RESIDENTIAL RESEARCH

Knight Frank

MADRID

NEW BUILD **2016**

SUPPLY | PRICES | DEMAND | OUTLOOK

DEMAND CONTINUES TO OUTSTRIP SUPPLY IN THE RESIDENTIAL MARKET

SUPPLY

PRICES

DEMAND

INVESTMENT

Last year saw the sale of a great deal of stock that had been on the market for many years.

This is a direct consequence of the lack of new supply

The new-build market is now clearly on the up. Future supply has increased considerably, but is still not high enough to meet current demand. This has helped to finally absorb the new-build supply that had been dragging its heels and had been on the market for some years.

This change in trend has also affected developer activity. 2015 saw an 8% fall in owner and co-operative development, in favour of more traditional development. Despite the fact that this is still a somewhat subdued figure, the outlook is that this figure will continue to recover going forward, as and when financing for developers becomes more flexible.

Prices continue to trend upwards, though growth this year has generally been more moderate than last year.

Supply is on the up, but is still insufficient to meet demand

Although future supply of new-build properties increased over 2015, there continues to be insufficient supply in order to meet current buyer demand. The number of building permit approvals has increased for the third year running. 2015 saw a 68% y-o-y increase, which will translate into future transactions between 2017-2018.

However, developers remain cautious, trying to find a happy medium that allows them to optimise sales prices, while also marketing them in reasonable timeframes.

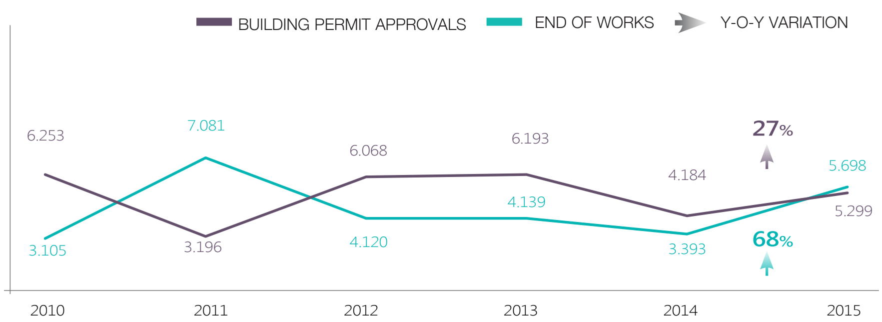
Available supply in Madrid stands at circa 3,000 homes. 30% of these are located inside the M-30, where supply is limited due to a lack of development land. 25% of available supply in this area are refurbished properties, while the remaining 75% are new-build projects.

20% of properties on the market are located in the area between the M-30 and M-40, while the remaining 50% of total available supply is primarily located in the PAUs (expansion areas in the

