BBVA Research

Chile

Real Estate Outlook

July 2010

Economic Analysis

- Following a dramatic contraction in 2009, the construction sector will again enter a cycle of rapid growth during 2010. The aftermath of the earthquake will entail a quicker recovery pace in the area of infrastructure than in the area of residential and business construction.
- The earthquake on February 27 thaffected the activity of the housing market, as much in delaying the recovery of sales as in that it changed the market share of houses versus apartments. This will lead to a slight contraction of sales during 2010 compared to 2009, although a recovery is expected in the second half of the year, culminating in a new growth cycle to begin in 2011.
- The earthquake also changed the priorities of the public sector in terms of housing, with emphasis being put on emergency solutions during the first half of the year. The normalization of the habitual subsidy programs is expected in the second half.
- Two factors that should boost recovery in construction are the maintenance of current favorable financing conditions (given that banks should prioritize the maintenance of their presence in the market) and the update and strengthening of the concessions system.
- The main risks associated with the real estate market would originate from the possible lateness or lack of definition of public policies with regard to subsidies and the norms affecting building construction.

Index

Closing date: 25 June 2010

1. Residential real estate market slow to recover after earthquake

When the financial crisis reached its apogee at the beginning of last year, home sales forecasts were quite pessimistic. Still, a number of factors determined that 2009 would end up showing 14% growth over 2008. On the private side, companies prepared for the plunge, initiating an aggressive promotion campaign. As for the public sector, the government intensified its policy of subsidies for home buyers, and the Central Bank applied an expansionary monetary policy that facilitated access to credit, especially toward the end of the year.

The earthquake of February 27th suddenly interrupted this recovery, and significantly changed the dynamics of various aspects of the market.

Total sales fell 50% in March, causing growth in the first quarter, compared its equivalent in 2009, to drop to 11.5%. Secondly, the distribution of sales between houses and apartments was dramatically changed, given that as a result of the greater damage to apartments, especially those in elevated positions, 25% less apartments were sold than a year earlier, which was in part compensated by increased sales of houses, which grew 12.5%. It is important to note, in any case, that the stock of homes in terms of the number of new homes for sale dropped 4.6% between December 2009 and March 2010. On the other hand, these figures should be seen from the perspective that a high number of used homes were destroyed by the earthquake and there will be a greater number of potential buyers for this type of home.

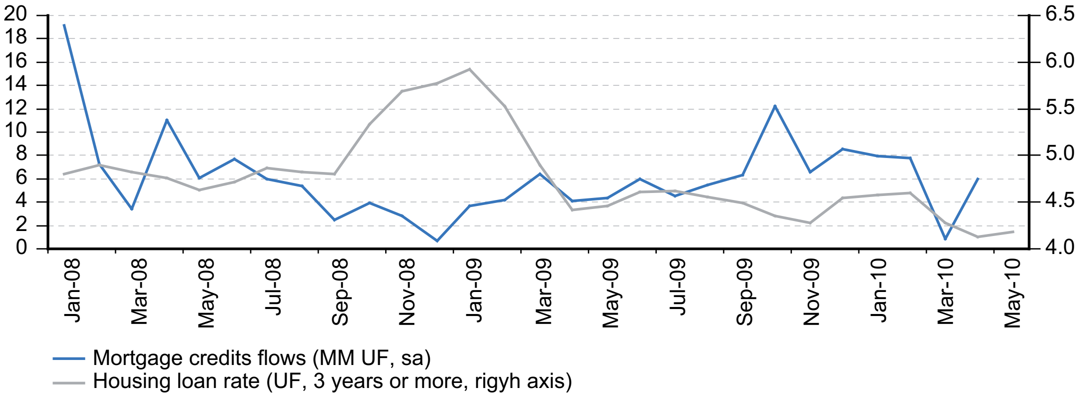
With regard to change in the home buying pattern, it is foreseen that current trends should continue for some time. After the previous earthquake to affect Chile (1985), the return to buying patterns took about three quarters. However, due to the magnitude of the catastrophe on February 27th we estimate that in this case the market will not regain its normal level of activity before a year. On the one hand, the great media coverage of certain particular cases of structural defects in buildings and the resulting conflicts between the parties must lead to a greater request for information and analysis on the buyers' part. On the other hand, the debate with regard to revising construction regulation has generated a defensive attitude within companies, with the latter possibly encountering difficulties to sell their homes if they start projects before other firms that choose to wait, or cost problems if they try to anticipate stricter construction standards.

