

Catalonia's Independence Push Risks Real Estate Revival

By Sharon Smyth – Nov 18, 2014

Catalonian independence, favored by 81 percent of those who voted in an unofficial ballot this month, would put at risk a growing regional economy lifted by one of Spain's recovering property markets.

An exit from the euro, debt downgrades and the flight of banks and other businesses are all possible consequences of separation from Spain. At the least, it would undermine a real estate revival that's made Catalonia's capital, Barcelona, the second-most popular city for commercial-property investment after Madrid, said Patricio Palomar, director of research and investment strategy at CBRE Group Inc.'s Spanish unit. The housing market, emerging from a seven-year slump, would also suffer, he said.

"Independence would be a complete disaster for the residential market," Palomar said in an interview in Madrid. "The region's housing stock would have to be digested internally because foreign investors tend to avoid buying property with currency risk."

The Nov. 9 ballot, which had been blocked by Spain's Constitutional Court, was the latest expression of a four-year resurgence of separatist sentiment in Catalonia, a region of 7.4 million people that's about the same size as Belgium. While the road to an independent Catalonia would be a long one, the potential consequences of flirtation with the idea were seen a week before the ballot, when Fitch Ratings threatened to downgrade Catalonia's debt to junk-bond status because of the political uncertainty.

'Fledgling Recovery'

"A junk bond rating would mean a lot of funds will automatically be prohibited from investing in commercial property there by their investment committees," Palomar said. "The residential market, which has seen a fledgling recovery, would also suffer as banks relocate and mortgage lending contracts."

The value of Catalonia's 1.3 billion euros (\$1.6 billion) of 4.75 percent bonds repayable in June 2018 have slumped since July as calls for independence merged into a set date for a vote. The bonds currently trade at about 107.81 percent of face value, down from more than 111 percent in the first week of September.

"Real estate prices lag behind bonds," said Nicholas Spiro, managing director of Spiro Sovereign Strategy in London, said by phone. "The fact that there's going to be more uncertainty is going to be unnerving."

Rajoy's Opposition

Catalan President Artur Mas plans to use the vote to force Spanish Prime Minister Mariano Rajoy into negotiating a path to independence. Rajoy opposes any vote on the issue.

This month's ballot took place as Spain's political establishment faces its biggest crisis since the return of democracy 36 years ago. Unemployment is at 24 percent, the second-highest in Europe after Greece, and corruption allegations have eroded confidence in the government.

Before the vote, Rajoy said the courts and the police would prevent it from going ahead. Ultimately, he took no action when more than 1,000 polling stations opened across the region, to avoid driving more Catalans into the separatist camp. Rajoy plans to visit the region on Nov. 29 to give a "better explanation" of arguments against independence.

Investment in Spanish commercial real estate more than doubled in the first half from a year earlier to 3.23 billion euros, according to data compiled by CBRE. Madrid took the lion's share with 60 percent of the total, though Barcelona is expected to catch up by the end of the year, Palomar said.

About 10.1 billion euros was invested in commercial properties when the Spanish market last peaked in 2007. CBRE estimates that total investment in Spanish real estate will be 9 billion euros this year.

Potential Fallout

While investors are still buying assets in Catalonia, some are beginning to weigh the potential fallout resulting from a decision to break away from the rest of Spain, said Jeff Greensmith, founder of Tarragona-based property brokerage Fincasdirect.com.

"Clients do ask what are the chances of Catalonia becoming independent," said Greensmith, whose firm specializes in sales of Catalan homes to foreign buyers. "It would go through a couple of very rough years. That would impact on property prices, but it wouldn't be catastrophic."

By cutting its ties to Spain, Catalonia would probably force its financial institutions to function without the support of the European Central Bank, Palomar said. Such a move would also prevent the region's government from raising money by selling bonds.

Damaging Impact

"All of this would have a damaging impact on the local economy, and that would filter through to the real estate market," he said. Catalonia accounts for 18 percent of Spain's gross domestic product.

Spanish leaders have had to contend with restive regions seeking independence for hundreds of years. Catalonia has periodically pushed for autonomy for 300 years, suffering considerable setbacks along the way.

General Francisco Franco banned the Catalan language when he came to power in 1939, following the Spanish Civil War. The region didn't overturn this measure or gain control of its health and education policies until after Franco's death in 1975.

Even then, Catalonia didn't get the tax-raising power awarded to Spain's Basque Country, where terror group ETA has killed more than 800 people during its own four-decade campaign for independence. ETA has since disarmed, though the Basque government is still seeking more autonomy over its finances.

Scottish Vote

After Scotland voted to stay in the U.K. in a September referendum, Catalonia has become the most likely country or region in the European Union to gain independence. EU leaders insist that in such a situation, the newly independent country would have to reapply for membership in the group of countries that share the euro, without any guarantee of success.

Barcelona, Spain's second-largest city, is emerging from the country's six-year recession in better shape than other areas. In the first quarter, Barcelona home prices rose 1.5 percent from a year earlier, according to Idealista.com. That was the first increase in any of Spain's 11 largest cities since 2007, the country's largest property website said.

It's a different story in the rest of Catalonia. The region has about 277,000 surplus homes, about 16 percent of the total and the second-highest after Andalucia, according to data compiled by property research firm R.R. de Acuna & Asociados. In September, Catalonia was one of only two Spanish regions in which the number of property sales fell from a year earlier, according to the national statistics office.

New Currency?

If Catalonia goes its own way, the mortgage market would contract as its regional banks relocate, Palomar said. Homeowners with outstanding loans could also see their capacity to repay debt denominated in euros weakened if the region adopted a new currency, he said.

"There is excessive uncertainty about what is going to happen," said Jose Garcia-Montalvo, an economy professor at Pompeu Fabra University in Barcelona. He said that real estate financing and mortgage markets will depend "completely" on whether an independent state would be allowed to use the euro.

"It's an unknown -- everyone from the ECB to the Bank of Spain is saying it would have to exit, but no one wants an economy the size of Catalonia's outside the European Union."

'Unfazed' Investors

So far, property investors have been "unfazed" by the prospect of a break by Catalonia, according to Palomar. That's because assets are cheaper than in other European cities and most investors still doubt it will happen.

In CBRE's 2014 Investors Intentions survey, Barcelona was among the top 10 most preferred cities for the first time. Madrid came second after London.

In July, Blackstone Group LP, the world's biggest manager of alternative assets, bought about 6.4 billion euros of mortgages concentrated in the region of Catalonia from CatalunyaCaixa SA for 3.6 billion euros.

In the same month, the regional government of Catalonia sold a portfolio of 13 commercial properties to Zurich Insurance Group AG in a sale and leaseback deal worth 201 million euros. No one turned up to the first public auction of the properties and Zurich was the sole bidder in the second.

A year earlier, the regional government sold a portfolio of 13 buildings to Axa SA's real estate arm for 172 million euros with a net yield of 9.5 percent.

"Axa and Zurich are conservative, core investors that completely avoid risk," Palomar said. "However, the yield indicates that all this noise about independence pushes down prices and in the end hurts the seller."

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