

Research Spain- November 2019

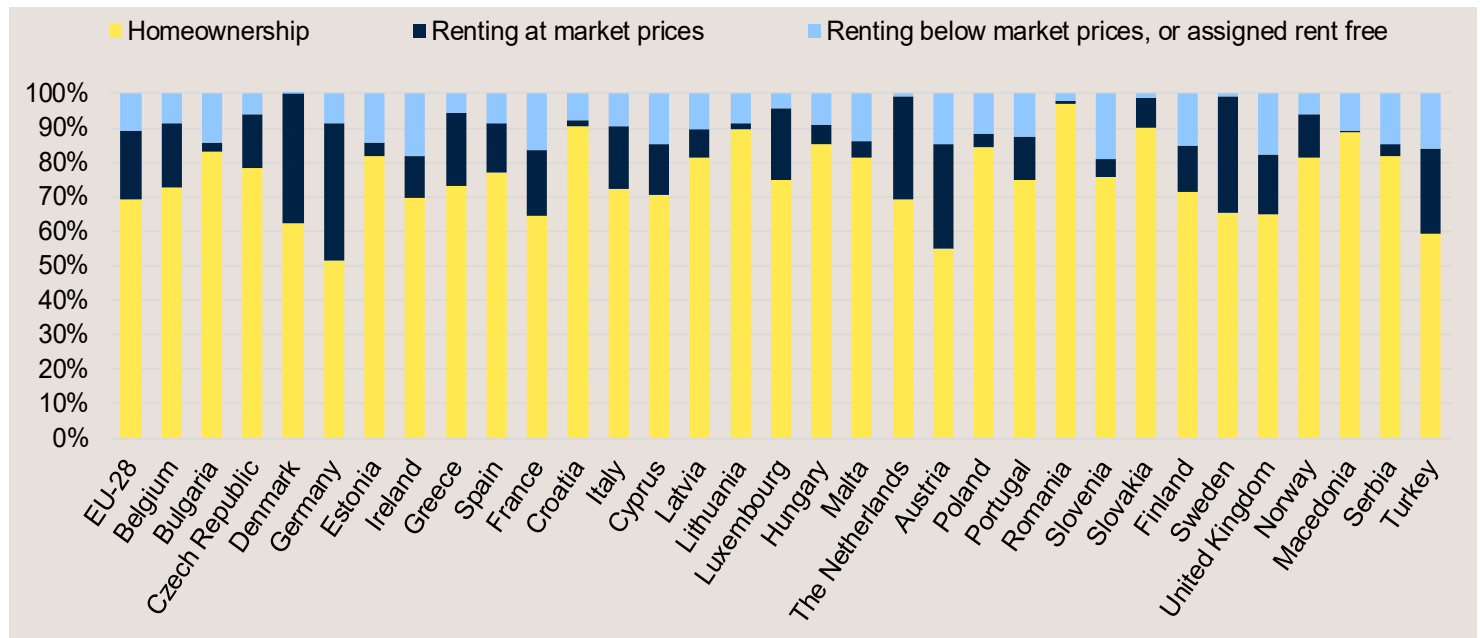
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SPOTLIGHT
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Rental Housing



“Although renting is becoming increasingly popular, the European housing market is still dominated by homeownership.”

Graph 1: Home tenure 2017 (% of total population)



Source Eurostat

Renting in Europe

A flourishing rental market

The European rental market

According to data from Eurostat, the European residential market is still broadly dominated by homeownership. In 2017 (latest available data), close to 70% of households were homeowner-occupied, while the rental market accounted for just over 30% – with 20.0% of these renters paying market price and 10.7% living in partially or entirely subsidised housing.

Homeownership is even higher in Spain, where just 22.9% of people rent – far below the EU average of 30.7% and the averages in other major economies such as Germany, France, Italy and the United Kingdom. However, in recent years the percentage of renters in the Spanish residential market has been ticking up and mirroring, albeit to a lesser extent, the trend being seen across Europe.

Germany has the lowest percentage of homeownership in Europe (51.4%), followed by Austria (55%), while Romania and Croatia have the highest percentages (96.8% and 90.5% respectively). Homeownership outweighs renting in all EU member states.

In terms of the rental market, 20% of Europeans live in accommodation that is let at market

price. This percentage varies considerably between each member state, rising to in excess of 40% in countries such as Germany and Denmark, yet barely reaching 3% in some Eastern European nations.

The percentage of Europeans living in partially or entirely subsidised rental accommodation stands at close to 10%. This figure is much higher in nations with a longer history of social housing, such as France, the United Kingdom, Austria, Finland and Ireland, as well as certain Eastern European countries.

Rental prices across Europe

10.4% of the EU-28 population spend at least 40% of their income on housing, whether that's buying or renting.

An analysis of the rental market (at market prices) shows that 26.3% of renters in EU-28 countries spend more than 40% of their income on rent – indicative of a major imbalance between rents and salaries. This percentage is higher in Eastern European nations such as Lithuania, Croatia, Bulgaria and Romania, and rises as high as 83.9% in Greece. The situation in Spain is not too dissimilar, with 42.1% of renters spending more than 40% of their income on rent.

However, recent data indicates that the number of people spending more than 40% of their income on rent in 2016-2017 fell by 6% y-o-y in EU-28 countries and by 2% in Spain.

