

Real Estate Outlook

Peru

2012
Economic Analysis

- **In 2012, the number of homes built in Lima rose 10.9%.** The dynamism was focused on homes with intermediate and high prices.
- **Growth in home sales slowed,** leading to a rise in the available supply.
- **Home prices continued to rise, especially in the wealthier areas of Lima.** Looking ahead, growth in prices is expected to slow, in keeping with the greater market slack and the lower return on rental.
- **Sharp growth in mortgage lending continued.** Against this background, authorities have taken measures to dampen this buoyancy and ensure its sustainability.
- **Offices registered a low vacancy rate and rent has increased.** This higher profitability should create an incentive for the expansion of supply.

Index

1. Abstract	3
2. In 2012, residential construction rose at a slower pace	3
Box 1: Higher return in offices will encourage its geographic expansion	9
3. Mortgage lending kept a strong pace of expansion	10

Closing date: 28 December 2012

1. Abstract

Housing construction for sale in Lima grew 10.9% in 2012, more slowly than the year before (38%). In terms of price ranges, residential building was focused on mid and high value units, while there are still shortages in the lower value segments.

On the other hand, sales of new units showed a slower growth rate (2.6% in 2012 versus 47.7% in 2011). This factor, along with increased housing construction, prompted a 20.6% rise in available supply. Additionally, a higher proportion of these units registered a sale period exceeding six months.

Regarding prices, the value per square meter in Lima increased by 21.2% (year-on-year in USD). Geographically, the highest increases were reported in the wealthier quarters of Lima, which is consistent with a demand shift towards higher value houses. Despite this increase, the affordability index (home price / income) stands at a similar level to the figure registered in 2010. However, profitability of rental housing has decreased from 7.5% in 2010 to 6.5% in 2012.

Looking ahead, there are several signs which suggest a slower growth in prices per square meter. First, new constructed units are taking longer to be placed. Furthermore, the fall in rental return would lower housing demand for investment purposes. In addition, interest in buying finished homes has decreased, due to greater preference for self-construction. Lastly, financial expenses of loans are expected to increase, in line with new regulations.

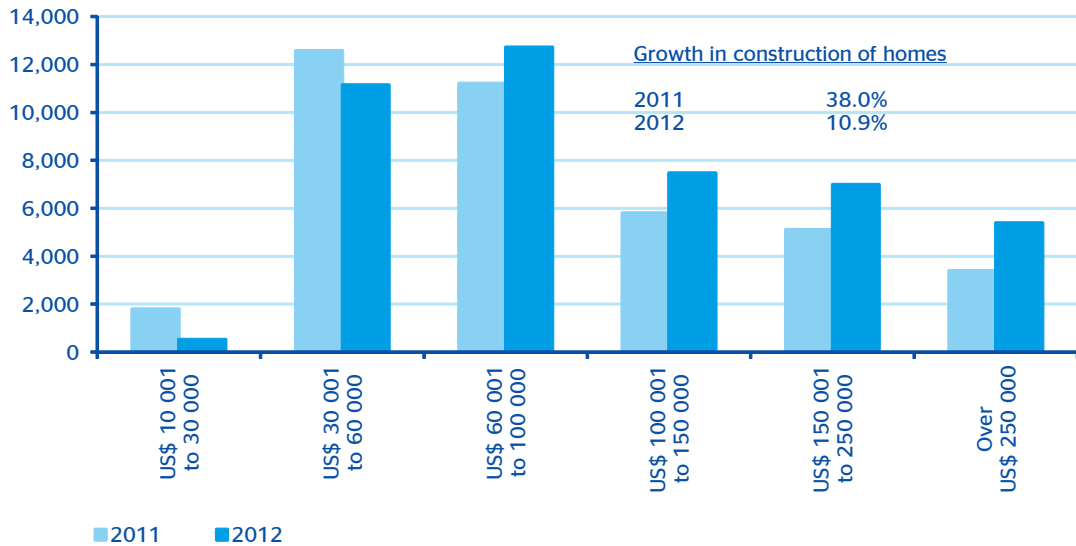
Turning to financing, mortgage lending maintained a strong pace of expansion and, in the last months, it has been growing at an annual rate close to 23%. This growth has been prompted by the fall in interest rates, largely in foreign currency, prompting macro prudential policy measures. On the one hand, the financial regulatory authority for banks (SBS) has imposed higher capital requirements, which will mainly affect dollar and long-term loans. In the case of mortgage loans, the requirements will be stronger, as the LTV is higher and as the credit is not intended for first-home buying. On the other hand, the Central Bank has been increasing reserves requirements of dollars and soles deposits. These measures will tend to make more expensive mortgage loans and will possibly reduce their flexibility in terms of duration and down-payment.

