ANALYTICAL ARTICLES
Economic Bulletin

2/2021

BANCO DE ESPAÑA
Eurosistema

THE IMPACT OF THE COVID-19 HEALTH CRISIS ON THE HOUSING MARKET IN SPAIN

Pana Alves and Lucio San Juan

ABSTRACT

The residential real estate market has been affected by the COVID-19 pandemic, which broke out at a time when the cycle of this market was in a mature phase. Activity fell off sharply in the early months of the health crisis, owing to the effect of the restrictions adopted. It has since seen a slow recovery and remains highly influenced by epidemiological developments and the related impact on agents' economic outlook. The pandemic has triggered manifest changes in the type of housing in demand, attributable to households' new needs arising from the lockdown and increased remote working. As compared with other crises, prices are showing greater downward rigidity, particularly in the case of new housing, although the impact of the pandemic is proving highly uneven across regions. The pandemic-induced economic crisis has not driven up the cost of financing for house purchase which has continued to decline to record lows. Nevertheless, there are some signs of a tightening of credit standards and of some of the terms and conditions applied to loans.

Keywords: housing, prices, interest rates, financing conditions, mortgage conditions.

JEL classification: D12, E22, E24, G21.

The authors of this article are Pana Alves and Lucio San Juan of the Directorate General Economics, Statistics and Research.

Introduction

This article analyses the impact of the COVID-19 pandemic on the housing market in Spain. When the health crisis began, the property cycle was in a mature phase, with several indicators evidencing a slowdown following the expansionary period that began in 2014. The measures taken by the authorities to combat the pandemic led to a sharp decline in real estate market activity in the first few months of the health crisis. From the summer (when the restrictions were partially lifted), activity began to recover, although its trajectory has been shaped by pandemic-related developments. The health crisis has prompted a change in preferences as to the type of housing in demand, with a shift towards larger housing with outdoor areas. Despite the sharp contraction in economic activity, house prices have not to date seen widespread declines, in the absence of pre-existing major imbalances in this market and in a context of households' sounder financial position compared to in the run-up to the 2008 crisis.

As regards financing conditions, the European Central Bank's monetary and financial measures have contributed to the decline in the average interest rates applied to new loans for house purchase. Nevertheless, there are signs of a certain tightening of credit standards and of some of the terms and conditions applied to loans.

The following section of the article describes the recent behaviour of activity and prices in this market, as regards both purchases and rentals. The final section analyses the recent course of real estate credit and financing conditions.

Activity and prices

Housing market activity was affected by the outbreak of the health crisis, at a time when the expansionary phase of its cycle was showing signs of petering out, as evidenced by the mild decline in purchases, the notable slowdown in housing starts and a moderate deceleration in prices over the course of 2019.

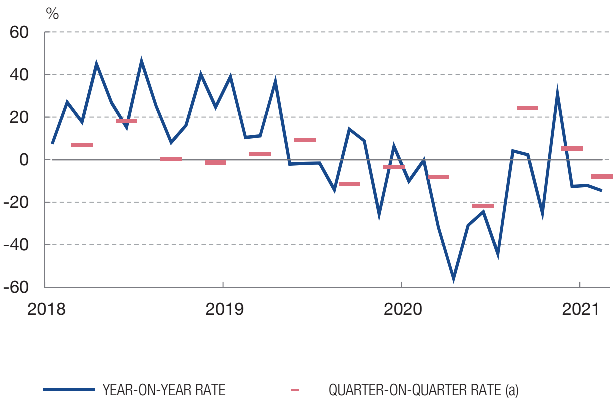
On the supply side, the most representative indicators of the sector fell sharply in 2020 Q2, owing to the effect of the suspension of non-essential activities imposed by

Chart 1

SUPPLY AND DEMAND FOR RESIDENTIAL PROPERTY HAVE RECOVERED GRADUALLY FOLLOWING THE INITIAL IMPACT OF THE PANDEMIC, BUT CONTINUE TO BE SHAPED BY THE WORSENING IN CONFIDENCE AND HOUSEHOLDS' LABOUR MARKET PROSPECTS AND ACCESS TO FINANCING

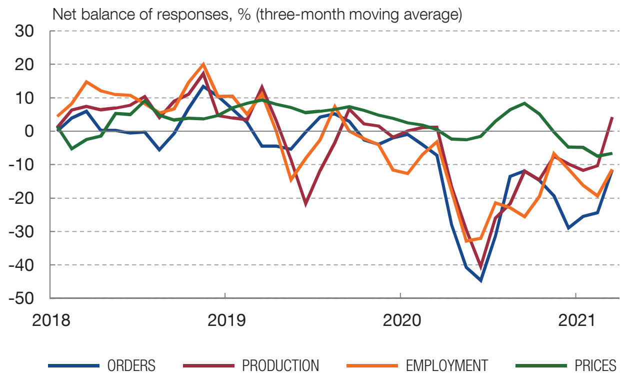
Following a sharp decline in the early months of the health crisis, both housing supply (proxied by the number of building permits) and demand (in terms of purchases) have gradually recovered. However, their levels in 2020 as a whole were far from those observed in 2019, and both continue to be affected by the uncertainty surrounding the course of the pandemic and its impact on agents' economic outlook.