FIGURE 1

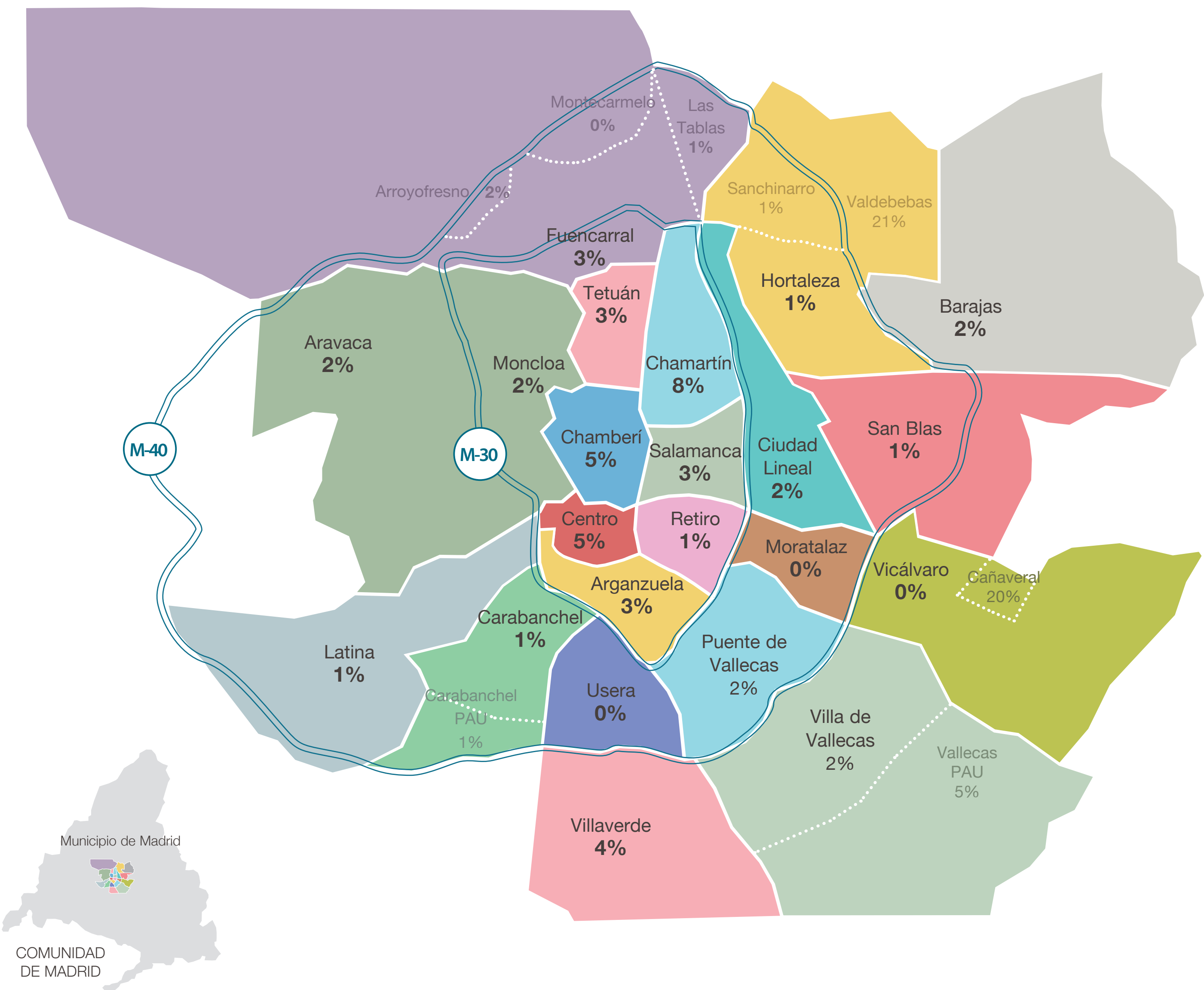
New-build residential building permit approvals

Madrid



Source: Munimadrid/Madrid Municipio

FIGURE 2
New build housing supply in Madrid



Source: Knight Frank

city suburbs). The number of properties available in PAUs has dropped by 12% y-o-y, which shows that there has been a good level of take-up in these areas as they continue to consolidate.

Average take-up last year stood at 37% of total supply. Perhaps most significant was the sale of stock which had been dragging its heels and had been on the market for many years. This is a direct result of the aforementioned lack of new supply.

Another change in trend noted in the report is the number of new-build projects in progress in the cooperative market. This currently stands at 20% of the total, which is an 8% y-o-y decline. This figure is confirmation that the market is normalising towards a greater balance between supply from developers and other players.

In terms of the types of home on offer, 3 bedroom properties continue to dominate the market and increased in number by 15% y-o-y. This property type accounts for 53% of all available supply.

Prices continue to trend upwards

Sales prices are performing well in central Madrid and are trending slightly upwards. The average sales price inside the M-30 has increased by 2% since last year. At the same time, the average sales price per sqm outside of Tier 1 has grown by just 1%.

Inside of the M-30, the Chamberí and Salamanca districts registered the largest increases in sales prices, with 5% and 4% respectively, while Chamartín and Moncloa have remained flat year-on-year.

Outside of the M-30, we would highlight the increase in the average price per sqm in locations such as Montecarmelo and Aravaca - 8% and 7% respectively - and Hortaleza in third place, with a 6% increase.

Valdebebas has not seen any major changes and Puente de Vallecas and San Blas are the only areas which have seen a 1% decrease.

