Real estate in Spain: Cautious optimism

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Returns on real-estate investment in Spain over the past decade have been consistently higher than the Ibex 35 and bond rates, even taking into account the recent crash in prices.

Although the Spanish real-estate sector is going through a period of consolidation, new data suggest that it is still an investment vehicle worth considering.

Over the past decade, the sector has generated an average yearly return of 7.2 percent, putting return on investment well above rates seen on the Ibex 35 (4.5 percent) or in the bond markets (4.6 percent).

More surprisingly, bricks and mortar have also seen better short-term results than the stock market, with an average return in 2010 of just under 5 percent. In the same year, the Ibex 35 fell 12.9 percent including dividends.

These are just some of the facts contained in a recently published book on the state of the Spanish real-estate sector.

The book, for which IESE's International Center for Financial Research (CIIF) provided research, offers a complete overview of the evolution of real-estate investment over the past decade, based on the tracking and interpretation of the IPD real-estate investment index.

The IPD index measures the total return on all real-estate assets, including capital and rental returns, using information provided by institutional investors.

Data for the 2010 IPD index, for example, was obtained by analyzing 330 assets valued at 8.5 billion euros as of December 31, 2010.

High, but highly variable, returns

Over the past 10 years, the IPD index has fluctuated between the maximum levels seen in 2005 and 2006, with gains of 17 percent, and the minimum level registered in 2009, with losses of over 9 percent.

In fact, evolution of the IPD index in Spain clearly shows two starkly different periods. Through 2007, returns were always positive, but since 2008, the index has been in the red.

Over the past decade, real-estate assets have been more profitable than the stock market or bonds. But everything comes at a price, and the price paid by institutional investors in Spain over these years has been the highly volatile nature of their portfolios.

This can be explained by the behavior of capital returns, which have varied greatly ? from the maximum gains of 11.4 percent registered in 2006, to losses of up to 13 percent in 2009.

That said, consistently positive rental returns, which make up more than 70 percent of the total, have helped to stabilize the market.

Real estate still a strong play

The book also analyzes the evolution of different segments of the real-estate investment market. Although no specific area differed from the general trend in each cycle, investment in retail assets generated the highest return.

Particularly worthy of note are shopping centers, especially large ones, which offered an average yearly return of 10.8 percent.

What's more, retail sales are also, somewhat surprisingly, leading the recovery. In 2010, the sector offered total returns of 7.7 percent and was the only one with positive capital returns.

During the same period, Spain?s industrial sector, still burdened by substantial capital losses, was in the red, with total returns of -0.6 percent.

Office buildings, which over the past 10 years have had an average yearly return of 5.7 percent, also appear to be recovering. Negative capital returns have shrunk from -12.9 percent in 2009 to -3.7 percent in 2010, and have also been balanced by healthy rental returns of around 6 percent, putting total average returns for 2010 at 1.9 percent.

Too early to tell

IESE's José Luis Suárez, who edited the book and wrote the introductory chapter, reminds readers that in 2007, at the height of the real-estate boom, Spain was ranked the eighth largest economic power in the world.

However, when the bubble burst in 2008, those countries that had seen the highest returns during the real-estate boom, such as Spain, Ireland, the United Kingdom, the United States and France, would also suffer the most dramatic real-estate corrections.

The most extreme case is undoubtedly that of Ireland. In the golden years, the market there registered gains of up to 70 percent, but has since corrected itself by as much as 40 percent.

As such, it may be too early to speak of recovery in the Spanish real-estate sector. However, there is reason to be cautiously optimistic, especially with the IPD index showing positive returns of 5 percent for 2010, following two consecutive fiscal years in the red.

Who's who of Spain's real-estate investors

According to a recent study carried out by Asprima, IESE, Sociedad de Tasación and IPD, the total stock of real-estate assets owned by institutional investors in Spain was valued at 47 billion euros at the end of 2009.

This stock is mainly held by foreign investors (42 percent of the total), followed by publicly traded Spanish real-estate companies (27 percent), real-estate investment funds (14 percent) and insurance and pension brokers (10 percent). The other 7 percent is held by private real-estate companies and other investors.

By type of asset, most of the stock is found in the office segment (44 percent of all real-estate investment) and in retail (20 percent) the products of choice for institutional investors.

Investment in housing is much smaller, making up 13 percent of the total value of all assets, although even less is invested in industrial and logistical assets.