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Spain Credit Falls to ’05 Shadow After Price Collapse: Mortgages

By Charles Penty - Dec. 5, 2014

Spanish property broker Donpiso pledges on its website it can sell homes within 60 days. That’s possible, said Juan Luis Nolasco, who runs one of the firm’s Madrid branches, only if owners are realistic about prices and the difficulties buyers face getting mortgages after six years of falling values.

“A lot of sellers are still living in the land of Peter Pan,” Nolasco said, referring to the fictional Neverland. “The biggest problem is lack of access to financing for buyers.” Currently, it can take about six months to sell a property, he said.

Buying a home hasn’t gotten any easier for Spaniards, even after home prices tumbled as much as 40 percent. Rising borrowing costs, currently more than one-and-a-half times the cost in Germany, the end of mortgage tax breaks, and shrinking disposable incomes are making it increasingly difficult for Spanish families to own their own home. Fewer than 15,000 mortgages were granted in September compared with about 129,000 at the September 2005 peak, according to the National Statistics Institute.

Spanish homeownership -- at 83 percent the third-highest among countries that share the euro after Slovakia and Estonia - - is under assault as the nation’s banks and government threaten to delay a real estate recovery. The collapse of a decade-long property boom, when mortgage lending surged almost four-fold, pushed Spain’s economy into a five-year slump and forced banks to take impairment charges of 87 billion euros ($118 billion) last year to help clean up soured assets linked to real estate.

Mortgage Cost

The average rate on a new mortgage with a term of more than 10 years was 5.19 percent in October even as 12-month Euribor, the benchmark used to price most Spanish home loans, has dropped as low as 0.51 percent, according to data compiled by the Bank of Spain.

That compares with a mortgage rate of 5.84 percent in 2008, when 12-month Euribor was as high as 5.38 percent. The same mortgage in Germany would cost 3.14 percent, 3.19 percent in France and 4.77 percent in Italy, according to the European Central Bank.

In Spain, a monthly installment for a “standard” 2007 floating rate, 27-year mortgage with a loan-to-value ratio of 80 percent would only be 5 percent higher than the same mortgage today because of higher margins now charged by banks, according to a Nov. 7 Fitch Ratings report.

Taking into account the government of Prime Minister Mariano Rajoy ending tax deductions for home acquisitions at the end of 2012, the total cost of buying a home with a mortgage is now higher than in 2008.

Prudent Buyer

"The irresponsible buyer who bought at the top of the market is paying less than the prudent buyer who's in the market now -- it's crazy," said Juan David Garcia, a structured finance analyst at Fitch in Madrid, who wrote the report with Carlos Masip. "If you do the numbers, you can see the market still has not reached its equilibrium," Garcia said in an interview.

Loans aren't just getting scarcer, they're also getting smaller. As the number of residential mortgages awarded to Spaniards fell by an annual 31 percent in September, the average loan was for 97,298 euros, down 5.5 percent from a year earlier and 36 percent from a peak of 152,482 euros in 2007.

"The few mortgage loans that banks are granting are for less and less money," Beatriz Toribio, head of research at fotocasa.es, a Spanish property website, said in an e-mail. "Without financing there won't be a recovery, however much prices fall."

Unemployment Rate

With Spain's unemployment rate at 26 percent and the economy barely growing, banks are cautious about who they lend to, said Santos Gonzalez Sanchez, chairman of the Spanish Mortgage Association, in an interview.

They're also charging more for mortgages to compensate for the increased risk and the fact that yields on Spain's 583 billion euros of home loans have plunged with the decline in Euribor, he said. Banks are now being more stringent in analyzing the ability of mortgage borrowers to pay as they factor in the impact of future Euribor increases for potential borrowers, he said.

"No one is competing in the mortgage market," said Gonzalez Sanchez. "The end result is that the interest rates charged are higher because the risk is perceived to be greater."

Moody's Outlook

While Moody's Investors Service yesterday increased Spain's credit rating outlook to stable from negative citing improving growth prospects, many people in the country aren't necessarily seeing the benefits. Missed payments on mortgages in Spain are rising as commentators such as the International Monetary Fund predict that unemployment will not fall below 25 percent until 2018. The default rate on home loans rose to 4.9 percent in June compared with 2.3 percent in 2008.

Banco Santander SA, Spain's biggest bank, said in October that 7 percent of its mortgage loans were in default, up from 3.1 percent in June, as it reclassified loans that it had refinanced as being in default. Alfredo Saenz, a former Santander chief executive officer, said in April 2012 that anyone claiming mortgage defaults were a problem for Spanish banks was "saying something stupid."

The bank has risen about 4.2 percent this year, while the Ibex-35 index of leading companies has gained 17 percent.

"The credit drought is keeping homebuyers away," said Eloy Bohua, manager director of Planner Exhibitions, the company that organizes the annual Madrid International Real Estate Exhibition, which took place last month. "We can't talk with any certainty about a recovery in the economy."

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Tax Changes

Tax changes are also reducing home affordability, Fitch's Garcia said. At the end of 2012, Spain ended an arrangement that allowed Spaniards to deduct 15 percent of annual mortgage payments up to a 9,000-euro maximum from their tax bills.

At the same time, levies on property transfers have been rising as cash-strapped regional governments take advantage of their ability to set stamp-duty rates. The government also has raised value-added tax on purchases of new homes to 10 percent from 4 percent.

A Spaniard buying a $150,000 home would, on average, have to pay taxes and fees of $10,500, or 7 percent of the property's price, according to a UHY International survey of 15 countries. That's the second-highest amount after India.

Buyers also need to contend with pressure on their own household budgets, said Fernando Acuna, project manager at RR Acuna & Asociados, a Madrid-based real estate consultant.

Cash Buyers

Spanish households' average income fell for a fourth year to 23,123 euros per year in 2012, compared with 25,556 euros at the start of the crisis in 2008, the National Statistics Institute said on Nov. 20. That left 22 percent of the population below the poverty threshold.

Economic conditions in Spain have left the market wide open for cash buyers who don't have to worry about tighter terms on mortgages and can negotiate discounts with sellers for quick sales, said Bernard Fay, co-managing partner at UHY Fay & Co., a Spanish firm that's part of the UHY network. Cash deals now account for 70 percent of home purchases in Spain even as sales fell 9.2 percent in September from the same month a year earlier, according to the General Council of Notaries.

"At the high end of the market, there's plenty of money and now it's starting to pour out as prices adjust," said Fernando de Salas, chairman of real estate broker De Salas Consultores Inmobiliarios. "Most clients that buy for us are people that don't need credit." His firm operates in wealthy neighborhoods in the Madrid region such as La Moraleja and Conde de Orgaz where sales are up 20 percent this year.

Bank Easing

Gonzalez Sanchez of Spain's mortgage association said banks may start to begin easing home-loan terms next year, though 2014 will also be weak in terms of lending volumes.

"The activity of the great majority of Spanish banks is retail and an important part of that business has been to meet demand for housing," he said. "Spain still needs to sell homes."

Broker Nolasco says he's seeing interest in buying in the center of Madrid, although financing is the biggest obstacle. And to sellers he has a simple message: "I can promise to sell a house in two months if they listen to me."

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