2. In 2012, residential construction rose at a slower pace

Growth in housing construction of intermediate and high prices stood out

The number of homes built for sale rose by 10.9% in 2012, a lower rate than the 38% reported the previous year. By value, building activity showed stronger growth in housing construction of intermediate and high prices, while the middle and lower prices recorded declines. (see Chart 1).

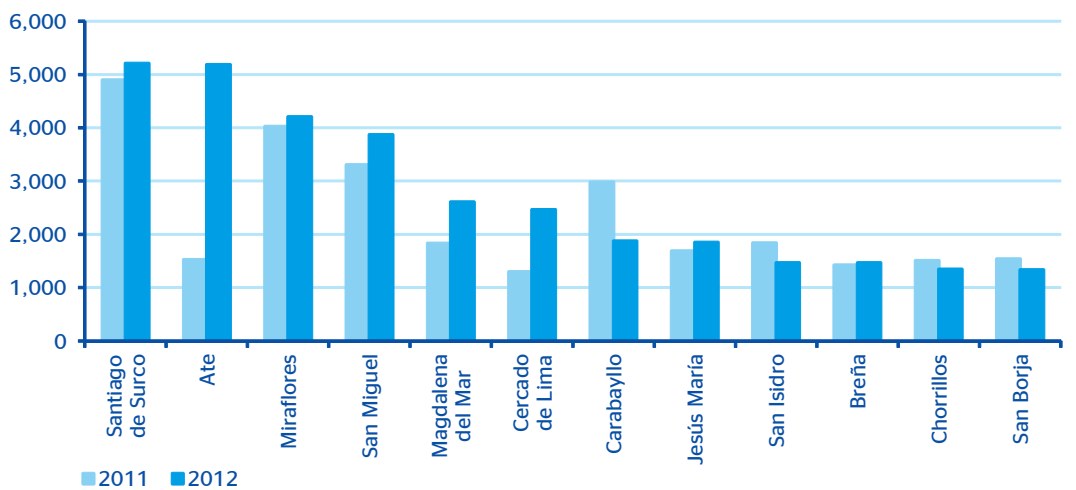
Chart 1
Lima: residential building by price range (units constructed for sale)



Source: CAPECO and BBVA Research

Geographically, there has been a particularly sharp increase in homes built in the Ate district, while Surco and Miraflores kept relatively important (see Chart 2). Magdalena and Lima Cercado districts also reported strong rises.

Chart 2
Building in the most dynamic districts (units constructed for sale)



Source: CAPECO

The pace of sales slowed and it prompted an increase in the available supply

There was a 2.6% rise in units sold, while the available supply increased by 20.6% (see Table 1). Additionally, the period of time taken to sell constructed homes also increased. Thus, the delayed sales indicator (units awaiting sale for a six months or longer) calculated by the Peruvian Chamber of Commerce (CAPECO) increased in 2012, accounting for 58.3% of the available supply (40.7% in 2011).

Table 1

Lima: residential building: house and apartments (units constructed for sale)

	2010	2011	2012	% change 2011/2010	% change 2012/2011
Constructed homes	28,881	39,870	44,215	38.0	10.9
Sold	14,516	21,441	21,990	47.7	2.6
For sale (Available supply)	14,365	18,429	22,225	28.3	20.6
Of which: delayed*	6,462	7,501	12,957	16.1	72.7

* Were on sale for a period of at least six months and were still for sale at the time of the survey
Source: CAPECO and BBVA Research

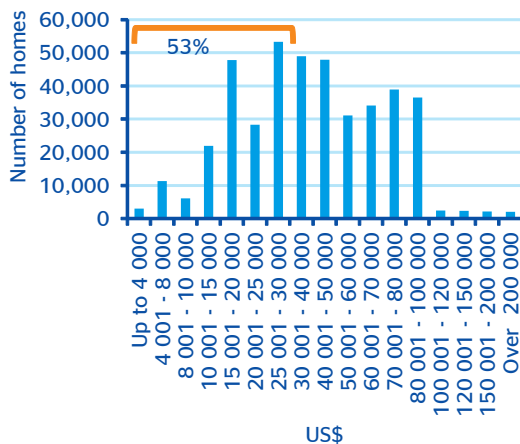
In terms of surface area, 51% of square meters were sold in Lima Top, 22% in the Modern sector and 7% in the Center¹.

