

## THE SPANISH CONSTRUCTION CRISIS AND THE FINANCIAL INSTITUTIONS

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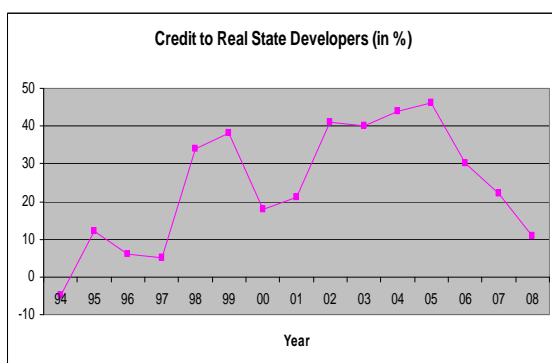
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For almost the last decade, Spain economic boom was strongly supported by the construction business. Some different circumstances make it happen. The Spanish culture for property instead of lease, the boom of retired people seeking for sunnier places to live, and the demand of new houses due to the increase of population, caused by a tremendous inflow of immigrants who, very little time after their arrival, were already “contaminated” by the Spanish property culture and wanted also to become the owners of their houses.

This made good times for developers, constructors and real estate agents, with yearly earnings even above 30%. Real estate investments were more attractive than any other, particularly in comparison to the stock market. The banks did not want to be left outside of such profitable business and this situation made them breach some of the traditional rules they had always followed when borrowing money to land promoters and constructors, mainly the rule according to which a land developer should always finance the acquisition of the land with its own resources and the banks were only financing the construction.

Banks started financing the 100% of land acquisitions by developers and gave to house purchasers mortgages covering 110% of the transaction cost. In a market where the rise of prices of land and real estate seemed to have no end, this was an easy game and no bank wanted to be out of it. Companies became tremendously over indebted owing to the banks billions of Euros, but no one seemed to have any concern about it.



in late 2006, concerns started about the viability of such model and the experts started predicting a construction business soft landing it was said the market would take from two to three years to absorb the excess of construction and prices would be reduced no more than 10%, but without any special fear about a crisis. This was a wishful thinking.

Probably the market would have suffered more the forecast but then the American subprime crisis came and, although the Spanish Banks seem not to be seriously affected by it, they started having difficulties to get its own financing at the international markets and suddenly, from one day to the other, they

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rejected to finance land acquisitions and rejecting mortgages for more than 60 or 70% of the purchase price. This provoked a situation in the market where there was a demand for new houses but the banks refusing to finance them. At the same time, the bank started asking construction companies for the payment of their credits.

The crisis was served. On one hand, developers could not cash enough money from sales to pay their enormous debt, and at the same time had to stop the projects that were under construction. Faced with this situation, companies were in the urgent need to renegotiate their huge debts with the financial institutions.

However, not all of them have succeeded in doing so, either due to lack of viability or because they started moving when it was too late. Some companies have not been able to withstand this abrupt change of cycle and have fallen by the wayside, owing more than 3 billion euros to the banks.

Other companies have managed to survive after hard renegotiations to reclassify their bank debt to long term. This has led to some major insolvencies in the industry.

<b>Main Insolvencies</b>		
<b>Company</b>	<b>Area</b>	<b>Debt (Million Euro)</b>
Grupo Lábaro	Madrid, Andalusia and Eastern Europe	850
Inmobiliaria Llanera	Comunidad Valenciana	700
Seop	Madrid	400
Cosmani	Madrid and Mediterranean area	350
Ereaga	Euskadi and Murcia	160
Sánchez Romero	Catalonia and Brazil	97
Contsa	Andalusia	50
Construcciones Juanes	Catalonia	50
Lovipro	Catalonia	42
Prasi	Central Spain	40

A few figures give an idea of the magnitude of the crisis. While 10 years ago the average financial leverage of construction companies was 45% of the value of their assets, at present, the industry average is above 70%, and with some companies, such as Colonial, it stands at 95% of their assets. Such figures are totally unsustainable. As a matter of fact, this situation has provoked the recent insolvency of Martinsa Fadesa, one of the largest constructors, being the largest insolvency ever in Spain.

At the time of starting renegotiations, the debt of some companies, such as Martinsa Fadesa, was already due or would become due very shortly, amounting to more than 2 billion euros. The bank debt owed by listed construction companies currently exceeds 38 billion euros.

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The question currently being asked is whether this refinancing will be enough to solve the problem or whether it will simply put it off three years, as it is not clear whether the market will have emerged from its downturn by then and offloaded its huge stocks of dwellings and land.

Although it is very difficult to see what will happen in the future, the analysis of the Spanish economic situation and the evolution of the interest rates do not augur well. In the experts' opinion, the number of insolvencies in the construction sector will probably increase substantially after the summer, which will further weaken confidence in this sector. Not to be forgotten, in the first six months of 2008, Insolvency proceedings in Spain have raised more than 78.6% in comparison to the same period of the previous year. Most of such insolvencies related to the construction business (23.5%).

However, it is not likely that this crisis will have any serious effect on the banks in the short term. The fact that they had reclassified the debt to long term will keep their balance sheets looking good for the moment. Moreover, the Spanish banking system has been kept very healthy due to the strict policies of the Bank of Spain, and this will continue in the future. Provisions into banks balance sheet related to the construction sector are expected and, thus, banks profitability will be reduced, this situation affecting more to saving banks, more involved into this business, then to the big Spanish banks.

<b>Main Refinancing</b>		
<b>Company</b>	<b>Debt (Million Euro)</b>	<b>Refinancing (%)</b>
Martinsa Fadesa	5.153	100%
Colonial	8.900	80%
Reyal Urbis	4.800	60%
Habitat	2.500	65%
Afirma	335	100%
Detinsa	650	100%