26.3%

of European renters
spend more than 40% of
their income on rent

Over 95% of rental supply in Spain is owned by private individuals

Renting in Spain

The Spanish rental market

Spaniards have traditionally favoured buying over renting, largely owing to a housing policy that for decades favoured homeownership and discouraged renting.

The approval of the Spanish Urban Leasing Act in 1964 proved decisive in triggering this trend. It introduced mandatory lease extensions, which favoured tenants, gave tenants' descendants the right to assume their rights and obligations and also prohibited landlords from adjusting their rents in line with market prices. The law effectively prevented Spain from creating the type of professional rental market found in other countries around Europe.

In recent years, more balanced legislation, along with an economic climate and jobs market that have stymied access to homeownership, have pushed up the number of renters in Spain. According to data from INE, the percentage of renters in the housing market climbed from circa 20% in 2008 to 24% in 2018.

However, despite this upturn, Spain still lags behind its European counterparts, with the average percentage of households renting standing at around 30% for EU-28 countries and rising to over 40% in countries such as Germany and The Netherlands.

In the last five years alone, Spain has seen the number of people renting spike considerably.

According to INE, the number of households renting has risen by nearly 370,000 since 2013, equating to an average increase of 73,500 households per year.

In 2018, however, rental demand started to slow slightly, partly due to the sharp growth registered in rental prices in recent years.

Who is renting?

Although people of all age ranges rent, in recent years the rental option has grown most notably among young people. Recent data indicates that 52.4% of young people between the ages of 16 and 29 were renting in 2018, compared to 36.5% in 2008.

This is largely due to the fact that young people looking to leave the family home are being forced onto the rental market because the current state of the jobs market is preventing them from getting onto the property ladder. Job market indicators suggest that the financial crisis hit this segment of the population hardest and that although the situation has been improving since 2014, young people are still feeling the effects. They are victims of high temporary employment (56.3% in 2018) – double the figure for the total population – they account for a significant percentage of unemployment (29.3%), particularly long-term unemployment (35.8%), and their salaries are low.

According to the Second Spanish housing study conducted by Century21, more than 84% of young

people in Spain still aspire to own their own home. As financial conditions and jobs improve, the proportion of people opting to rent falls dramatically, amounting to just 14.3% of people aged between 45 and 64, and less than 7% for people over the age of 65.

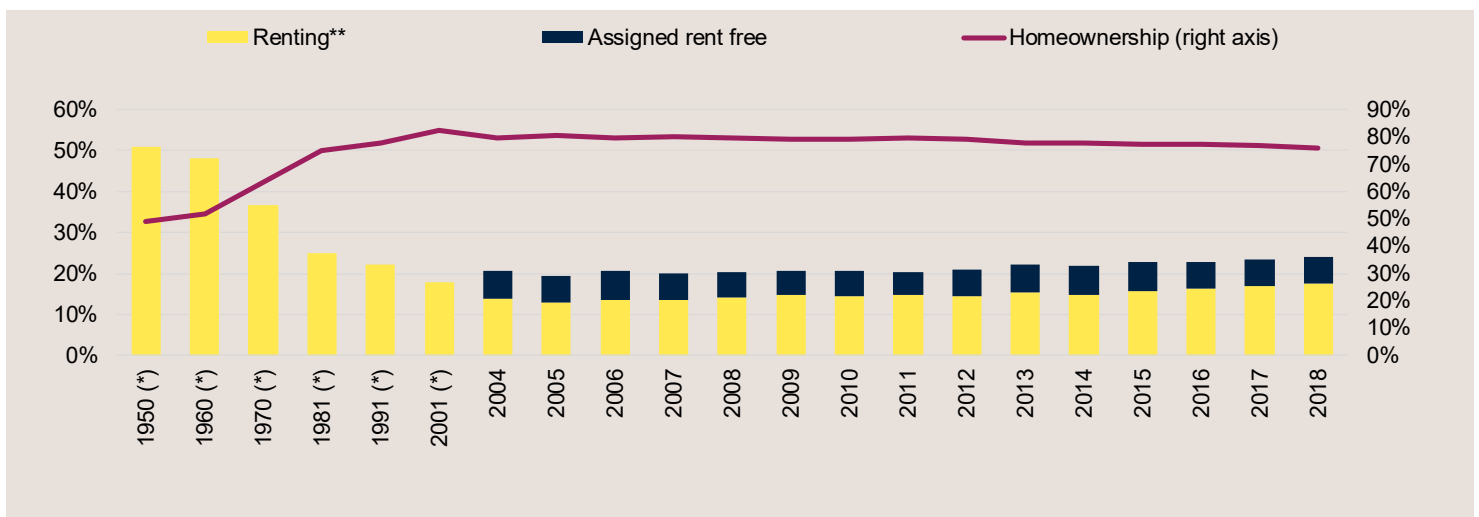
In terms of supply, over 95% of rental properties are owned by private landlords, normally individuals owning one or two properties, rather than institutional investors. Generally speaking, this type of landlord does not tend to invest heavily enough in property maintenance.

As a result, the rental market has become deeply fragmented and many homes have been left in a poor state of repair. It is also hard to find entire buildings dedicated solely to the rental market, as supply tends to be spread across a broad range of different properties. This landscape is preventing institutional investors from building up major portfolios and forcing them to focus on designing and developing new projects with different formats.