Medium and low priced homes remain scarce

There is a considerable difference in the bias of distributions for housing demand and supply. While over half of effective demand prefers homes at a price below USD 40 thousand, only 4.0% of the supply targets this segment. And even though there is a high concentration of homes between USD 40 thousand and USD 100 thousand, the demand for this price range is almost 13 times higher.

Chart 3

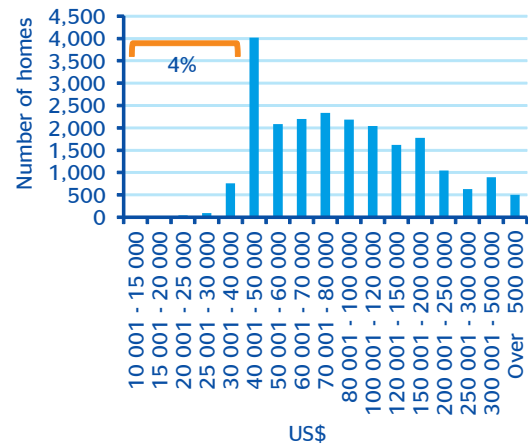
Lima: effective housing demand (number of families, prices in USD)



Source: CAPECO

Chart 4

Lima: total housing supply (number of units, prices in USD)



Source: CAPECO

Shortage of land appears to be the most important limiting factor for a more rapid supply expansion of medium-and-low-value homes. This would be associated with the lack of water and sewage services, on the one hand, and the lack of urban planning, on the other.

With regard to the former, SEDAPAL (state company responsible for the distribution of water and sanitation in Lima) is not equipped with sufficient financial resources to carry out a large scale works plan. In this sense, the recent announcement by the Ministry of Housing to allocate 900 million soles (USD 350 million) for water and sanitation works in Lima in 2013 is a positive step, as it represents more than double SEDAPAL's expenditures for these purposes in 2012. However, the long-term solution is to give SEDAPAL greater autonomy to conduct its operational planning and to be able to set rates in accordance with the arising financing needs.

¹: Following the classification used by CAPECO, we have grouped Lima districts in areas: Lima Top (Miraflores, San Isidro, La Molina, Surco and San Borja), Modern Lima (Jesús María, Lince, Magdalena, Pueblo Libre, San Miguel, Barranco and Surquillo), Lima Center (Cercado, Breña, La Victoria, Rimac and San Luis), East Lima (Ate, Cieneguilla, Chaclacayo, Lurigancho and Santa Anita), North Lima (Carabaylo, Comas, Independencia, Los Olivos, Puente Piedra and San Martín de Porres), South Lima (Lurín, Pachacamac, San Juan de Miraflores, Villa el Salvador and Villa María del Triunfo), and Callao (Bellavista, Callao, Carmen de la Legua and La Punta)..

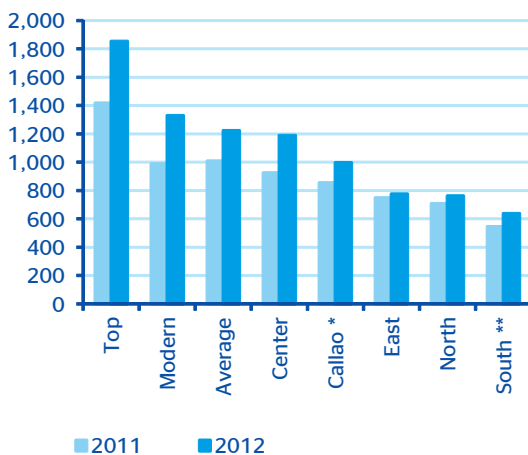
Regarding urban planning, in the recent years, there were controversies between Lima’s district and provincial authorities regarding the use that should be given (residential, industrial or agricultural) to certain land. In this sense, the recent Ordinance No. 1617, issued by the City Council of Lima, which states that the opinion of the district’s authorities is not binding, is a step in the right direction.