1 BUILDING PERMITS

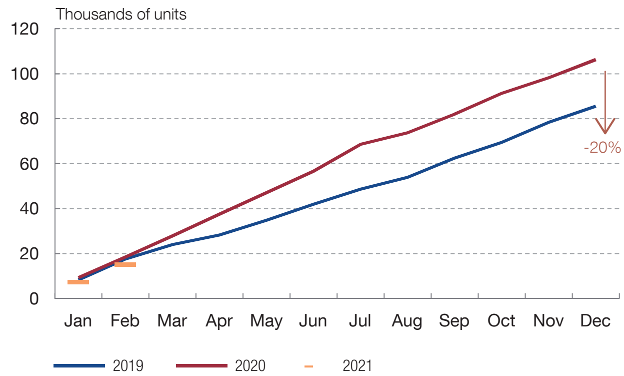


2 INCIDENCE OF FURLOUGH SCHEMES IN EACH SECTOR

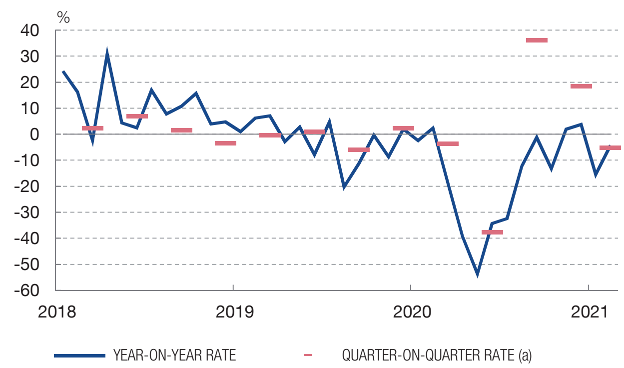
3 CONFIDENCE INDICATORS: EXPECTATIONS THREE MONTHS AHEAD



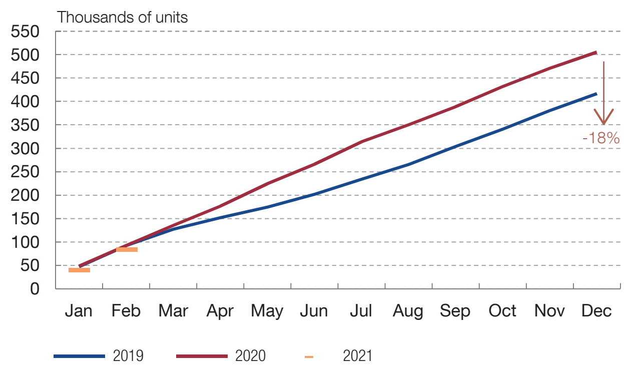
4 CUMULATIVE BUILDING PERMITS IN THE YEAR



5 PURCHASES



6 CUMULATIVE PURCHASES IN THE YEAR



SOURCES: Banco de España, INE, Ministerio de Asuntos Económicos y Transformación Digital, Ministerio de Trabajo y Economía Social and Ministerio de Transportes, Movilidad y Agenda Urbana.

a Calculated on seasonally adjusted series. The latest quarter-on-quarter rate is calculated as an average of the data available in that quarter, to February, on the average of the data of the previous quarter.

DOWNLOAD

the Government in late March to curb the spread of the pandemic. When the lockdown was eased, the works that had been suspended in the spring of 2020 were resumed, leading to a robust pick-up in the indicators in the final stretch of Q2 and in Q3 (see Chart 1.1). As regards Social Security registrations, the COVID-19 pandemic is having a smaller impact on the construction sector than on other sectors, as reflected by the lower incidence of furlough schemes in this sector (see Chart 1.2).

The supply indicators show a loss of momentum in the final stretch of 2020 and protracted sluggishness in residential construction activity in early 2021, attributable to the new adverse developments associated with the pandemic and the related impact on demand for new-builds[1] (see Chart 1.3). In 2020 as a whole, the number of building permits fell by 20% from already very low levels in 2019. As a result, there are expected to be even fewer housing completions in the coming two years (see Chart 1.4).

On the demand side, purchases also felt the initial impact of COVID-19, on account of the mobility restrictions and social distancing measures, with the result that a large number of transactions were postponed and carried out in the final stretch of Q2 and in Q3 (see Chart 1.5). Indeed, when the restrictions started to be eased in May, purchases picked up and began to recover gradually. However, this recovery was less intense than the sharp decline observed in the early months of the state of alert. Thus, in 2020 as a whole, the volume of transactions was 18% down on 2019, and there have been fewer purchases in 2021 (to February) than in the same, pre-pandemic period a year earlier (see Chart 1.6). Therefore, recent developments continue to be influenced by the continuation of some restrictions on activity and by the decline in confidence among households and the worsening of their labour market prospects and access to financing.

The impact of the pandemic on housing investment is proving to be similar to that witnessed in purchases and building permits, with a fall of close to 17% in 2020. This decline is higher than that recorded in other investment components, suggesting that housing investment has been more affected by the uncertainty associated with the pandemic and its impact on households' economic outlook, against a backdrop in which the worsening of the pandemic in the final stretch of 2020 led to the delay of part of the projects to be started[2] (see Chart 2.1). Compared with other European countries, housing investment in Spain, which, as a percentage of GDP, was higher than in the euro area before the health crisis, has declined more sharply in the wake of the pandemic, in step with the relatively more unfavourable economic developments in this country (see Chart 2.2). Thus, in GDP terms, housing investment in Spain is once again below that of the euro area.

