

# Real Estate Outlook

## Chile

2011  
Economic Analysis

- **Construction will grow by around 10% in 2011** as the recovery extends to all its sectors.
- **There will be a major upturn in the housing market in 2011**, but the reactivation of projects will be mainly reflected in 2012.
- **The stronger economy and better employment conditions have improved access to finance against the background of low interest rates.** In April, mortgage lending was up by 13.1% y/y, after averaging growth of 11.1% in 2010.
- **There has been some delay in the program of subsidies and the execution of the reconstruction plan**, but the new housing policy has received approval by the industry.
- **There has been a new boost to the system of concessions**, after the slump resulting from the conclusion of major infrastructure transport works in 2006.

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Closing date: June 21, 2011

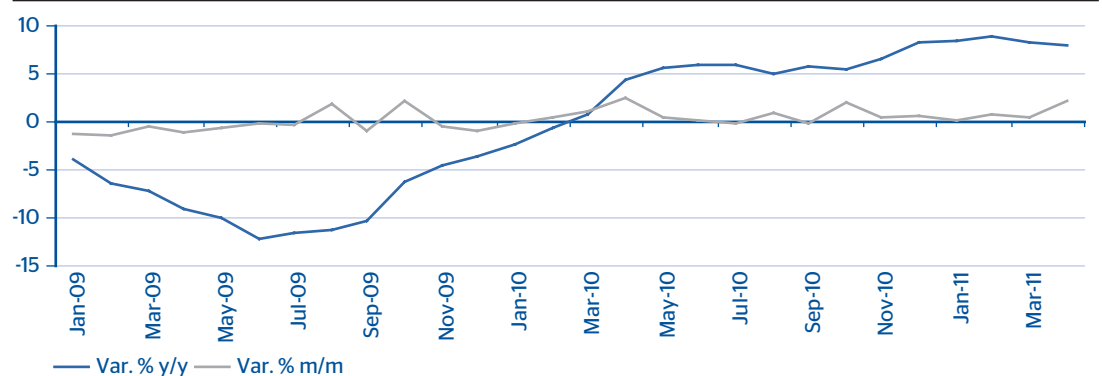
## 1. Renewed strength in the construction sector

Construction has been one of the sectors that have lagged behind most in the strong recovery of the Chilean economy since the second quarter of 2010. The sector grew by 3.6% in 2010, significantly below the 5.2% growth in the economy as a whole. However, starting in the last quarter of 2010 it began to show greater strength and in the first quarter of 2011 grew by 10.7% y/y.

This recovery in construction activity is reflected in the unemployment rate in the sector, which is 8.7% in the February-April moving quarter, the lowest rate since figures have been available from the National Employment Survey.

However, as we will see below, the performance has varied greatly between the different construction sub-sectors.

Chart 1  
Monthly Construction Activity Index



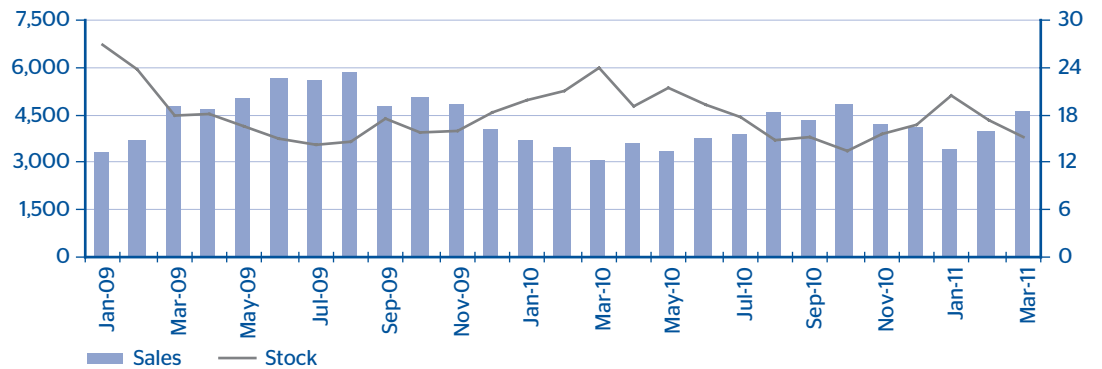
Source: Chilean Construction Chamber (CChC)