For large-scale real estate projects, the delay and discretion for the approval of Environmental Impact Studies (EIS) is an additional bureaucratic obstacle. According to Medina and Vera Tudela (2012), although the legally stipulated period for approving EIS is 120 working days, the procedure can last up to 10 months. Furthermore, there is a lack of transparency in the procedure for establishing the scope of the required information. Although there are three legal regulations for EIS, none of them clearly establishes the criteria to determine the type of study to be carried out.^{2,3}

Prices per square meter continued to rise, especially in traditional quarters of Lima

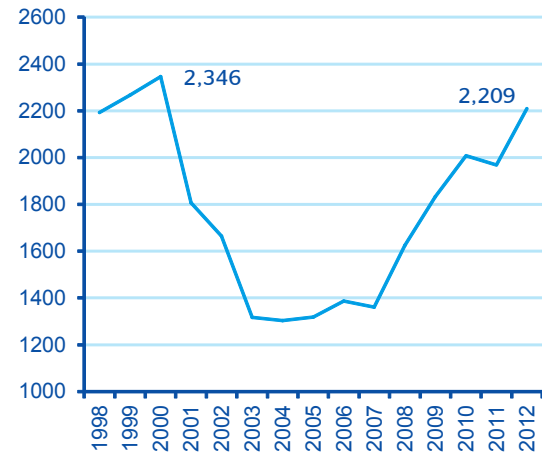
In 2012, the average price per square meter in Lima rose 21.2% (year-on-year in USD), higher than the increase of the previous year (4.4%, see Chart 5). This trend became more pronounced from the third quarter of 2011 onwards, after completing the election period and in a context of higher household income. In real terms (new soles adjusted for inflation), house prices rose 12.2%, and are still below the peak reached in 2000 (see Chart 6).

Chart 5
Lima: housing prices by zone (USD per square meter)



* Does not include the Ventanilla district.
** Does not include beaches.
Source: CAPECO and BBVA Research

Chart 6
Real house prices in Lima (Constant soles of 1998 per m2)



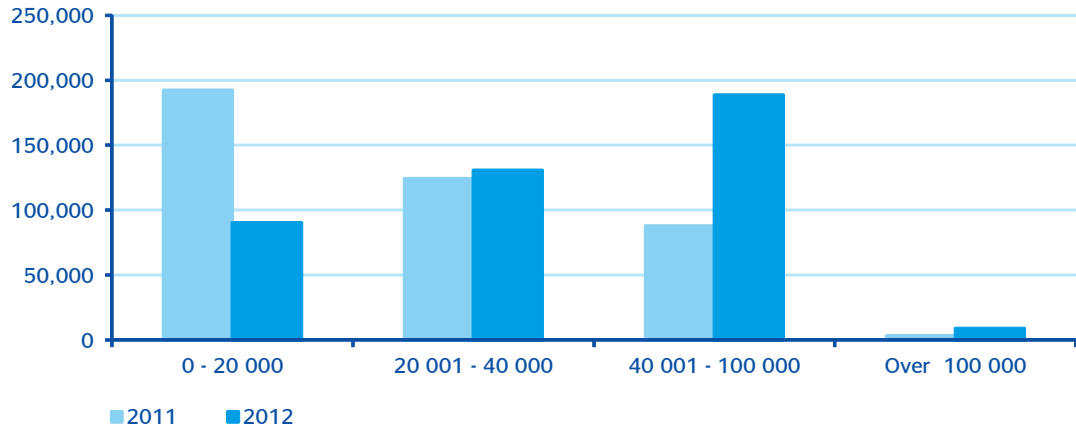
Source: CAPECO, BCRP and BBVA Research

The increase in prices has not been even across different areas in Lima. While the average increase in the Top, Modern and Center areas was around 30% in USD, average prices kept relatively stable in the East and North areas (see Chart 5).

This performance is in keeping with the trend of demand shifting towards higher value homes, and the expansion of the middle class witnessed in recent years. Thus, while demand for homes for less than USD 20 thousand fell to less than half between 2011 and 2012, demand for homes between USD 40 thousand and USD 100 thousand increased twofold. In higher-priced homes, demand nearly tripled; though the level is still relatively low (see Chart 7).

2: Medina, Andrés and Rafael Vera Tudela (2012), Certificación ambiental para la construcción: tareas pendientes. ("Environmental certification for construction: pending tasks"). In Moneda No. 151, October 2012
3: Three types of EIS may be required: the Environmental Impact Declaration, the Semi-detailed Environmental Impact Study and the Detailed Environmental Impact Study.

