the year. The good rate of vaccination is helping to revive household consumption and tourism (especially domestic and European), to which will be added the first transfers of NGEU funds during the second half of the year.[1] **CaixaBank Research therefore expects the Spanish economy, after falling by 10.8% in 2020, to grow by a significant 5.7% in 2021, speeding up to 6.2% in 2022.**

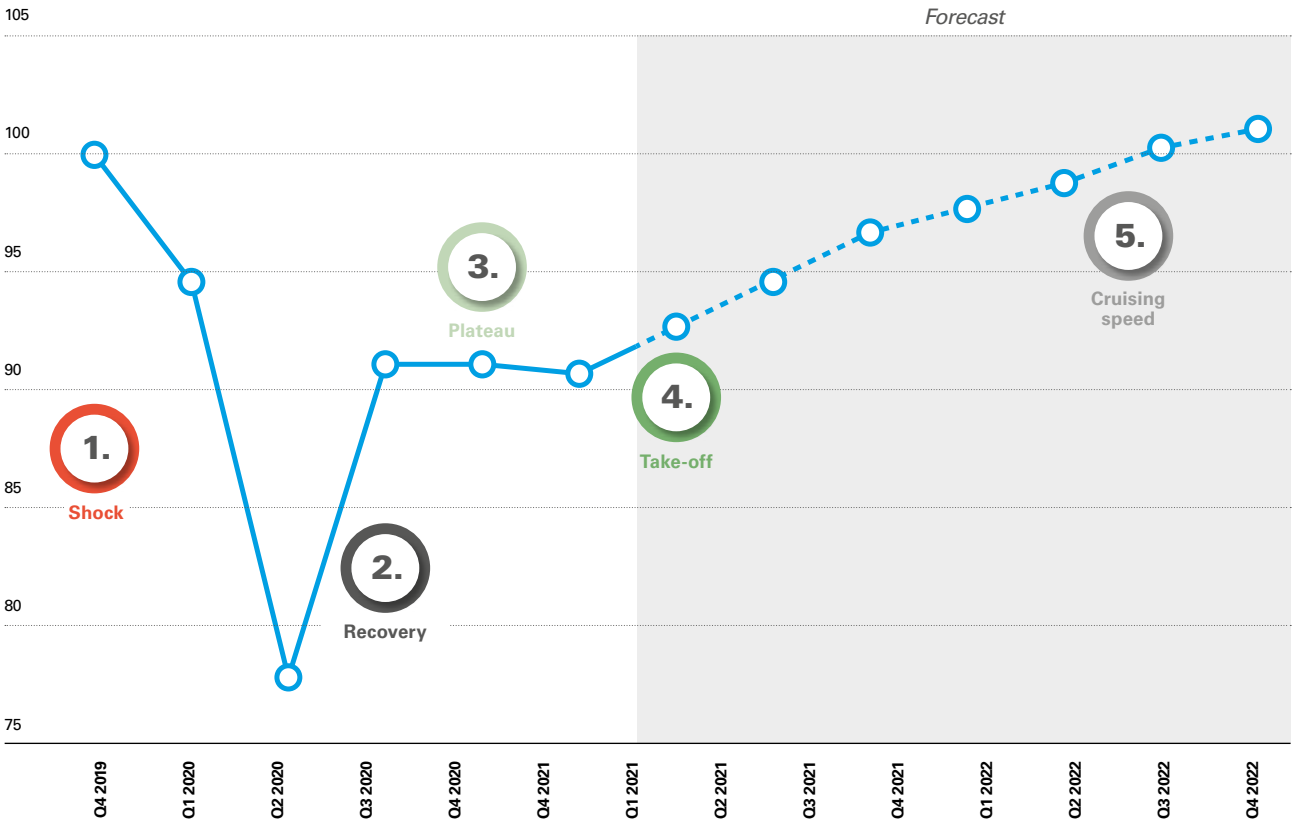
**(1) According to our forecasts, tourism will get back to around 50% of its 2019 level. In addition, the NGEU funds will contribute 1 pp to growth in 2021. However, developments in the epidemiological situation remain uncertain (such as the appearance of new, more contagious variants) and this continues to be the main determining factor for the macroeconomic scenario.**

## The Spanish economy has now reached the turning point we have been waiting for, thanks to the extensive easing of restrictions on economic activity and the progress made in vaccinating the population

**The labour market is reviving with the lifting of restrictions on business**, with job creation and the reincorporation of furloughed workers intensifying since the end of the state of emergency in May. Specifically, the number of workers registered with Social Security rose by 579,000 between April and June, while the number of furloughed employees fell by 277,000. As a result, effective employment (non-furloughed workers registered with Social Security) increased by 856,000 in Q2 to over 19 million, a very positive trend that we expect to continue in the coming months as the economic recovery takes hold.

### The economic recovery is consolidating

Real GDP (100 = Q4 2019)




**Source:** CaixaBank, based on data from the National Statistics Institute.

# Real Estate

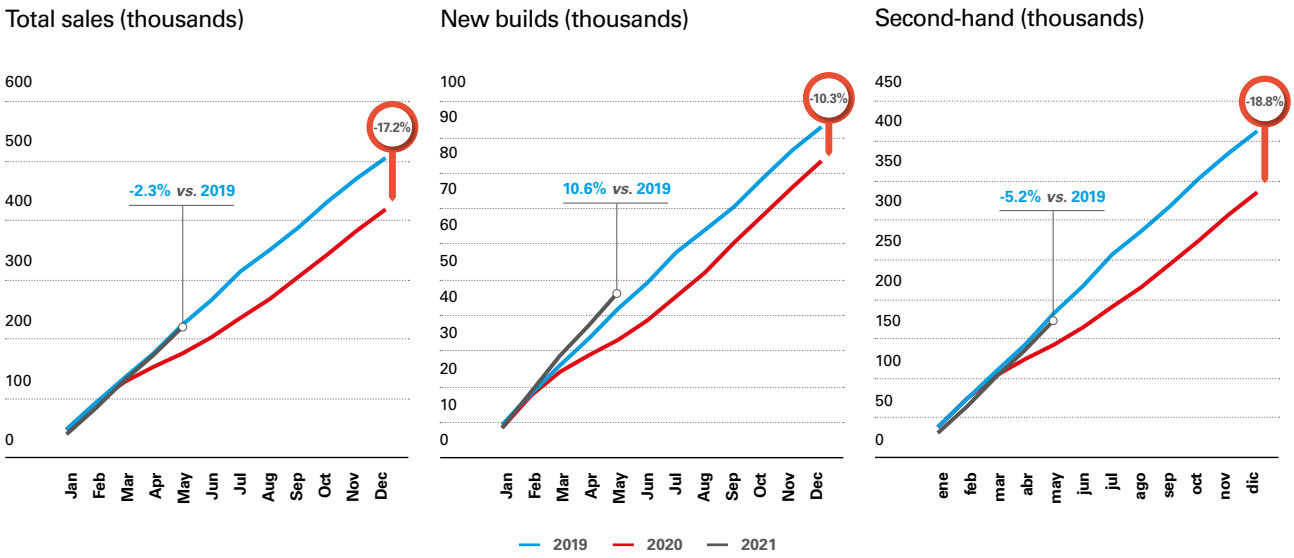
## Dynamic demand for housing

The demand for housing looked remarkably lively in the first few months of 2021, so much so that the cumulative number of house sales from January to May was only 2.3% below the figure for the same period in 2019.[2] This recovery in sales is concentrated in new builds, which are growing quickly (+10.6% for the cumulative January to May figure compared to 2019), while second-hand sales remain weaker (–5.2%). As a result, the share of new house sales out of the total so far in 2021 has risen by 1.2 points compared to 2020, up to 21.1%. This more dynamic demand for new housing compared to second-hand is probably related to the new preferences of buyers for larger homes with bigger outdoor areas, as they have been spending more time at home because of lockdowns and the rise in teleworking, requirements that new developments find it easier to meet.

**(2) The months of March, April and May 2020 were heavily affected by the slump in activity during the big lockdown, so we have taken 2019 as our baseline. Compared to 2020, sales rose by 24.8% year-on-year in the cumulative January to May figure.**

**House sales are very close to the figures posted in 2019, with a notable upturn in new housing linked to new needs on the part of households emerging with the lockdown and rise in teleworking**

### Sales are recovering from the decline in 2020, especially new builds




**Note:** Cumulative monthly data for the year.
**Source:** CaixaBank, based on data from the National Statistics Institute.

If we look at the type of buyer,[3] we can see that the increase in house sales in Q1 2021 compared to Q1 2019 (2.2%) is due to a considerable rise in purchases of main residences by Spaniards (9.6%). In other words, the evidence seems to indicate that this is replacement demand by segments of the adult population with a medium-high socio-economic position, given that the crisis has had a greater impact on young people and workers with temporary contracts and low incomes, who would find it more difficult to buy their own home. The other buyer categories were less active: second home sales fell by 8.9% in Q1 2021 compared to the same period in 2019, while purchases by foreigners decreased by a significant 21.4%. The next article in this Report, entitled «How has the slump in foreign tourism affected the Spanish residential property market?», provides an in-depth analysis of the trend in foreign demand.

**In line with the trend in sales, the number of new loans granted to households to purchase housing has rebounded** (28.1% in the cumulative figure for January to May 2021 compared to the same period in 2019). Financing conditions for home purchase loans have also remained accommodative,[4] reflecting the ECB's monetary policy which aims to maintain an expansionary financial environment to support economic recovery. In this respect, CaixaBank Research does not expect any change in the ECB's official interest rates during the forecast period (2021-2022).

**The pandemic has led to a certain change in the type of housing demanded, although it remains to be seen whether this is merely a temporary phenomenon**

**(3) The transaction statistics published by the Ministry of Transport, Mobility and Urban Agenda (based on data from the General Council of Notaries) differentiate between purchases by foreigners, purchases of second homes (those in which the buyer and the home are in different provinces) and the rest, which are considered to be purchases of main residences by Spaniards.**

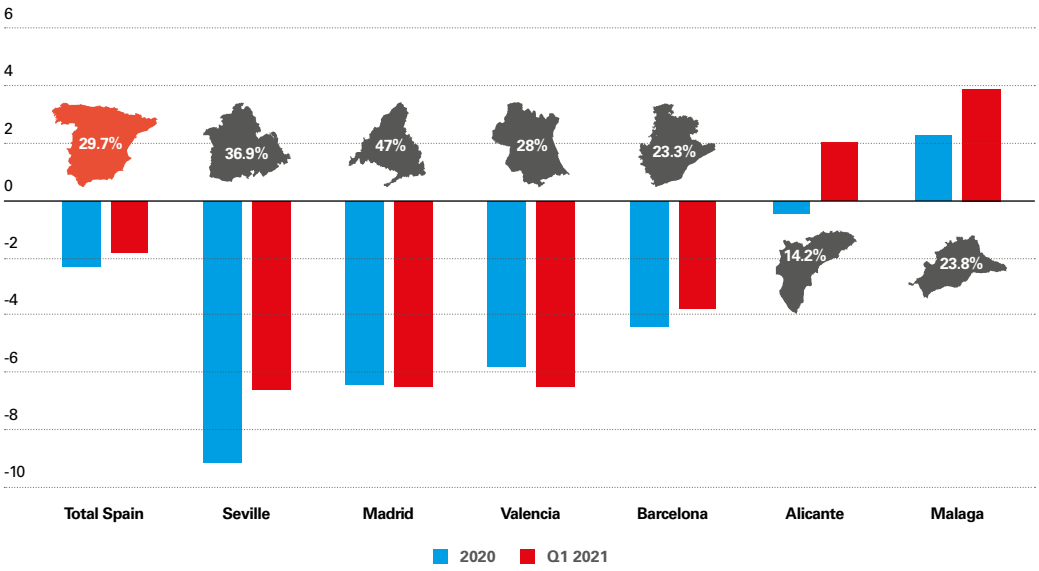
**(4) Specifically, interest rates on loans for house purchases have fallen by nearly 20 bp year-on-year to 1.5% in May 2021 (latest available figure), which is an all-time low, without the rest of the conditions becoming tighter, be it the terms, collateral required or amounts, except for conditions related to the borrower's solvency.**

# Real Estate

Since the outbreak of the health crisis, there has been an increase in the average size of residential properties, both interior and exterior,[5] the proportion of purchases of single-family homes has grown[6] and there has been a certain shift in demand from provincial capitals to other less populated municipalities.[7] Specifically, in 2020, 69% of the provincial capitals reduced their share of the total sales in their respective provinces compared to their average share in the previous four years. The city of Seville is a case in point, as its share of the province's sales fell from 46.1% in 2016-2019 to 36.9% in 2020. However, in Q1 2021 most capital cities have stopped losing their share of sales with respect to their provinces, suggesting that this trend has been temporary, associated with the new needs of families arising from the lockdown and the increase in teleworking. Nevertheless, teleworking is likely to become more prevalent than before the pandemic, so a higher proportion of buyers may choose to live in locations further away from their place of work.[8]

## Sales decline in the provincial capitals in 2020

Change in share of sales in the province's capital out of the province's total sales in 2020 and in Q1 2021, compared to the average share for 2016-2019 (pp)




**Notes:** The figures on the map represent the share of sales in the capital compared to the total for the province in 2020. For the national total, the share is calculated as the sum of sales in the 52 provincial capitals in relation to total sales.
**Source:** CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.

## How will house sales perform in the next few months?

The main factors boosting housing demand will continue to support its positive trend in the coming months. Firstly, we expect the improvement seen in the labour market in Q2 to continue in the next few months as the tourism sector and leisure and culture-related activities recover. Secondly, **the improvement in consumer confidence**, already approaching pre-pandemic levels, and greater certainty regarding the developments in the health situation thanks to the progress made by the vaccination campaign, will encourage more long-term decisions to be made, such as buying a home. Thirdly, financial conditions will remain extremely accommodative and support the flow of credit

**5 According to the College of Registrars, the average area per residence in 2020 was 101 m², an increase of 2.2% over 2019. In Q1 2021, the average area continued to grow (+0.8%) to 103 m², the highest level for the historical series.**

**6 In 2020, single-family properties accounted for 20% of house sales (+1.9 pp compared to 2019), reaching the highest percentage in the historical series in Q4 2020 (22.5%). This percentage was still high in Q1 2021 (21%).**

**7 These changes in demand may have also contributed to new builds being more dynamic during the pandemic, as they tend to be more adaptable to new buyer preferences.**

**8 See «How will teleworking change urban mobility and residential decisions?» at https://www.caixabankresearch.com/en/economics-markets/labour-market-demographics/how-will-teleworking-change-urban-mobility-and**

to households. And, finally, the «forced»[9] savings accumulated by households during 2020 could end up being allocated, in part, towards real estate investment. Indeed, a large proportion of these savings, around 3.5% of GDP,[10] has been accumulated by middle and high-income households which tend to have a lower propensity to consume. If, in addition, we take into account the low returns offered by alternative assets, such an environment is likely to boost investment in real estate.

## In 2021 as a whole, we predict 7.7% growth in residential property sales, totalling 450,000 homes

On the other hand, however, it is also true that the dynamic housing demand observed in the first few months of the year is partly due to a **build-up of pent-up demand** during the months of lockdown,[11] an effect that will tend to dissipate in the near future. Likewise, foreign demand will continue to weaken until international travel gets back to normal (new outbreaks or more contagious variants could therefore affect the trend).

Consequently, in the coming quarters we expect housing demand to continue to grow but at a somewhat more moderate pace compared with the upturns seen in March and April. **In 2021 as a whole, we predict 7.7% growth in residential property sales, totalling 450,000 homes.** This forecast is significantly lower than the 505,000 sales posted in 2019, a sign that we expect housing demand to remain below potential until the economic recovery takes hold and, above all, foreign demand recovers fully, something we do not think will happen until 2023.