## 2. Recovery in the housing market

The housing market in 2010 was marked by the effects of the earthquake of 2/27. As we anticipated in our earlier report, despite the favorable economic conditions for buying homes, the fall in demand meant that total national home sales fell by 18% on the figure for 2009 (figures from the Chilean Construction Chamber). However, this fall in sales was not reflected in an increase of housing stock, as at the same time the number of construction projects fell. This decrease in new projects would be explained by both the price correction resulting from the recession of 2009 that affected the balance sheets of many companies (with a sluggish response from the supply side) and the announcement of changes to the rules governing construction after the 2/27 earthquake. Thus according to the Ministry of Housing and Urban Planning, the housing stock available for sale fell by 88,740 units in January 2009 to 69,147 units in December 2010. Nonetheless, in monthly terms the stock actually increased in the first half of 2010. However, the stronger recovery of the demand in comparison with the supply observed towards the end of 2010 led to an 8% increase of prices in 2010 (see Chart 3). In the first quarter of 2011, sales grew 18% in annual terms.

This increase in sales, together with the relative stability in the number of homes available for sale, has led to a fall in housing stocks to 15 months by March 2011, below the average levels reached to the end of 2008. For apartments, the figure is 20 months, and for and single-family houses 8 months. In January 2010, stocks were 26 and 10 months, respectively, so the fall has been proportionally higher in the case of apartments, despite the earthquake.

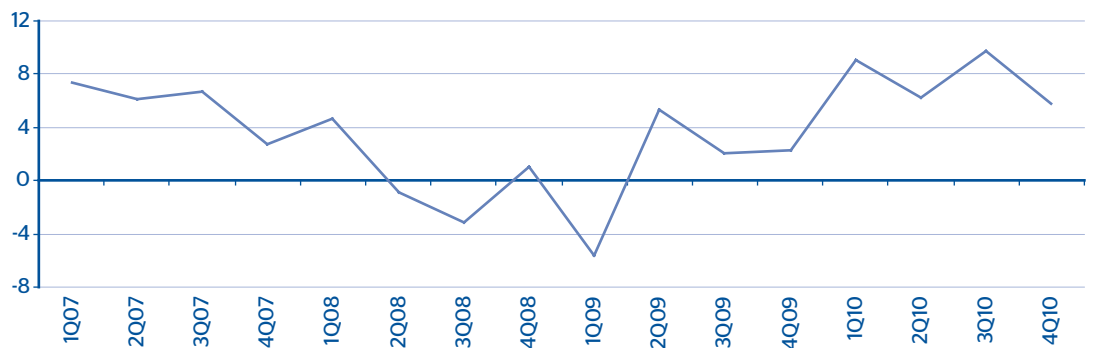
Chart 2  
Total domestic sales and housing stock (units and months) National Statistics Institute



Source: Ministry of Housing and Urban Planning (MINVU) Housing Observatory

This factor, combined with the implementation of the new subsidy policy (dealt with below), should continue to boost supply in the housing market. Construction permits in seasonally-adjusted moving average quarters reached similar levels to 2008, and operators in the sector reckon there has already been a significant increase in new project starts. However, the average time taken to construct a house is around 8 months, and in the case of apartments between 1.5 and 2 years, so the impact of activity in the sector will not be reflected until the second half of the year and above all in 2012.

Chart 3  
Average housing price in Gran Santiago in UF (% y/y change)



Source: MINVU Housing Observatory.

## 2.1 The rising cost of supply

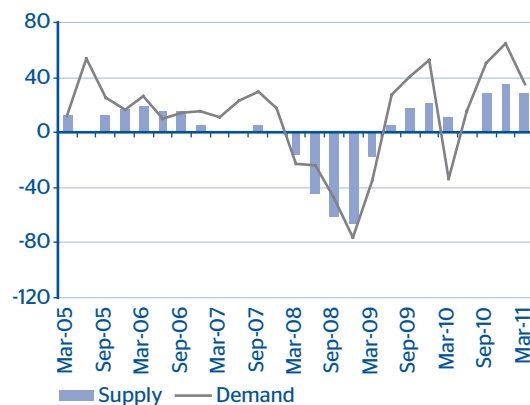
A number of factors are affecting construction costs and will probably continue to push up the prices of buildings. According to the April Report by the Construction Chamber, the index of construction costs (ICE) grew by 4% in February 2011 in real terms. The report highlights that this indicator, which takes into account the costs of materials, wages and other items, is moderating after the earthquake. However, with respect to the wage component, increased employment and the fall in the unemployment rate pointed out above have been passed on to the nominal construction wage index (Índice Nominal de Remuneraciones de la Construcción) for April, which was up 6.4% over twelve months, substantially above the level of inflation. The greater activity forecast for the sector could suggest increased costs, but the conclusion of reconstruction and repair work following the earthquake should moderate this effect.