Chart 7
Effective demand for housing (number of homes)

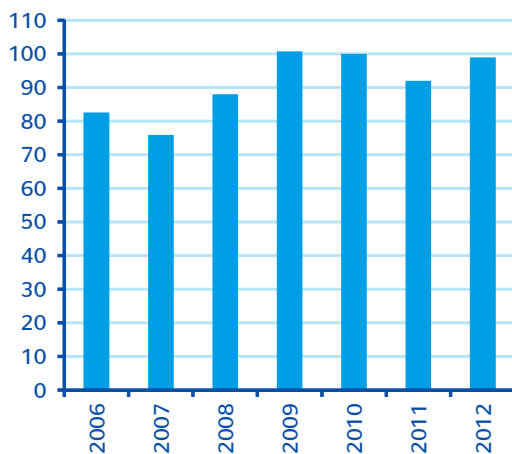


Source: CAPECO and BBVA Research

The price increase has not eroded the ability to access to housing but has affected the profitability of rent

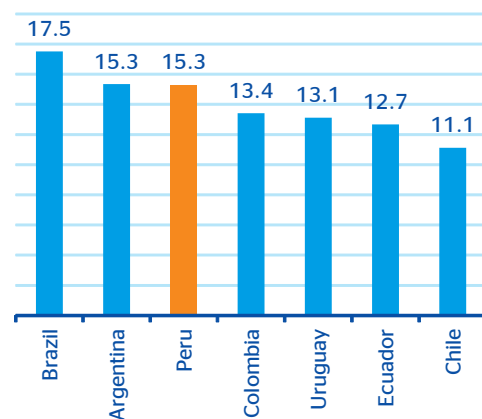
Despite the increased price per square meter, the accessibility index (home price / income) stands at a similar level to the figures registered between 2009 and 2010 (see Chart 8). However, this increase has prompted lower returns on home rental. This return is measured inversely by the PER ratio (sale price / annual rental), which increased from 13.3 in 3Q10 to 15.3 in 3Q12. This is tantamount to a fall in home rental from 7.5% to 6.5% per annum. This makes Peru one of the three countries in South America with the highest PER ratio, behind Brazil and Argentina (see Chart 9).

Chart 8
Accessibility index: price of a 100 meter² home / GDP per capita (Index 2010=100)



Source: CAPECO, BCRP, IMF and BBVA Research

Chart 9
PER: house price / rental income (years to recover investment)



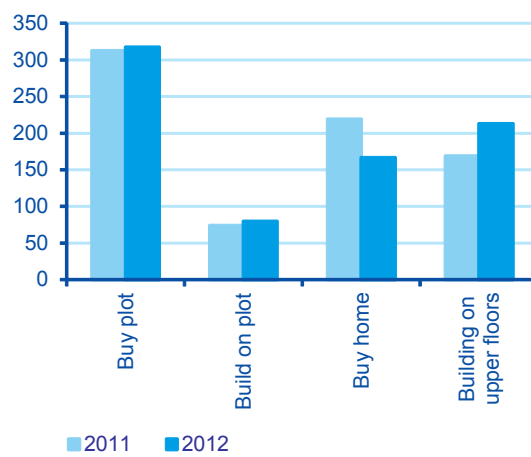
Source: BCRP, Global Property Guide and BBVA Research

We expect a moderation in the pace of price increase per square meter

There are several signs which point to a slower rate of increase in real estate prices in the coming months. First, new constructed units are taking longer to be placed, prompting a rise in the available stock for sale. Furthermore, the fall in rental return appears to be lowering housing demand for investment purposes, which could shift towards demand for offices (see Box 1). Moreover, interest in buying homes has dropped, from 219 thousand households in 2011 to 167 thousand households in 2012, due to a fact that there are more households (50 thousand) who plan to build their homes on their own (see Chart 10). Lastly, financial expenses of loans are expected to increase, in line with new laws (see next section).