PAUs lead the way

Demand, which was already showing signs of a change in tack in 2014, has continued to grow for a number of reasons: confidence in the improved economy and the future job market, and the drop in interest rates and improved financing terms and conditions. In addition, the poor performance of traditional financial products such as deposits and bonds has encouraged investors to acquire property as safe haven assets.

According to the Consumer Confidence Index, early 2016 saw consumer and business confidence in the Spanish economy reach levels not seen since March 2011.

The number of new-build transactions increased by 15% compared to 2014. Forecasts also remain positive for the next few years, in part due to the increase in building permit approvals. 73% of transactions signed in 2015 were off-plan purchases, which demonstrates buyer confidence in projects under construction. The remaining 27% related to turn-key homes, a 9% y-o-y increase.

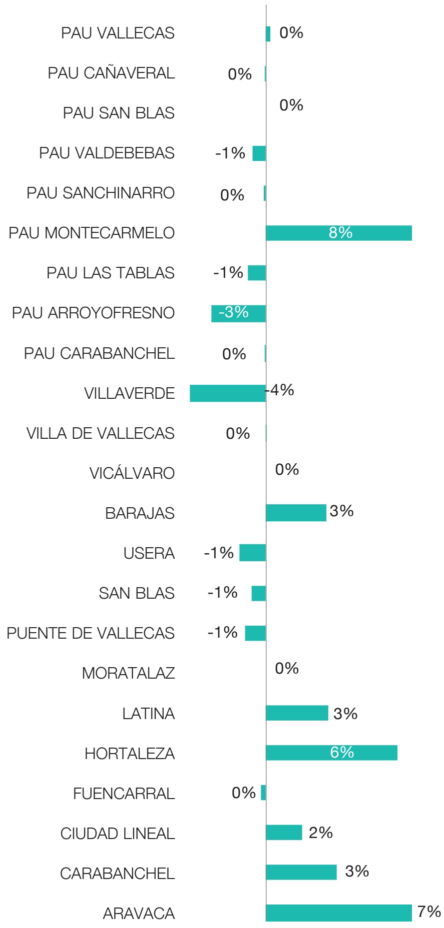
It is worth noting that in terms of demand by area, PAUs are out in front with 48%. Valdebebas stands out with 20%, and Ensanche de Vallecas with 10%, partly due to the amount of more affordable homes in the area.

Areas inside the M-30 account for 23% of demand. The most sought after districts were Tetuán (6%), followed by the Centre and Chamberí (4%) and Salamanca (3%) districts.

The tier between the M-30 and M-40 ranked third accounting for 18% and finally the districts outside the M-40, which accounted for 11% of all demand.

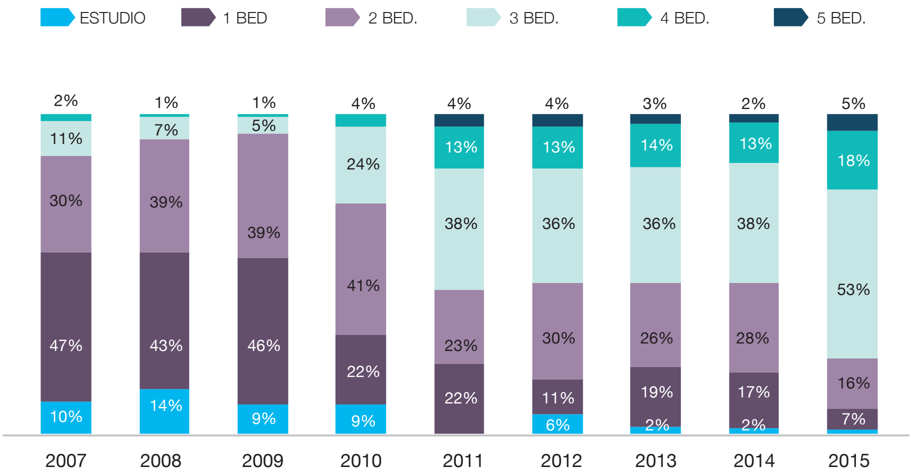
The buyer profile continues to be primarily families with medium to high purchasing power, looking for a replacement home located in areas with good levels of services and good transport links, in well designed homes with good finishings, in gated developments with communal areas.