### 3. A more favorable scenario for mortgage lending

The strength in economic activity over the last twelve months and the strong growth in employment, mainly in the salaried sector, has had a positive effect on consumer expectations and generated a climate of greater stability and confidence that supports home buying.

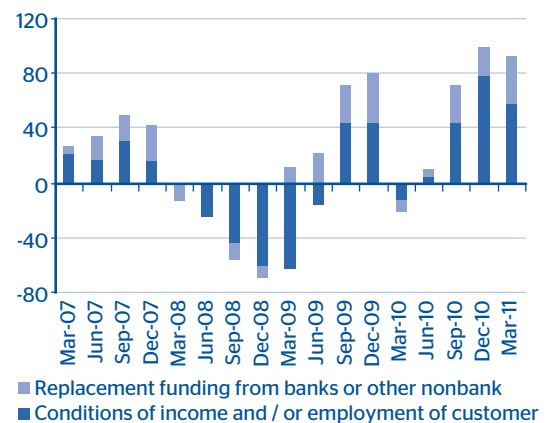
Since September 2010 banks have noted a steady growth in demand for mortgage loans (Chart 4). The explanation for this is their customers' improved income and/or employment conditions, and more easily available finance from banks or other institutions (Chart 5).

Chart 4  
Perception of demand and flexibility in credit supply (\*)



(\*) Negative values indicate perception of weaker demand and less flexible supply conditions.  
Source: BBVA Research, based on the Central Bank of Chile Credit Survey

Chart 5  
Factors that explain changing demand for mortgages



Source: BBVA Research, based on the Central Bank of Chile Credit Survey

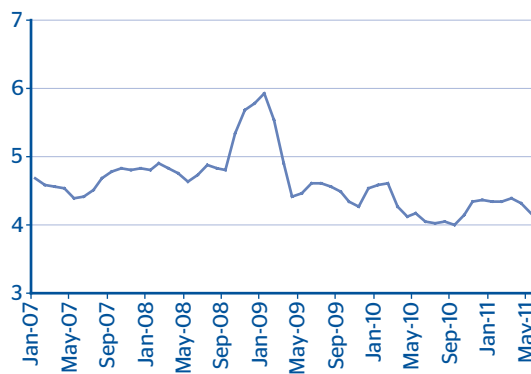
The supply of mortgage loans has also been more flexible since September 2010 to date. The factors influencing this greater flexibility are the reduction of credit risk in the customer portfolio (lower default rates and provisions), competition between banks and other sources of non-bank mortgage finance, and improved growth prospects.

The greater flexibility in credit conditions has mainly resulted in extending coverage of the total value of the home (debt/guarantee ratio) and lowering requirements in applicants' payment/income ratio. At the same time, there has been a reduction in requirements of credit scores and spreads over the cost of funds.

Apart from the economic improvements, housing interest rates have performed well. They have averaged around 4.2% in real terms over the last 12 months, under pre-crisis levels (Chart 6).

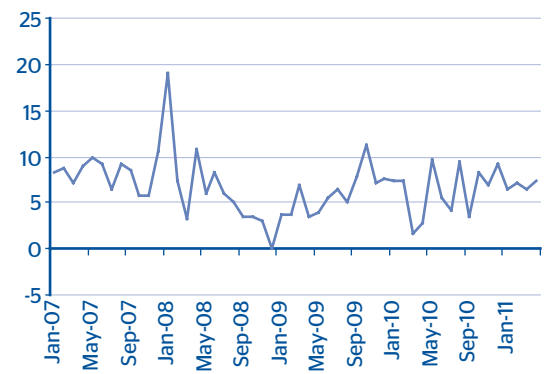
In all, the greater demand for mortgages, together with a more flexible supply, in a context of low interest rates, has maintained mortgage lending flows at around 7 million UF per month over the last 12 months (Chart 7). After averaging 11.1% in 2010, in April 2011 growth stood at 13.1% y/y.

Chart 6  
Interest rates for home mortgage loans (UF)



Source: Central Bank of Chile

Chart 7  
Seasonally adjusted mortgage flows (million UF)



Source: BBVA Research

## 4. Social housing and infrastructure

### 4.1. Social housing

The earthquake and tsunami on February 27, 2010 led to an increase in the housing deficit, which was 420,000 homes in 2009, of more than 40% according to the surveys carried out by the Ministry of Housing and Urban Planning (MINVU). The Reconstruction Plan was created as a response to the catastrophe. It has set a target of delivering 220,000 subsidies over the period 2010-2011. Of the total subsidies to be assigned, 85,000 correspond to subsidies for the construction of new homes, 20,000 for acquisition of already constructed homes and 115,000 for repairs to homes. Two categories of new home construction have been established: own-plot construction (CSP) and construction on new land (CNT) as part of a new housing project.