Chart 10

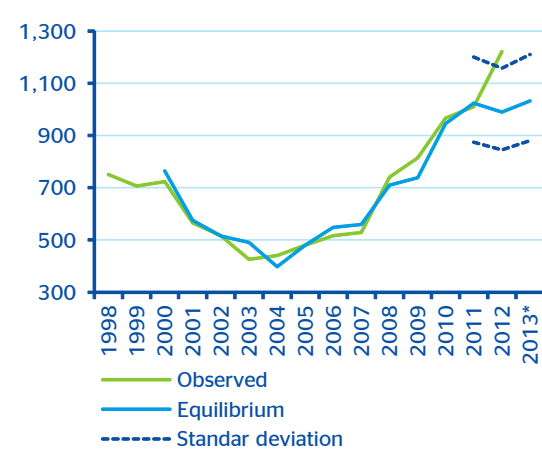
Interest in buying homes in Lima
(number of families)



Source: CAPECO

Chart 11

Housing prices in Lima (USD per square meter)



Source: CAPECO and BBVA Research

According to our estimates, the price per square meter in Lima would be slightly above its equilibrium level (see Chart 11)⁴, which could possibly trigger a slowdown in coming months. Thus, in the wealthiest areas of Lima, house prices in the third quarter of 2012 fell 4% in real terms⁵.

4: In this model, the factors which explain housing prices are real income, supply of homes and construction costs. For further details, see: http://serviciodeestudios.bbva.com/KETD/fbin/mult/120910_Peru_EW_Burbuja_tcm346-357358.pdf?ts=19122012

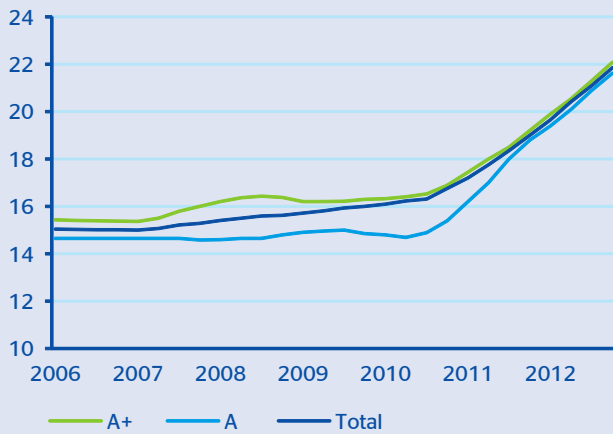
5: For further details, see the Studies Note No. 76-2012 of the Central Reserve Bank of Peru. This Note only includes statistics for the Top and Modern areas of Lima.

Box 1: Higher return in offices will encourage its geographic expansion

Rental prices in the prime office market continued to rise this year. They accumulated a growth of almost 40% since 2009, from USD 16 per m2 to around USD 22 per m2, according to data provided by real estate operator Colliers (see Chart 12)⁶. This performance reflects the dynamism in private investment and companies' growing preference

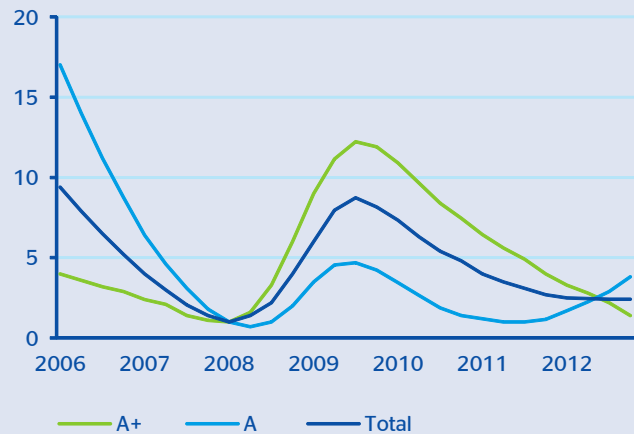
for higher quality spaces to conduct their operations. Consequently, most of the supply which has come on to the market has been quickly absorbed, bringing the vacancy rate for prime office space below 5% for the second successive year (see chart 13).

Chart 12
Rental prices in the prime office market (US\$)



Source: Araper and BCRP

Chart 13
Vacancy rate in the prime office market (%)



Source: Araper and BCRP

An interesting fact is that in this market the recovery period is significantly lower than in the market for homes. According to CAPECO figures, the sale price per m2 for offices currently stands at US\$ 2,194, bringing the PER rate to 8 years, almost half than the figure for homes. This is an incentive for growth in office supply to remain strong in the future.

Against this background, we expect that the scarcity of land in the traditional financial zone (San Isidro and Miraflores) will stimulate supply in other areas of Top and Modern Lima (Surco, San Borja and Lince, mainly). We also expect the average quality of new supply to improve, with more buildings with LEED type certifications (acronym for Leadership in Energy & Environmental Design) or "green" buildings, for example, seeking to increase the value of offices.