**9 In addition to precautionary savings resulting from the high uncertainty that normally comes with a recessionary period, the particular features of this health crisis have also forced households to save as it has been impossible for them to continue their usual level of consumption due to the restrictions on travel and business imposed to control the spread of the pandemic.**

**10 See «Pent-up demand during the health crisis and the outlook for consumption» at https://www.caixabankresearch.com/en/sector-analysis/retail/pent-demand-during-health-crisis-and-outlook-consumption?index=**

**11 Pent-up demand refers to households that wanted to buy a home but were unable to do so due to travel restrictions, or that postponed their purchase due to the uncertainty caused by the pandemic.**

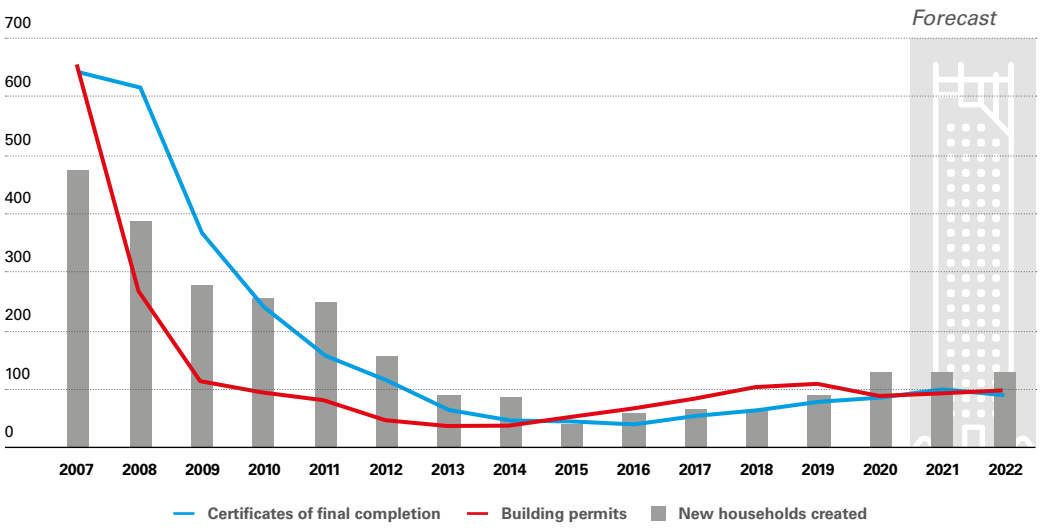
# Real Estate

## Supply indicators point to a weak start to the year but with a trend of gradual recovery

On the supply side, new building permits posted a weak start to the year. Between January and April 2021, around 33,000 residential properties were approved, a figure 12.3% lower than for the same period in 2019 (+16.7% compared to January-April 2020). On the other hand, the trend in certificates of completion is much more positive (28,754 homes for the cumulative figure from January to April, 22.1% more than in the same period of 2019). This shows that the pandemic had a huge impact on the start of new developments (permits fell by 20% in 2020), while construction work that was already underway restarted quickly after last spring's interruption (around 86,000 homes were completed in 2020, 9.1% more than in 2019). Nevertheless, we should remember that this sharp fall in new building permits in 2020 suggests there will be a smaller number of homes completed over the next two years.

### The production of new housing lags behind net household creation

(thousands)




**Note:** The number of households forecast for 2021 and 2022 is assumed to be the same as in 2020 (129,000).
**Source:** CaixaBank Research, based on data from the Ministry ofTransport, Mobility and Urban Agenda and the National Statistics Institute.

Having overcome the weak first quarter in which, in addition to the pandemic, construction was also affected by the Filomena snowstorm, supply indicators have looked more positive in recent months. Cement consumption grew by 3.5% in May compared to May 2019 and confidence in the construction sector has improved considerably (now above its pre-pandemic levels). There is also a favourable trend in the sector's labour market data; in June, the number of registered workers in construction, excluding furloughed employees, was 2.3% higher than in June 2019. By branch of activity, registered employment in the building sector seems to be less affected by the COVID-19 pandemic compared to the other branches of construction, as shown by the greater growth in effective registered workers (+2.5% in June 2021 compared with June 2019).

## Despite the recovery in construction, the production of new housing is not keeping up with the structural demand due to the net creation of households, potentially pushing up prices

**Construction will continue its gradual recovery in the coming quarters.** We expect a moderate increase in new building permits (5%), totalling 90,000 homes in 2021 and 95,000 in 2022. On the other hand, housing completions could total 100,000 in 2021 (when the builds started in the final part of 2019 would enter the market), but would fall to around 90,000 in 2022 (due to the fall in permits in 2020). In both years, new housing production would again be lower than net household creation, something that has been occurring since 2010.

## Construction costs rise temporarily due to bottlenecks in the global economy

The recent rise in commodity prices is having an effect on construction materials, whose prices rose particularly sharply in the first few months of 2021 (+4.6% year-on-year in April compared to April 2019). This increase is largely due to temporary factors related to bottlenecks in the global economy as a result of the strong economic recovery and short-term difficulties of adjusting supply to changes in demand, so it should not have a significant impact on the real estate market in the medium term.

# Real Estate

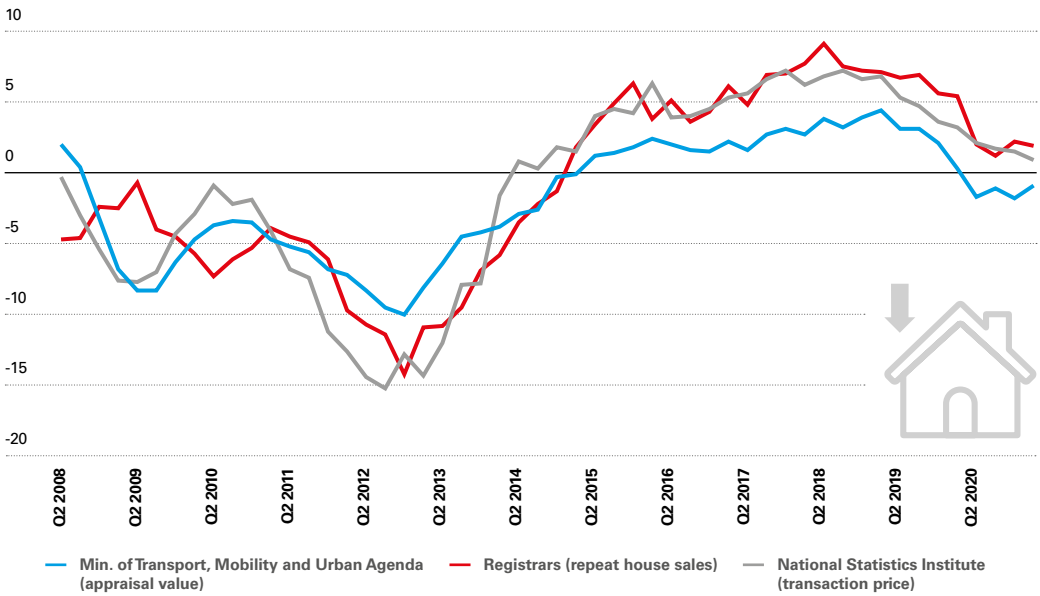
## House prices prove to be remarkably resistant to the downturn

Despite the historic economic slump and sharp drop in real estate activity in Q2 2020, house prices have been resilient. Although the downward trend observed since mid-2018 was aggravated last year, **during the pandemic house prices were surprisingly resistant to falling, particularly in the case of new housing**. This resilience has not been exclusive to Spain's real estate market but has also been observed in most real estate markets in advanced economies, an aspect we analyse in detail in the article «The impact of the pandemic on international housing markets: is there a risk of overheating?» in this Report.

Among the factors behind this resilience of prices during the pandemic are the solid starting position of households (i.e. low aggregate debt), a housing market without excess supply and a decisive economic policy response, deployed through a wide range of instruments that have enabled households to maintain their income. Financing conditions for loans for house purchases also remained broadly accommodative. Prices were even more resilient in the case of new housing, thanks to two additional factors. Firstly, because a large proportion of the purchases made last year were, in many cases, transactions that had been undertaken prior to the pandemic. Secondly, prices have also been supported by the relative scarcity of new housing in the face of growing demand for this type of residence, more in line with the new preferences of buyers due to location, more space, higher sustainability standards, etc.

### The growth in house prices is slowing but they are still remarkably resistant to falling

Year-on-year change (%)




**Source:** CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda, the College of Registrars and the National Statistics Institute.

The most recent data, corresponding to Q1 2021, show moderate but sustained rises in house prices. According to the National Statistics Institute, these rose by 0.5% quarter-on-quarter in Q1 2021, although in year-on-year terms their growth continued to slow down (0.9% compared with 1.5% in Q4 2020). The prices of new builds slowed sharply to more sustainable growth rates (from 8.2% in Q4 2020 to 2.3% year-on-year in Q1 2021), although they are still rising faster than for second-hand housing (0.7% year-on-year in Q1 2021).

Similarly, the repeat house price index published by the College of Registrars rose by 2.1% quarter-on-quarter in Q1 2021 (1.9% year-on-year), while the appraisal value of free housing provided by the Ministry of Transport, Mobility and Urban Agenda advanced by 0.2% in Q1 2021, matching its figure for the previous quarter. In year-on-year terms, house prices slowed down their rate of decline (–0.9% compared with –1.8% in Q4). The price indicators published by different real estate portals and other agents in the real estate market suggest that the recovery in house prices continued in Q2 2021. At CaixaBank Research, we expect house prices to continue posting moderate but steady gains, perhaps growing by slightly more than 1% in 2021.

**Adjustments in house prices have been very limited and we expect them to continue posting moderate but steady gains**

## The rental market: much harder hit, especially in large cities

Rental prices are usually more flexible and adjust more quickly to the economic situation than purchase prices. According to the indicators available on various real estate portals, **rents have fallen more sharply in Spain as a whole** (according to Idealista, they had fallen by 5.6% year-on-year in June 2021). This adjustment has been more acute in the larger cities (–13.2% in Barcelona and –12.4% in Madrid), although the most recent monthly data show rents stabilising at this lower level.

One factor affecting the reduction in rents during the pandemic is the notable increase in the amount of rented accommodation available, resulting from properties that had been destined for tourist rental being transferred to the traditional residential market.[12] Now that the end of the current health crisis is in sight and the tourism market is starting to pick up, we expect this situation to readjust again, swelling the supply of rented accommodation for tourists, albeit within moderate parameters as there is still a great deal of uncertainty regarding how quickly tourism will recover. On the supply side, the shortage of rental accommodation is encouraging the development of Build to Rent (B2R) projects, i.e. the construction of whole buildings for rent. These developments are currently concentrated in the major capital cities and their outskirts, i.e. those that tend to have the highest demand for rented accommodation, but this kind of business has evident growth potential given the growing trend in the proportion of households living in rented accommodation.[13] We look at the recent trends in residential investment in this Report, in the article «The impact of COVID-19 on commercial real estate investment in Spain and its high demand potential».

**(12) According to a study by pisos.com, last summer 20% of the tourist rental accommodation on offer in Spain had changed to residential, a trend that is gradually reversing in 2021: since January 2021, 2% of the residential rental supply in Spain has swapped to tourist rents. A study by Fotocasa in April estimates that 84% of the flats for rent are for residential use and only the remaining 18% for holiday rentals.**

**(13) In 2020, 17.3% of Spanish households lived in rented accommodation, a slight decline compared to 2019 (18.3%) but a clear rise if we take a medium-term perspective (16.1% in 2013) which becomes even more marked over a long-term perspective (less than 10% in 2001).**

# Real Estate

## The real estate sector will be boosted by the European Next Generation EU funds

In contrast to the previous crisis, the construction industry could be a lever for growth in the current recovery thanks, in part, to the many different investments and reforms proposed by the Recovery, Transformation and Resilience Plan (PRTR), which has already been approved by the European Commission. This includes a package of investments and fiscal measures aimed at the sector totalling 6.82 billion euros over the period 2021-2023.

## Next Generation EU funds will spur economic recovery and help to tackle the major challenge of climate change

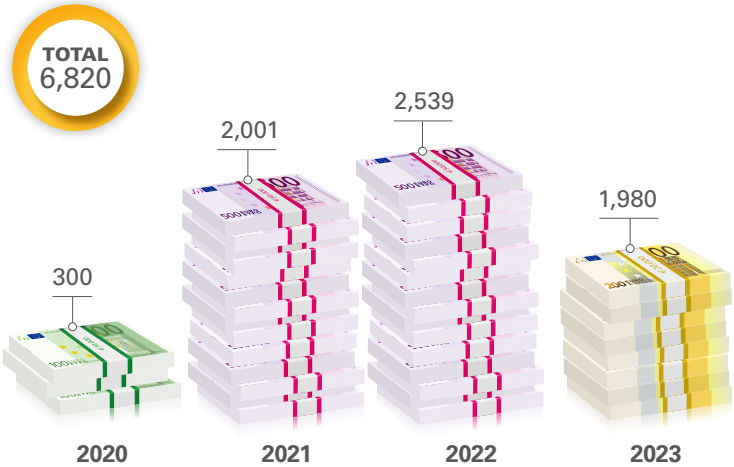
Within component two of the PRTR, consisting of the implementation of the Spanish Urban Agenda, **3.42 billion euros will be allocated to renovating housing and the economic and social renewal of residential environments**. The grants will be conditional and proportional to the energy savings achieved by each project, in order to encourage comprehensive renovation and improvements in the energy efficiency of Spain's housing, currently among the oldest in Europe.

An additional **1 billion euros have also been earmarked for the construction of social rented accommodation in energy-efficient buildings, a much-needed measure to improve the stock of public housing with social and/or affordable rents**. In fact, Spain has one of the smallest supplies of such accommodation in Europe: social housing accounts for 2.5% of the total number of main residences in Spain compared with a European average of 9.3%, according to Eurostat data. To reach the European average, 1.2 million additional social housing units would be needed, a figure that would be difficult to achieve without public-private partnerships.[14]

**(14) For more details, see «NGEU: an opportunity to relaunch Spain's real estate sector», available at https://www.caixabankresearch.com/en/sector-analysis/real-estate/ngeu-opportunity-relaunch-spains-real-estate-sector**

### Urban renewal and regeneration plan

Distribution of the funds (million euros)




**Breakdown of funds by project**
(million euros)

| | TOTAL | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| Rehabilitation programme for economic and social recovery in residential environments | 3,420 | - | 1,151 | 1,389 | 880 |
| Programme to construct social rented accommodation in energy-efficient buildings | 1,000 | - | - | 500 | 500 |
| Energy renovation programme for buildings (PREE) | 300 | 300 | - | - | - |
| Regeneration and demographic challenge programme | 1,000 | - | 350 | 350 | 300 |
| Programme to promote the renovation of public buildings | 1,080 | - | 480 | 300 | 300 |
| Aid programme for the implementation of pilot projects for local action plans within the Spanish Urban Agenda | 20 | - | 20 | - | - |

Source: Recovery, Transformation and Resilience Plan (PRTR).

Drop in demand

# How has the slump in foreign tourism affected the residential property market?

The Spanish residential market has suffered from a slump in foreign demand during the pandemic. Restrictions on international travel have hit the most tourist-oriented areas of the Mediterranean coast and islands particularly hard, which have seen a sharp fall in purchases by foreigners. Nevertheless, although house prices in these tourist-oriented municipalities have seen a marked slowdown, the adjustment was very moderate until Q1 2021 and the outlook for the coming quarters is good, thanks to the revival of international tourism, especially in the coming year.