According to the Chilean Construction Chamber, the sector could satisfy the demand for new homes within a year by using the installed capacity only if construction took advantages of economies of scale on new land, with housing projects of at least 150 homes. However, most of the subsidies for construction of new homes (60,000) correspond to the own-plot CSP program, in which each home is an independent project. This not only increases construction time and costs, but also the time for processing the subsidies.

Table 1  
Reconstruction Plan: progress to April 2011

Programa	Reconstruction Plan Goal for 2011	Assigned Subsidies		Initiated Works and Projects in Execution		Finished Works	
		N°	% Progress on the Goal	N°	% Progress on the Goal	N°	% Progress on the Goal
Construction CSP	60,000	26,901	44.8%	7,823	13.0%	1,151	1.9%
Construction CNT	25,000	22,825	91.3%	11,975	47.9%	0	0.0%
Purchase of built houses FSV AVC and DS 40	20,000	13,913	69.6%	13,511	67.6%	602	3.0%
Reparation Heritage Family Program	115,000	82,530	71.8%	59,127	51.4%	37,543	32.6%
<b>Total</b>	<b>220,000</b>	<b>146,169</b>	<b>66.4%</b>	<b>92,436</b>	<b>42.0%</b>	<b>39,296</b>	<b>17.9%</b>

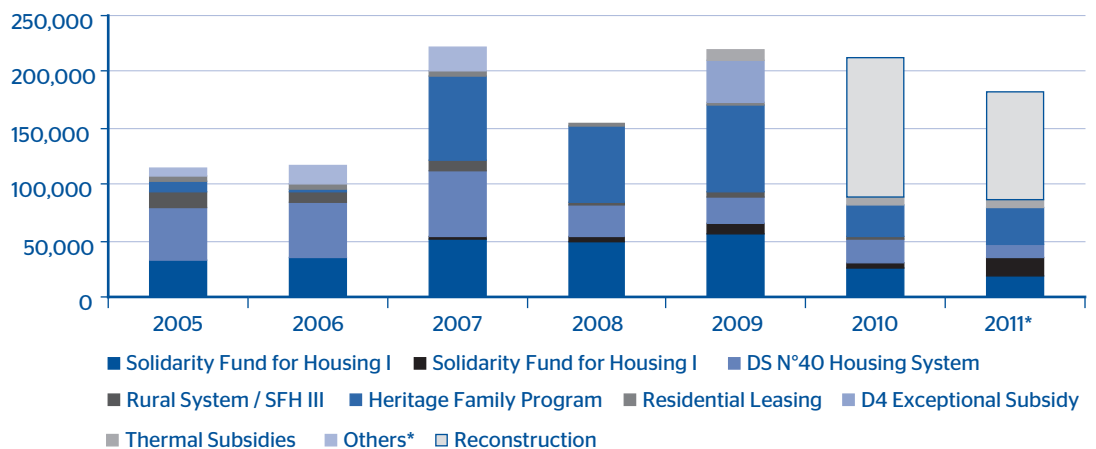
Source: CChC

As can be seen in Table 1, as of April 2011 progress towards the target for the end of the year stood at 66.4% in the allocation of subsidies and 42% in work begun. It is worth pointing out that most delays are in the own-plot CSP program, with 44.8% of the subsidies earmarked and only 13% of projects started. With respect to work completed, progress towards the target is still very low, at 17.9%, almost all the result of the delivery of repair works, given that in construction and acquisition progress has been practically nil.

The regular housing program has declined strongly compared with previous years. In 2010 the number of "regular" subsidies granted fell overall by 60% on 2009, due to the high level of commitments in the wake of the damage caused by the earthquake and tsunami. In terms of the total subsidies granted (regular and earthquake program), the fall in 2010 is only 3% on the figure for 2009. For 2011 the regular program will be reduced by only 2% on 2010.

Chart 8

Number of subsidies granted under the Housing Program and 2011 target



\* 2011: Approved Budget for the year and complete reconstruction goal.  
Source: CChC and MINVU

A new public housing policy for the middle classes was recently announced. It involves the launch of Supreme Decree No. 1. The new subsidy, like the previous one, is designed to boost demand and complements own savings and/or a mortgage loan for the construction or purchase of new or existing housing in urban or rural areas. Supreme Decree 1 supports the acquisition of homes costing up to 2,000 UF (USD 92,790) and increases the amount of the subsidy, which may be as much as 450 UF (USD 28,878) in the case of lower price homes, decreasing as the price rises up to 2,000 UF.