FIGURE 4
Percentage change in prices €/sqm (%)
Outside M-30



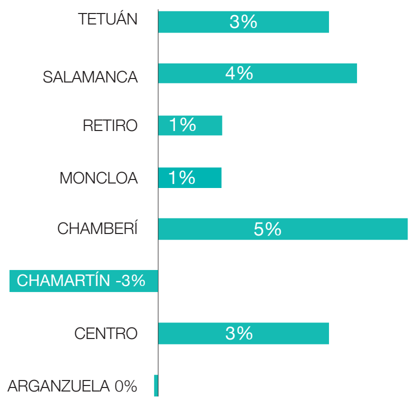
Fuente: Knight Frank

FIGURE 3
Supply by type of home (%)



Source: Knight Frank

FIGURE 5
Percentage change in prices. €/sqm (%)
Inside M-30



Source: Knight Frank

The most sought after product is 3 bedroom homes within the €230,00 and €450,000 price range located in PAUs or suburban areas. Property prices rise significantly the closer one gets to the city centre, up to 167% inside the M-30.

The existing relationship between mortgage rates versus residential rents means that many buyers contemplate investing in property either for their own use or to buy to let.

Residential investment: Madrid is out in front

The market for new-build open-market homes in Madrid is worth €8,000 million. This figure is 23% higher than in the previous year for two reasons: the increase in supply and upward trend in prices. Both factors clearly indicate that the market is recovering well.

Investment in the new-build residential market in 2015 exceeded expectations, surpassing €800 million. This includes the acquisition of land and properties for refurbishment for the development and marketing of new open-market homes in Madrid. This equates to approximately 4,500 - 5,000 homes that will come onto the market in the next 18-24 months.

Madrid is the most sought after area for investors in search of residential product, accounting for 19% of all investment. Andalusia, the Community of Valencia and Catalonia follow with 16%, 15% and 14% respectively.

However, investor profiles have shifted: the traditional investor remains; financing structures are designed using private funds for residential development with local managers while private equity firms and family offices are becoming more prominent in residential investment and development. This has caused an influx of overseas capital for residential development at a time when financial institutions continue to offer only modest financing for purchasing land and residential development offers greater returns on investment than that offered by income-producing properties.

Investors continue to purchase schemes located in the city centre, mainly buildings that require refurbishment. In 2015, properties accounted for 19% of total investment, whereas land accounted for 81%.

One can see that for land available in specific areas, with a high number of homes per project, it is the cooperative managers that are meeting land owners'

Investment in land and residential properties exceeded all expectations, reaching €800 million in 2015, equivalent to 5,000 homes.