## Foreign demand for housing has suffered during the pandemic

There is no doubt that the pandemic severely affected the property market on the Mediterranean coast and islands throughout 2020 and the first few months of 2021. The slump in international tourism due to restrictions on travel and uncertainty regarding how the health and economic situation would develop have led to a significant decline in the number of foreigners buying residential properties in Spain, plummeting by almost 50% year-on-year in Q2 2020. Although purchases began to recover in the second half of last year, they could not avoid ending the year with a sharp fall of 24.2%, almost 10 pp more than the decline recorded in purchases by Spaniards (–15.6%), which were not so severely affected by restrictions on travel within the country.

**Purchases by foreigners fell by 24% in 2020, accounting for 11.3% of the total**

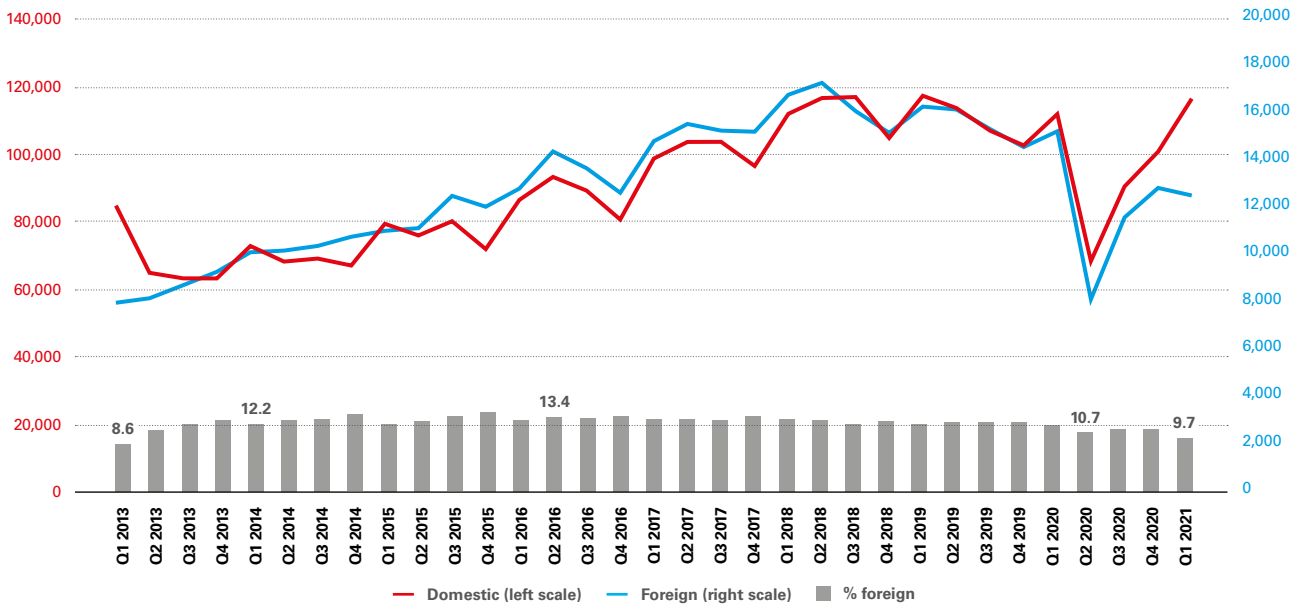
The restrictions on international travel in place in Q1 2021 continued to weigh heavily on foreign demand, which still posted significant declines in year-on-year terms (–17.8%) while domestic purchases were starting to recover slightly (4.1% year-on-year, –0.7% with respect to Q1 2019). As a result, the share of foreign purchases out of all sales fell below 10% in Q1 2021 (to 9.7%), something not seen since 2013.

Nevertheless, in spite of this slump in foreign demand, the numbers of transactions have remained strong: foreigners bought around 47,500 homes in Spain in 2020 (11.3% of all sales), a figure similar to that of 2015 and much higher than the average for 2008-2014 (28,000 homes per year), suggesting their interest in acquiring a residence in our country has not diminished.

One factor that has helped to sustain international purchases during the pandemic has been the digitisation of the marketing and financing for new developments. Developers that had already invested in adopting new digital technologies have been able to continue offering their services remotely, for example through virtual tours of properties. Financial institutions have also improved the range of digital products and services for their non-resident customers, offering the possibility of opening an account or applying for a mortgage 100% online, among other facilities.

**Foreign demand for housing is recovering more slowly than domestic demand**

Number of house purchases per quarter




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

## Uneven impact depending on the buyer's nationality

The overall trend in purchases by foreigners is a sharp fall in 2020 and a certain recovery in 2021, but both the size of the decline and the speed of the recovery are quite different depending on the buyer's country of origin.

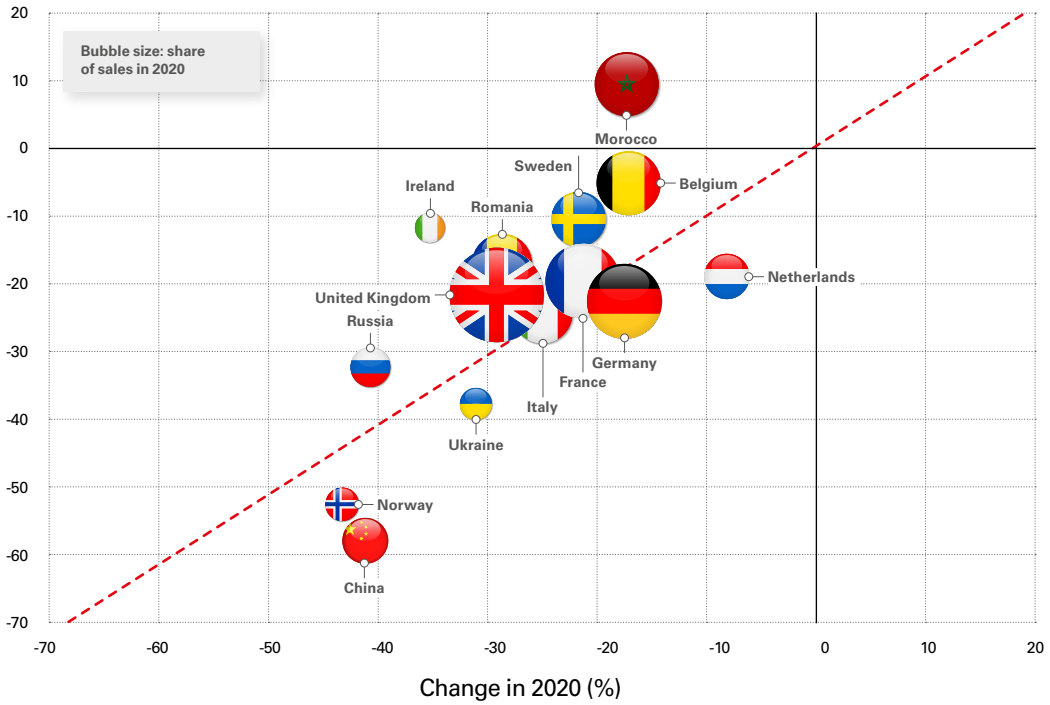
Among the major markets for Spain, British purchases fell the most sharply in 2020 (–29.1%), not only because of the strong impact of the pandemic in the UK but possibly also because of Brexit. Nevertheless, this was still the nationality that bought the most homes in Spain in 2020 (around 6,200, 13% of all foreign purchases) and purchases are recovering at a similar speed to the other two major buyers, the French and Germans, a recovery which is relatively slow (the chart shows the German bubble below the

45-degree straight line marked in red dots). The Netherlands is in a similar position, with its purchases falling slightly but a slower recovery.

On the other hand, Norway, China and Ukraine recorded the largest declines in 2020 and showed no signs of recovery in Q1 2021. However, this is not a worrying statistic as the relative weight of these three nationalities combined only accounts for 6.3% of the total, as indicated by the size of the bubble in the chart. Finally, Morocco, Belgium and Sweden show a positive trend, posting a limited decline in 2020 and a rapid recovery in Q1 2021. In particular, Morocco stands out as the only nationality with a year-on-year growth (9.2%) in purchases in Q1 2021.

### Purchases by foreigners: an uneven recovery across nationalities

Year-on-year change in Q1 2021 (%)




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

## Waiting for foreign demand

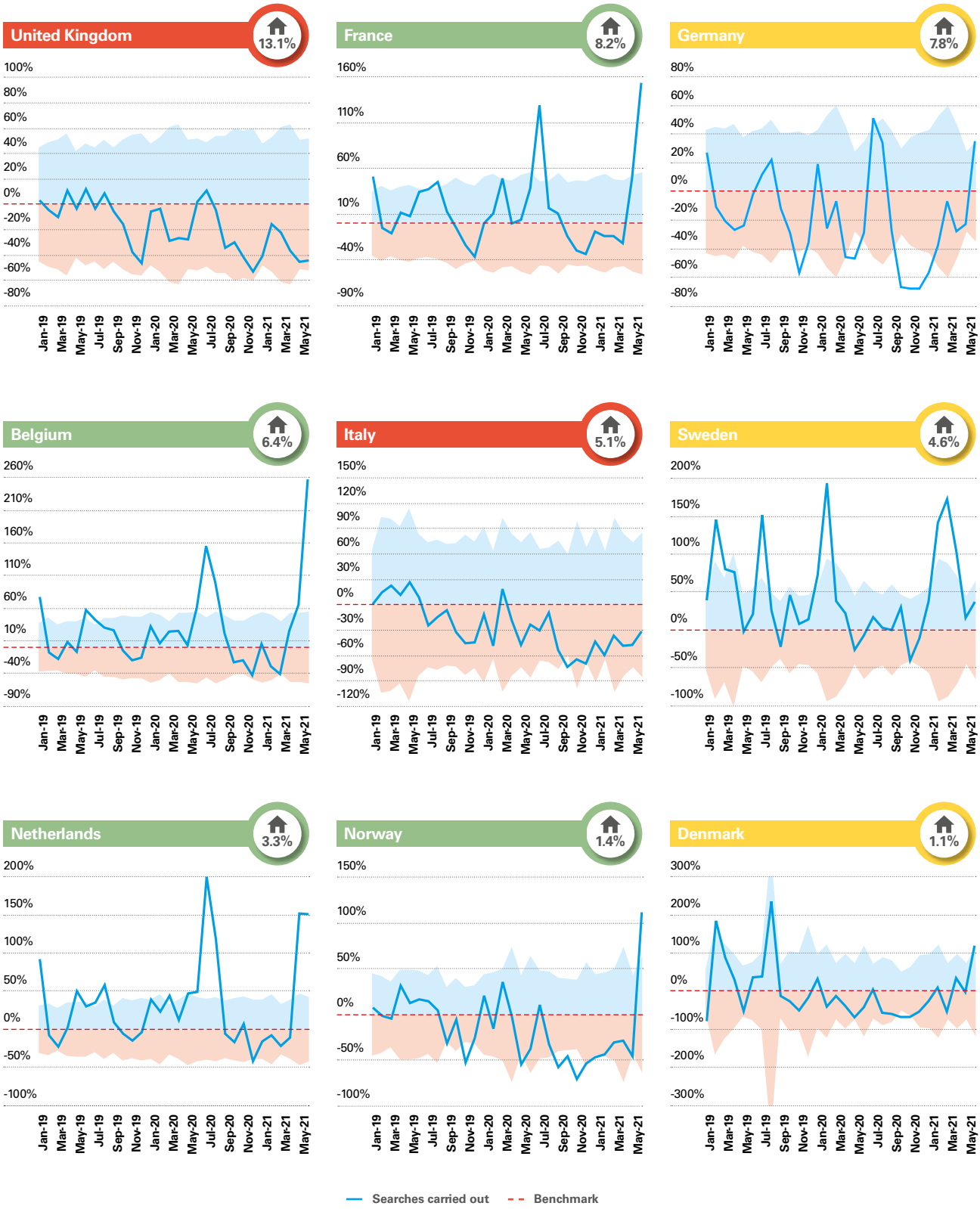
Looking to the future, the prospects for recovery are encouraging, as suggested by the number of Google searches on buying a home in Spain carried out from other countries. In May, coinciding with the start of the easing of restrictions on international travel, there was a strong recovery in the intention to buy on the part of foreigners, especially in France, Belgium, the Netherlands and Norway. In contrast, searches from the UK and Italy remain depressed, with Germany, Sweden and Denmark somewhere in the middle. It is expected that the progress of the vaccination campaign in European countries and the implementation of the EU's COVID digital certificate will boost the pent-up demand from foreigners, who are waiting until they can travel to buy a home in Spain.[15] In addition, new work patterns accelerated by the pandemic, such as teleworking, will allow European workers to stay in Spain for longer periods of time to enjoy the Mediterranean climate while working remotely, so the market now has a new profile of international buyer.

**(15) For an analysis of the reasons why foreigners tend to buy a home in Spain, see the article «The rise in house purchases by foreigners in Spain» at https://www.caixabankresearch.com/en/sector-analysis/real-estate/rise-house-purchases-foreigners-spain**

# Real Estate

## Monthly Google searches related to buying a home in Spain

Percentage of purchases by each nationality out of the total number of purchases by foreigners



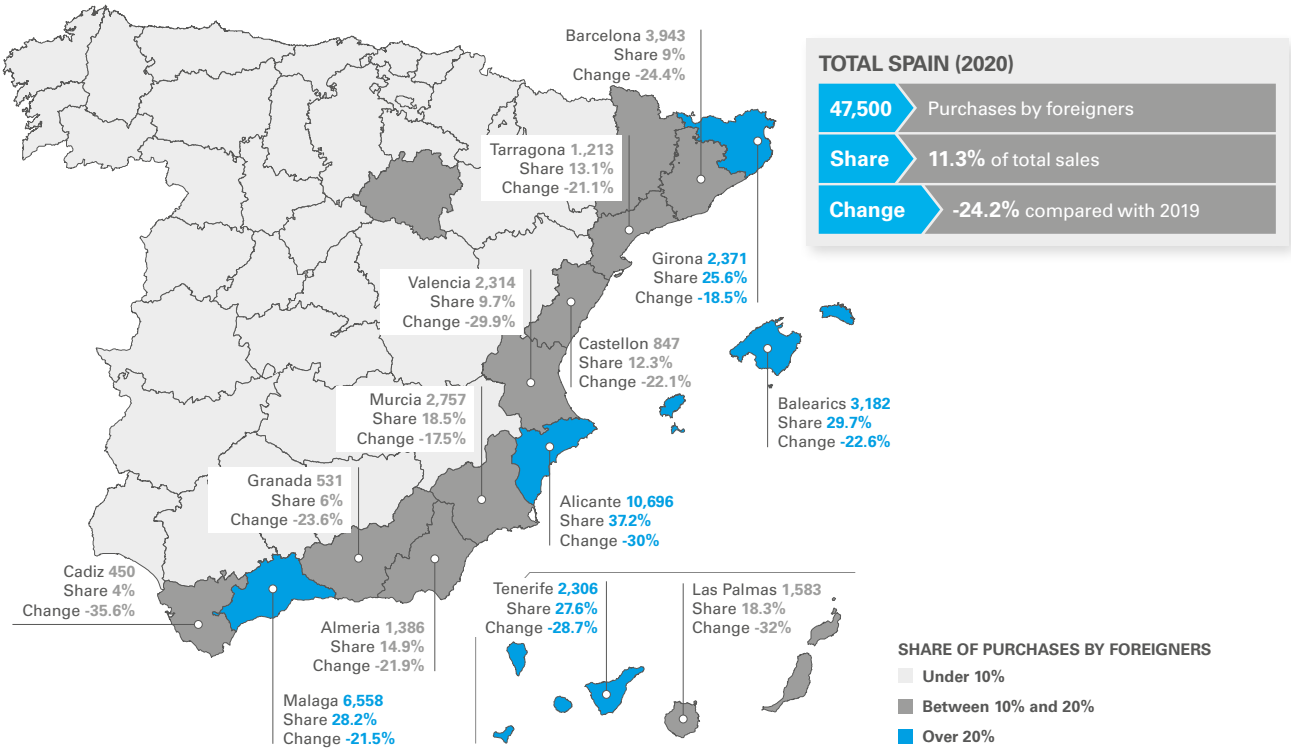

**Notes:** We have used data from searches with the word «Spain» from each country in its official language, within the category of «real estate». Expected searches consist of the forecast for searches produced with data from one year previously, using an ARIMA model $(1, 1, 1)_{52}$. The shaded area reflects a 68% confidence interval ($\alpha = 1$).
**Source:** CaixaBank Research, based on data from Google Trends.