For their part financial conditions began to normalize in the second half of 2009. This improvement in general conditions was reflected in the Enquiry on the State of Credit by the Central Bank and in the lowering of rates offered for mortgage credits in the various repayment period scenarios. As we can see in chart 1, mortgage indexed rate has decreased steadily while credit lines have been recovering from the minimum reached at the start of 2009.

The primary consequence of the earthquake on February 27th was that decisions on the purchase of a home were postponed. This reduced credits and negatively impacted the start of programs to offer more attractive conditions for home seekers who could have access to credits. Still, as can be seen in chart 1, this impact seems to have been temporary given that following their dramatic fall in March, credits quickly recovered between April and May.

Chart 1 also shows that, in spite of the fact that the uncertainty generated by the catastrophe could have increased risk premiums, interest rates for mortgage credits not only were maintained but decreased at the margin.

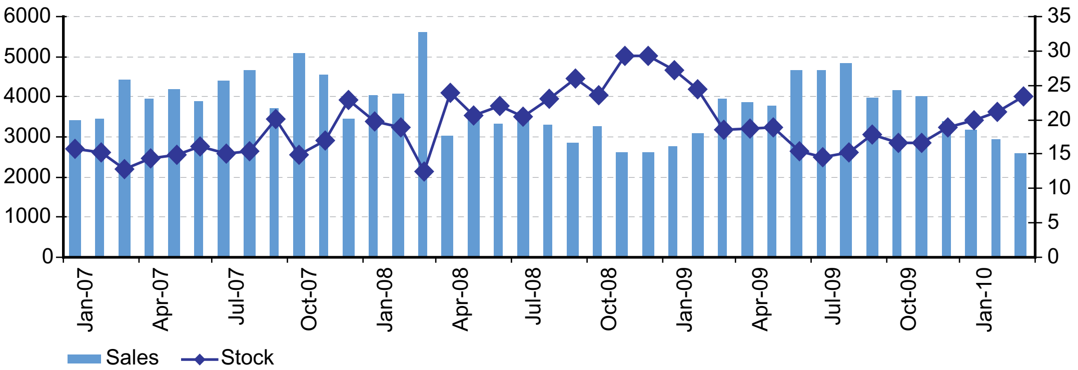
Chart 1
Housing rates and mortage flows, in UF



Soruce: BCCh, SBIF and BBVA Research

Although some of the factors that have determined this positive evolution of mortgage lending have begun to change, we believe that the situation will continue to evolve favorably. One of these is the monetary policy rate which increased to 1% in June and should reach 3% at year's end, to end up at a neutral level (between 5.5% and 6%) around the third quarter of 2011. As a consequence of this normalization and an increase in the issuance of public and private securities, we expect increases in the rates of the main securities that serve as underlying assets for mortgage credits, the Central Bank's 10-year indexed bonds (BCU-10). In spite of this tendency however, we believe that mortgage rates will continue to be low in the rest of the year due to reductions in the financial margins in the mortgage market. This is due to the high level of competition confronting the sector, given a low availability of real estate projects and the financial gap for the banking sector, leading financial institutions to prioritize their continued participation in the market. The government's recent decision to maintain the stamp duty at 0.6% also will contribute to keeping credit costs low.

Chart 2
National total of home sales and stock (number of houses and stocks in months)



Source: Minvu, CChC and BBVA Research

On the other hand, the cost of fire insurance with earthquake coverage seems to have increased 40% after the earthquake due to the raised premiums of international reinsurance policies. The effect of this factor would be equivalent to a rate increase of approximately 0.1%.