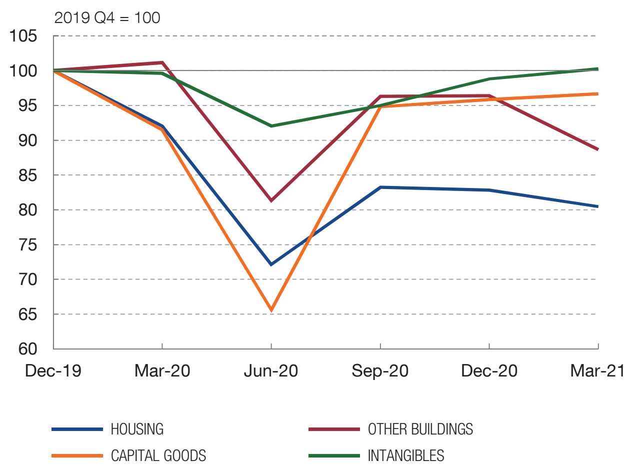
1 In the beginning of the year, construction activity was also hit by the snowstorm in January, as reflected by the year-on-year fall of close to 20% in cement production in that month. However, this effect was transitory, as the production lost in January appears to have been largely recovered in the following two months.

2 The greater household uncertainty in Spain and other European countries has been reflected in a significant build-up of their precautionary savings. For further details, see Cuenca, Martínez and Del Río (2021).

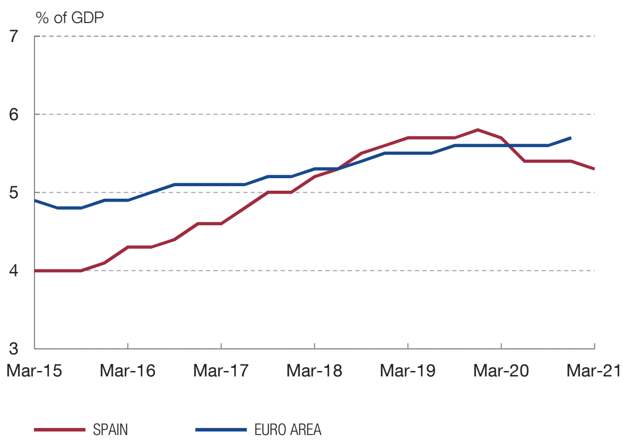
Chart 2
HOUSING INVESTMENT IN SPAIN HAS PERFORMED MORE UNFAVOURABLY THAN OTHER INVESTMENT AND IN COMPARISON WITH OTHER COUNTRIES

Housing investment has performed worse than other investment components, against a backdrop in which part of the projects that had to be started were suspended at end-2020, evidencing the worsening of the pandemic and the deterioration of household confidence. Housing investment has declined more sharply in Spain than in the euro area, in step with the more adverse developments in the pandemic in this country and the greater impact on economic activity.

1 INVESTMENT IN HOUSING AND OTHER COMPONENTS



2 HOUSING INVESTMENT IN SPAIN AND THE EURO AREA



DOWNLOAD

SOURCE: Eurostat.

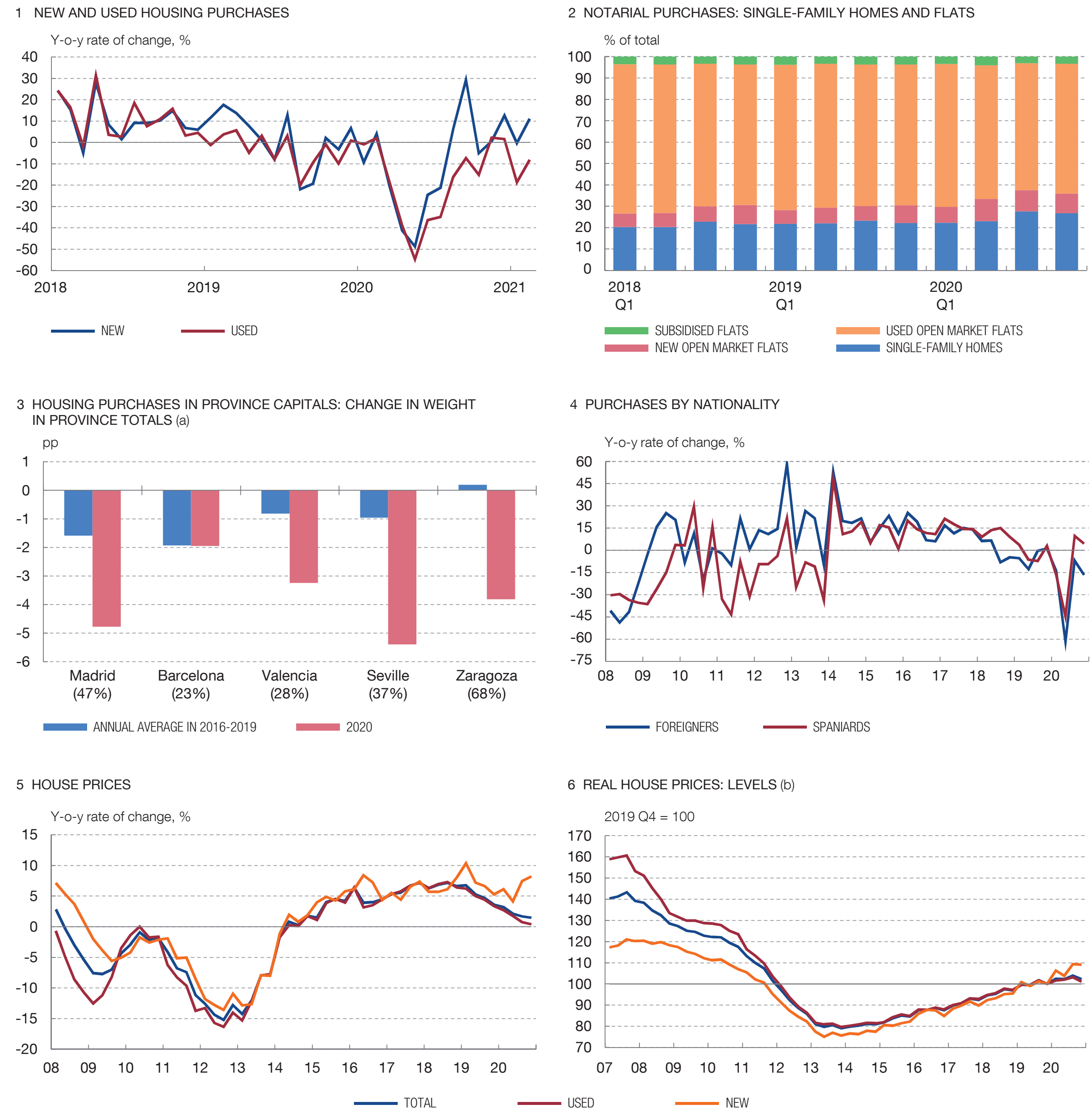
By segment, in terms of transactions recorded in the real estate registry, purchases of new and used property showed similar falls during the early months of the pandemic, which chiefly reflects the stringency of the restrictions in that period. The subsequent recovery in purchases has been stronger in the new housing segment (particularly during the summer of 2020), mainly because these transactions stem from commitments that were undertaken well before the pandemic and had been postponed until the mobility restrictions were lifted (see Chart 3.1).

