Spanish property boom ends amidst share panic

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Spanish property values took a massive hammering recently, as fears grew that the market boom had ended. Amidst panic amongst investors and property developers, some companies saw large percentages of their share price wiped out in a few hours.

One such company affected was Astroc, which saw 65 percent of its share values disappear. Last year, the Valencia-based company was floated at €6 a share and reached its highest level at €75 in February 2007. Last week, it had fallen to €14.

Eight other major property companies were affected. Spain's blue chip index also fell by 2 percent as a result of the property crash, as losses rose to €2.2 billion. Shares in Spain's biggest property group, Sacyr, fell by 8.15 percent, and property developers Colonial and Immocracal saw stock fall by more than 11 percent.

The immediate panic was caused by signs that Spain's property market was suffering from a massive overbuilding programme, coupled with high euro interest rates.

Paul Isbell from the Elcano Royal Institute said, "Spain is living its longest and most intense period of expansion since it became a market democracy in the late 1970s. But Spain has to ask itself, when will this change? We are past due for a recession. The question is whether it will be a soft landing, with growth tapering off without a recession, or a harder landing."

While some economic analysts have played down the prospect of a much "harder" landing, nearly all have agreed that the property boom is over. According to Lombard Street Research Analysts, "The country is over-housed, households are over-indebted and the construction industry continues to churn out houses."

According to Lombard, Spain has a massive oversupply of houses, with more than 800,000 new homes built last year. In the town of Galicia, housing stock has grown six times as fast as the population. During this period, planning permission has been granted for more than 240,000 properties, while Galicia's population has only grown by 35,000.

A substantial price drop would force numerous owners into distress sales, further depressing the market. Speculation has mounted that one company had been buying its own properties in order to keep prices artificially high. If true, this would add to the already seamy side of this market. A number of recent corruption scandals linked to the construction industry in Spain have revealed the outright criminality at the heart of the country's recent economic boom.

The most high-profile of these scandals centres on the jet-set resort of Marbella on Spain's southern coast. To date, no fewer than 79 companies have been implicated, 50 people arrested and €2.6 billion (US$3.3 billion) worth of assets seized. In March, more than 50,000 people demonstrated in Mallorca to protest against the unsustainable developments. Many were protesting the numerous illegal construction projects that are going on in the area, often spoiling scenes of natural beauty.

Another indicator of the looming crisis has been the cutting of vacation home prices by Spanish property agents, in some cases by 10 percent. "This slowdown will impact in Europe and will have a psychological effect" across the continent, said Tobias Just at Deutsche Bank.

The second-largest US real estate broker, Re/Max International, lowered its prices by 26 percent on just under 5,000 homes in Spain in January 2007. General housing prices in Spain have recently stalled. Prices rose only 7.2 percent in the first quarter of 2007 compared with nearly double that figure over the same period in 2006. This is the lowest increase since 1999 and the ninth consecutive quarter easing since 2004.

The Organisation for Economic Cooperation and Development said in January that house prices in Spain may be overvalued by as much as 30 percent. It warned that a sudden increase in interest rates could cause an "abrupt adjustment in which prices would plunge." According to Deutsche Bank, a 30 percent slump could reduce Spain's economic growth by as much as 1.8 percentage points.

Another indicator that all is not right with the property-driven Spanish economy is a study by Bloomberg News showing that some Spanish real estate developers were paying five times more to borrow money than their American counterparts. This means that Spanish companies are perceived as a much higher risk.

Any kind of slump in house prices would have a dramatic impact on Spanish banks. Many of the country's largest financial institutions, such as Santander, Central Hispano and Banco Bilbao Vizcaya Argentaria, are owed €1.3 trillion by

builders, developers and mortgage holders, according to the Spanish Mortgage Association. The €379 billion of loans to property firms is equal to nearly half of all corporate loans, according to recent research by the Bank of Spain.

The housing bubble in Spain—as elsewhere in the world—is being driven in large part by financial speculation. With interest rates at historic lows over the past several years and returns on investments in the stock market declining with the bursting of the dot-com bubble, both large and small investors have been pouring money into the real estate market.

Fully 18.5 percent of the Spanish economy is housing related, twice as high as the rest of Europe. If Spain were to fall back to the European level, it would have serious implications, as the country has one of the lowest rates of productivity growth in the European Union. Such a slump would further exacerbate the already dangerous position of Spain's foreign balance of payments, which has steadily declined year on year. Last year, Spain had a current account deficit of US$107 billion—the second largest in the world behind the United States. To offset the crisis, in the previous two months the Banco de Espana has sold off 80 tonnes of gold in what some have said is an effort to finance the current account deficit, which stands at 9.5 percent of GDP.

Many of the new housing complexes are being built by a new layer of businessmen who have gotten extremely rich off the back of Spain's construction boom. One such person is Astroc's Enrique Banuelos, who made it to the Forbes top 100 richest people in March of this year with a fortune of US$7.7 billion. The working class, however, has been plunged further into debt as it fights a constant, losing battle to keep up with the cost of living.

Leading banks have begun targeting the most vulnerable sections of society, such as the country's 4 million immigrants. This population is particularly vulnerable, as it is largely young people, low skilled and with next to no credit history. For the predatory Spanish banks, this is too tempting. While this is a high-risk strategy for the banks, it can turn a quick profit in the short term. The banks can charge a high interest rate on mortgage loans, and the homes of the large number of defaulters can be repossessed and placed on the market again.

Spain's fourth-largest bank, Caja Madrid, has close to half a million immigrant customers—20 percent of the bank's mortgage section. To attract business amongst the immigrant community, many banks have opened new branches staffed with immigrants from countries such as Morocco, China and various Latin American countries.

Asprima, a property developers' association, estimates that one in three new homes were sold to immigrants. With immigrant workers generally employed in very-low-income jobs, Asprima estimates that they are, on average, borrowing eight times their annual income.

The banks have also taken advantage of the difficulties faced by young people in getting onto the housing ladder. Many of the sub-prime loans target the young and poorest sections of Spanish society. Figures show that the average age that young people leave home has risen to 34 years old.

According to the Youth Council of Spain, on average, 60.8 percent of a young person's wage is needed to access private market housing. These young workers earn an average wage of €1,922 (US$2,480) per month before tax and social security payments. They are already spending nearly half of their income on accommodation, which has doubled in price in real terms over the last decade.

Household debt has risen to more than 110 percent of income and approaches US levels. The most recent reports show the amount of outstanding mortgage loans stands at a record €811 billion (US$1 trillion), a rise of 26 percent since last year. As 80 percent of Spain's population own their own homes, many workers are in an extremely vulnerable position should interest rates rise sharply.

In Spain, just over 95 percent of mortgage loans are at a variable rate. While interest rates were falling, this led to a massive rise in sub-prime loans. The recent steady rise of interest rates, however, is having a massive effect on the ability of low-wage families to pay back their loans. According to the Association of Ecuadorean Migrants in Barcelona, "We have families who are doing OK, but an increasing number are struggling."

It is a particular scandal that Spain has regularly overbuilt houses in the private sector under conditions of a major shortage of affordable housing in the public sector.

According to official figures produced in December 2006, some 20 percent of Spaniards live below the poverty line. The majority of homes in the rental sector are in private hands. Just 2 percent of dwellings are classified as social housing, compared to 10-30 percent in other EU countries.