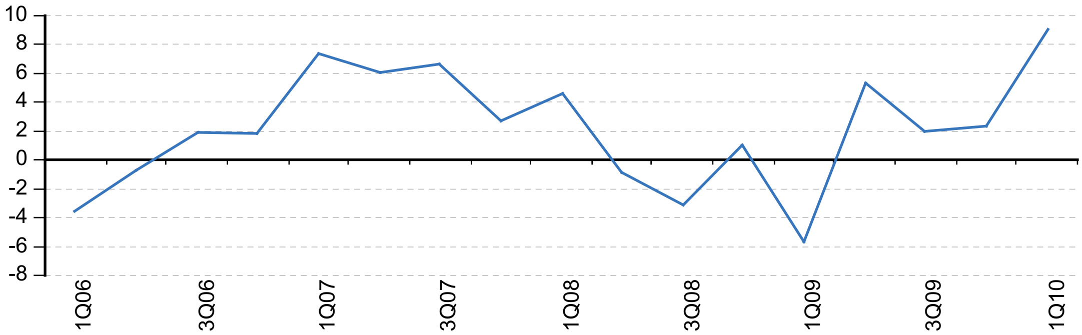
Another one of the variables that has been strongly impacted by the earthquake is the cost of home construction. According to The Chilean Chamber of Construction, the Construction Costs Index (ICE) rose due to the strong demand in materials and remunerations, which increased from 4.8% year-on-year and 7.7% year-on-year in March[1], which should increase with the intensifying of reconstruction activity during the second half of the year. With regard to remunerations, the increase in employment also resulting from reconstruction after the earthquake (5.7% annually) will create additional upward pressures, although moderate ones, given that the unemployment rate is maintained at levels relatively high (12.1% in the mobile quarter February-April).

1: Supplies will average 53.7%, remunerations 39.3%, and miscellaneous spending 3.4% at the ICE

As for the evolution of demand factors, expectations about the future is probably the most relevant point considered in the decision to buy a home. Therefore, although some indicators, such as the retail sales or employment have been progressing positively, consumer confidence has deteriorated in the last three months and as of May continues to be low (47.2 points). However, the boost of the economic activity expected for the second half of the year and a reduction in the unemployment rate should favor a return to an optimistic playing field in terms of consumer confidence. On the other hand, one of the most important factors in the decision to buy a home is the installment, a factor even more important than the price of the home. Consequently the expectation that mortgage credits will remain low over the next months will favor a strengthening of demand during the second semester and toward 2011. With all this in mind, we expect a slight fall in home sales for 2010.

Chart 3

Average price of housing in the RM of Santiago (var. % y/y)



Source: Minvu, CChC and BBVA Research

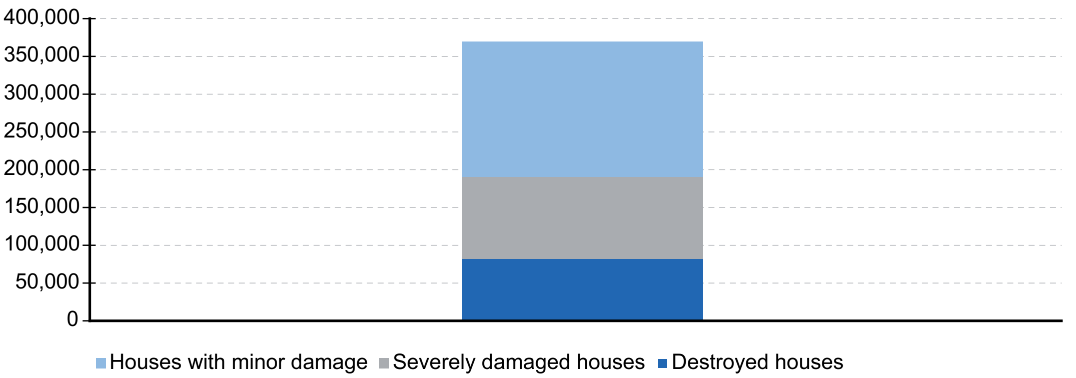
In the medium to long term, trends in income and demographic factors will be favorable to the maintaining and expansion of the residential mortgage market. On one hand, it is predicted that the production potential will grow from 2012 and, on the other, demographic tendencies concerning smaller families should compensate the low population growth rate.

2. Social housing and infrastructure

The public sector budget for 2010 included an increase on the previous year of 24.5% in real terms of the funds attributed to the Ministry of Housing and Urban Development (MINVU), amounting to US$2.023 billion. It is stipulated that 65% of the total is destined to housing programs and 29% to urban development programs and home repairs. It should be noted that the government pays the subsidies once the works are finished, not when they are contracted, so that only a small portion of the subsidies awarded in one year are paid in the same year.

Chart 4

Houses Affected by the Earthquake



Source: MINVU

According to estimates by the government, the earthquake would have left some 81,444 homes destroyed, 108,914 with major damage, and 179,693 with minor damage, all of which amounts to 10.6% of the total of existing homes in the affected regions. This implies an increase of 45.9% in the housing deficit, which now affects 544,000 new homes and 630,000 needing repairs. The state will give subsidies for the construction of a new home to families whose home was severely damaged and who are not owners of a second home. Subsidies will also be granted to repair damage, under the protection of family wealth program, when the property can be brought back to habitable conditions.