The incipient shift in demand towards larger residential properties with outdoor areas could have also contributed to the greater buoyancy in new housing, as such criteria can be met to a greater extent by this type of housing.[3] Thus, since the outbreak of the health crisis, the percentage of single-family residence purchases has risen, as has the average surface area of residential properties, reaching all-time

3 In addition to the different characteristics of new and used housing for meeting the new needs, another reason for buyers' greater preference for new, rather than used, housing in the wake of the pandemic is their reluctance to undertake an extensive renovation that could be needed in second-hand housing, especially if their housing needs are immediate. These new demand needs have been met, in some cases, by housing under development that became available owing to the termination of the purchase agreement with the real estate developer and, in others, by housing for which a purchase agreement could not be signed during development. Pointing in this direction are the data on new housing transactions and renovation permits granted, which show a more dynamic trajectory in the former since last summer.

Chart 3
MANIFEST CHANGES ARE ARISING AS A RESULT OF THE PANDEMIC IN THE TYPE OR LOCATION OF HOUSING IN DEMAND, WHILE PRICES SHOW SOME DOWNWARD RIGIDITY

Purchases of new housing have shown greater momentum than those of used housing since last summer, because the former stem from commitments undertaken before the pandemic. In turn, the increase in the time spent at home owing to lockdowns and remote working has sparked a greater preference of households for larger, single-family homes or homes outside large cities. In comparison with other crises, prices are showing greater downward rigidity, particularly in the case of new housing.



SOURCES: Centro de Información Estadística del Notariado, INE and Ministerio de Transportes, Movilidad y Agenda Urbana.

a The percentage shown within brackets below the names of the provincial capitals represents their weight in purchases in the corresponding province total in 2020.
b House prices are CPI-deflated.

DOWNLOAD

highs, widespread across regions, in practically all housing segments (see Chart 3.2).[4] The worsening labour market prospects in the wake of the pandemic also appear to have prompted a shift in the make-up of buyers towards slightly older buyers who are in a somewhat better socioeconomic position.

The pandemic has also accelerated some pre-existing trends in housing demand, such as the shift from more populated municipalities towards other, less densely populated ones. This change had already been prompted by the greater scarcity in the supply of new housing and a higher average price in large cities. However, it has intensified on account of the new preferences in demand for larger, open spaces owing to the greater time spent at home in the wake of the lockdowns and increased remote working (see Chart 3.3). On registry information, this change has been broad-based across regions: over 80% of provincial capitals saw their weight in total property sales in their province decline in 2020.

In terms of nationality of the buyer, purchases by foreigners are weaker than those by Spanish nationals, due to the greater restrictions on people's international movement, with no differential impact of the pandemic being observed based on the nationality of the foreigner[5] (see Chart 3.4).

To date, the house price adjustment has not been as sharp in this crisis as it was in the global financial crisis. This is, among other factors, because the real estate sector is not as oversized as it was then, indebtedness among the agents involved is now lower and lending standards are more rigorous than they were then. In addition, the early deployment of different economic policies by the European and national authorities has prevented greater destruction of the productive system and employment and helped to sustain household income.[6] These measures have, for the moment, prevented an increase in non-performing loans and the need for forced property sales with a feed-through to prices. Thus, house prices continued on the slowing path that began before the pandemic, particularly in the second-hand home segment (see Chart 3.5). By contrast, average new house prices quickened in 2020 H2, posting a new high in nominal terms (2% up on the previous peak recorded in 2008 Q3), coinciding with high demand and low supply in this segment. However, it should be noted that, in real terms, new house prices are nearly 10% below their peak in 2007 (see Chart 3.6). That said, public deed information for the last few months points to a possible exhaustion of this acceleration in new house prices.