FIGURE 6
Demand ranking by area

Source: Knight Frank

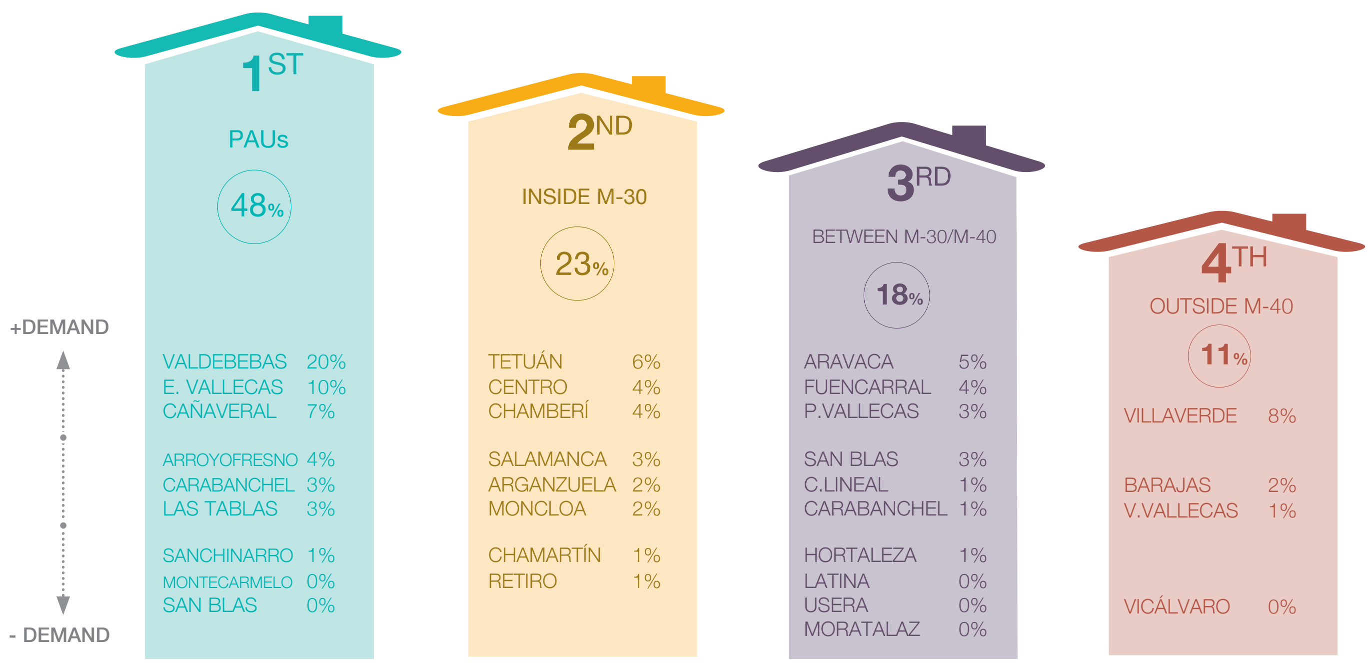
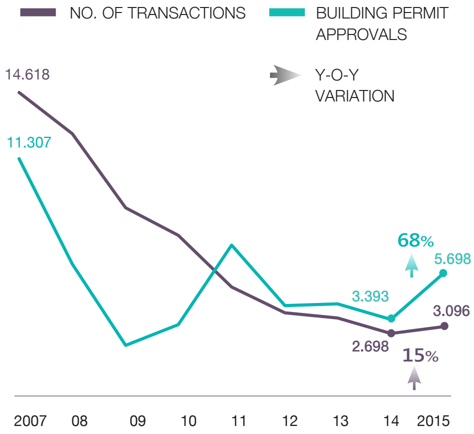
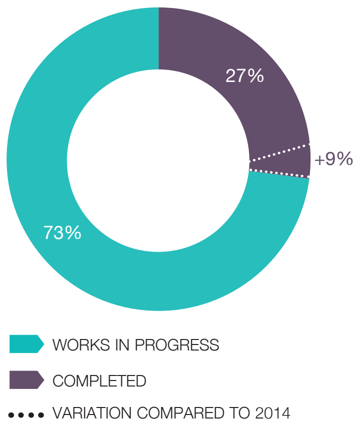


FIGURE 7
Evolution of transactions
Madrid



Source: Spanish Development Ministry

FIGURE 8
Transactions completed



Source: Knight Frank

expectations, in exchange for flexibility on the purchasing timeframes for the plot of land and mitigating the commercial risk of the project.

Residential financing

For the first time since records began, Euribor rates are negative (-0.025%), which has caused a drop in mortgage rates. According to the Bank of Spain, interest rates directly linked to Euribor dropped considerably to 2.2% in 2015.

This makes it easier for households to acquire financing. However, variable interest rates affect the distribution and perception of risk and can affect the financial stability of both families and businesses.

Banks are targeting mid-to high-end clients, who have easier access to funds to purchase a property, meaning there is a lower risk of default. Variable interest rates can cause banks to make incorrect risk assessments.

The average deposit (effort rate) in order to purchase a property currently stands at 33% of the final sales price, this is the best figure on record.

In addition, financial institutions have begun to lend again, financing an average of 70% of the final sales price.

Hence, 2015 saw the number of mortgage approvals increase by 20% y-o-y.

Positive outlook, but on stand by due to political uncertainty

The political uncertainty in Spain, along with a politically unstable backdrop, has put a dampener on forecasts for this year.

