



# Dark clouds over Spain

Should we be surprised by the property price crash?

**If the scare headlines in the property press and broadsheets are to be believed, then the housing market in Spain is about to implode. Should we be surprised and how should second home investors be reacting? Dan Anderson, a Principal Associate with Locum Consulting, considers the news.**

The OECD has Spanish house prices 30% overvalued. In one day in May this year, the five largest property stocks lost 20% of their value, dragging the entire Ibex down 5% in the process. A further concern is the knock-on effect that a property market crash will have on the banking and construction sectors, which between them account for more than a quarter of the Spanish economy. House building accounts for nearly 50% of turnover for Spanish contractors and the building industry alone employs two million people. Spanish banks are heavily exposed to the mortgage market. Freefall in the housing market would have far-reaching effects.

The only surprise in all of this, of course, is that anyone could be surprised. Though more prone to speculation and bubbles, the housing market behaves like almost any other market. When demand is much greater than supply – as it was in Spain in the early-1990s – then prices go up. When supply exceeds demand, then prices go down. And there is no doubt that Spain is dramatically over-housed at the moment.

In fact, prompted by one of these recent articles on the Spanish crash, I carried out a little experiment. I scrolled the satellite image of Google Earth over the Spanish coast from Gibraltar to Valencia and found barely a patch of coastline that wasn't developed, paved over or cleared. Every now and then I thought I found one, but zoom in a little closer and – whoops – golf course!

The Spanish have built houses at an astonishing rate – 800,000 last year alone, which was more than France, Germany and Italy combined. Low interest rates, easy loans, high immigration, foreign investment and changes in household composition kept demand high enough to absorb all of this additional housing for a long stretch, but the rate of new house building far outpaced demand growth. Excess supply was inevitable. Add to this a recent rise in interest rates, 85% home ownership, household debt that is amongst the highest in Europe and the fact that the gulf between average house prices and average wages is even greater than it is in this country, and the words 'bubble' and 'burst' spring immediately to mind.

If the cooling of the Spanish market comes as no particular surprise, the interesting thing to observe over the next year or so will be the reaction of foreign house buyers – not least the British and not just in Spain. The British are heavily invested in Spanish property and stand to lose a great deal if the worst predictions come true. We have been enthusiastic players in the Spanish market, snapping



In fact, if there is an easy explanation as to why the housing market is imperfect and does not behave exactly as markets should, it is that a fundamental tenet of market theory does not apply – consumer's often do not act rationally. Housing is subject to the psychology of manias and mobs. If you are acting rationally, but everyone around you is not, you will start to doubt your judgement and join the herd. That's why property – like the stock market – is so prone to bubbles.

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The further we are in living memory from a bad slump – and hasn't it been a while? – the more susceptible we are to the estate agency lie that housing is an iron-clad investment. And it works the other way too – live through a bad correction and you will be squeamish about buying again for years to come. When it comes to housing we are cursed to look constantly at yesterday to predict tomorrow.

If all the doom-and-gloom about Spain is warranted and a large number of British buyers have their fingers burned, then one could easily imagine us meekly retreating from the Spanish Costa and Tuscan hills. Which is a pity, because the idea of releasing equity from our overvalued homes in the UK and investing in overseas property remains as valid as it was in the 1990s, provided you pick the right destination. There are still plenty of bargains all over Europe, particularly centrally and to the east, and many destinations ripe for development – the highly desirable Dalmatian Coast to name but one.

Hungary also provides clear examples of bargains to be had: it is hard not to stop in front of every 'For Sale' sign and want to calculate the capital gains to be had. Evidence of growing prosperity is around every corner, from the cars people drive, through the clothes they wear, to the occupied shopfronts and the crane count on the horizon – but the houses are a steal.

Pick the right destination and it can still seem like low hanging fruit. Nothing irrational about that. Just don't be the last to get there.

up properties all over the place. A third of UK residents who purchased an overseas property last year bought it in Spain. Most recently, this market has been dominated by speculators, seduced by the rapid growth in prices, who bought off plan with the intention of selling on completion. There is now a good chance that those homes will never even be built and if they are, owners may have to sell at a discounted price – or learn to love paella.

For those of us who didn't join in the Spanish gold rush, it's tempting to snicker as the smug grins are wiped off the faces of those who did. But grim panic in a downturn is no better than blind euphoria in a boom. It is just another form of bandwagon jumping.

Let's not forget that those who bought in Spain early will have seen enough growth in value to still feel satisfied now. The majority of second-home buyers from the UK need not feel overly concerned. Without a comparable coastline and climate and with cheap flights from discount airlines, the British were among the first to join the party. The ones who buy in early and cash out first normally do well out of bubbles. Others will comfortably ride it out, either through having no intention to sell or knowing that a crash today means bargains tomorrow. Those who are seriously vulnerable are the late-joining speculators who gambled on a quick profit. As ever, the last to join a pyramid scheme are the ones who suffer most.

But the funny thing about the housing market is how emotionally – as well as financially – invested people can become in it.

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