---

4 On notary information, the average size of residential properties sold in 2020 Q4 was close to 120 m^2, up by more than 6% on end-2019, with the average size of flats increasing slightly more than that of single-family residences.

5 By foreign nationality, purchases decreased across the board in 2020. This decline was higher in the case of British citizens, although they continue to account for the highest number of housing purchases by foreigners in Spain, representing approximately 13% of such purchases in 2020 – nearly 1 percentage point (pp) less than in 2019.

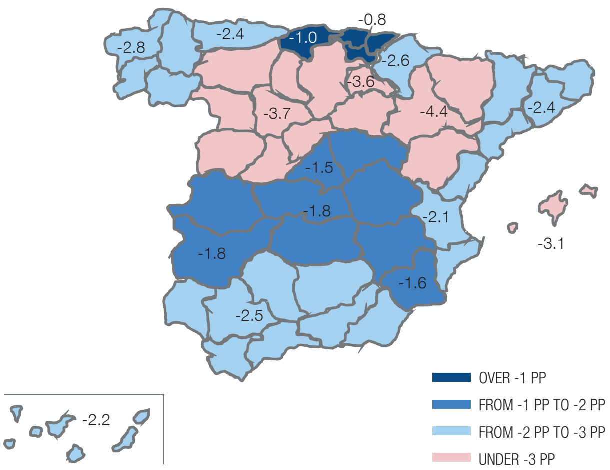
6 For further details on the factors behind the relative current strength of house prices, see Banco de España (2020), which concludes that the systemic risks associated with the residential real estate market were more limited at end-2019 than in the run-up to the financial crisis that began in 2008.

Chart 4

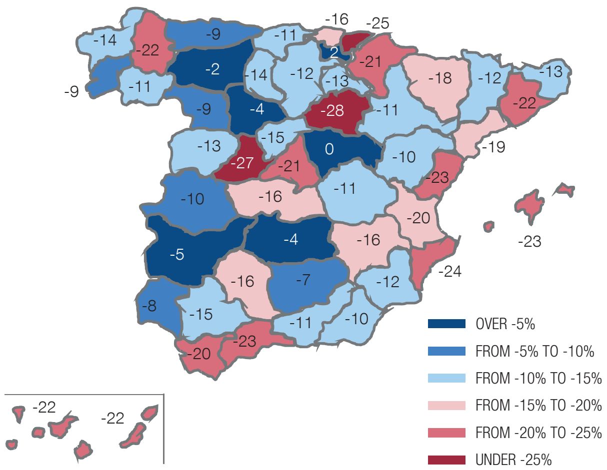
THE IMPACT OF THE HEALTH CRISIS ON HOUSE PRICES AND PURCHASES IS HIGHLY UNEVEN ACROSS REGIONS

The impact of the pandemic on house prices and purchases is more pronounced in the Mediterranean coast and island regions, which are more affected by the collapse of tourism as a result of the restrictions on international mobility. The weight of these regions in foreign purchases was greater before the crisis.

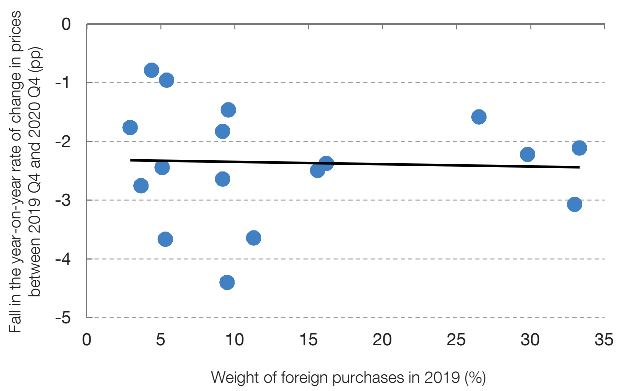
1 PRICES: ANNUAL SLOWDOWN IN 2020 (a)



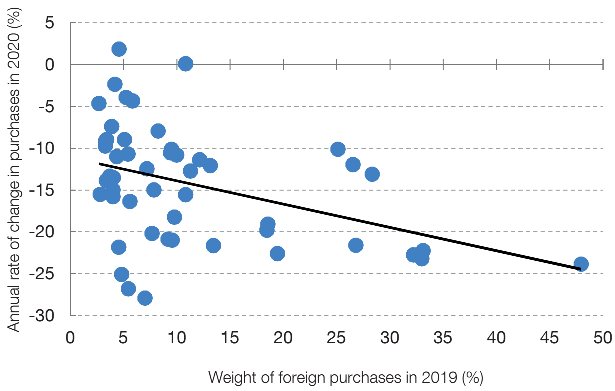
2 PURCHASES: ANNUAL RATE OF CHANGE IN 2020 (%)



3 SLOWDOWN IN PRICES IN 2020 AND WEIGHT OF FOREIGN PURCHASES IN 2019, BY REGION



4 ANNUAL RATE OF CHANGE IN 2020 IN PURCHASES AND WEIGHT OF FOREIGN PURCHASES IN 2019, BY PROVINCE



SOURCES: INE, Ministerio de Transportes, Movilidad y Agenda Urbana, and own calculations.

a The fall in the year-on-year rate of change in prices between 2019 Q4 and 2020 Q4 is shown in pp terms.