In other European countries, it is more common to find rental properties managed by specialist firms. Compared to private landlords, institutional firms ensure higher quality supply and a more efficient management system.

Socimis are beginning to play a more prominent role in the rental market, scaling up their rental

Graph 2: Variation in home tenure in Spain (% households)



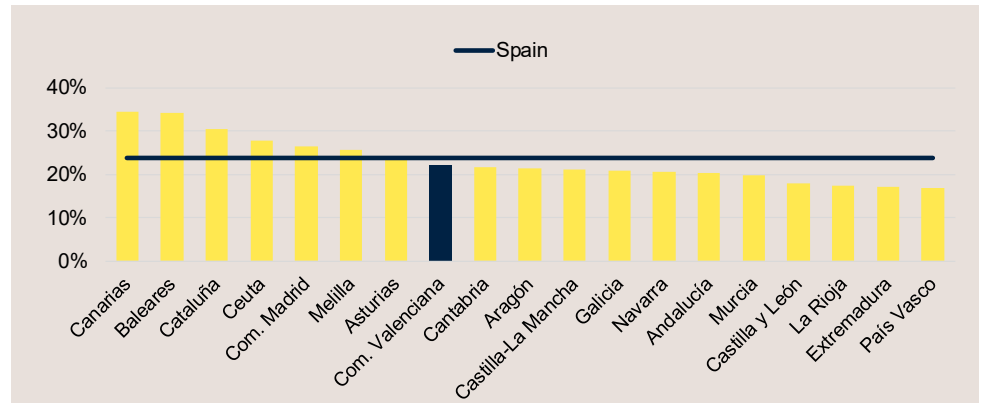
Source INE, Encuesta de Condiciones de Vida / * subsidies reflected in rent until 2001 / ** Renting at or below market price

“The large majority of renters in Spain are young people”

stock by 57% in 2018, and taking their total number of apartments owned to approximately 42,000. The remainder of non-listed institutional investors own approximately 100,000 rental units. Although these firms have expanded their portfolios in recent years, their market share still remains relatively low and a far cry from those owned by large income producing property owners in Europe. For example, in Germany, a single company alone – Vonovia – owns over 350,000 rental properties, seven times more than all the listed rental companies put together in Spain.

The largest operator in Spain is the investment fund Blackstone, which owns approximately 30,000 homes via several other companies (Testa, Fidere, AlbiranaProperties, Torbel, EuripoProperties). The market's other main players include Lazora, with over 6,000 homes, Vivenio – owned by Dutch pension fund APG and property firm Renta Corporación – with a portfolio of 3,200 homes, and Encasa Cibeles and Tempore Properties – respectively owned by Goldman Sachs and the fund TPG RE Partners – with more than 2,000 units each.

Graph 3: Households renting in 2018 (%)



Source INE

Renting in Spain

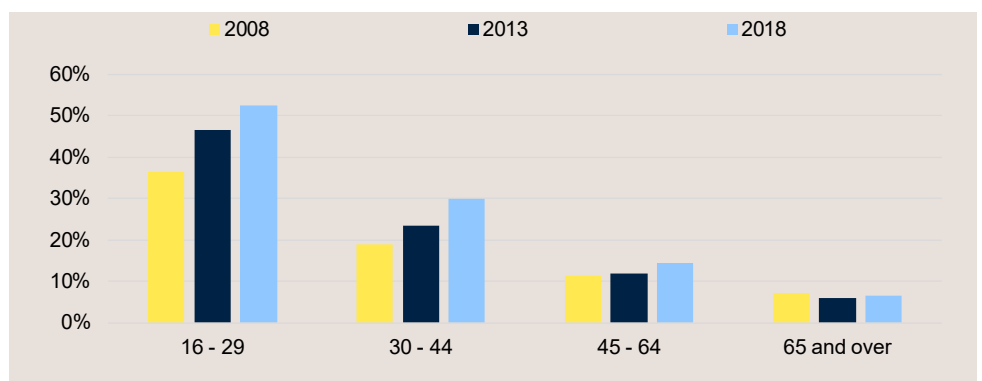
The rental market varies significantly across the different regions of Spain. Markets that attract more people for economic and job-related reasons, such as Madrid and Catalonia, boast stronger rental markets. Sales prices in these markets are also very high and unaffordable for a significant proportion of the population.

Spain's island regions, along with Ceuta and Melilla, also boast some of the country's largest rental markets. This is largely because a significant percentage of residents harbour the desire to one day move to mainland Spain and therefore avoid creating additional ties to the region, such as owning property.

For example, according to INE, around 22% of the employed population in Canarias have been in the same job for less than one year. This is related with seasonal jobs, a trend that has been stable since 2008 and has its impact in the rental market in the region.

At the other end of the spectrum, in regions such as the Basque Country, Extremadura, La Rioja and Castilla y León, the proportion of rented homes stands at below 18%. The population in these areas tend to pursue long-term stability and have no plans to move further afield in the future.

Graph 4: Rental variation by age group (2008-18)



Source INE, Encuesta de Condiciones de Vida

👉 Rents have been increasing by between 5% and 9% every year since 2014 🏠

Rental performance

Spain's rental market is growing faster than the sales market. In June 2019, rental prices hit an all-time high of €11 per sqm/month (according to figures from Idealista). The provinces posting the highest rents are Barcelona and Madrid, with an average of over €16 per sqm/month. These are followed by the Balearic Islands and Guipúzcoa, where prices are closer to €13 per sqm/month.