## Searches about buying a home in Spain are on the rise among the main residential property buyers for our country, with the notable exception of the British

### The Mediterranean coast and islands have been hit the hardest

As we pointed out at the beginning, the slump in foreign demand has hit the real estate market particularly hard on the Mediterranean coast and islands, locations which accounted for 85% of foreign purchases in 2019. There were sharp falls across all the provinces in the region albeit with some differences in terms of intensity: in Girona the decline was relatively more moderate (–18.5%) while Cadiz posted the largest fall (–35.6%), as can be seen in the chart. Alicante, the province with by far the largest number of property purchases by foreigners (24% of the national total), posted a decline of 30% in 2020. Nevertheless, more than 10,000 transactions were completed in 2020 (37% of all purchases in the province, compared to 41% in 2019).

### The islands and Mediterranean coastline concentrate foreign housing demand

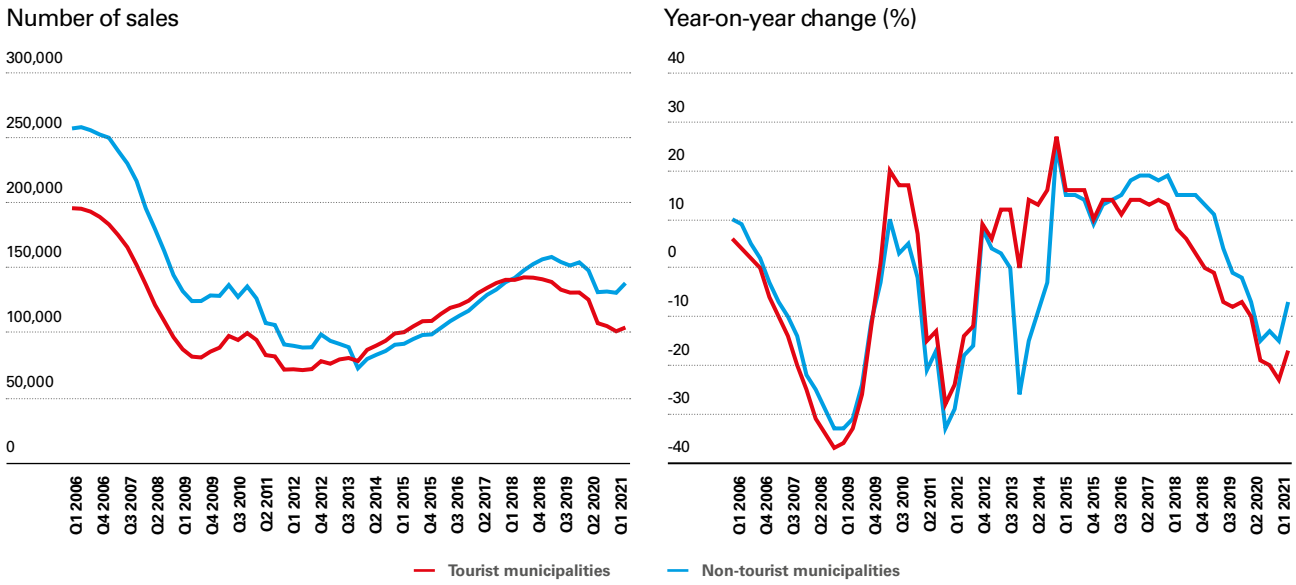



**Note:** Data from 2020.
**Source:** CaixaBank Research, based on data from the College of Registrars.

The figures by province encompass very different local real estate markets in terms of the distribution of foreign nationals. For instance, looking again at the province of Alicante, the share of tourists for Benidorm is very different to that of Alcoy and the potential impact of the slump in international tourism on either locality is therefore also necessarily different. However, at a municipal level, the official data on residential property purchases do not distinguish the origin of the buyers, which is why we have used internal CaixaBank data in order to assess the impact of tourism on such purchases by municipality. By analysing the percentage of CaixaBank POS terminal spending using foreign cards, we have been able to classify municipalities into tourist and non-tourist.[16] The following chart shows the trend in purchases for all municipalities according to this classification (in terms of number and year-on-year change). In 2020, the drop in purchases in tourist municipalities was much sharper than in non-tourist municipalities (–17.8% compared to –12.4%) while, in the first few months of 2021, the recovery was weaker in tourist municipalities. Returning to our previous example, in Benidorm, where foreign card spending accounted for 33% of the total in 2019 compared to 1% in Alcoy, property purchases fell by 37.3% in 2020 compared to an increase of 7.1% in Alcoy.

**16 Specifically, if spending with foreign cards via CaixaBank POS terminals accounted for more than 10% of the total in 2019, we classify this location as a tourist municipality.**

## Tourist municipalities posted the largest decline in residential property purchases during the pandemic



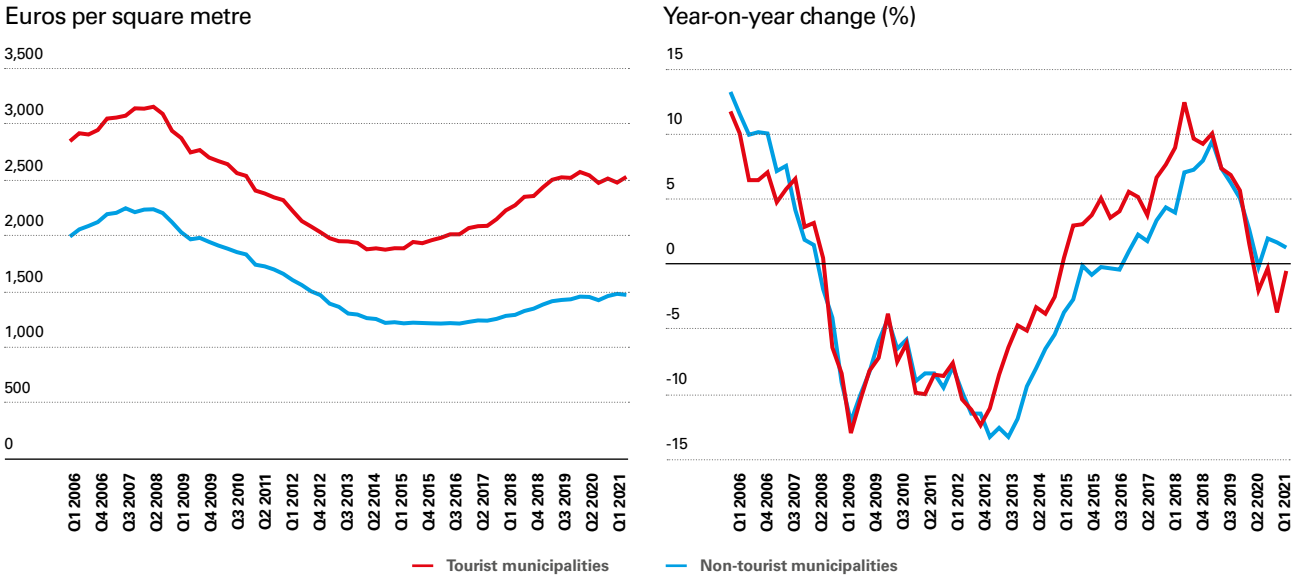

**Notes:** A municipality is considered tourist (or non-tourist) when the share of payments via CaixaBank POS terminals using foreign cards was higher (or lower) than 10% of the total in 2019. Cumulative data over four quarters for municipalities with over 100 purchases per quarter.
**Source:** CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.

## The impact on house prices has been more contained

In 2020, house prices slowed down across the board throughout Spain, although the loss of dynamism was greater in tourist municipalities. Specifically, the average price in tourist-oriented municipalities went from 7.5% growth in 2019 to a decline of 1.1% in 2020. The slowdown in non-tourist municipalities was also notable, albeit less intense: the average house price went from 7.1% growth in 2019 to 1.6% in 2020 (still positive).

The effects of the pandemic on international tourism therefore had more of an impact on residential property prices in the most tourist-oriented localities. Returning once again to the municipalities of Alicante, we can see that house prices in Benidorm went from 7.0% growth in 2019 to a decline of 3.1% in 2020. In contrast, house prices in Alcoy accelerated from 3.0% growth in 2019 to 4.5% in 2020.

### House prices in tourist-oriented municipalities are suffering more during the pandemic




**Notes:** A municipality is considered to be tourist (or non-tourist) when the share of payments via CaixaBank POS terminals using foreign cards was higher (or lower) than 10% of the total in 2019. The charts show the average house price weighted by the number of inhabitants in each municipality.
**Source:** CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.

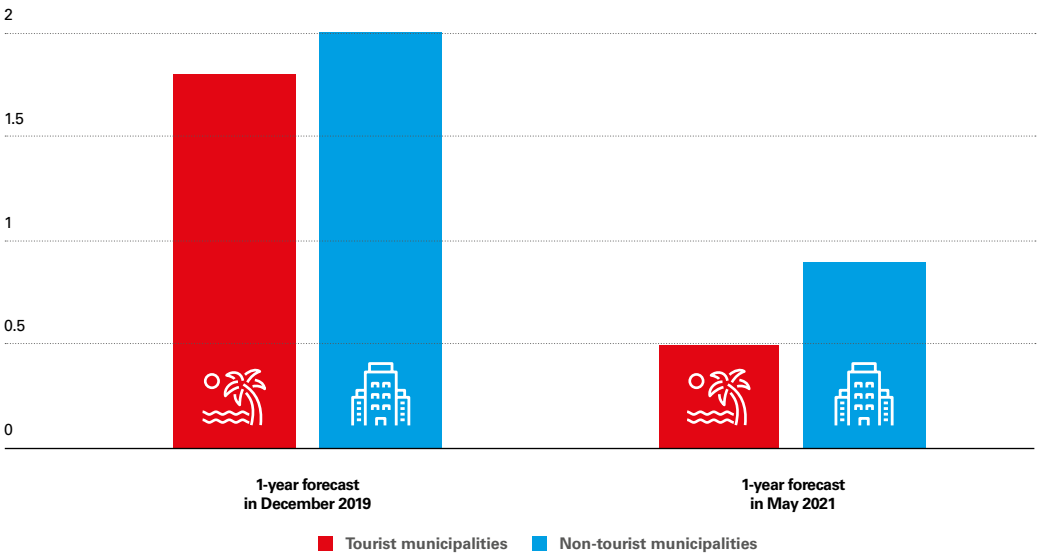
## House prices have slowed markedly in tourist areas but are showing some resistance to falling and the outlook is good

Looking ahead, the projected house prices at a municipal level, obtained from the machine learning models of CaixaBank's real estate big data tool,[17] show a slight upward trend for the coming year. In particular, the model predicts an average house price increase of 0.5% in tourist municipalities and a slightly higher increase of 0.9% in non-tourist municipalities. These forecasts, although positive, are more moderate than those provided by the model before the pandemic, when growth of around 2% per year was projected.

[17] This tool combines millions of internal CaixaBank data with reliable external sources of data. This enables the application of machine learning algorithms, which improve the forecasts as more information is available. The Ministry of Transport, Mobility and Urban Agenda's historical series of house prices has been used to train the models, based on free housing appraisals.

### Trend in house price forecasts in tourist and non-tourist municipalities

Year-on-year change (%)




**Source:** CaixaBank Research, based on internal models and data from the Ministry of Transport, Mobility and Urban Agenda.

## A promising outlook for foreign housing demand

In short, after an atypical 2020, the outlook for 2021 in terms of foreign demand and prices in tourist areas is positive, although the speed of recovery will depend on how quickly international tourism revives and the excellent communications are restored that existed before the pandemic with Spain's main source countries for inbound tourism. In 2022 we expect international tourism to get back to normal and connections to be re-established, so it is very likely the boom in foreign demand for residential properties will be even greater than before COVID-19.[18] Spain continues to be hugely attractive due to many different factors, such as climate, quality of life, safety, health and culture, and to all this we must add a new type of international buyer who can now do their work remotely, thanks to the flexibility offered by teleworking.

[18] However, it should be remembered that Spain has rivals in the Mediterranean, not only in terms of the tourists they attract but also the number of foreigners buying a home there.

Commercial Real Estate

# The impact of COVID-19 on commercial real estate investment in Spain

The pandemic has altered the commercial real estate investment landscape, creating different types of assets according to the degree of disruption caused by the travel restrictions imposed to tackle the health crisis. Assets that have benefited include residential property, logistics assets and data centres, as well as a large proportion of retail assets. Among the most disadvantaged are offices and hotel assets, weighed down by the rise in teleworking and slump in international tourism.

## The pandemic is altering the attractiveness of different real estate assets

Before the outbreak of COVID-19, investment in offices and hotel assets was by far the most important in the Spanish commercial real estate sector: accounting for almost 50% of the total between them. The commercial residential segment (multifamily properties, which includes rented accommodation as well as student housing and care homes), retail and, above all, logistics, were secondary.

# Real Estate

But the pandemic has turned real estate investment on its head and caused it to fall by 24%, down to around 9.5 billion euros.[19] The particular features of the health crisis led to the imposition of restrictions on national and international travel and also on certain economic activities, altering the attractiveness of the different assets that make up real estate investment in our country. **Broadly speaking, some retail assets, the logistics sector and residential assets have been less affected or are even at an advantage**. The first have benefited from the role played by supermarkets as suppliers of basic goods for the population; the second, due to the rise in e-commerce and the third, because of a combination of more heterogeneous factors. Interest in student housing has been tempered by the expansion of online classes while care homes have suffered first-hand from the impact of the healthcare crisis. However, residential lets have been given a new lease of life by build-to-rent initiatives and it is evident that the trend for care homes will continue to rise, given the country's demographic fundamentals.

**19 The data on the volume of investment in CRE come from the Spain Real Estate Market Outlook 2021 by the international real estate consultancy CBRE.**

**The pandemic has altered the attractiveness of different real estate assets. Residential property, logistics assets and data centres have benefited while offices and hotels have attracted less investment**

At the other end of the scale are what, before the pandemic, had been the star assets of the Spanish market: the appeal of offices has plummeted due to the growth in teleworking; commercial premises (historically one of the most important segments in the retail sector) were greatly affected by the limitations on opening hours, capacity, etc. (more or less strict depending on the region) and hotels suffered the consequences of rock-bottom demand.