It is hoped that 195,950 families will be able to benefit from the reconstruction program in the period from 2010 to 2011, with an estimated US$2.465 billion requirement. To date, some US$1.130 billion have been earmarked for attribution in 2010. Nineteen percent of this amount will be destined to the acquisition of built homes, 13% to the repair program, and the remaining 68% to the construction of new projects. The government has expressed its intention to continue with the habitual housing programs, however, in the context of the fiscal adjustment after the earthquake, the number of subsidies under the previous program was reduced to 28.8%. In all, the total number of subsidies to be assigned in 2010 has increased by 218% with respect to 2009.

The housing reconstruction program plans for a recovery phase from the emergency situation followed by a phase for the delivery of permanent homes to families having lost theirs. As one can expect, during the first months of the year, the MINVU has been focused on the emergency, providing temporary roofs for those left homeless. This could explain the important delay in the programs planned for this year. As of April 30th, only 16.3% of the subsidies of the regular program had been selected, while at the same date the previous year, this figure was 69%; in addition, in the reconstruction program only 0.3% of the subsidies have been assigned. Therefore we should expect a strong boost in the second semester of 2010.

Table 1

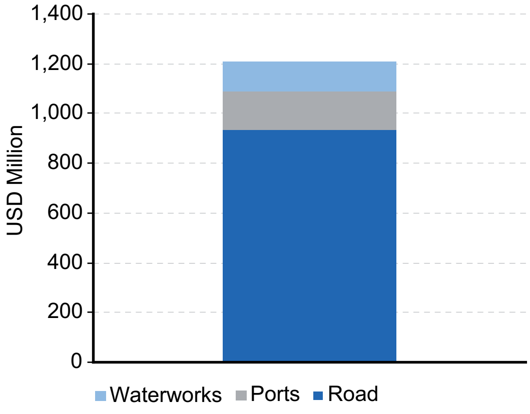
Special Call for Reconstruction

Program	Total Assigned Amount	Subsidy: Average Amount*
Construction Projects	USD Million	USD
DS N°40	104	6,559
Solidarity Fund for Housing chapter I	352	15,622
Solidarity Fund for Housing chapter II	44	13,038
Heritage Family Program	148	2,385
Solidarity Fund I and II. Construction in own land.	264	2,783
Purchase of Built Houses		
Solidarity Fund for Housing chapter I	132	13,634
Solidarity Fund for Housing chapter II	88	11,051

* Estimation based on the legislation, the 2007-2009 average, additional subsidy for saving replacement
Source: BBVA Research

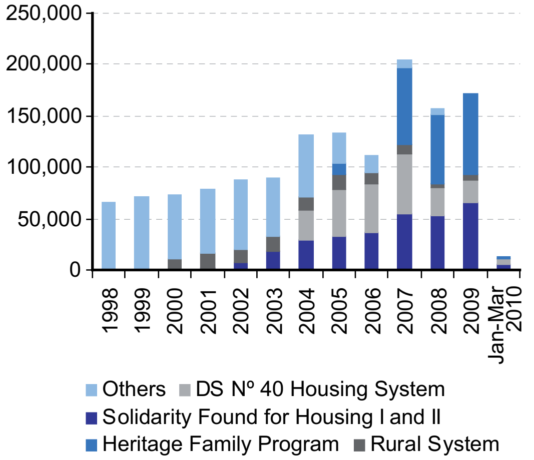
As regards infrastructure construction, the new government has indicated that it will provide new assistance to investment by the sector. During the coming four years, projects will be launched worth US$14 billion, of which US$8 billion will be in contracts to private companies. The announcement would seem to indicate a redirection of public policy after the reduction of the budget to US$29.4 million and the possible postponement of key projects such as the extension of the Santiago underground. However, public works capacity could prevent the totality of these projects to become reality. This is even clearer considering that the public post-earthquake infrastructure reconstruction plan calls for an investment of US$1.227 billion during the coming four years, of which we estimate that 23% will be executed during 2010, amounting to US$279 million.

Chart 5
Reconstruction Program by Area



Source: MOP

Chart 6
Subsidios Otorgados (número)



Source: MINVU

Apart from this, investments of US$ 3.300 billion will be required to replace the social infrastructure destroyed by the earthquake, of which approximately US$2.200 billion will be for construction. The government has indicated its intention to contract out some of this investment, and recently with the new law and regulation on concessions the operation began of the Concessions Council, which will be formed by the Public Works Minister and five council members named by the former. The body will be of a consultative nature and it will be charged with providing information on the type of infrastructure to be built, of the projects and rules of the concessionary process, and of the social evaluation approved by the competent planning committee.