Although the industry values this new policy positively, there is some concern about the increase in bureaucracy involved compared with the earlier Supreme Decree 40. In addition, there has been no announcement or ratification of the housing policy for subsidies not involving debt. Funds invested in the housing industry are high and the time frames involved extensive, so the private sector needs clear rules if it is to start new projects.

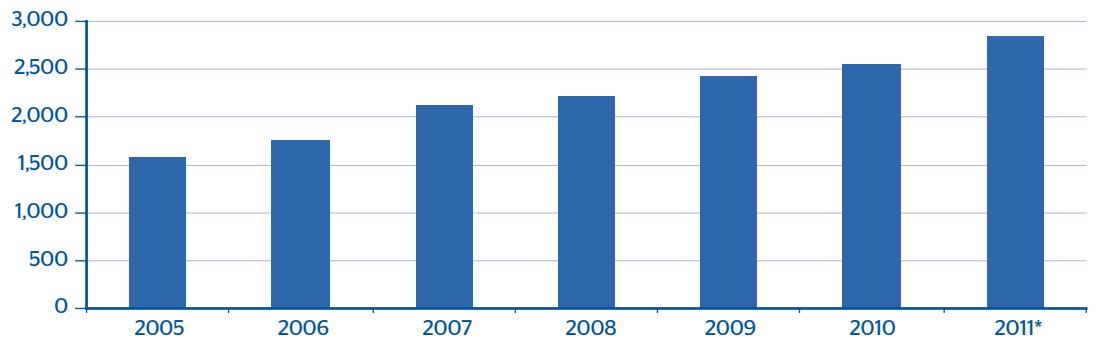
The sector is expected to gain a new boost with the announcement of the housing policy and the greater flexibility of the reconstruction program.

#### 4.2. Infrastructure

A Master Plan has been set up by the government for the construction of infrastructure as a 20-year scheduling and coordination instrument. Investment of USD 15,920 million to 2025 has been specified for road and hydraulic projects. In addition to this program, there are other specific programs of lesser value, such as the Chiloé Plan, the Austral Connectivity Plan and the Interlagos Network. These would be in line with the infrastructure investment that the government has been executing over recent years.

Chart 9

Public infrastructure investment. Millions of 2010 dollars



\* 2011: budgeted for 2011  
Source: MOP

A new regulation has been drafted by the government for the Concession Law, forming a Concession council and boosting the concession of second generation works such as prisons and hospitals. As can be seen in Table 2, the concession program aims to execute a total of USD 11,739 million between 2010 and 2014, with more than USD 1,500 million on second-generation concessions.

Table 2

Concession Program 2010-2014

	Investment MM USD
2010 Biddings*	523
2011 Biddings	1,890
2012 Biddings	1,441
2013 Biddings	2,324
2011-2013 Hospital Program	1,338
2011-2013 II-B Prison Program	245
2011-2013 Transantiago Program (Public Transport)	248
<b>Subtotal</b>	<b>8,009</b>
Projects Under Study	3,730
<b>TOTAL</b>	<b>11,739</b>

\* plus \$1,062 million of projects in the bidding process.  
Source: MOP

## 5. Conclusions and outlook

Following the adverse effect of the financial crisis and earthquake in the construction sector, a vigorous recovery began in the last quarter of 2010, backed by both supply and demand factors. On the supply side, the fall in housing stock levels has brought about price corrections that are helping to reactivate many projects that had been suspended. In the case of demand, conditions are favorable in both economic and financial terms. On the economic side, growth in employment and wages, as well as expectations of high economic growth, lead to positive prospects for disposable income of households and companies. On the financial side, conditions for granting finance have improved, and interest rates remain at below pre-crisis levels.

In addition to this favorable outlook for the residential and commercial construction sector is the positive outlook on housing subsidies for low-income and medium-income sectors, following a major delay in the policy implementation.

The biggest progress with respect to the reconstruction effort is in infrastructure, and given the survey of projects and forecast investment in the concession program 2010-2014, this trend is expected to be maintained in the medium term. In this scenario, we expect real growth of around 10% for the construction sector and around 14% average nominal growth in mortgage lending in 2011. In 2012 the backlog in residential construction will also ensure a high level of activity.



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