As a result, in 2020 **residential properties became the main investment asset** (28% of total real estate investment), followed by retail (about 25% of the total) and logistics (almost 15%), while investment in offices and hotels remained below 20% of the total.[20]

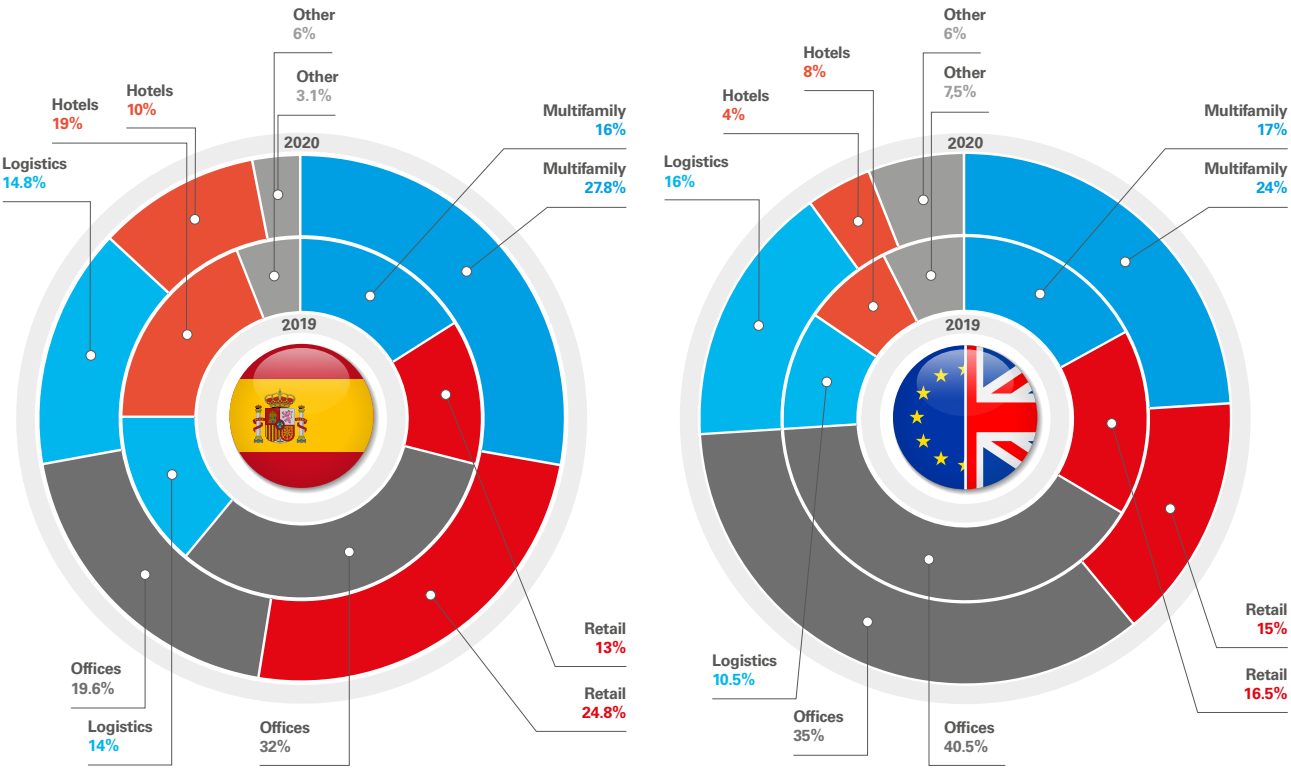
**20 The data in this Report come from various market studies, conducted by CBRE and JLL among other key players in the commercial real estate market.**

**Compared with Spain, Europe's offices withstood the impact of the pandemic better while the retail segment was hit harder. Hotels are losing share while logistics centres are making similar gains in both markets**

If we compare the trend for real estate investment in Spain with that in Europe, we can see that, on the continent, the fall in office investment has not only been smaller but that, after the impact of the pandemic, it continues to be by far the main commercial real estate investment (almost 35% of the total), thanks to the recovery in the second half of the year in the region's major financial centres (Germany, the United Kingdom and Netherlands). On the other hand, the relative weight of the retail sector in Europe decreased compared to previous years, in this case harder hit by restrictions on travel and business. In any case, there is a common trend in Spain and Europe: the boom in the logistics sector (associated with the increased penetration of e-commerce) and the deterioration in assets associated with accommodation and hotels, severely impacted by the restrictions on international travel.

### The relative weight of retail real estate investment in Spain is increasing

Breakdown of real estate investment by segment
(% of total commercial real estate investment)




**Source:** CaixaBank, based on data from CBRE.

## Interest in residential assets has picked up

In 2020, investment in the commercial residential segment, which comprises rented accommodation as well as student housing and care homes, rebounded to €2.6 billion, more than doubling the investment made in 2019. We expect this increase in residential investment to consolidate in the next few years, given that the supply of this type of asset is limited in the Spanish market, especially when compared to other similar European markets, and because the demand for rented accommodation continues to rise gradually, reaching around 4.3 million homes in 2020, about 23% of the total (significantly less than the EU average of 30%).

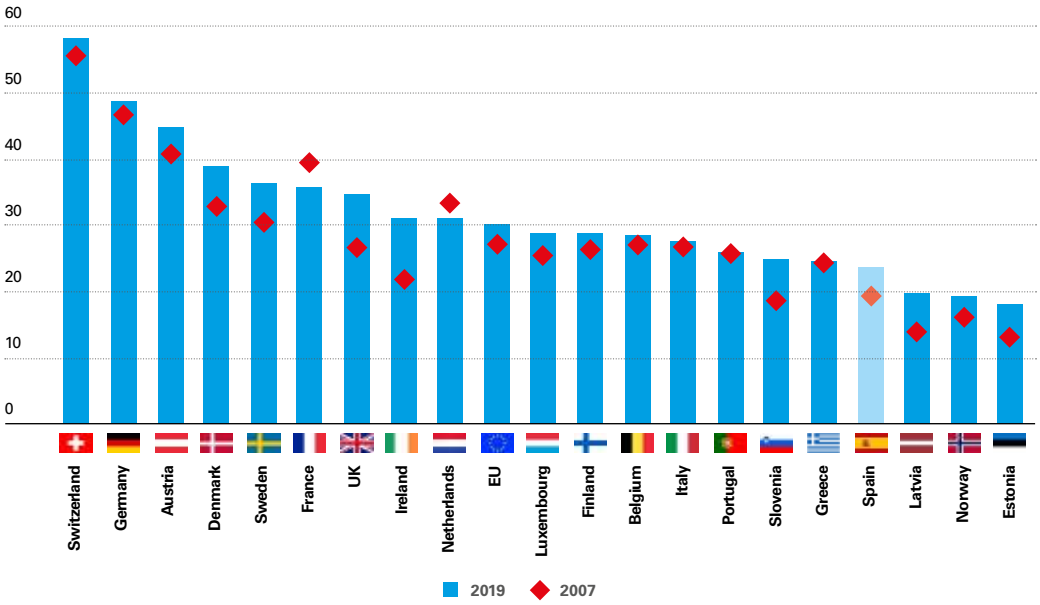
# Real Estate

## Residential assets have attracted a lot of interest in the wake of the pandemic, a trend we expect to continue given the shortage of supply and growing demand

**Increasing demand and a shortage of supply have boosted the investor appeal of residential properties at a time when build-to-rent initiatives are beginning to spread in Spain.** In fact, public-private initiatives to increase the supply of rental housing are emerging and will increase thanks to the support of European recovery funds. On the other hand, one of the factors limiting investment in the sector is the intention to control rents and intervene in prices.

### There is room for the rental market to gain share in Spain

Percentage of households renting their home (%)




**Source:** CaixaBank Research, based on data from Eurostat.

### Logistics assets are no longer the ugly duckling of CRE

The logistics sector was one of the most resilient in 2020, especially with regard to the rental market. Investment volume in 2020 was better than expected at around 1,428 million euros and it is expected to reach a new all-time high in 2021. Behind the good data in this CRE segment lie the effects of lockdown, resulting in an unprecedented upturn in e-commerce and an inevitable boom in proximity logistics, causing high investor interest in last-mile assets in cities with more than 100,000 inhabitants, a trend that will continue over the next few years.

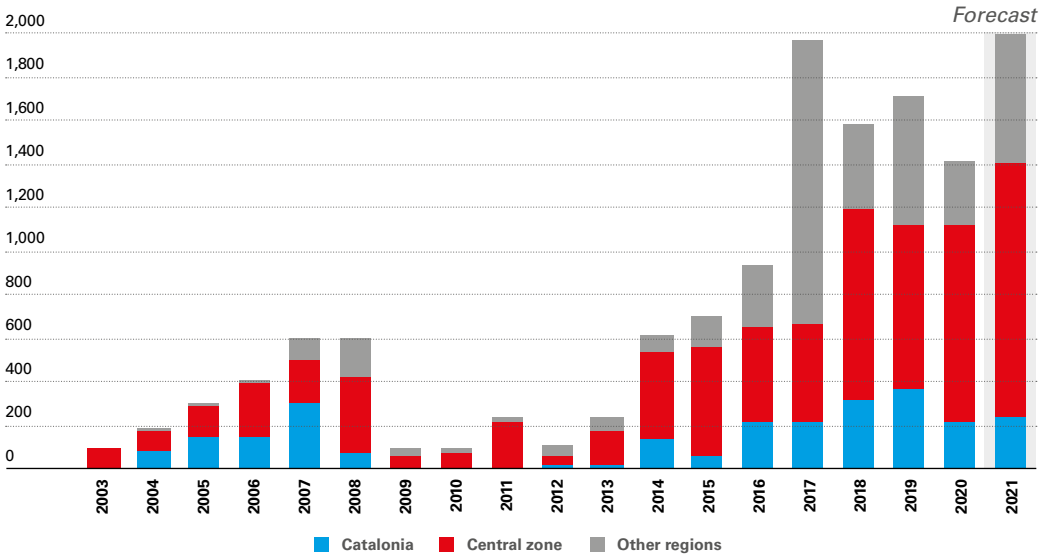
## Logistics assets will once again perform well in 2021 thanks to e-commerce becoming part of Spanish consumer habits

On the rental side, prime rents in Madrid (€5.50/m²/month) and Barcelona (€7/m²/month) remained stable in all logistics markets in 2020, a trend that is expected to continue in 2021. Such stability may be surprising considering the high demand but this effect has been offset by the extra supply entering the market.

The sector is expected to perform similarly in 2021, especially since e-commerce has become established in the consumption habits of a large proportion of Spanish consumers. In the medium and long term, the challenges faced by Spain's logistics sector include achieving greater automation, promoting greater efficiency in last-mile logistics (bringing packages closer to the end consumer) and placing more importance on sustainability and job quality in the sector.

### Investment in logistics could reach new highs in 2021

Real estate investment in logistics assets (million euros)




**Source:** CaixaBank, based on data from CBRE Research.

## Supermarkets and shopping centres keep commercial real estate investment in retail afloat

According to the real estate consultancy firm JLL, **retail real estate investment increased by 40% in 2020 in the Spanish market, totalling 2.25 billion euros.** This is a surprising figure given the backdrop of severe restrictions on face-to-face trading and it is possible that much of the increase is a correction effect following the particularly low investment volumes in 2019. If we compare this figure with the average of the previous three years, we get a 30% drop in retail real estate investment in 2020.

# Real Estate

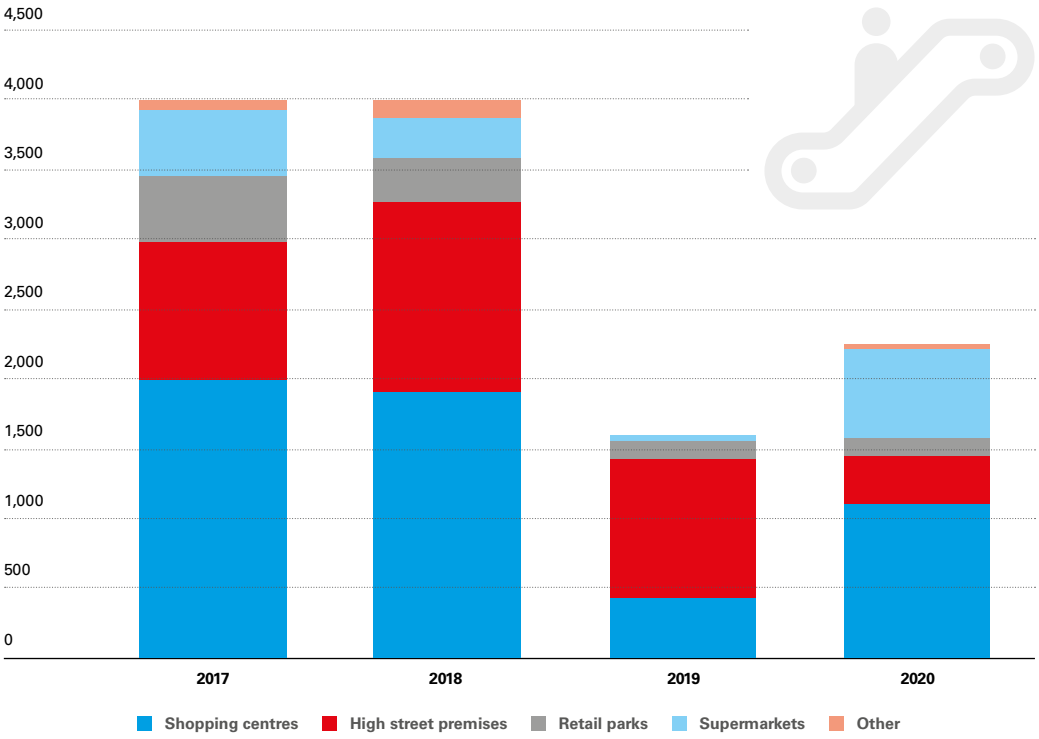
Across the different types of asset, **shopping centres accounted for most of the real estate** investment with a volume of around 1.1 billion euros, although 80% of this figure is due exclusively to two large transactions (Intu Asturias and Puerto Venecia) which were negotiated and closed at the beginning of 2020, before the outbreak of the pandemic. In other words, if we exclude these transactions, the level of investment would be the lowest since 2013.

**This was followed, in volume terms, by supermarket investment**, posting an all-time high in 2020 with an investment of around €600 million, accounting for 30% of all retail real estate investment when, between 2017 and 2019, it barely represented 5%-10% of the total. Its success is not surprising: it is one of the sectors that has come out of the health crisis the strongest, thanks to its role as a supplier to the population.

On the other hand, **commercial premises, especially in the textile, leisure and restaurant sectors, were the worst affected among real estate assets**. Firstly, they have been particularly affected by the restrictions (on capacity, time limits and forced closures) and by lower tourist arrivals (–77% in 2020). Secondly, the pandemic has speeded up the growth in online shopping, causing some oversupply of retail premises.

## Supermarkets and shopping centres led investment in 2020

Real estate investment in Spain's retail sector (million euros)




**Source:** CaixaBank Research, based on data from JLL Research.

**On the other hand, returns on real estate assets declined across the board throughout 2020 as a result of the pandemic.** The lack of buyers and the economic recession resulting from the health crisis have pushed up vacancy rates and the availability of premises, as well as triggering turnover among operators. Not only have small stores closed but big brands have also reduced their physical stores while boosting e-commerce. As a result, according to JLL data from the end of 2020, high street prime rents (premises of 100 $m^2$ or more) fell by 16% year-on-year in Madrid and 18% in Barcelona. Prime rents in shopping centres and retail parks in Spain also fell throughout 2020 but to a lesser extent, with decreases of between 10% and 12.5% year-on-year.

