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Spanish banks

Land has gone from being the safest of bets to the riskiest

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HOW bad Europe's debt crisis gets depends largely on Spain, which would be much harder to rescue than smaller economies like Greece. How bad things get in Spain depends largely on the banks, which are already trying to find an additional €15 billion ($21.1 billion) to meet new capital requirements imposed by the government. And how bad things get for Spanish banks depends largely on the country's unfolding property bust. Nestling at the heart of these worries is land.

Land was the hot commodity in the decade-long Spanish property boom. Local councils allowed ever more plots to be zoned for urban development, issuing building permits with abandon and receiving fees or a percentage of the land. The scale of the boom is only now apparent, following requests from the Bank of Spain for details of lenders' exposures.

Almost a quarter of the banks'€320 billion in loans to developers is backed by land, according to estimates by Goldman Sachs. Land also makes up nearly half of the €70 billion of real-estate assets now owned by the banks and savings banks. Add it all up, and Spanish institutions have exposure to more than €100 billion of empty plots, either as lender or owner. "The main issue for the banks isn't excess housing, it's land," says Carlos Ferrer-Bonsoms of Jones Lang LaSalle, a consultancy.

According to Fernando Rodríguez y Rodríguez de Acuña of RR de Acuña, another consultancy, there are approximately 1.5m unsold homes in Spain, of which 1m need to be sold before most of that acreage is developed. Digesting that housing glut will take at least five years. He calculates that another 2.7m homes could be built on existing developable land. Plots located in crowded metropolitan areas like Madrid or in prime coastal locations stand the best chance. But he estimates that 1.45m of those developments won't see the light of day until after 2020, due to their poor location. Many will never get built at all.

Some banks are striking bargains with stronger property developers or co-operatives to build housing units on the more attractive land plots in exchange for a slice of the development. But a bank will finance the project only if the developer manages to sell a high percentage of the units upfront, a tall order.

La Caixa, one of Spain's largest savings banks, is pioneering the use of land for affordable housing. It is building 1,100 units of low-rent apartments for the young and old on plots swapped for loans with bust developers. The construction is funded by its charitable foundation, Obra Social la Caixa. After ten years tenants will have an option to buy.

Options for taking land holdings off banks' balance-sheets are unattractive. Land transactions totalled just €4 billion in 2010, down from €23 billion in 2004. Distressed funds are willing to buy, albeit at steep discounts. But many banks are carrying the land on their books at higher prices and are reluctant to sell at a big loss. Even those lenders that have braced for big losses—Spain's biggest bank, Santander, has provisioned 35-40% of its acquired land, for instance—may need to set aside more. Just how much more is a question with ramifications well beyond those empty tracts of Iberia.