DOWNLOAD

Although the slowdown in prices has been widespread across regions, the loss of momentum has been greater on the Mediterranean coast and in the islands, which have traditionally recorded a higher percentage of purchases by foreigners because they are more attractive tourist destinations (see Chart 4). The greater impact on tourism and the restrictions on international mobility seem to have contributed to a relative greater weakening in transactions and prices in these regions.

Prices in the rental market have decreased in certain areas, reversing the upward trend of previous years. According to data from the main real estate portals up to March, rental prices appear to be falling somewhat sharply in the Catalonia, Madrid and island regions, while other regions are seeing a gradual slowdown or stabilisation in prices. The loss of momentum in rental prices is greater in certain larger cities owing to both the increase in supply and the decrease in demand. Thus, there appears to have been an increase in the supply of residential rentals at the expense of more temporary (e.g. holiday) rentals, which have been much more affected by the collapse of tourism. For its part, rental demand decreased owing to several factors. First, student demand was weighed down by the mobility restrictions and the increase in distance learning. Second, there has been a shift in demand towards other less populated areas with lower rental prices.[7] Another possible explanation of the weakening of rental prices, with implications for the whole of Spain, is the worsening of the labour market, particularly among young people and temporary workers, who are more likely to require rental housing.

The real estate credit market

The measures taken by the economic authorities in response to the pandemic have helped financing conditions for house purchase remain loose overall. Thus, the more expansionary monetary policy stance has translated into a decline in market interest rates and in the funding costs of financial institutions. At the same time, the temporary relief in capital and operational requirements has contributed to supporting the flow of credit.[8]

Against this backdrop, the synthetic interest rate[9] applied to new mortgage loans has decreased by around 30 basis points (bp) since the start of the health crisis, to 1.5% in March 2021 (the latest figure available), an all-time low (see Chart 5.1). This decline was close to 35 bp in the case of fixed-rate and mixed-rate mortgages (approximated as loans whose interest rates are revised every five or more years) and 25 bp in floating-rate mortgages (whose cost is revised in under five years). In floating-rate mortgages, the market interest rate falls were passed through in full to the cost of loans, while in the case of fixed-rate and mixed-rate mortgages, the

7 The number of properties used for holiday rentals in Spain declined by more than 8% between the onset of the pandemic and the end of last summer, according to AirDNA data on two of the most active digital platforms in this segment, Airbnb and Vrbo. Also, according to the real estate portal Idealista, the number of rental housing advertisements increased by close to 80% in 2020, rising more intensely in the main capitals, where the supply of rental housing more than doubled.

8 See Aguilar et al. (2020) and the European Central Bank press release "ECB Banking Supervision provides temporary capital and operational relief in reaction to coronavirus", published on 12 March 2020.

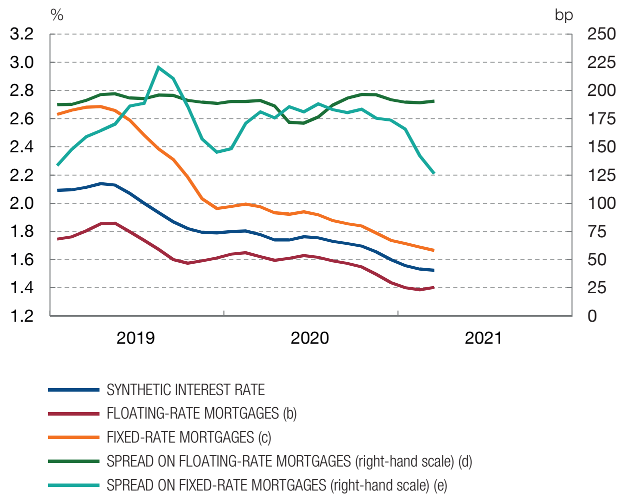
9 The interest rates mentioned in this paragraph are narrowly defined effective rates (NDERs), which exclude associated costs, such as mortgage protection insurance premiums, and fees and commissions. See the definition of the NDER in Banco de España Circular 1/2010 of 27 January 2010. In addition, these rates are estimated on a trend-cycle basis, i.e. they are adjusted for seasonality and the irregular component (small alterations of the series with no recognisable periodic or trend patterns).

Chart 5

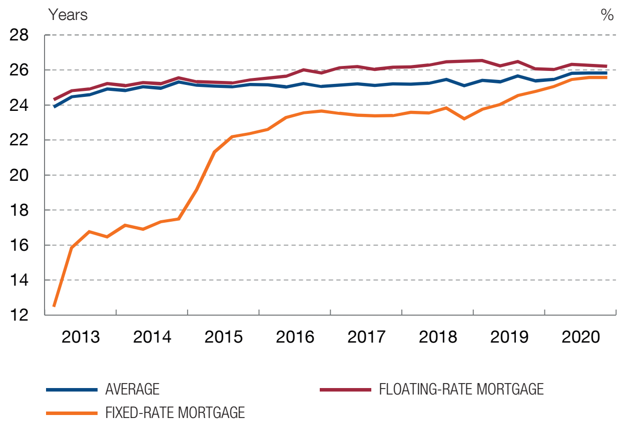
THE COST OF FINANCING FOR HOUSE PURCHASE HAS FALLEN SINCE THE OUTBREAK OF THE PANDEMIC, BUT BOTH CREDIT STANDARDS AND TERMS AND CONDITIONS HAVE TIGHTENED MODERATELY

The interest rates on loans for house purchase have seen further falls since the outbreak of the pandemic thanks to the ECB's measures, and the repayment periods on fixed-rate mortgages have continued to increase. However, the credit standards for loans have tightened moderately and the LTP ratio has continued to decrease. Demand for credit fell sharply during the spring 2020 lockdown and has subsequently recovered.