## The need for connectivity boosts interest in data centres

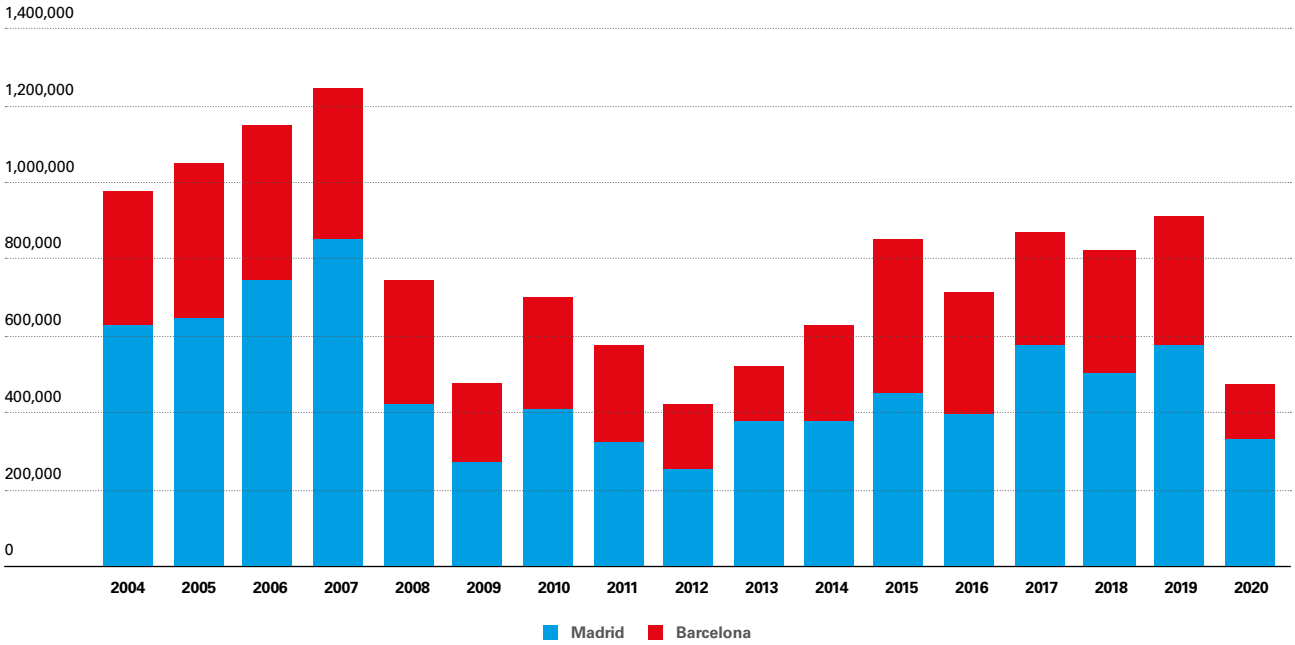
Finally, the expansion of 5G and fibre optics and the increased penetration of new digital technologies such as the Internet of Things (IoT) and cloud computing have been closely linked to some of the consequences of the pandemic (such as the rise in teleworking), in which connectivity has clearly become vital to ensure our professional and social lives can continue. In this respect, there is growing interest among investors in an increasingly attractive commercial asset, namely data centres. In the case of Spain, its geographical position, new connections via underwater cables with America and Africa, good connectivity and the high penetration of renewable energies are driving new developments of this type of property. In fact, in 2020 investment in such centres soared by more than 20% annually.

## The expansion in teleworking reduces the appeal of office space

Investment in the office sector fell by 53% in 2020 compared to the previous year and 47% compared to the average for the previous four years (2015-2019). Similarly, demand for rented office space fell by 42% in Madrid (334,000 m² of occupied space) and by 64% in Barcelona (140,000 m²). Taking both economic hubs together, office occupancy plummeted by more than 50% year-on-year to lows similar to those of 2009 and 2012, these being due to the financial crisis and sovereign debt crisis, respectively. It is worth noting that office occupancy in both Madrid and Barcelona had remained more or less stable in the five years prior to the pandemic (see the chart below), a far cry from the levels before the 2008 financial crisis. On the supply side, vacancy rates increased over the past year (by 11% in Madrid and 8% in Barcelona), thanks to the completion of some projects under construction and a return to the second-hand market, with contracts being renewed but with a reduction in floor space and subletting to adapt to the lower demand.

### Slump in leased office space

Demand for office space in large urban centres (m²)




**Source:** CaixaBank Research, based on data from JLL.

Importantly, the pandemic has served to accelerate trends that had already been observed in the office sector. Traditionally, Spain's teleworking rate was among the lowest in Europe:[21] 3.2% in 2019 compared to 9.9% in the EU, according to Eurostat. Once the pandemic is over, there can be little doubt that fewer people will be working in offices than before COVID-19, so the demand for physical space by companies will be structurally reduced, albeit not drastically or suddenly. However, a number of factors can be perceived that will help to mitigate this lower demand for office space.

**(21) See the article «The COVID-19 outbreak boosts remote working» at:** https://www.caixabankresearch.com/en/economics-markets/labour-market-demographics/covid-19-outbreak-boosts-remote-working?1079=

## The pandemic has accelerated the adoption of teleworking and this may lead to a major change in the type of offices in demand

Firstly, although the number of teleworking hours may increase, the offices of the future[22] will have to cope with peaks in attendance (central days of the week) while avoiding the opposite: having too much unused space on less busy days (Mondays and Fridays). Secondly, it seems obvious that social distance per worker will need to increase in the short/medium term as a consequence of the behavioural changes brought about by the pandemic. This is a radical departure from the pre-COVID world, when the trend was towards high density. Finally, offices will have to be redesigned to adapt to a new way of working that combines remote and face-to-face work, increasing the space dedicated to collaborative areas and services and thereby offsetting the fact that less space is required for individual workstations. In this respect, companies have become more interested in so-called flexible properties (dynamic business centres that adjust to the needs of companies) in the past year, with transactions in this segment up by 85% in Q1 2021 in Madrid and Barcelona, according to data from the real estate consultancy firm CBRE.

**(22) For a historical overview of the trends for office space, see «The office of the future: a return to the past?» at https://www.caixabankresearch.com/en/economics-markets/labour-market-demographics/office-future-return-past**

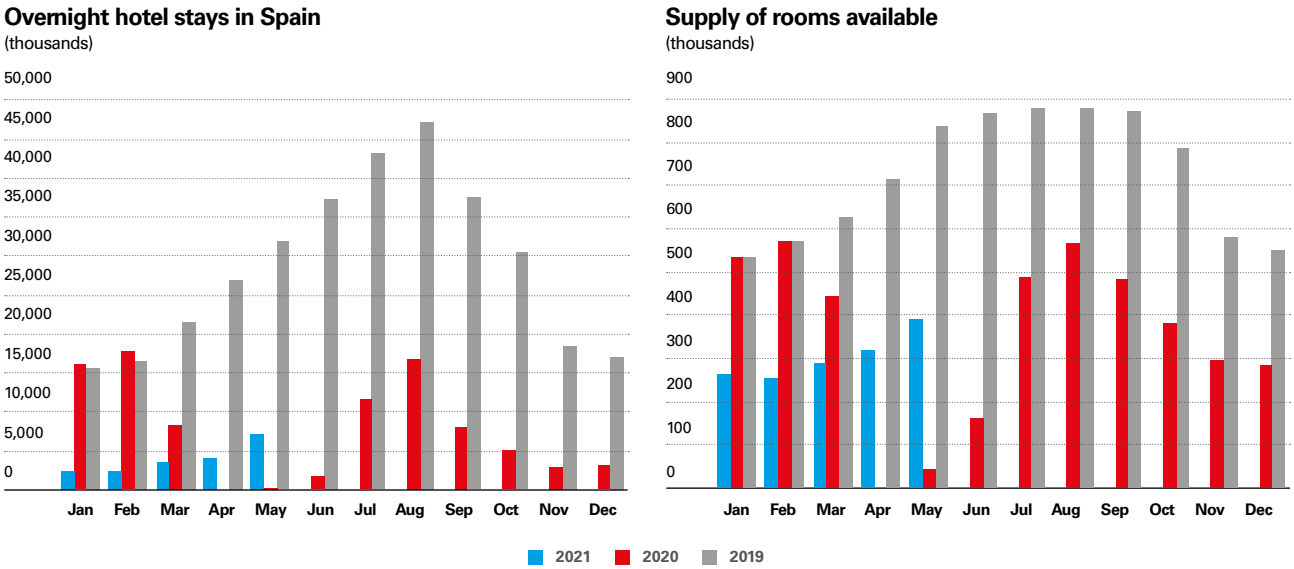
Given these opposing forces, **demand for office space is likely to diminish in the short to medium term although a significant or worrying decline is not expected.** In fact, this is a trend that was already expected before the pandemic and would have occurred anyway, albeit over a longer timeframe.

For the second half of 2021, we therefore expect the vacancy rates observed during the toughest months of the pandemic to moderate although they will remain below the figures of previous years. In terms of rents, the current weakness in demand suggests they will continue to adjust downwards through 2021 before recovering from 2022 onwards as demand picks up more significantly.

## Investor interest in hotel assets will increase in 2021

There is no doubt that, in a country like Spain where tourism is so important, the hotel sector has been one of the hardest hit by the restrictions on travel, both local and international. This has led to a sharp decline in demand (overnight stays fell by 73% in 2020), supply (–40% of establishments open) and profitability (–57%, according to the RevPAR index). In terms of real estate transactions, investment in hotel assets fell by 61% in 2020 to around 950 million euros, according to CBRE. Although these are the worst figures since 2013, when the economy was still digesting the financial and debt crises, the data are not surprising given the high uncertainty regarding the sector's recovery; with administrators and owners being more concerned about rent renegotiations, safety protocols and the day-to-day management of the costs of their assets, and with buyer and seller expectations being so far apart.

### Hotel demand almost zero, except for the summer, with supply at 50%




**Source:** CaixaBank, based on data from the National Statistics Institute.

As for 2021, the success of the vaccination campaign in Spain and in its main European source markets for inbound tourism, together with the launch of the EU's digital COVID certificate, suggest greater domestic tourist mobility and the arrival of a larger number of international tourists (although we do not expect a quick return to the figures achieved in 2019), which will help to improve activity in the sector. However, as was already the case in the summer of 2020, the recovery will occur at different speeds: the fastest should be rural tourism, which is less crowded and less dependent on international tourists, followed by city and island beach destinations, which are particularly reliant on foreign tourist arrivals, and lastly the corporate and events (MICE) segment, displaced by teleworking and online meetings thanks to the expansion of standardised technologies throughout the pandemic.

## Hotel assets have been among those hardest hit by the pandemic, but their outlook is positive thanks to the revival in tourism

Moreover, the evidence suggests that the positions taken by property owners and investors will get closer in 2021. Regarding existing hotel asset owners, the strain on cashflow built up over the last year and a half and the end of rent moratoriums could force some hotel owners to divest their assets in 2021. On the investor side, the continued strong interest in the Spanish hotel sector is in addition to an environment of low interest rates, high stock market volatility and lower returns on other Commercial Real Estate (CRE). In Q1 2021, several major deals were finalised, worth around 230 million euros, and investment is expected to burgeon in the second half of the year once travel restrictions are lifted and the tourism sector starts to recover. Although a correction in prices is inevitable given the circumstances, investor confidence in Spain's tourism industry will make it possible for discounts on operations to be contained to some extent, at least in those considered to be the most prime or strategic.[23]

**23 Prime rent refers to the most exclusive commercial zones with the highest demand.**

By way of summary, we can highlight the following general trends regarding the impact of COVID-19 on CRE investment:

- The real estate assets generating the most interest among real estate investors are those that have been most resilient or least affected by the consequences of the pandemic: residential real estate (known as multifamily assets), logistics (associated with the e-commerce boom) and data centres (due to growing connectivity needs), as well as some retail real estate assets (mainly supermarkets).
- On the other hand, demand is subdued and investor interest limited in those assets hardest hit by the consequences of the pandemic: the rise in teleworking has reduced demand for offices, a trend that will continue as the penetration of teleworking in the Spanish labour market increases, while hotel assets have been affected by limited local and international travel, an aspect that will reverse as travel gets back to normal.

Global real estate cycle

# The impact of the pandemic on international housing markets: is there a risk of overheating?

Despite COVID-19, house prices in most advanced economies rebounded in 2020, largely thanks to the expansionary fiscal and monetary policies introduced to revive economic activity. Some real estate markets were already close to being overvalued before the pandemic, so the faster growth in prices has merely fuelled debate about the risks of overheating in certain countries. Such risks could possibly be managed with so-called macroprudential tools but could also raise questions regarding the need to adjust some monetary policy tools before the economic recovery is fully established.

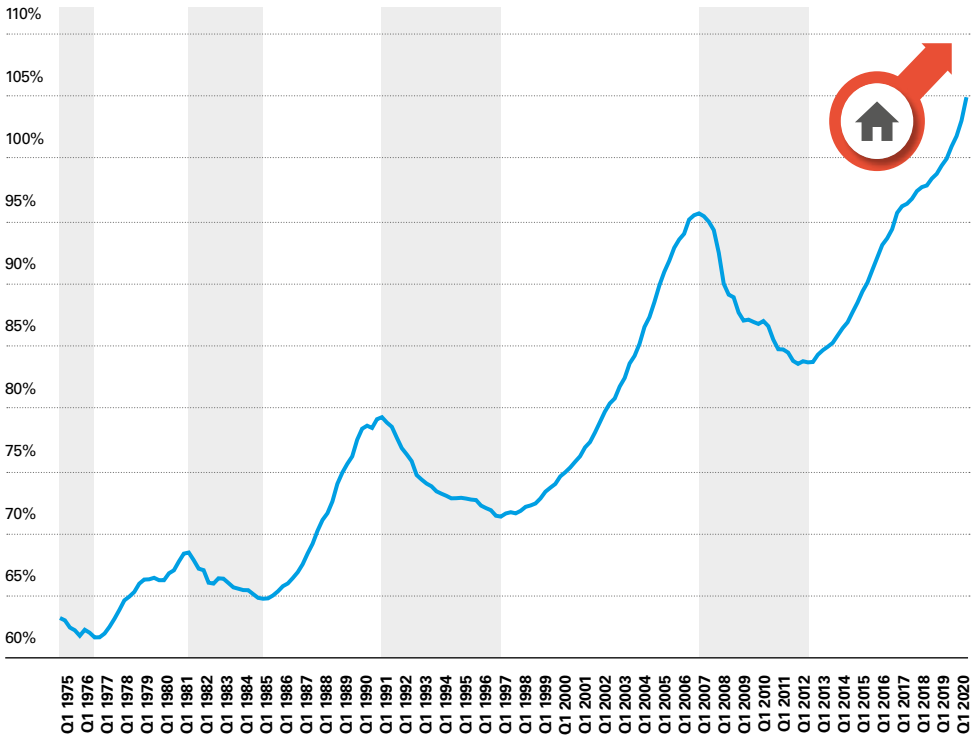
## Global house prices accelerate their upward trend during the pandemic

The initial assumption of many analysts at the outbreak of the pandemic last year was that residential property markets would be severely affected by the fall in household income due to the economic downturn. As it turns out, nothing could be further from the truth: **real house price growth at a global level accelerated during the pandemic**. According to the indicator produced by the Dallas Fed's International Housing Observatory,[24] global house prices picked up from 1.8% growth in 2019 to 3.6% in 2020 in real terms (from 3.2% to 4.6% in nominal terms).

(24) See: https://int.housing-observatory.com/

## Global house prices gather speed during the pandemic

Index (100 = Q4 2019)




**Note:** Aggregate price in real terms of 25 countries with dynamic weights.
**Source:** CaixaBank Research, based on the database of the International Housing Observatory, described in Mack and Martínez-García (2011).

**FACTORS SUPPORTING THE RISE IN HOUSE PRICES**

**Change in buyer preferences:**
- Larger housing with open spaces.
- Housing in the suburbs.

**Limited supply in some markets.**

**Expansionary fiscal policy:**
- Income support for families.
- Accumulation of «forced» savings.

**Expansionary monetary policy:**
- Low interest rates.
- Flow of credit to buy housing.
- Attractive real estate investment compared to other assets.