On the other hand, the Chilean Chamber of Construction estimates an increase of 10% in investment in productive infrastructure during 2010, and of 52% in 2011. The expansion would be spearheaded by the mining sector, which it is believed will undertake construction projects worth US$14.136 billion over the next four years, followed by the energy sector, set to spend US$8.367 billion over the same period. Both sectors would account for 78% of spending on the construction of productive infrastructure for the period from 2010 to 2013.

3. The office property market recovers in 2010 and the prospects for commercial projects improve for 2011

In Chile, investment in productive infrastructure construction is mainly targeted at four sectors: mining, energy, industrial forestry, and non-residential building construction. Of the total number of productive infrastructure projects that are now being built, the mining sector is responsible for 26%, the energy sector 40%, the industrial forestry sector 13%, and the non-residential building sector 12%.

Investment in offices represents a subsector within the non-residential real estate sector, where other sub-sectors are also found such as architecture, commerce, education, offices, health, and tourism[2]. It should be mentioned that investments in non-residential building are concentrated mainly in the metropolitan region, where 71% of the estimated construction for the five-year period will take place. For this reason, it is important to mention that the effects of the earthquake have not had a relevant impact on forecasts for non-residential construction–in particular on the offices and commercial premises market, mainly because in the metropolitan region impacts of the earthquake on the the non-residential real estate market were moderate and mainly took place in the business district of the town of Huechuraba.

2: The perspectives of the subsectors of education and health depend to a great extent to public sector investment in infrastructure, analyzed in another section of this report. Here we shall focus mainly on the perspectives of the real estate market, of offices and commerce, subsectors that depend more on the economic activity cycles.

As per the information published by the Chilean Chamber of Construction (CChC) in its May 2010 report, estimated spending in the construction of non-residential facilities for 2010 is US$680 million (10% less than last year), within which the activity derived from infrastructure for offices will account for construction costs of approximately US$255 million, 17% more than in 2009. In turn, it is expected that the commerce subsector will spend US$230 millon, 12% less than last year, while the tourism subsector should spend US$147 million, representing 35% less than in 2009.

The real estate market in general, and that for offices in particular, is highly linked to the parallel progress of the economy. An important portion of office buildings delivered during 2009 and others to be delivered this year began to be constructed before the last financial crisis, so that the future of the subsector is uncertain and depends in large part on the the construction calendar of projects whose construction has already begun. Although for 2010 a strong recovery of economic activity is expected, it is known that the latter impacts the activity of the construction sector in a delayed manner, a factor that, combined with the current inertia in the offices market, provokes relative uncertainty as to prospects for this market. According to the interpretation of the Chilean Chamber of Construction, the reduced dynamism of the non-residential real estate sector will rebound in 2011 through the development of projects for commerce, spearheaded by Cencosud and its mega-project Costanera Center (see table 2).

Table 2

Non-residential Construction Infrastructure: Main Projects for 2010 (Millions of Dollars)

Construcción

Company	Project	Region	Estimated Investment	Beginning	End	2010	2011
Manso de Velasco Real Estate	Pudahuel Business and Airport Center (Enea)	RM	1885	May-98	Dec-20	90	96
Cencosud S.A.	Costanera Center Mega-project	RM	700	Jan-04	Jun-12	65	214
La Cruz del Molino Real Estate	Puerta del Mar	IV	700	Jan-02	Dec-15	60	66
Gestora de Patrimonio S.A.	Business Center	RM	800	Oct-95	Mar-15	57	47
Rantrur S.A. (Grupo Enjoy Chile)	El Reino de Los Andes (Casino Rinconada)	V	130	Mar-08	Dec-10	44	0
Titanium Real Estate	Titanium Park Santa Rosa de Las Condes	RM	300	Dec-09	Dec-12	40	86
Cencosud S.A.	Portal Ñuñoa	RM	40	Oct-09	Oct-10	28	0

Source: MACh 29, Chilean Chamber of Construction

The earthquake will have different effects over the various subsectors of the construction sector. The uncertainty cause by the disaster has resulted in a delay in the recovery pace of the office and residential segments. On the other hand, a strong boost is forecast in the construction of productive and social infrastructure. In net terms, including in the first quarter of the year, the construction sector grew 0.7%, and with the activity forecast for the coming quarters, growth hovering around 9% is expected for 2010.

