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OBSERVATORIO VASCO DE LA VIVIENDA

The Construction Sector in the Autonomous Community of the Basque Country (CAE): Evolution 2008-2016

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1. Evolution of the construction sector 2008-2016

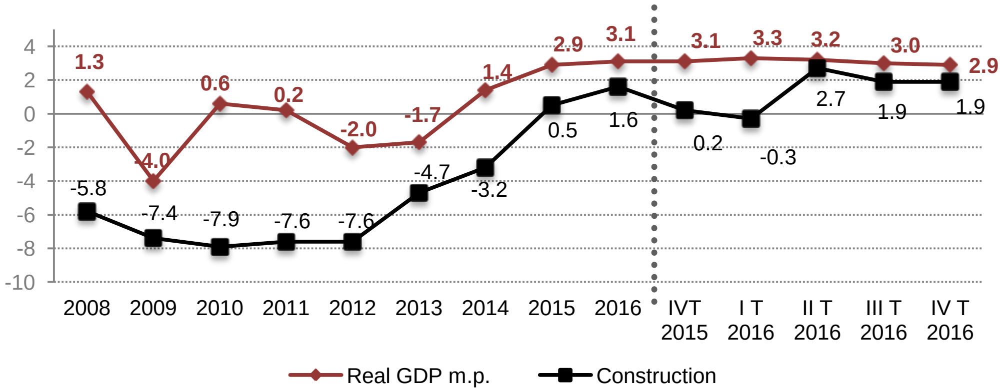
In 2016, the recovery of the sector's activity, which began in 2015, is consolidated and intensified

The added value of the construction sector in 2016 has increased by 1.6%, representing a significant increase compared to the 0.5% registered in 2015. The evolution of the sector's production throughout 2016 has been irregular. In the first and second quarters of 2016 it barely increased, however, from the third quarter the sector's growth rate showed considerable strength (+2.7%).

Despite the positive evolution of this sector in 2016, the performance of the Basque economy as a whole continues to be more dynamic compared to the performance observed in the construction sector.

Therefore, despite the improvement in activity, the trend towards the sector's loss of relative weight in the Basque economy continues, although at a considerably lower rate than observed in previous years.

Comparative evolution of real GDP at market prices of the CAE and of the added value of the construction sector 2008-2016. (Year-on-year variation rates)

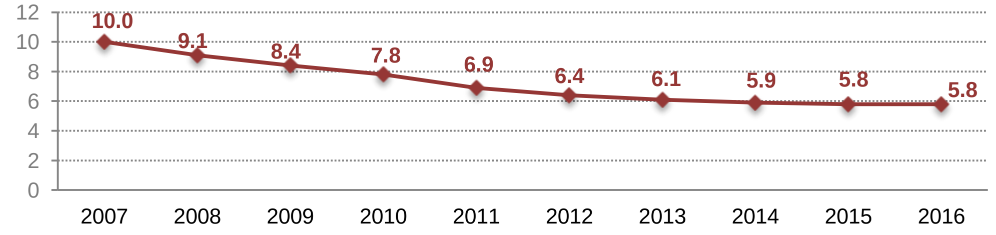


Source: Eustat

In any case, the crisis continues to have a very considerable impact on the sector compared to levels of production prior to the crisis. **The added value generated in 2016 is still 61.5% of the production in 2007.**

Thus, in 2016 the sector's production represents 5.8% of the Basque economy, a much lower ratio than that reached at the beginning of the crisis; in 2007 it reached 10%.