## Why have house prices increased during the pandemic? The role of monetary policy

The upward trend in house prices during the pandemic reflects several factors linked to the surge in demand driven by the particular features of the crisis. People being confined to their homes and the increase in teleworking have brought about a change in buyers' preferences regarding the type and location of their home. In addition, fiscal policies have cushioned the impact of the crisis on household income, albeit to a greater or lesser extent depending on the country. In fact, in many advanced economies households have accumulated large amounts of «forced» savings due to strict lockdowns and restrictions on certain activities, and some of these savings have been channelled into real estate investment. On the supply side, the decline in construction in the second half of 2020 affected the number of properties delivered, helping to push up prices, especially in markets where housing was already in short supply.

> **In addition to the recovery in demand and the restrictions that temporarily limited supply, low interest rates are also pushing up house prices**

An additional factor that has had a decisive impact on rising house prices has been the low interest rates (and the expectation that they will remain low for a long time) as a result of the monetary policy adopted to stimulate the economy. Numerous academic studies have shown that house prices tend to rise when mortgage interest rates fall, as buyers can afford a more expensive home for the same mortgage payments, and real estate investment becomes more attractive in an environment of low returns on alternative assets considered as safe. The pandemic may have reinforced this relationship between interest rates and house prices: the forced savings accumulated by households, together with very low interest rates, have meant the option of investing these savings in real estate has gained even more weight.[25]

## The impact of COVID-19 on prices has been uneven across countries

The acceleration in the growth of the global house price index is widespread in advanced economies (with the notable exception of Japan) but the rate of increase varies widely across countries, as the following tables show. If we look at the change in the annual rates in 2019 and 2020, we can differentiate between two groups: countries with faster house price growth in 2020 and countries with slower growth.

Canada (+8.3 pp up to 8.2% in 2020) and Luxembourg (+4.4 pp up to 14.5%) stand out in the first group, followed at some distance by Denmark, the United Kingdom, France and Italy, where annual price growth increased by at least 2 pp.

**(25) In terms of size, a recent study by the International Monetary Fund suggests that a 100 basis point change in interest rates would have an impact of between 1.5 and 2 basis points on the rate of change in house prices. See the presentation: «The Global Real Estate Boom: Is It Time to Worry Again? available at https://ieo.imf.org/-/media/IEO/Files/Seminars/ieo-webinar-igan-real-estate-markets-covid19-june-2021-v2.ashx**

## Countries where house prices accelerated in 2020

| | Change in price in 2019 | Change in price in 2020 | Difference (pp) | Change in trend? | Overvalued? (Dallas Fed) | Overvalued? (ECB) |
|---|---|---|---|---|---|---|
| Canada | -0.1% | 8.2% | 8.3 | Yes | No | - |
| Luxembourg | 10.1% | 14.5% | 4.4 | No | Yes | Yes |
| Denmark | 2.3% | 4.8% | 2.5 | Yes | No | - |
| United Kingdom | -0.4% | 2.0% | 2.4 | Yes | No | - |
| France | 3.3% | 5.4% | 2.1 | No | No | Yes |
| Italy | -0.1% | 1.9% | 2.0 | No | No | No |
| Poland | 8.7% | 10.5% | 1.8 | Yes | - | - |
| Austria | 5.8% | 7.6% | 1.8 | No | - | Yes |
| Sweden | 2.5% | 4.2% | 1.7 | No | No | - |
| Germany | 5.8% | 7.4% | 1.6 | No | Yes | Yes |
| Finland | 1.0% | 1.8% | 0.7 | Yes | No | No |
| US | 3.1% | 3.8% | 0.7 | Yes | No | - |
| Netherlands | 7.3% | 7.6% | 0.3 | Yes | Yes | Yes |
| Belgium | 4.0% | 4.2% | 0.2 | No | - | Yes |

## Countries where house prices slowed down in 2020

| | Change in price in 2019 | Change in price in 2020 | Difference (pp) | Change in trend? | Overvalued? (Dallas Fed) | Overvalued? (ECB) |
|---|---|---|---|---|---|---|
| Japan | -0.4% | -1.3% | -1.0 | No | Yes | - |
| Portugal | 9.6% | 8.4% | -1.2 | No | No | Yes |
| Bulgaria | 6.0% | 4.6% | -1.5 | No | - | - |
| Ireland | 2.3% | 0.3% | -2.1 | No | No | No |
| Slovenia | 6.7% | 4.6% | -2.1 | No | No | - |
| Spain | 5.1% | 2.1% | -3.0 | No | No | No |
| Latvia | 9.0% | 3.7% | -5.3 | No | - | Yes |
| Hungary | 17.0% | 4.4% | -12.6 | No | - | - |

**Notes:** We consider there to be overvaluation, according to the ECB indicator, when the value is greater than 5. House prices in nominal terms.
**Source:** CaixaBank Research, based on data from Eurostat and the database of the International Housing Observatory, described in Mack and Martínez-García (2011).

In this group of countries, it can be seen that the pandemic has, in many cases, led to a change in trend compared to previous years. This is the case of Canada (+8.2% in 2020 after two consecutive years of falling prices), Denmark (+4.8% in 2020 after years of slight price moderation), the UK (+2.0% compared to the downward trend since the historical rates of 2015) and the US (3.8%, breaking the trend of moderation from the previous five years). However, as the change in trend appears to be a response to the effects of the pandemic, we do not expect any significant or worrying overheating in the residential market; in fact, this should moderate or correct itself as these effects (such as changing habits, tax relief or supply shortages) dissipate.

**Signs of overheating in most real estate markets predate the pandemic, although the «temperature» increased significantly in 2020**

In other countries, prices were already growing at fast rates before the pandemic and accelerated further in 2020. A case in point is the Luxembourg residential market, whose prices did not overheat during the 2000-2007 expansionary cycle but grew steeply and more or less gradually (10.1% in 2019), accelerating even further over the past year (14.5% in 2020) to values equivalent to an overheated market (to which we must also add an increase in household debt, up to 175% of disposable income in 2020).

In the second group of countries (those recording a moderation in house prices between 2019 and 2020), Hungary (with a sharp decline of –12.6 pp down to +4.4% in 2020) and Latvia (–5.3 pp down to +3.7%) stand out, followed at a greater distance by Spain, Slovenia and Ireland, among others, all of which recorded a fall in the annual growth rate of at least 2 pp. In contrast to the previous group of countries, in this case all countries recorded a decline in line with a trend already occurring before the outbreak of the pandemic. Broadly speaking, these are residential markets that had become more or less overheated in the economic cycle ending with the global financial crisis of 2008. In other words, economies which, between 2000 and 2007, saw fast growth in prices, a sharp increase in residential investment's share of GDP and high household debt. These countries have since corrected such excesses and are now in a relatively expansionary phase of the cycle.

## Should we be concerned about rising prices? Are there signs of overheating?

In general, the statistical models used to estimate whether or not house prices are overvalued are subject to a high degree of uncertainty and should be interpreted with caution. As we will see below, various indicators suggest that, in general, there are signs of overvaluation in some markets but not across the board. Moreover, in these cases the situation was not caused by the outbreak of the pandemic but a trend that had already been observed.

The ECB produces a very useful indicator to assess whether prices are moving away from equilibrium levels.[26] According to this indicator, the Luxembourg market was already showing clear signs of overvaluation before the pandemic and recovered in 2020, an interpretation that is consistent with the analysis earlier in this article. Then, at a greater distance, we can find countries such as Austria, Germany and Belgium, which showed certain signs of being overvalued before the pandemic and increased in 2020. In fact, the ECB notes that house price growth during the pandemic has generally been higher in those countries that were more overvalued before the advent of COVID-19.

**The risks of overheating are more limited in countries where price rises have accelerated due to pandemic-related factors, while the risks have increased in countries that were already showing signs of overheating before the appearance of COVID**

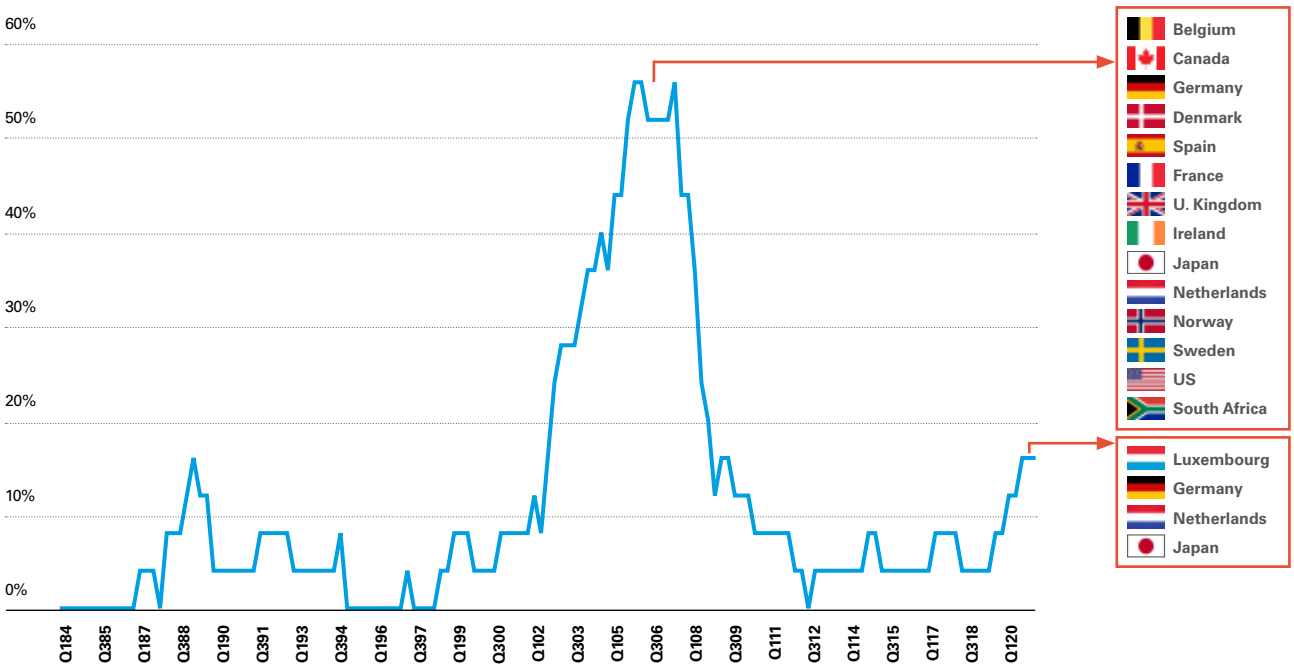
**(26) The ECB indicator is a simple average between the ratio of house prices to household income and the result of a model designed to detect house price misalignments from fundamentals. Specifically, this model statistically relates the trend in house price-to-income, the real mortgage interest rate and the housing supply per capita. The methodology is described in Box 3 of the *Financial Stability Review*, ECB, May 2015.**

Another indicator to assess whether house prices are moving away from equilibrium levels is the Exuberance Indicator, created by the Dallas Fed for a group of developed economies.[27] The markets where house prices are most overvalued would again be Luxembourg, closely followed by Germany (overvalued since 2016) and Japan (even though house prices are falling). The Netherlands would be the only economy where signs of overvaluation emerged during the pandemic.

27 The Exuberance Indicator detects explosive periods in the house price-to-income ratio. For more details on its construction and calculation, see the work of Mack, Adrienne and Enrique Martínez-García (2011), «A Cross-Country Quarterly Database of Real House Prices: A Methodological Note».

## Countries with clear signs of overvaluation in the residential market

Relative share of all the countries studied




**Note:** Countries with an Exuberance Indicator higher than the critical value (model with 1 lag).
**Source:** CaixaBank Research, based on the database of the International Housing Observatory, described in Mack and Martínez-García (2011).

A recent study by the Bank for International Settlements[28] concludes that, since the start of the pandemic, house prices have risen more than would be implied by developments in fundamentals, such as the cost of mortgage loans and household income. In particular, based on the historical relationship of house prices to household income and interest rates, house prices in many countries would be expected to rise from the beginning of 2020 but, in most cases, by less than the actual increase observed. This apparent misalignment between house prices and their fundamentals could lead to corrections in the future.

28 See «House prices soar during the COVID-19 pandemic», published in the BIS Annual Economic Report, June 2021.

## Is it different this time around?

A catalyst for the housing boom that led to the global financial crisis of 2008 was the rapid growth in household credit to purchase a home, creating a kind of vicious circle in which higher house prices boosted growth in credit. Everything seems to indicate that the situation is different this time, for the following reasons:

1. The growth in loans to households with a low credit rating has been contained in recent years, thanks largely to much tighter lending standards among the large developed economies. For example, in the US the proportion of loans granted to people with a low credit rating is relatively small.[29]

2. There is no clear association between the recovery in house prices and credit growth but rather the opposite: prices have risen most in those countries where households have deleveraged the most during the five years before the pandemic. This situation contrasts with what happened during the five years preceding the global financial crisis, as can be seen in the following charts.[30] Spain perfectly illustrates this paradigm shift: between 2001 and 2006, credit to households increased from 47% of GDP to 78% (+31 pp) and house prices rose by 71%. By contrast, between 2014 and 2019 credit to households fell from 73% of GDP to 57% (–17 pp) while house prices rose by a moderate 8%.

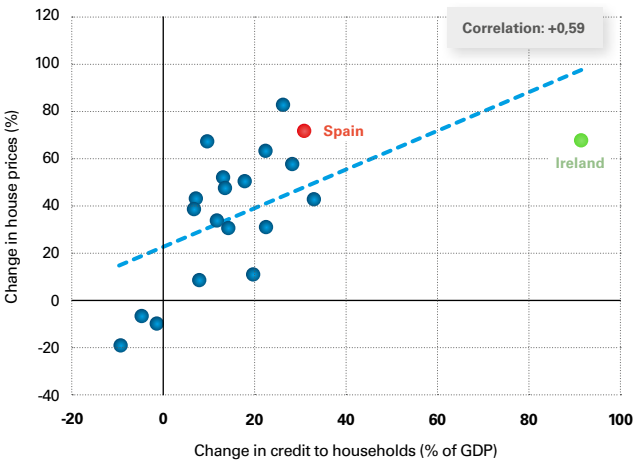
3. There is a third reason why the situation might be different this time around: the household debt burden in most developed economies is smaller than in the last international financial crisis. Therefore, in the event of a rise in interest rates, households would be less vulnerable than in other recessions, when the residential market was at the epicentre of the crisis.

**29 In 2007, 1 in 4 new mortgage loans was granted to a buyer with a low credit rating (below 659). In contrast, this share was only 5% in 2020, while 70% had a high rating (above 760), similar percentages to previous years.**

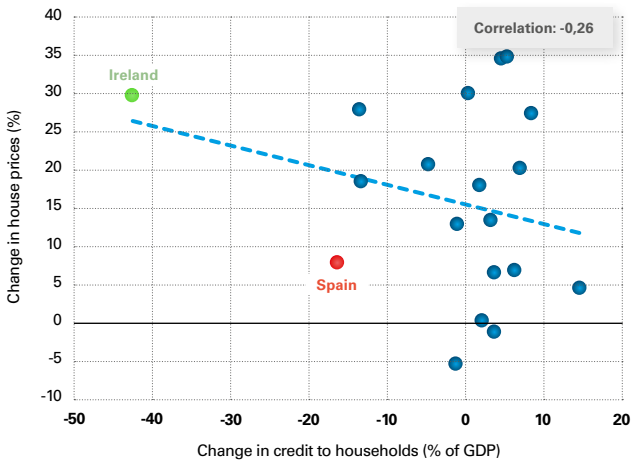
**30 In both charts, Ireland appears as an outlier. If we exclude this country, the correlations would be 0.73 in the period 2001-2006 and –0.09 in the period 2014-2019.**

### Relationship between the increase in credit to households and house prices

Before the global financial crisis (2001-2006)




Pre-COVID (2014-2019)




**Note:** Each point on the chart represents a country.
**Source:** CaixaBank Research, based on data from BIS and the database of the International Housing Observatory, described in Mack and Martínez-García (2011).