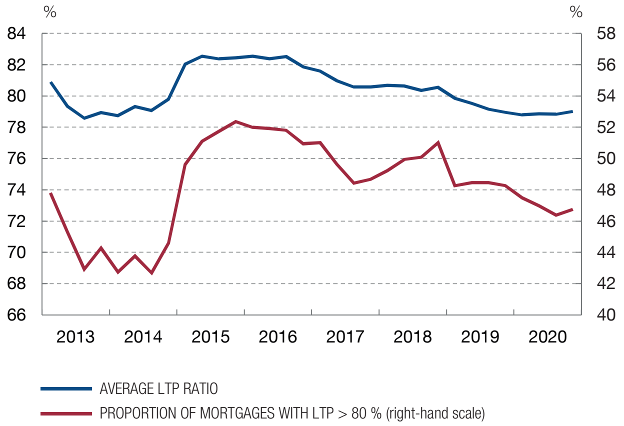
1 COSTS OF LOANS FOR HOUSE PURCHASE (a)



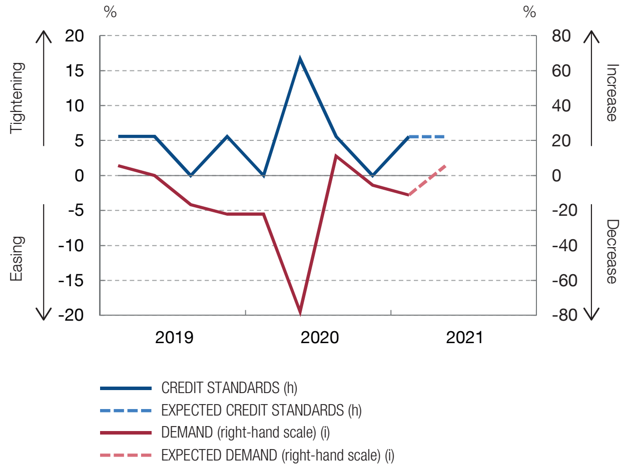
2 AVERAGE REPAYMENT PERIODS OF NEW MORTGAGES (f)



3 LOAN-TO-PRICE (LTP) RATIO FOR HOUSING (f) (g)



4 BLS: CHANGE IN CREDIT STANDARDS AND DEMAND FOR LOANS FOR HOUSE PURCHASE



SOURCES: Refinitiv Datastream, Colegio de Registradores and Banco de España.

a The bank interest rates are narrowly defined effective rates (NDERs), which exclude associated costs, such as mortgage protection insurance premiums, and fees and commissions. In addition, these rates are estimated on a trend-cycle basis, i.e. they are adjusted for seasonality and the irregular component (small alterations of the series with no recognisable periodic or trend patterns).
b Calculated as those loans whose interest rates are reviewed in under five years.
c Calculated as those loans whose interest rates are reviewed every five or more years.
d Spread over the 12-month EURIBOR of the previous month.
e Spread over the 20-year interest rate swap of the same month.
f Data weighted by the capital of each mortgage granted in the quarter.
g Ratio of the mortgage loan amount to the transaction price for housing.
h Indicator = percentage of institutions that have tightened their credit standards considerably × 1 + percentage of institutions that have tightened their credit standards somewhat × 1/2 – percentage of institutions that have eased their credit standards somewhat × 1/2– percentage of institutions that have eased their credit standards considerably × 1.
i Indicator = percentage of institutions reporting a considerable increase × 1 + percentage of institutions reporting some increase × 1/2 – percentage of institutions reporting some decrease × 1/2 – percentage of institutions reporting a considerable decrease × 1.

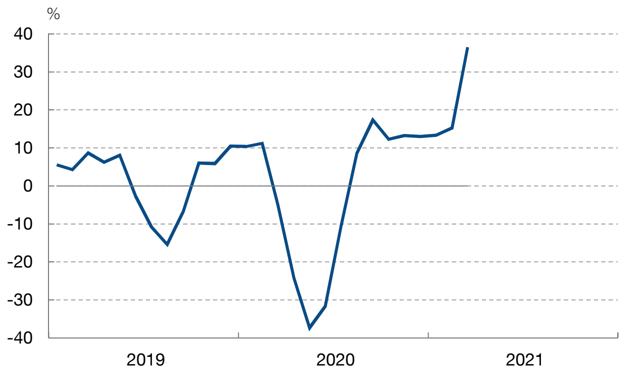
DOWNLOAD

Chart 6

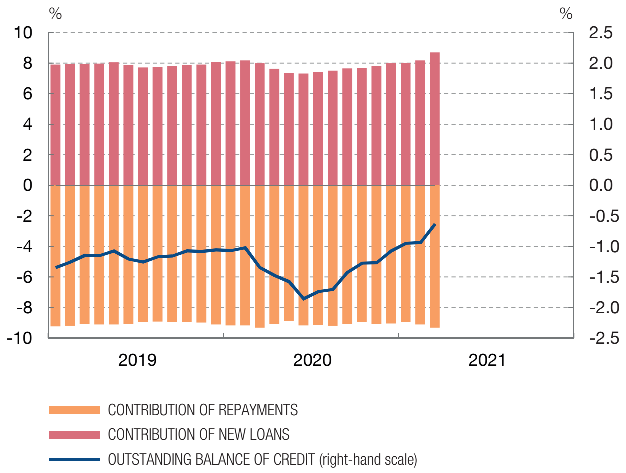
NEW LENDING AND THE OUTSTANDING BALANCE OF CREDIT FOR HOUSE PURCHASE HAVE BEEN CONDITIONED BY THE SPRING 2020 LOCKDOWN AND THE EASING OF RESTRICTIONS FROM SUMMER