On one hand, the rise in rental demand has pushed rental prices up. On the other, the growth of tourist rentals has also pushed up rents in the central areas of both cities, and also in other cities with a high tourism component. This situation is trying to be stopped by local authorities by increasingly demanding regulations for this type of rental.

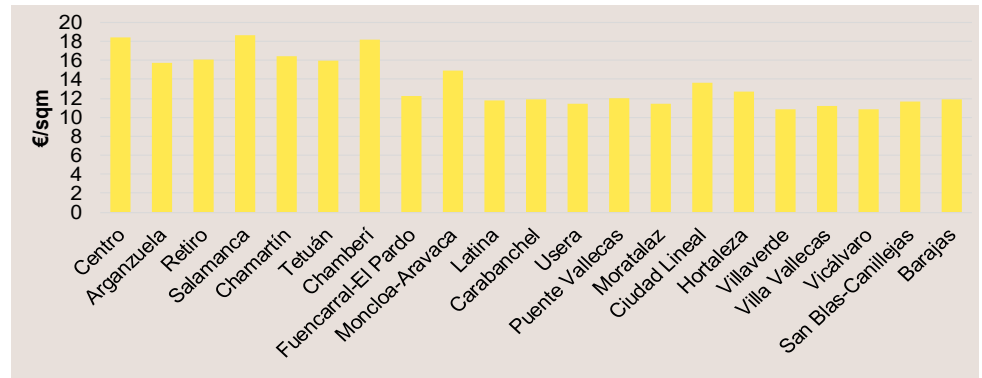
The available indicators published by various real estate portals, reveal an average annual increase across Spain of between 5% and 9% between 2014 and 2018, with prices soaring by almost 40% in the cities of Barcelona and Madrid. Although this upward trend started to slow in 2018, rental prices in the main cities are still expected to keep growing over the next few years, albeit at a more modest pace. A further uptick is expected in Madrid, while prices are set to remain stable in Barcelona. However, both cities register major differences between different districts and neighbourhoods.

Renting in Madrid

According to data from Madrid's City Council and the leading real estate portals and consultancy firms, the highest rents in Madrid are found in the city centre, while out-of-town markets offer more competitive prices. The most expensive areas for renting are the Central district, and the Salamanca and Chamberí neighbourhoods, where average prices hover around the €18.60 per sqm/month mark. In contrast, Vicálvaro, Villaverde and Villa de Vallecas are home to the city's most affordable rents, with prices closer to €10 per sqm/month.

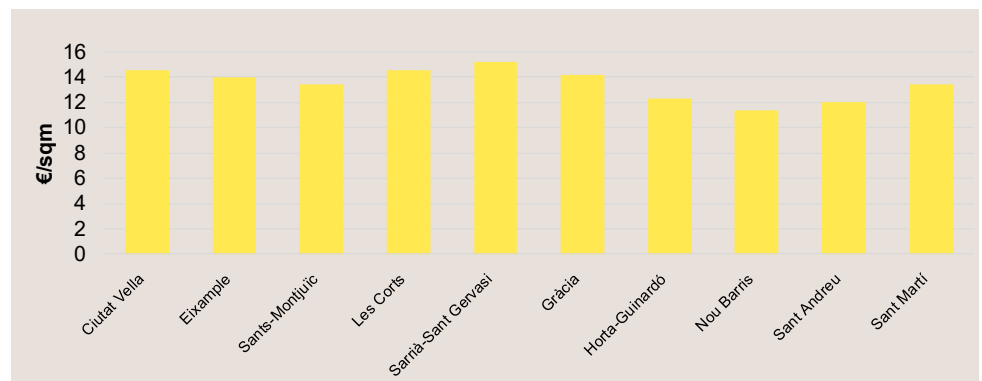
The Madrid districts located between the M-30 and M-40 ring roads recorded the most pronounced rental hikes in H1, with Vicálvaro, Usera and Puente de Vallecas recording the sharpest upticks – 12.4%, 9.5% and 8% respectively. The Villaverde district also posted a very notable increase, with prices climbing 20.5% compared to Q2 2018. High prices in the city centre are causing some renters to shift their gaze further afield, and this is putting upward pressure on prices in the out-of-town markets.

Graph 5: Rental prices in Madrid Q2 2019 (€/sqm)



Source INE, Encuesta de Condiciones de Vida

Graph 6: Rental prices in Barcelona Q2 2019 (€/sqm)



Source INE, Encuesta de Condiciones de Vida

Prices in the Central and Salamanca districts remained stable last year, registering minimal variations of 0.7% and 1.5% respectively. In Chamberí, one of the city's most sought-after locations, rents increased by 3.7% y-o-y during H1 2019.

Renting in Barcelona

According to data from Barcelona's City Council and the leading real estate portals and consultancy firms, the highest rents are found in Ciutat Vella, with €18.30/sqm/month, followed by Sarrià Sant Gervasi, Eixample, Sant Martí and Gràcia, where rents are closer to €16.50/sqm/month.

The districts to the north, such as Nou Barris, Horta-Guinardó and Sant Andreu, offer the most competitive rents, with average prices standing at circa €13 per sqm/month.