4. Risks for the sector

The most relevant risks anticipated in the construction sector have to do with policies and decisions of the public sector. On the one hand, the notion is widespread that the delay in the progress of the subsidies program has been due to the fact that the priority has been providing emergency relief, and to the most affected regions, at the expense of the habitual programs, and the rest of the country. For this reason, a strong recovery both in the reconstruction of destroyed infrastructure and in the support policy for the residential sector are expected, in particular the normalizing of subsidy granting. Likewise, it is very important to move forward in the area of the definition of technical regulations that are currently being revised as a result of the defects found in some buildings. Delays in these areas can have negative effects on confidence, as occurred with that of the entrepreneurs of the sector over the last months, the only segment covered in the enquiry on Business Expectations (published by the University of Development) that has remained in pessimistic terrain.

There are also some risks associated with a deterioration of the international financial situation and a return to a restrictions on credit. Still, the progress of the sector in 2009 is a good indication of its resilience before adverse external conditions. One example is the Central Bank's Report on Financial Stability published in June, where there is a report on a stress test to which the Chilean banking system is submitted, assuming similar conditions to those observed last year, with results clearly positive in terms of solvency, liquidity, and in general with regard to its capacity to continue to exercise adequately its function of financial mediation, in an adverse international environment.

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.

This document is provided in the United Kingdom solely to those persons to whom it may be addressed according to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 and it is not to be directly or indirectly delivered to or distributed among any other type of persons or entities. In particular, this document is only aimed at and can be delivered to the following persons or entities (i) those outside the United Kingdom (ii) those with expertise regarding investments as mentioned under Section 19(5) of Order 2001, (iii) high net worth entities and any other person or entity under Section 49(1) of Order 2001 to whom the contents hereof can be legally revealed.

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 and the rest of entities in the BBVA Group which are not members of the New York Stock Exchange or the National Association of Securities Dealers, Inc., are 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”.

This report has been drawn up by the Chile Unit:

South America Chief Economist
Joaquín Vial
jvial@bbvaprovida.cl

Chile Chief Economist
Alejandro Puente
apuente@grupobbva.cl

Nathan Pincheira
npincheira@bbva.cl

Soledad Hormazábal
shormazabal@grupobbva.cl

Andrés Muñoz
amunozo@bbva.cl

BBVA Research

Group Chief Economist
José Luis Escrivá

Chief Economists & Chief Strategists:

Regulatory Affairs, Financial and Economic Scenarios:
Mayte Ledo
teresa.ledo@grupobbva.com

Financial Scenarios
Daniel Navia
daniel.navia@grupobbva.com

Financial Systems
Ana Rubio
arubiog@grupobbva.com

Regulatory Affairs

Economic Scenarios

Market & Client Strategy:
Antonio Pulido
ant.pulido@grupobbva.com

Equity and Credit
Ana Munera
ana.munera@grupobbva.com

Interest Rates, Currencies and Commodities
Luis Enrique Rodríguez
luisen.rodriguez@grupobbva.com

Asset Management
Henrik Lumholdt
henrik.lumholdt@grupobbva.com

Spain and Europe:
Rafael Doménech
r.domenech@grupobbva.com

Spain
Miguel Cardoso
miguel.cardoso@grupobbva.com

Europe
Miguel Jiménez
mjimenezg@grupobbva.com

United States and Mexico:
Jorge Sicilia
j.sicilia@bbva.bancomer.com

United States
Nathaniel Karp
nathaniel.karp@grupobbva.com.com

Mexico
Adolfo Albo
a.albo@bbva.bancomer.com

Macro Analysis Mexico
Julián Cubero
juan.cubero@bbva.bancomer.com

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

Cross-Country *Emerging Markets* Analysis
Sonsoles Castillo
s.castillo@grupobbva.com

Pensions
David Tuesta
david.tuesta@grupobbva.com

Asia
Stephen Schwartz
stephen.schwartz@bbva.com.hk

South America
Joaquín Vial
jvial@bbvaprovida.cl

Argentina
Gloria Sorensen
gsorensen@bancofrances.com.ar

Chile
Alejandro Puente
apuente@grupobbva.cl

Colombia
Juana Téllez
juana.tellez@bbva.com.co

Peru
Hugo Perea
hperea@grupobbva.com.pe

Venezuela
Oswaldo López
oswaldo_lopez@provincial.com

Contact details

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