Evolution of the relative weight of the construction sector's added value compared to the Basque economy as a whole 2008-2016. (Year-on-year rates of change 2007-2016)



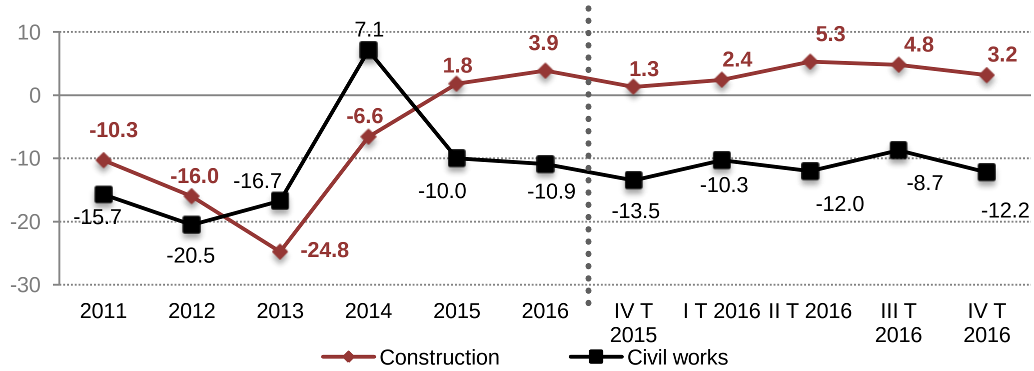
Source: Eustat

Activity linked to construction is driving the sector in this recovery process, compared to the more negative behaviour observed in the activity linked to civil works.

Another of the sector benchmarks, the Eustat Construction Sector Index, confirms the **positive trend in construction activity throughout 2016 with a growth of 3.9%**, which is proof of a stronger rate of progress than observed in 2015 (+1.8%).

On the other hand, the **activity associated with civil works continues to show a negative trend in 2016 (-10.9%,** similar to 2015 (-10%), and, therefore, a similar recovery process to the one observed in the case of construction is not being produced.

Construction Sector Index in the CAE. (Year-on-year rates of change)



Source: Eustat

2. Sector activity regarding housing construction

2.1.- Evolution of building permits in the CAE

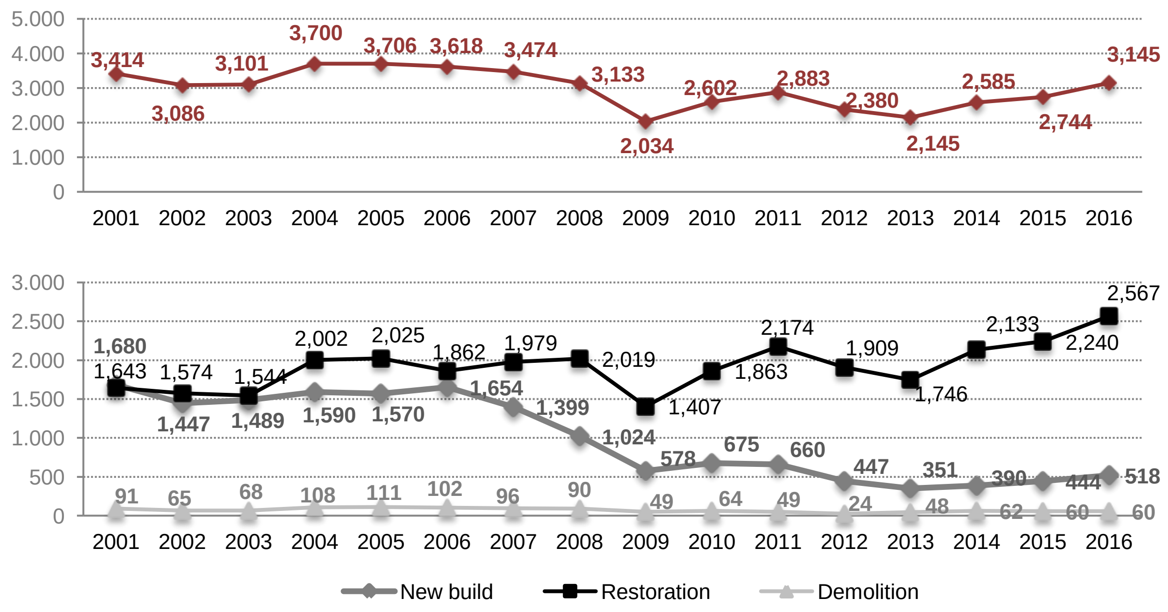
In 2016, the number of building permits increased significantly, both in the case of new builds and restorations, an indicator that it is reaching record highs.