New lending for house purchase fell sharply during the spring 2020 lockdown, but the easing of restrictions from summer allowed for a recovery, driven, in part, by purchase decisions that had to be postponed. This performance was reflected in the behaviour of the outstanding balance of credit, although the mortgage moratoria contained, in part, the decline in the outstanding amount of mortgage debt.

1 NEW LENDING FOR HOUSE PURCHASE (a)
Y-o-y change in 3-month cumulative flows



2 OUTSTANDING BALANCE OF CREDIT FOR HOUSE PURCHASE
Y-o-y change



SOURCE: Banco de España.

a Excludes loans resulting from restructurings of previously granted loans. See the definition of restructured loans in Rule one (e) of Banco de España Circular 1/2010 of 27 January 2010 to credit institutions on statistics on interest rates applied to deposits and loans vis-à-vis households and non-financial corporations.

DOWNLOAD

decline in the cost of loans resulted from the reduction in the margins applied by institutions.

Another important aspect of financing conditions is the average loan repayment term. In the case of floating-rate mortgages, it has remained slightly above 26 years, with hardly any changes in recent years (see Chart 5.2). However, in fixed-rate mortgages, the average repayment period continued to increase during 2020, to 25 and a half years, thus continuing the previous trend.

The average ratio of the loan value to the transaction price for housing, i.e. the loan-to-price (LTP) ratio, remained steady in 2020, standing at around 79% at year-end (see Chart 5.3). The share of riskier loans to new business, approximated as those whose LTP ratios exceed 80%, has continued to decline in recent quarters, in line with the trend over the last few years, reflecting lenders' greater prudence.

According to the Bank Lending Survey (BLS),[10] credit standards tightened following the outbreak of the health crisis, owing to banks' heightened risk perceptions (see Chart 5.4).

10 See Menéndez and Mulino (2021).

Demand for credit had already been showing some weakness prior to the outbreak of COVID-19, in line with the maturity of the housing market's expansionary cycle, as noted in the BLS. As occurred with transactions, the mobility restrictions imposed during lockdown led to a plunge in credit demand in Q2 (the sharpest fall since the start of the series in 2002). From the summer, however, when the restrictions were lifted, credit demand began to grow again in Q3, in part because purchase decisions that had to be postponed materialised. This behaviour translated into a strong fall, in year-on-year terms, in new lending for house purchases in the spring of 2020, a rebound in the summer and, in recent months, growth at a rate higher than that seen before the pandemic (the high figure recorded in March 2021 reflects a base effect) (see Chart 6.1).

The performance of the balance of credit for house purchase in 2020 was mainly marked by this behaviour of new lending, together with the moratoria on mortgage debt for individuals,[11, 12] which constrained the volume of repayments. Overall, therefore, the year-on-year rate of decline in the outstanding amounts in this segment intensified in the spring of 2020, contracting year-on-year by 1.9% in June (a rate not seen since mid-2018). However, since then, the fall has begun to moderate, standing at 0.6% in March 2021, 0.4 pp less than before the outbreak of the pandemic (see Chart 6.2).

11.5.2021.

11 A legislative moratorium on the mortgage debts of economically vulnerable individuals (see Royal Decree-Law 8/2020 of 17 March 2020 on extraordinary urgent measures to address the economic and social impact of COVID-19) and a banking sector moratorium that extends the range of beneficiaries and allows deferrals to be extended when the legislative moratorium expires (see Royal Decree-Law 19/2020 of 26 May 2020 adopting supplementary measures on agricultural, scientific, economic, employment and social security and taxation matters to alleviate the effects of COVID-19) have been approved.

12 For further information, see Banco de España (2021) and "Briefing note on application of moratoria established by law and by the banking sector up to 31 March 2021".

REFERENCES

Aguilar, P., Ó. Arce, S. Hurtado, J. Martínez-Martín, G. Nuño and C. Thomas. (2020). *The ECB monetary policy response to the COVID-19 crisis,* Occasional Paper No 2026, Banco de España.

Banco de España (2020). *The housing market in Spain: 2014-2019,* Occasional Paper No 2013.

Banco de España (2021). "Monitoring loan moratoria schemes", Box 2.2, *Financial Stability Report,* Spring 2021.

Cuenca, J. A., C. Martínez and A. del Río (2021). "Household saving during the pandemic and its possible effects on the future recovery in consumption", Box 4, "Quarterly Report on the Spanish Economy", *Economic Bulletin,* 1/2021, Banco de España.

Menéndez, Á., and M. Mulino (2021). "April 2021 Bank Lending Survey in Spain", Analytical Articles, *Economic Bulletin,* 2/2021, Banco de España.