Price variations over the last year have been very similar to Madrid. The sharpest increases were seen in areas with the most competitive rents, such as Nou Barris, where they grew by 3.6%. Meanwhile, Ciutat Vella (-1.30%) and Sarrià-Sant Gervasi (-0.40%) saw rents slide slightly.

Sharp rental increases in recent years have sent effort rates spiralling, with levels now exceeding the recommended threshold, particularly in bigger cities, where rental demand is being displaced towards out-of-town areas.

☞ Once prospective homebuyers have saved enough to cover the 20% down payment and other related fees (+/-10%), the effort rate for buying is still lower than for renting ☞

Rental yields

Renting – an increasingly secure investment option

The gross yield for rental housing in Spain (average national) reached 3.9% during Q2 2019, according to official figures from the Bank of Spain. This ROI is far more attractive than the yields offered by fixed-income products (the Spanish 10-year bond offers 0.4%) and is also higher than the yields found in the prime office and high street markets.

Buy or rent?

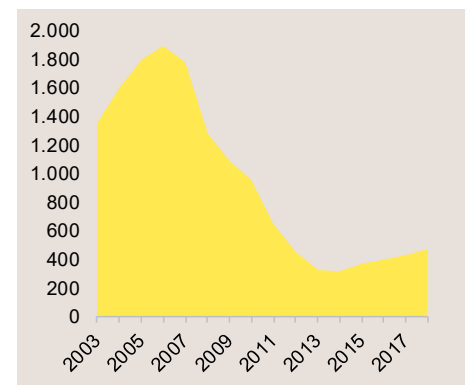
Since the economy plunged into recession in 2008, banks have tightened the conditions for accessing mortgage financing. The LTV has been capped at 80% of property value, while the minimum mortgage requirements are now much stricter than they were before the crisis. More specifically, prospective buyers with temporary work contracts or who are unable to meet their monthly mortgage payments with 30-35% of their earnings are now refused a mortgage. As a result, the number of mortgages

granted in 2018 was 74.8% lower than in 2006.

In terms of the younger generations, their consumption habits and the growing instability of the jobs market make it much harder for them to save money. This is one of the main reasons that they find it so hard to take out a mortgage, as they are simply unable to front the 20% down payment required by banks. In addition, the removal of the tax deduction for purchasing a permanent residence in 2013, now makes it even more difficult for them to get a foot on the housing ladder.

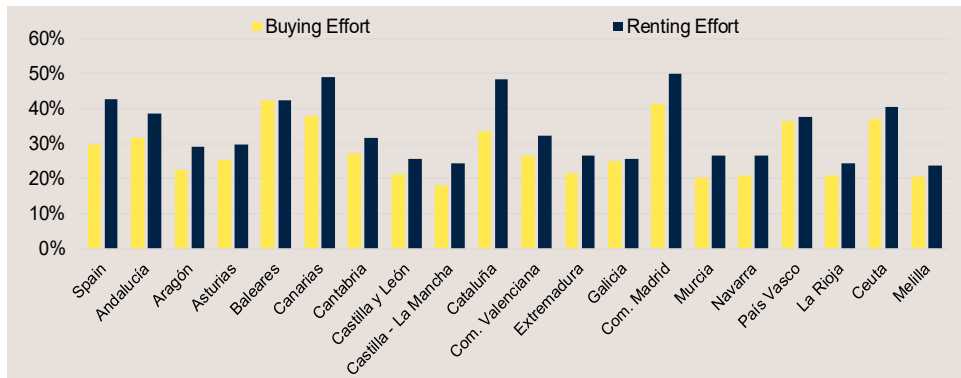
The following results were obtained from a hypothetical exercise aimed at demonstrating the effort rate required by Spanish households to buy or rent a home. This effort rate was calculated by inputting regional rent and sales prices from Idealista, along with net household income data published by INE. The monthly mortgage rate was

Graph 7: Mortgages granted in Spain (thousands)



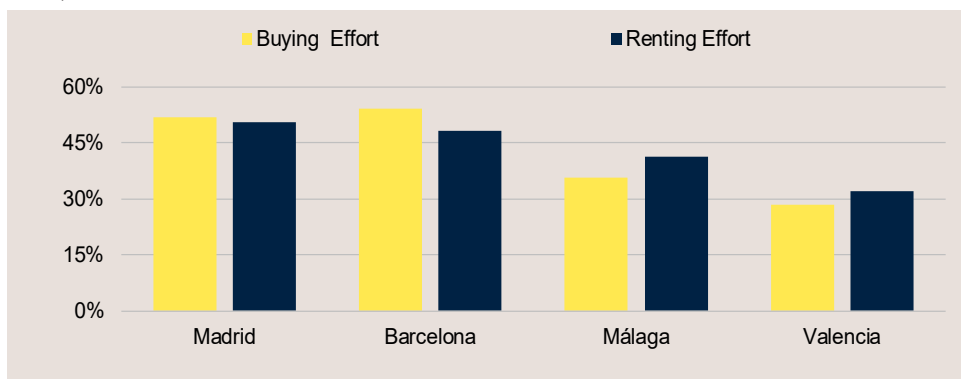
Source INE

Graph 8: Effort rates: Buyer vs. Renter (% of income spent on mortgage/rent)



Source Savills Aguirre Newman, leading real estate portals

Graph 9: Effort rates: Buyer vs. Renter (% of income spent on mortgage/rent)



Source Savills Aguirre Newman, leading real estate portals

calculated based on an 80% LTV, a repayment period of 20 years and an interest rate of 2.7%. The exercise was carried out for a 97 sqm home.