The Basque Government Building and Housing Survey confirms **the consolidation of the improvement in the sector's activity detected since 2014.**

In 2016, 3,145 building permits were registered in the CAE, 14.6% more than in 2015, representing a significant improvement in the growth rate observed in 2015 (+6.3%).

This positive trend is particularly consistent, as it occurs both in the building permits for new builds (+16.6%) and in the case of restoration permits (+14.5%). Likewise, in both cases the rates of increase observed in 2015 were exceeded, reaching +13.8% and +5%, respectively.

Evolution of large-scale building permits accorc



Source: EDYVI. Basque Government

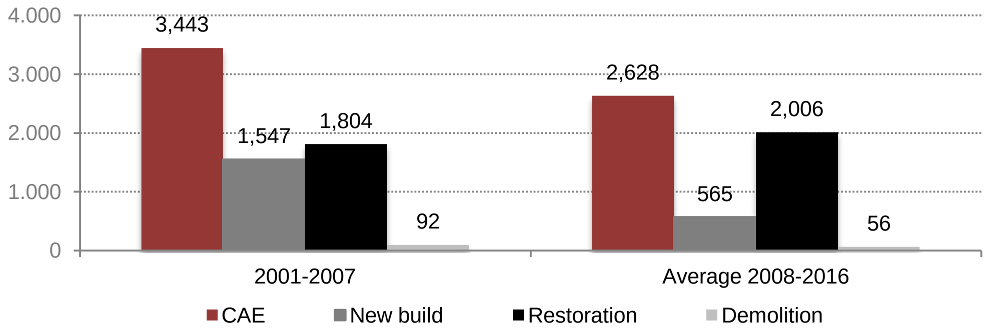
For the first time, since the EDYVI was been developed, **the number of restoration permits exceeds 2,500, reaching a record high**.

On the other hand, despite the improvement observed in 2016, **the 518 new building permits represent just one third (31.3%) of the record high reached in 2006** (1,654 permits).

The average number of **building permits for new builds** registered between 2008 and 2016 highlights the **considerable impact of the recession in terms of the drop in sector activity** for sector companies, with 565 permits/year, just one third of the 1,547 permits counted from 2001-2007.

In contrast, in the **2008- 2016 period the average number of restoration permits is 7% higher than that registered in 2001-2007**, from 1,804 permits in 2001-2007 to 2,006 permits in 2008-2016.

Average number of annual building permits according to type of work in the CAE 2001-2007 vs. 2008-2016



Source: EDYVY. Basque Government Department of Employment and Social Policies

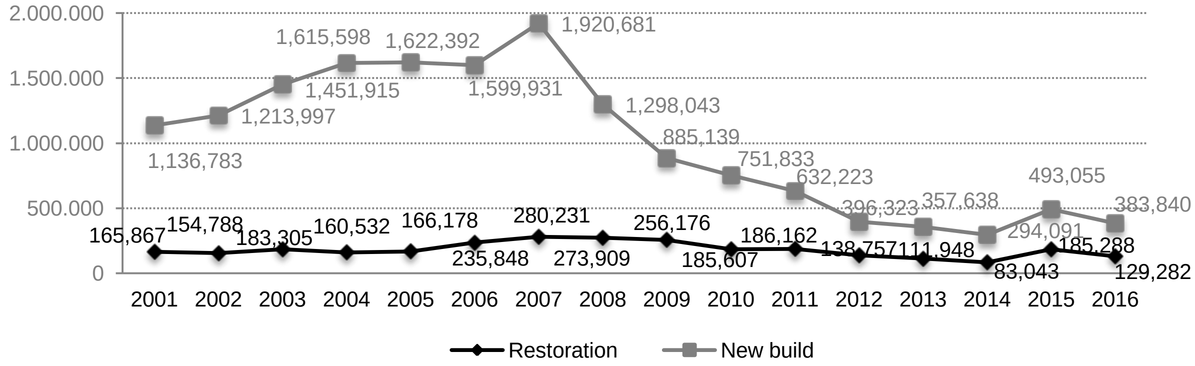
However, the **improvement in activity in terms of the number of permits in 2016 does not appear to have generated a similar economic impact in terms of budget** and economic activity for sector companies.