## The debate concerning the residential market has reached the central banks

The current situation of some developed residential markets has not gone unnoticed by central bank governing councils. Once again, questions have been raised concerning the role played by extremely accommodative monetary policy in pushing up financial asset prices. Our analysis suggests that some housing markets were already close to being overvalued before the pandemic and, indeed, some central banks are beginning to warn of the additional imbalance in house prices caused by fiscal and monetary stimuli. Such risks could possibly be managed using macroprudential instruments but might also result in the need to adjust some monetary policy tools before the economic recovery is fully established.[31]

**(31) There is also growing concern about the impact of monetary policy on inequality, since rising house prices would make it even more difficult for young people and low-income workers to buy their own home. In addition, a certain «crowding out effect» would be created, as higher-income households would be moving to the outskirts of large cities, where lower-income families have traditionally lived.**

## Aware of the impact of monetary policy on house prices, central banks are keeping a close eye on property market developments

In the euro area, this debate has taken its toll on the ECB's new strategy, encouraging the European statistics agency, Eurostat, to look at how house prices could be better incorporated into the HICP, as currently only rental prices are included. For now, the ECB will limit itself to monitoring house prices as another aspect in its discussion of price developments (as it does with wage trends). For their part, several Fed members have expressed concern about recent developments in US house prices. The minutes from the 15-16 June meeting mention concerns about the financial risk associated with strong housing demand and also, in the discussion on reducing the purchase programme, a call to lower MBS purchases (Mortgage Backed Securities).[32] In other regions, central banks have already taken action and introduced macroprudential measures. For example, the Central Bank of New Zealand has reimposed loan-to-value restrictions on new mortgages to reduce the risks associated with an overheated residential market.

**(32) For a more in-depth review of the minutes from the meeting on 15-16 June, visit the following link: https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20210616.pdf**

## An overview of the US residential market: no worrying signs of overheating for the time being

The US residential market became overblown in the previous economic cycle, ending with the bursting of the real estate bubble and the global financial crisis in 2008. As from 2013 there were more evident signs of the market recovering and, just before the arrival of the economic and health crisis generated by COVID-19, prices were posting very modest growth rates (+2.0% annually in 2019), house sales were growing in line with demographic trends (similar to their long-term average between the 1980s and 1990s) and residential investment accounted for just under 4% of GDP.

The outbreak of the pandemic was a stimulus for the US residential sector right from the start: sales of new single-family homes soared (+45% year-on-year in Q3 2020), house prices have been growing at double-digit year-on-year rates since December (+14% in April 2021) and residential investment accounted for 4.8% of GDP in Q1 2021. Although travel restrictions were somewhat more moderate than in Europe, much of this upturn is also due to changing habits and a preference for living in larger spaces and away from urban centres.[33] However, another influence has been the investment of pent-up savings during the pandemic, particularly after the strong fiscal policy of direct stimuli for the population implemented by both the Trump and, more recently, the Biden Administrations, as well as the Federal Reserve's monetary stimulus package. Finally, there are also problems on the supply side; some of a more temporary nature such as difficulties in finding skilled labour and the rising cost of some materials, and other factors that were present before the pandemic, such as the shortage of attractive land.

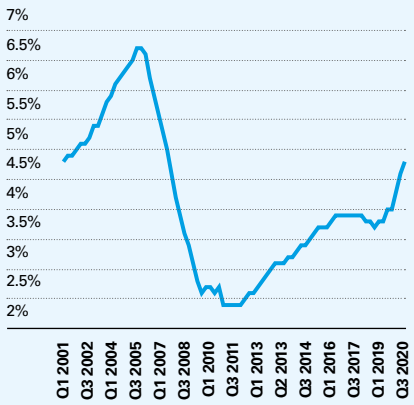
**(33) See Gupta *et al.* (April 2021), «Flattening the curve: pandemic-induced revaluation of urban real estate», NBER Working Paper 28675.**

In short, the US case is striking because the pandemic has pushed up indicators for housing market activity to rates similar to those seen during the sector's boom in 2000-2006. However, it is still too early to be overly concerned about this development, which could be a one-off or short-term boost as a direct reaction to the effects of the pandemic and the considerable package of stimuli. In fact, the house price-to-income ratio fell slightly in 2020 due to higher growth in income than in prices and it is still well below the levels reached in the previous boom. Other indicators (such as sales of new builds) are already showing signs of moderating towards pre-pandemic trends.[34]

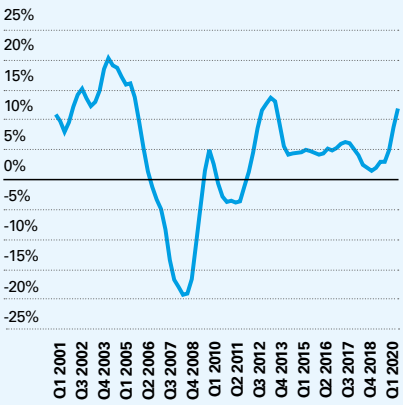
**(34) For a more complete analysis of the US residential market, see «The US housing market does not appear to be a bubble», published by Credit Strategy Research, Goldman Sachs, July 2021.**

### Economic activity indicators for the US residential market

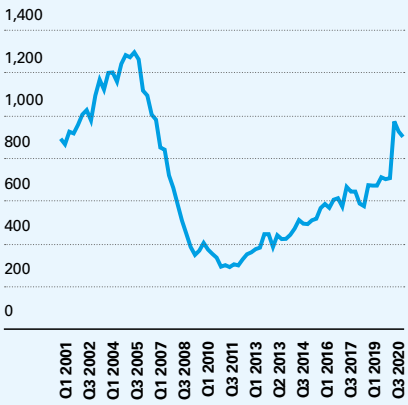
**Residential investment**
(% of GDP)




**Case-Shiller home price index 10**
Year-on-year change (%)




**Sales of new builds**
(thousands)




**Source:** CaixaBank Research, based on data from BEA, S&P and the US Census Bureau.

## Indicators and forecasts

Annual change (%), unless otherwise specified

| | Average 2000-2007 | Average 2008-2014 | Average 2015-2019 | Data 2020 | Forecast 2021[1] | Forecast 2022[1] | Trend |
|---|---|---|---|---|---|---|---|
| ***Economic activity indicators*** | | | | | | | |
| Total GDP | 3.4 | -1.3 | 2.6 | -10.8 | 5.7 | 6.2 | |
| GVA construction | 3.1 | -9.8 | 3.6 | -14.5 | 0.8 | 5.5 | |
| Investment in construction | 5.4 | -9.4 | 4.7 | -14.0 | 2.9 | 9.3 | |
| Residential investment | 5.4 | -8.5 | 9.6 | -16.6 | 5.5 | 10.1 | |
| Investment in rest of construction | 3.1 | -9.8 | 3.6 | -14.5 | -0.3 | 8.1 | |
| New building permits (thousands) | 642 | 94 | 80 | 86 | 90 | 95 | |
| New building permits | 2.8 | -28.7 | 20.9 | -19.5 | 5.2 | 5.6 | |
| Certificates of final completion (thousands) | 482 | 230 | 57 | 86 | 100 | 90 | |
| Certificates of final completion | 8.3 | -34.9 | 14.9 | 9.1 | 16.4 | -10.0 | |
| Confidence in the construction sector (level)[5] | 13.1 | -41.8 | -20.7 | -18.4 | -4.8 | - | |
| ***Labour market*** | | | | | | | |
| Total workers registered with Social Security | 3.5 | -2.4 | 3.1 | -2.1 | 2.3 | 1.0 | |
| Registered workers in construction | 6.1 | -13.5 | 5.1 | -1.7 | 4.1 | 1.0 | |
| Construction of buildings | - | -14.4 | 7.1 | -2.2 | 4.9 | 1.2 | |
| Civil engineering | - | -16.4 | 1.2 | -1.6 | 2.0 | 0.8 | |
| Specialised construction | - | -8.9 | 4.3 | -1.5 | 3.7 | 0.9 | |
| Registered workers in real estate activities | 10.3 | 2.1 | 6.3 | -1.5 | 2.0 | 1.7 | |
| Total employees (LFS) | 4.1 | -2.7 | 2.6 | -2.9 | 1.2 | 2.1 | |
| Employees in construction (LFS) | 6.7 | -14.0 | 4.5 | -2.6 | 3.0 | 1.0 | |
| Temporary employment rate in construction (%)[5] | 57.6 | 39.6 | 41.4 | 36.7 | 34.9 | - | |
| Unemployment rate in construction (%)[5] | 7.5 | 22.8 | 12.4 | 11.0 | 10.9 | - | |
| ***Demand for housing*** | | | | | | | |
| Sales[2] (thousands) | 886 | 388 | 450 | 418 | 451 | 491 | |
| Sales[2] | -0.1 | -8.7 | 9.2 | -17.2 | 7.7 | 9.0 | |
| New housing[2,5] | 12.1 | -13.4 | 4.8 | -10.3 | 60.7 | - | |
| Second-hand housing[2,5] | -7.8 | -5.0 | 10.3 | -18.8 | 39.1 | - | |
| Foreign sales[3] | - | 11.3 | 5.5 | -25.6 | 17.2 | 15.8 | |
| Second home sales[4] | - | -8.5 | 8.5 | -20.4 | 12.5 | 12.5 | |
| ***Prices*** | | | | | | | |
| House prices (Min. Public Works)[5] | 12.9 | -5.7 | 2.7 | -1.1 | 1.1 | 1.6 | |
| House prices (INE)[5] | - | -6.8 | 5.7 | 2.1 | 1.1 | 1.6 | |
| New housing[5] | - | -5.7 | 6.5 | 6.5 | 2.3 | - | |
| Second-hand housing[5] | - | -7.7 | 5.5 | 1.4 | 0.7 | - | |
| Land prices[5] | 17.5 | -8.7 | 1.3 | -9.4 | -4.6 | 2.6 | |
| CPI rent[5] | 4.3 | 0.8 | 0.8 | 1.1 | 0.7 | - | |
| ***Affordability ratios*** | | | | | | | |
| House prices (% gross disposable income)[5] | 6.5 | 7.5 | 6.6 | 7.2 | - | - | |
| Theoretical burden (% gross disposable income)[5] | 14.2 | 31.3 | 28.1 | 27.4 | - | - | |
| Return on rent (%)[5] | 4.5 | 3.5 | 4.2 | 3.7 | - | - | |
| ***Financing[5]*** | | | | | | | |
| Number of mortgages | 5.8 | -20.9 | 10.0 | -6.9 | -0.1 | - | |
| Outstanding balance of credit to purchase housing | 14.8 | -1.4 | -2.2 | -1.8 | -1.1 | - | |
| New loans, housing | 17.7 | -24.9 | 12.4 | -2.1 | 64.0 | - | |
| Outstanding balance of credit for property development and construction | 23.6 | -12.8 | -11.0 | -5.4 | -6.0 | - | |
| NPL ratio of credit for housing (%) | 0.5 | 3.5 | 4.6 | 3.4 | 3.2 | - | |
| NPL ratio of credit for property development and construction (%) | 0.5 | 20.2 | 20.4 | 5.8 | 5.5 | - | |

**Notes:** 1. Forecasts at 26 July 2021. 2. The 2000-2007 average for house sales corresponds to the period 2004-2007 and the data come from the Ministry of Public Works (Mitma). The sales figures from the National Statistics Institute (INE) are as from 2007. 3. Foreign sales according to Mitma. 4. Sales of second homes are estimated based on the sales carried out in a different province than the buyer's residence. 5. The data in the column «Forecast 2021» correspond to cumulative data up to the latest data available for 2021.

**Source:** CaixaBank Research, based on data from the National Statistics Institute (INE), Ministry of Transport, Mobility and Urban Agenda (Mitma), Ministry of Employment and Social Security and the Bank of Spain.

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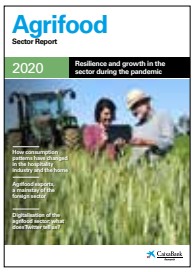


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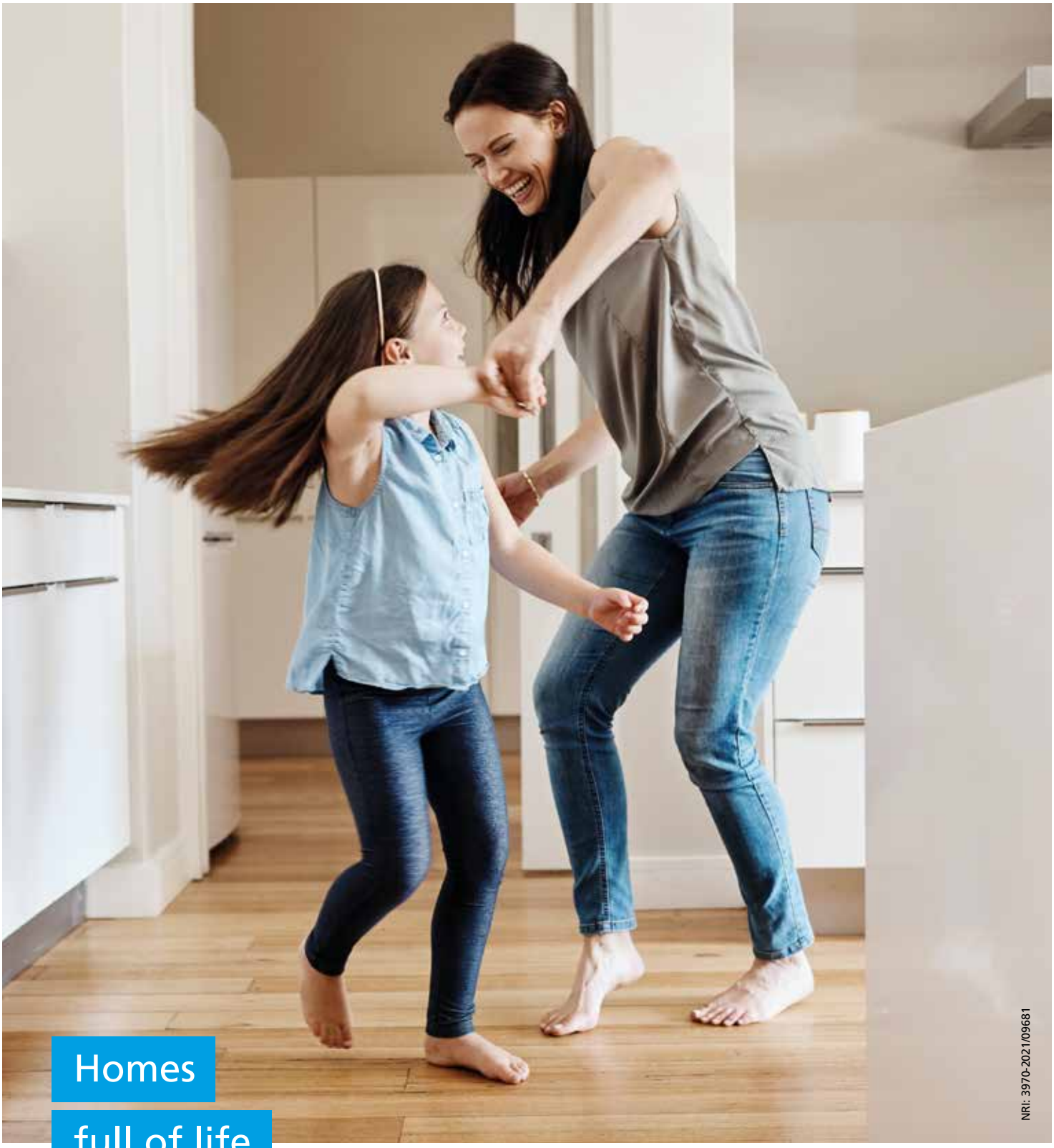

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