The results show that once prospective homebuyers have enough savings to cover the 20% down payment and the +/-10% of additional fees (approximately €50,000 for an average house in Spain), the effort rate for buying a home is lower than for renting.

In cities such as Madrid, Barcelona, Malaga and Valencia, the effort rates for buying and renting tend to be fairly similar and also tend to exceed the recommended effort rate – understood to be that households should not spend any more than 30% of their monthly income on rent or mortgage payments. In Madrid and Barcelona, where the price per sqm is much higher, the effort rate to buy a home is higher than it is to rent.

In our analysis of these four cities, the effort rate for renting is either similar or lower than the effort rate for buying property, despite the fact that rental prices have continued to tick up in recent years.

“ The gross yield for rented housing in Spain reached 3.9% during Q2 2019 ”



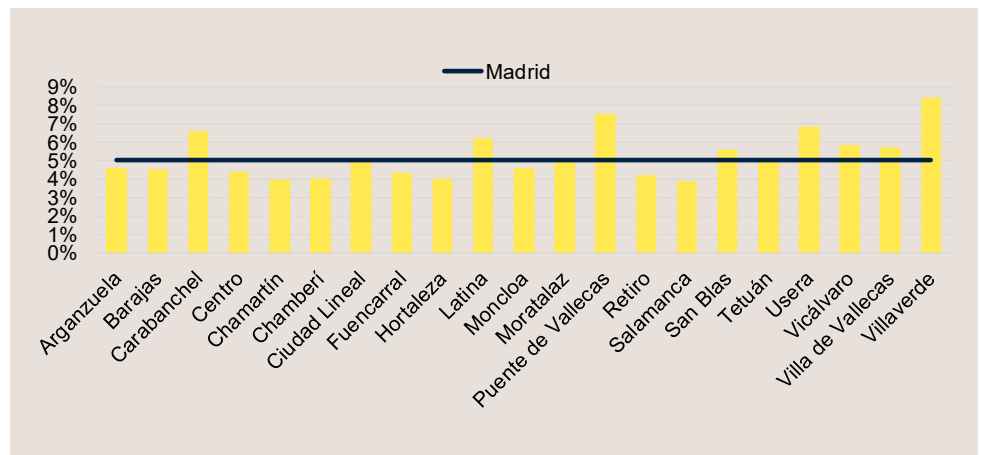
Market yields in Madrid

According to the Bank of Spain, the average initial yield in Madrid's rental market stands at 5.06%. The rental yields for the different districts of the two main cities have been calculated following a similar methodology. Taking as reference the rental and sale prices, in €/sqm, and multiplying the first one by 12 months and then dividing it by the rental price. The result is a gross percentage of profitability that provides an owner to rent his house.

There is a clear distinction between the more exclusive markets, where the risk of vacancy and defaulting is lower, compared to less exclusive markets where this risk is higher.

The gross yield is lowest in the districts of Salamanca, Chamartín, Chamberí and Retiro – around 4% – and highest in the districts of Villa de Vallecas, Villaverde, Usera and Carabanchel, where it ranges from 6.5% to 8%

Graph 10: Yields by district in Madrid (%)



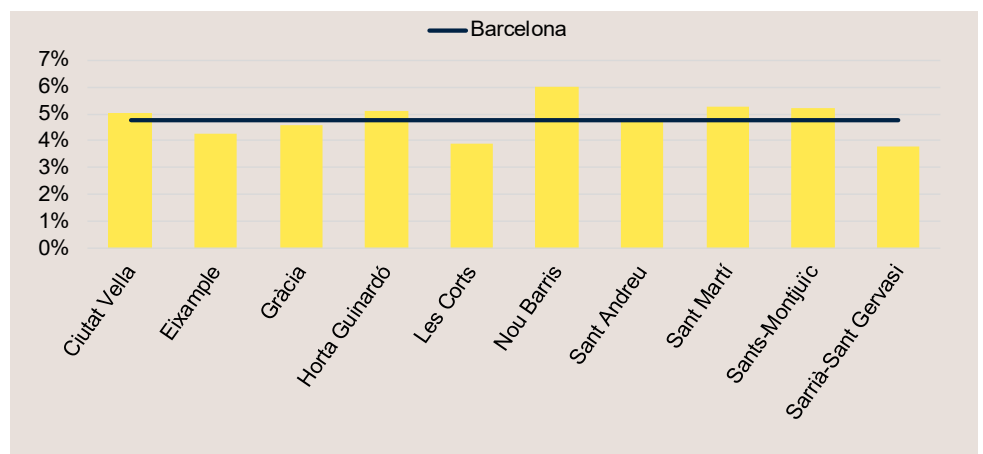
Source Savills Aguirre Newman Research

Market yields in Barcelona

As in Madrid, the greater instability associated with renting in less exclusive areas of the city translates into a greater risk premium.

The average initial yield in Barcelona's rental market stands at 4.74%, while the lowest yields can be found in Les Corts, Sarrià-Sant Gervasi and Eixample, where they stand in the region of 4%. At the higher end of the scale, the (gross) initial yield in Nou Barris stands at close to 6%.