Thus, in 2016 the physical construction budget associated with building permits for new builds came to €383 million and the budget related to restoration works came to €129 million, representing a decrease of 30% and 22%, respectively, compared to 2015.

Therefore, it can be concluded that the increase in number of permits observed in 2016 is associated with a type of building work of a significantly smaller size and average budget.

Along these lines, **the economic activity generated in 2016 is still notably lower than the levels reached in the years immediately prior to the beginning of the recession**, when annual amounts exceeding €1.5 billion were reached.

Evolution of the physical construction budget in worksite management permits in the CAE (thousands of €). 2001-2016



Source: Ministry of Development

2.2.- New-build free-market housing market

In 2016 the number of new home purchases in the CAE increased by 5.5% to 2,495 transactions, the highest level since 2012

The information provided by the Ministry of Development's Property Transaction Statistics **confirms the greater dynamism of new-build free-market housing in the CAE, which in 2016 registered an increase of 5.5% in the number of transactions registered,** after the moderate reduction observed in 2015 (-1.4%).

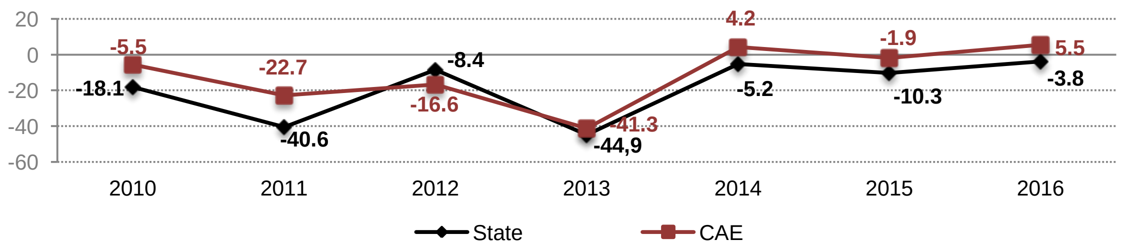
This positive evolution contrasts with the drop observed in the state housing market (-3.8%), which continues the negative path observed since 2008.

In this way, 2,495 new home purchases were registered in the CAE in 2016 compared to 2,365 homes counted in 2015. **This level of activity of the Basque property market is the highest since 2012**.

However, the level reached is still far from those registered before 2012. Thus, the number of transactions registered in 2016 represents only 38% of those recorded in 2009.

Evolution of new-build free-market housing in the CAE and the Spanish State 2009-2016 and annual variation rates

	2009	2010	2011	2012	2013	2014	2015	2016
State	201,726	165,215	98,094	89,838	49,487	46,915	42,072	40,489
Autonomous Community of the Basque Country	6,467	6,110	4,724	3,941	2,313	2,411	2,365	2,495