6: Equivalent to an increase of 9% in constant soles.

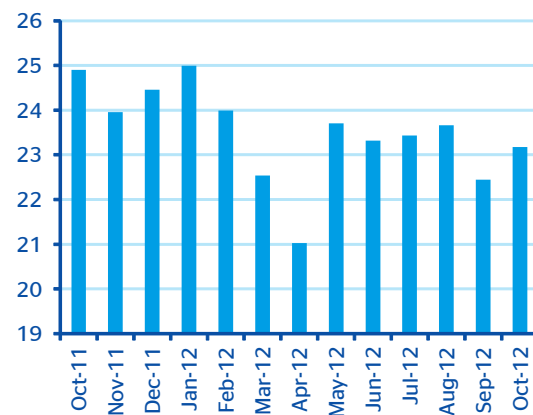
3. Mortgage lending kept a strong pace of expansion

Double-digit growth continued in mortgage lending

In recent months, growth of mortgage loans remained at around 23% (see chart 14), while the average amount granted increased from 136 thousand soles (USD 46 thousand) in September 2008 to 230 thousand soles (USD 85 thousand) in September 2012, in line with the evolution of housing prices⁷. As a result of the mortgage loans dynamics, their penetration continued to rise, going from 4.1% of GDP at the close of 2011 to 4.4% in October 2012 (3.2% in 2008).

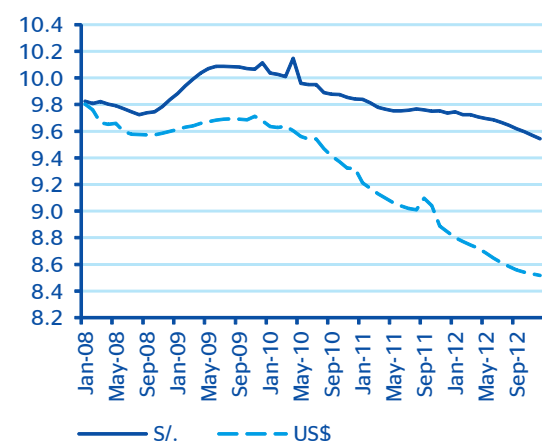
Growth in mortgage loans has been fuelled by the large effective housing demand and the fall in interest rates, particularly in foreign currency, which has gone from 9.3% at the end of 2010 to 8.5% in November 2012.

Chart 14
Growth of mortgage loans balance (%)



Source: SBS

Chart 15
Interest rate on mortgage loans
(%, for loans in soles and dollars)



Source:BCRP

Regarding the currency composition of mortgage loans, at end November, 48% was denominated in foreign currency (51% in December 2011, and around 70% at the end of 2008). As a result, the downward trend in mortgage loan dollarization continued, reducing credit foreign exchange risk. It should be noted that in 2012 the default ratio for mortgage loans kept between 0.8% and 0.9%.

On the financing of social housing, MiVivienda credit placement has remained relatively stable. At October 2012, it has been granted a monthly average of 900 credits, similar to the level achieved in the same period last year. The amount granted increased by 10% yoy, bringing the average amount per beneficiary to 100 thousand soles. This reflects that more and more people are accessing higher priced homes.

It should be pointed out that the maximum price of the homes that can be financed by this fund has recently increased by 40%, from S / . 182.500 to S / . 255.500. In 2013, the fund expects to place 17 thousand loans. Additionally, the placement of credits under the program *Techo Propio* will continue and the new *Mi Construcción* and *Mis Materiales* programs, targeting the self-construction sector, will also be promoted. A total of 40 thousand loans are expected to be granted through these programs.

7: See Financial Stability Report, November 2012, pp. 31, Central Reserve Bank of Peru.

Regulatory measures are expected to dampen the rapid growth in home loans

The dynamism that is exhibiting the property market continues to draw attention of policymakers. The concern comes from the rapid growth of mortgage loans, which could raise households' financial burdens, and the possibility that eventually the prices in the housing market may significantly misaligned from the level associated with fundamental factors. Authorities have acted by imposing macro prudential and preventive policy measures. The financial regulator (SBS) recently raised the capital requirement for credit risk. This measure would affect credits for consumption and mortgage loans in dollars, and credits with longer terms. In the particular case of mortgage loans, the capital requirement should be greater when the loan-to-value ratio (LTV) is higher, the residual maturity is longer, the loan has been denominated in foreign currency, or it is not used for first-home buying. These measures will enter into force at the start of 2013.