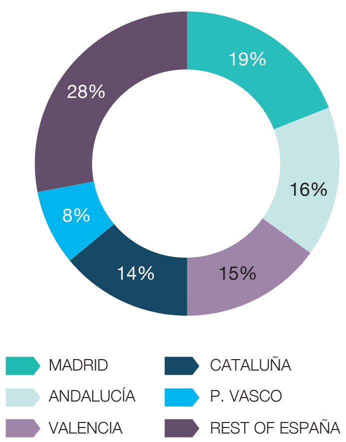
There will be a moderate increase in supply of new-build homes, despite the fact that the current rate of production stands below acceptable levels. Production levels will remain stable thanks to investments made by the main market players and will not create an imbalance between supply and demand.

Prices per sqm will continue to increase for new-build properties, although more moderately, due to the considerable increase in land prices. This growth will be more marked in the prime districts and their immediate surrounding areas, while prices will remain stable in PAUs, where there is still available development land.

While demand has been active in the last few months, it could slowdown until after the results of the coming elections. Nevertheless, provided that the outcome of the elections does not result in extreme changes to government, demand should grow in line with employment, provided that there are no unexpected interest rate hikes.

Investment will continue to increase for schemes situated in good locations, with attractive mid to long-term returns.

FIGURE 9
Investment in open-market va



Source: Spanish Development Ministry

FIGURE 10
Effort rate to purchase a home (%)

Source: Bank of Spain

TRIBUNA

The world economy continues to back Spain

It appears that the global economic slowdown is now a fact. The IMF has been forced to cut world growth forecasts by two tenths of a per cent for 2016, leaving them at 3.2%. We are faced with a backdrop of volatile financial markets and somewhat lethargic international trade.

The oil crisis is directly affecting emerging markets and their growth, deepening recessions such as that of Brazil, which could have a knock-on effect on the rest of Latin America. The economic slowdown in China has unnerved the rest of the world and, though it has recently improved slightly, the halt in consumption is worrying.

Meanwhile, in the Eurozone these concerns appear to have further affected the outlook of emerging economies. The financial instability seen at the beginning of the year and the economic information at hand, point to lower growth for the first quarter than previously forecast a few months ago.

The outlook in the medium term seems to indicate a gradual recovery, with monetary policy continuing to show signs of expanding. In addition, the recent worsening of the international geopolitical scenario and the increase in uncertainty of the changes to the Eurozone economy suggest that these forecasts could be subject to a downturn.

Though growth in Spain is expected to slow in the coming years, lowering the strong position it currently holds in the Eurozone, and the unemployment rate remains high at around 20%, it continues to drive growth. This year Spain will be the developed economy with the highest growth this year, even ahead of the United States. GDP will increase by 2.7%. And although the IMF has reduced its growth forecasts for all the main economies, Spain has seen the lowest adjustments, just one tenth of a per cent. It is worth noting that private consumption and residential construction are the two areas in which the greatest growth is forecast.

Nevertheless, political uncertainty continues to cast a shadow over Spain's future. This is one of the factors of most concern to the IMF, in particular if this situation continues to drag out over time.

Madrid grew by 3.4% in 2015, with the service sector being one of the main drivers, in which there was increased job creation, while the construction sector also saw a considerable improvement growing by more than 4%.

The improvement in GDP has been driven by good household and business spending, which has, among other factors, improved financial terms and conditions. Household income in particular has been bolstered by the fall in oil prices, the increase in employment and, to a lesser extent, the introduction of various budgetary measures.

In terms of the job market, the increase in the number of workers affiliated to Social Security suggests that employment levels will continue to grow as in 2015. There has been a considerable fall in the unemployment rate in Community of Madrid, where it currently stands at 16.5%.

In terms of prices, the CPI is expected to fall to 0.1% in 2016. The first months of the year have seen the CPI return to negative year-on-year levels.

The Euribor is at an all time low, the Consumer Price Index and inflation have remained flat and the unchanging market activity rate in 2015, all contribute to a scenario that supports the continued recovery of the residential market in the medium-term.

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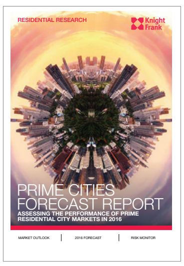

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