Source: Ministry of Development

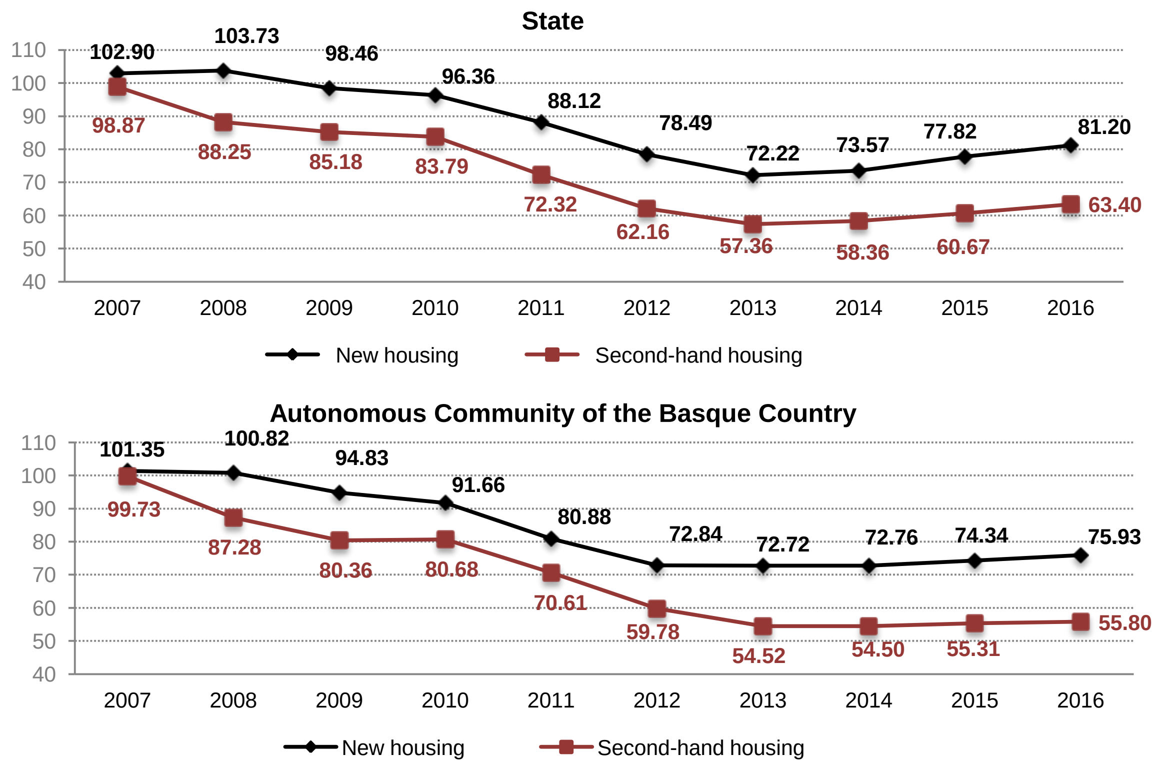
… at the same time as the price of housing increases moderately

The drop in the number of purchases between 2008 and 2014 was accompanied by a sharp decline in the price of new and second-hand housing in the CAE.

The INE Housing Price Index reflects a **slight increase in the price of new and used housing in the CAE since 2014**, consistent with the moderate increase in sales already indicated.

Despite this moderate increase in the price of housing, in 2016 **the price of new housing in the CAE was still notably lower than in the years before the crisis began**, at least 25 percentage points below the record highs.

Evolution of the House Price Index (HPI). 2007-2016



Source: INE

3. Evolution of employment and business fabric 2008-2016

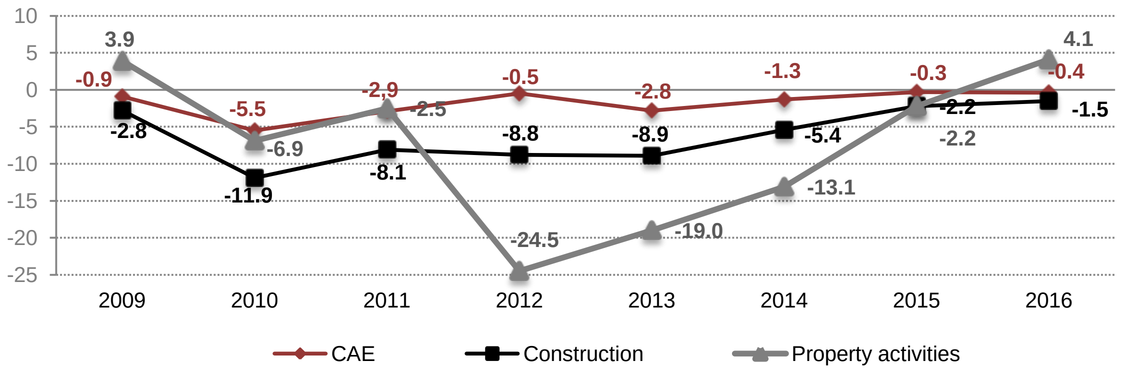
For the first time since 2009 the number of property businesses has increased, while the loss of the business fabric in the construction area continues

In 2016, for the first time in seven years, there was an increase in the number of property companies (+4.1%), leading to the figure of more than 3,000 businesses across the CAE (3,015).