Furthermore, the Central Bank has raised reserves requirements (in domestic and foreign currency) during the year, in an attempt to slow down the pace of growth in lending. These policy measures are expected to dampen the speed of growth in lending and are in line with the more moderate increase of housing prices expected for 2013.

DISCLAIMER

This document and the information, opinions, estimates and recommendations expressed herein, have been prepared by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA") to provide its customers with general information regarding the date of issue of the report and are subject to changes without prior notice. BBVA is not liable for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, or to undertake or divest investments. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. The contents of this document is based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. BBVA accepts no liability of any type for any direct or indirect losses arising from the use of the document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, options and securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances, investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying stocks. Investors should also be aware that secondary markets for the said instruments may be limited or even not exist.

BBVA or any of its affiliates, as well as their respective executives and employees, may have a position in any of the securities or instruments referred to, directly or indirectly, in this document, or in any other related thereto; they may trade for their own account or for third-party account in those securities, provide consulting or other services to the issuer of the aforementioned securities or instruments or to companies related thereto or to their shareholders, executives or employees, or may have interests or perform transactions in those securities or instruments or related investments before or after the publication of this report, to the extent permitted by the applicable law.

BBVA or any of its affiliates' salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") Of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons. The remuneration system concerning the analyst/s author/s of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

BBVA is not a member of the FINRA and is not subject to the rules of disclosure affecting such members.

"BBVA is subject to the BBVA Group Code of Conduct for Security Market Operations which, among other regulations, includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. The BBVA Group Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance".

BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.

This report has been produced by the Peru Unit:

Chief Economist for Peru

JHugo Perea
+51 1 2112042
hperea@bbva.com

Francisco Grippa
+51 1 2111035
fgrippa@bbva.com

Daniel Barco
+51 2111548
daniel.barco@bbva.com

Isaac Foinquinos
+51 1 2111649
ifoinquinos@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia*Emerging Markets:*

Alicia García-Herrero
alicia.garcia-herrero@bbva.com.hk

Cross-Country Emerging Markets Analysis

Álvaro Ortiz Vidal-Abarca
alvaro.ortiz@bbva.com

Asia

Stephen Schwartz
stephen.schwartz@bbva.com.hk

Latam Coordination

Juan Ruiz
juan.ruiz@bbva.com

Argentina

Gloria Sorensen
gsorensen@bbva.com

Chile

Alejandro Puente
apuente@bbva.com

Colombia

Juana Téllez
juana.tellez@bbva.com

Peru

Hugo Perea
hperea@grupobbva.com.pe

Venezuela

Oswaldo López
oswaldo_lopez@provincial.com

Mexico

Carlos Serrano
carlos.serranoh@bbva.com

Macroeconomic Analysis Mexico

Carlos Serrano
carlos.serranoh@bbva.com

Developed Economies:

Rafael Doménech
r.domenech@bbva.com

Spain

Miguel Cardoso
miguel.cardoso@bbva.com

Europe

Miguel Jiménez
mjimenezg@bbva.com

United States

Nathaniel Karp
nathaniel.karp@bbvacompass.com

Financial Systems & Regulation:

Santiago Fernández de Lis
sfernandezdelis@bbva.com

Financial Systems

Ana Rubio
arubio@bbva.com

Pensions

David Tuesta
david.tuesta@bbva.com

Regulation and Public Policy

María Abascal
maria.abascal@bbva.com

Global Areas:

Economic Scenarios

Julián Cubero
juan.cubero@bbva.com

Financial Scenarios

Sonsoles Castillo
s.castillo@bbva.com

Innovation & Processes

Clara Barrabés
clara.barrabes@bbva.com

Market & Client Strategy:

Antonio Pulido
ant.pulido@grupobbva.com

Equity Global

Ana Munera
ana.munera@grupobbva.com

Global Credit

Javier Serna
Javier.Serna@bbvauk.com

Global Interest Rates, FX
and Commodities

Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Contact details:

BBVA Research Latam
Pedro de Valdivia 100
Providencia
97120 Santiago de Chile
Tel: + 56 26791000
E-mail: bbvaresearch@bbva.com