



Portugal's Property Glut

July 2010

Holidays give you a good opportunity to assess what is happening in other countries. A lot has been written in the media about the collapse of the housing market in Spain but Portugal also seems to be experiencing some of the same problems of weak demand and growing supply. The internet may be full of articles written by those in the property industry who say that the market is 'resilient' and back on the way up but the picture on the ground looks rather different. A recent trip to the Algarve opened my eyes to the massive amount of new-build property that is currently on sale and which looks like it is struggling to attract buyers, and it is only when you travel round the region that you realise that there must be thousands of empty apartments and houses in which someone has their money tied up. You begin to realise what a potential nightmare either the banks or the property developers are sitting on.

Over the years Portugal has received billions of Euros to develop its tourist towns and the town of Lagos which I visited seems to have received more than its fair share. Every street has been newly cobbled, the new town hall is a stunning piece of architecture, the recent fish market building looks like it was designed by Terence Conran and the modern marina is surrounded by upmarket bars, apartments and townhouses. One gets the impression that there is no work left to do that could actually improve the town but if the money is there then they'll find a way to spend it. Hopefully, this will stand them in good stead for the years to come as a lot of that money is likely to dry up when heavily indebted European countries reign in spending and cut back on fancy infrastructure projects. The shiny new town centre has been a big draw to foreign holidaymakers and the holiday home market has benefited accordingly. However, a lot of new property developments were started when the holiday home boom was in full swing whereas today's tourists often don't have the means or the desire to buy a second home as many of them are more worried about hanging onto their first home. This lack of demand means that lots of developments are sitting less than half sold and some look completely deserted.

One block of apartments that I saw in Lagos had been created by redesigning what looked like a large 1960s hotel but only about a quarter of the development had been completed, leaving a very modern block attached to a concrete ruin. You wonder who would be brave enough to buy one of these before the rest of the building is completed. At another completed development of 104 apartments that was being marketed by an upmarket UK estate agency I was told that 30 had been sold so far and that the remainder were being offered at a 15% discount to 2007 prices. A slightly older mixed use building next door had a ground floor of empty shops. Another large block of apartments only 2 minutes away has just been finished and shows no signs of life except for a few individual For Sale signs.

It's possible that most of the newest buildings contain more empty apartments than sold ones and one problem for existing owners in largely-empty developments is the question of who will pay the condominium fees. A pool and nice gardens would normally help attract buyers who would share the cost of the upkeep but if there are only a handful of owners then the developer must still be paying. My enquiries with one agent revealed that once 55% of the apartments had been sold the developer was able to hand over the responsibility for the condominium to the owners, which suggests that maintenance fees could be a lot higher than residents had originally envisaged.

The potential downside of this issue is apparent in some of the more mature developments of apartments and townhouses that I visited in Lagos. Walking around a series of streets and courtyards where townhouses were once on sale for 800,000€ the scene is one of neglect and deprivation, very reminiscent of a run-down council estate. Here the gym complex has closed down, weeds are growing out of the pavement, ugly corrugated iron fencing separates the cobbled square from the waste land that was supposed to be the site for the next stage of construction and practically every ground floor shop and office is empty. Residents in these streets clearly have no chance of getting back what they paid for their properties in the near future and you wonder who would dare buy here, at any price.

It also became clear that the resale market for existing properties must add thousands of townhouses, villas and apartments to the stock of new-builds up for sale. It is difficult to find up to date official data about housing market

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activity in Portugal but what you see here with your eyes suggest that sales are moving at a glacial pace. Prices in real estate agent windows look extremely high when you consider the huge choice open to any buyer who has the money to invest and it seems absurd that prices haven't plummeted significantly when supply clearly exceeds demand by so much.

Who is holding up the market at these price levels? Low Eurozone interest rates certainly help and banks are able to borrow money virtually cost-free. There are millions of Euros tied up in new property here but no-one seems like they are under duress to offer big discounts to get sales working again. The free market seems to have seized up. My explanation for this is that developers are being propped up by banks who a) don't want to own a repossessed property portfolio and b) certainly don't want to set a new price level in the market by selling assets at fire sale prices. Most lending banks already have large existing mortgage portfolios and if they suddenly flood the market with hundreds of properties at considerably lower prices in order to shift them then they also have to revalue the assumed equity in the properties of their existing customers. If they were to do this then they risk putting a large proportion of their customers into negative equity. As long as property prices can be kept aloft, until the market picks up again, they will be supported at artificially high levels.

To date, there have been relatively few distressed assets on the market. Many of these developments might not even be classed as bad debts in the books of the lending banks because they are still in play and have not yet technically defaulted. Banks are choosing to ignore covenant breaches as long as interest payments can be serviced. However, if credit markets seize up again, when developers loans need refinancing or if lending rates are pushed up by renewed concerns about sovereign defaults then we might see the true extent of the financial crisis in Europe, as illustrated by foreclosure sales, big discounts and prices that actually reflect the massive gap between supply and demand. Portugal is not oversupplied on the same scale as Spain but there is a hell of a lot of property waiting for buyers.

If property prices escape being 'marked to market' in the next few years we can already imagine a future of overgrown streets, empty shops and unfinished buildings that will serve as a reminder of times when everyone could imagine owning a second home. If you visit the Algarve in a couple of years time it might look similar to today, except it could look a lot more run down and you might find that areas containing former holiday homes resemble a depressing council estate. But the most likely scenario is a gradual realisation that the property boom is not coming back soon and that, at some point, these empty properties will be forced to sell at considerably lower than prices than are being asked today. This will have huge implications for the lenders, the developers and, perhaps rather unfairly, the homeowners who invested their savings in the Algarve dream.

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