Graph 11: Yields by district in Barcelona (%)



Source Savills Aguirre Newman Research

Rental market trends

Political and regulatory factors in the rental market

Spain has a widespread problem when it comes to accessing housing, and one that can be attributed to the increase in the cost of buying and renting in recent years. This rise comes on the back of a clearly identifiable demographic shift: healthier economies and jobs markets in cities have been drawing more and more people from the rest of Spain and abroad towards cities and their surrounding areas.

Many administrations have recently been putting measures in place to regulate and create a more efficient rental market. In most cases, they all agree on what the issues are and what needs to be done to improve the current situation, regardless of their political stance, (boost the amount of social housing allocated to renting, improve housing accessibility, help young people to leave the family home, attract vacant homes to the rental market instead of the buyer market), the real difference lies in how they plan to achieve it. Each and every measure that has been taken in this regard has sparked controversy, as there are always lingering doubts over the consequences that they will ultimately have.

Economic and work-related factors

The rental market continues to expand and looks set to carry on gaining traction over the coming years. Considering the factors that have driven up rental housing demand, it seems likely that this demand will ease slightly as the economy improves. Young people are expected to gradually shift from renting towards buying, as their employment conditions improve.

According to INE forecasts, the segment of the population set to experience the largest growth

is overseas residents – a demographic that shows a far higher preference for renting (around 60% of foreigners rent compared to 12% of Spanish households). This will help to offset the drop in the number of young people renting and keep the rental market ticking up.

Job mobility is another crucial factor when it comes to choosing between renting and buying a home. The big cities such as Madrid and Barcelona are Spain's main poles of economic and employment activity, drawing people in from other areas of Spain and abroad. Renting is ideal for these groups of people given the current levels of job insecurity.

According to official INE figures, almost a third of Spain's workers (31.8%) have never moved away from their hometown. Some 40.4% of workers had moved elsewhere in their own province, 4.3% had moved to a different province but in the same region, 14.2% had moved to a different region and 9.2% came from another country.

How is tourism affecting the rental market?

The main reason that people rent a home is to live in it permanently. However, in recent years, demand for short-term tourist lets has soared on the back of the rise in collaborative platforms (under the sharing economy) and the growth in tourism. The number of tourists visiting Spain from abroad has doubled in the last decade, making Spain the world's second most popular tourist destination, behind France and ahead of the United States. The majority of overseas tourists visiting Spain stay in hotels, but people are increasingly opting to stay in rented accommodation. More specifically, 11.77% of overseas tourists stayed in rented accommodation in 2018, up from 10.73% in 2016. This equated to

an increase of 1.7 million people in just two years, taking the total to over 9.7 million.

The rise of tourist apartments has been shrouded in controversy due to its economic, social, environmental and urban effects, but also due to its potential impact on the residential and hotel markets. It is currently difficult to complete a thorough analysis of this market due to the lack of data available, although several international studies have revealed a direct link between the rise of tourist apartments (primarily in city centres) and the lack of rental housing supply and rising rental prices. In any event, given the increasing amount of regulation in this area, the market is likely to gradually adjust until it reaches a balance between the needs of the various parties involved and the people that tourist apartments affect.

The main political parties are aware of the need to find a solution to the issues surrounding tourist apartments. However, once again, they disagree on how this should be done. Some suggest introducing a cap on the number of days that an apartment can be used for this purpose, limiting these apartments to certain areas or making it obligatory for them to have independent access, while others opt for measures aimed at building an understanding between property owner associations and tourist apartment owners.

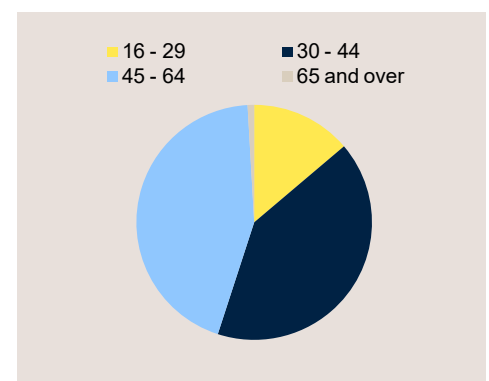
Build-to-Rent

The lack of a professional rental housing market and the subsequent room for growth in this area, coupled with the arrival of Socimis, has led to a gradual increase in the number of institutional investors on the market since 2013.

Main measures contemplated in the last Decree-Law

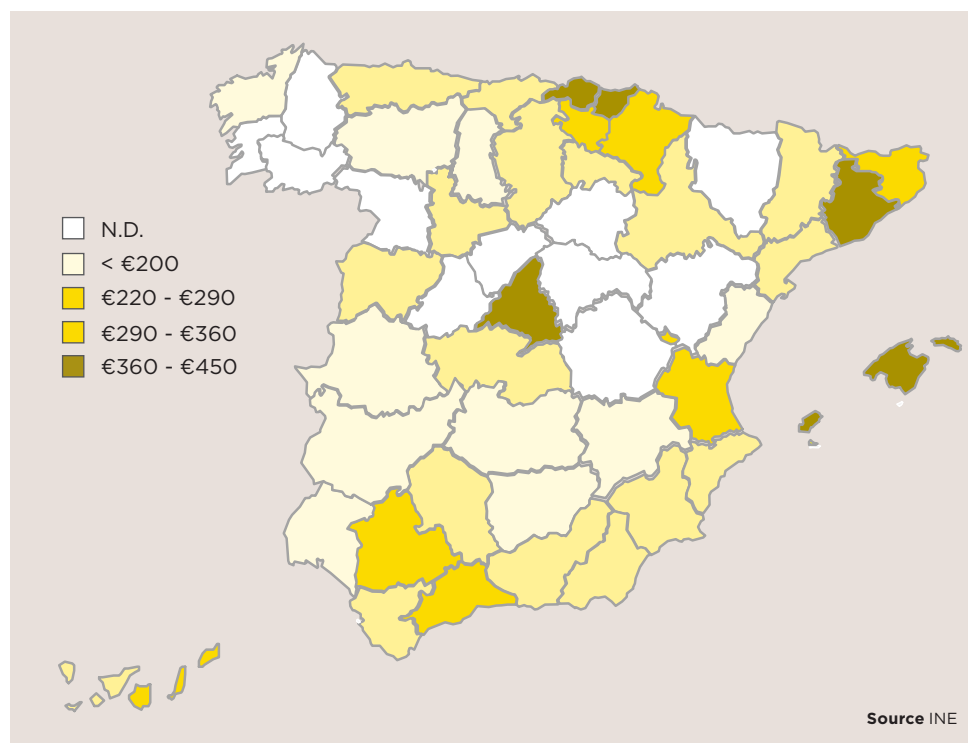
- Rising rents marked by the CPI or the price index of Housing (currently under development).
- The possibility of recovering rented housing for own use must be reflected in the rental agreement.
- The increase in the duration of the contracts, extending the mandatory extension period from three to five years (seven in the case of a legal entity), and the tacit extension of one to three if the opposite is not agreed between the parties.
- The Catalan government has raised a Decree-Law to limit rental prices, setting the maximum price depending on the benchmark and housing characteristics.

Graph 12: % People employed by age group



Source INE

Graph 13: Rents per room in provincial capitals



In 3Q of 2019, it is estimated that practically 30% of the institutional investment in the residential market is focused on Build-to-rent. The new developments are located in Madrid and Barcelona in the main municipalities of the periphery, where the Ares Capital projects located in Arganda and Torrejón stand out. Other major investors appear alongside Ares Capital, such as AXA with Residencial Méndez Álvaro 59 in Madrid or Marina Living in Badalona; as well as Vivenio, Locare and M&G with their projects in Madrid.

These institutional investors aim to build large rental property portfolios so that they can drive significant economies of scale and achieve higher yields as a result. It is practically impossible, however, to create these kinds of portfolios in Spain due to the fragmented nature of the market (with entire apartment blocks dedicated to renting few and far between) and the fact that most rental housing is owned by private investors, who tend to own just one or two properties each.

Some of the major operators have solved this issue by buying up new build-to-rent projects from residential developers. These projects are often structured using a forward purchase contract, with developers selling an entire residential building to an investor for rental purposes. This approach is drawing interest from institutional investors (Socimis, pensions funds, etc.) who are looking

to diversify their risk with long-term investments that offer better returns than those available in other secondary markets.

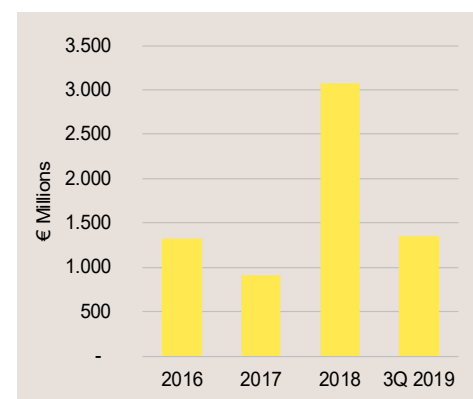
Flat-sharing

Flat-sharing is another trend making its mark on the rental market. This trend is linked to the rise of the sharing economy, which has been gaining traction since 2007 and has started to expand more rapidly in recent years on the back of rising rental prices. This practice involves renting a room in an apartment rather than the entire property.

According to figures from the Idealista real estate portal, contrary to the popular belief that most flat-sharers are university students, the majority involve people over the age of 25. The main reason for flat-sharing is the current climate of the jobs market – where mobility is increasingly important, salaries are low and temporary contracts are common – and, to a lesser extent, a shifting mentality towards a collaborative economic model.

Landlords who opt for this business model are interested in the higher returns on offer when each bedroom is let individually. However, this option also carries greater associated risk; greater vacancy risk, higher tenant rotation, increased management and more often than not a greater CapEx requirement.

Graph 14: Institutional investment in residential market in Spain



According to Idealista, so far this year (2019) shared housing supply has grown 26.9% y-o-y. This supply is mostly located in Madrid (34.1%) and Barcelona (19.2%), followed by Valencia (9.2%), Seville (5.6%) and Granada (3.5%).

The average rent for a room in a shared flat in Spain is €340 per month, up 2.9% y-o-y according to figures from the real estate portal. In Madrid and Barcelona, this cost climbed 3.1% and 2.9% respectively during the same period. However, the sharpest increases were recorded in Pamplona (15.8%), Almería (13.3%) and Alicante (12%). The highest average prices are found in Barcelona (€442 per month), followed by San Sebastián (€425 per month), Palma (€417 per month) and Madrid (€415 per month), while at the other end of the spectrum, Ciudad Real (€156 per month), Cáceres (€164 per month) and Badajoz (€169 per month) are home to the lowest prices.



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