On the other hand, the number of businesses operating in the construction activity continued to decrease in 2016 (-1.5%), although at a clearly lower rate than that observed in the recession years.

In total, in 2016 there were 20,629 businesses in this area of activity. This figure is highly relevant, given that it represents a very important part (11% of the total) of the Basque business fabric.

Evolution of the number of businesses in the construction and property activities sector, as well as in the business fabric of the CAE as a whole. 2009-2016



Source: DIRAE. Eustat

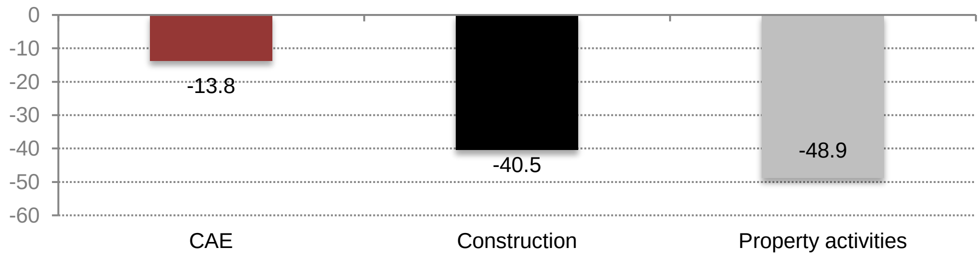
Since 2008, the number of property businesses has been reduced by half and the businesses belonging to the construction area by 40%.

The impact that the 2008 crisis has had on the sector's business fabric is very significant despite the improvement observed in 2016.

Compared to 2008, 14,019 businesses have been lost in the construction sector, as well as a total of 2,886 property businesses.

In percentage terms, since 2008 decreases of 40.5% have been recorded in the number of construction businesses and 48.5% in property businesses, well above the decrease observed in the Basque business fabric as a whole (-13.8%).

Rates of reduction in the number of businesses in the construction and property sector compared to the CAE as a whole 2008-2016



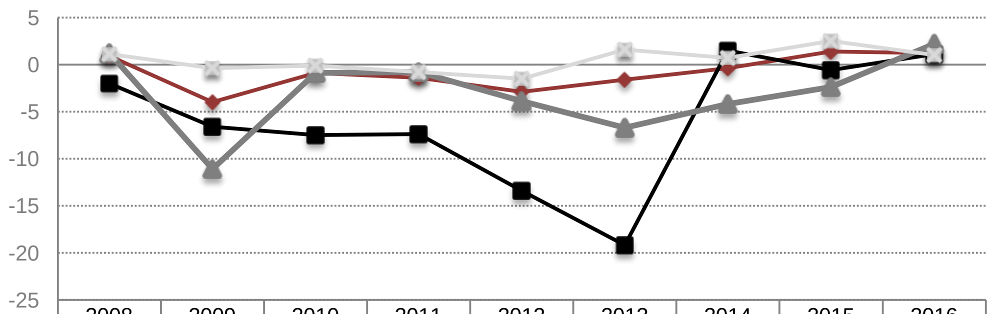
Source: DIRAE. Eustat

One of the best pieces of news of 2016 is associated with the job market recovery (+1.1%), growing at a rate similar to that of employment as a whole in the CAE this year

In 2016, there appears to have been a **change in the negative trend of employment registered since the beginning of the crisis (with the exception of 2014), where the sector's employment grew by 1.1%**. This positive evolution was already distinguishable in the previous sector report, when analysing the positive data on job creation of the second quarter of 2016.

Thus, the positive evolution of employment across the whole of the Basque economy that was already noticed in 2015, extended to the construction sector in 2016. In this way, **2016 was the first year since 2007 in which all sectors of the CAE generated net employment.**

Variation in the employed population 2008-2016 (Year-on-year variation rates)



	2008	2009	2010	2011	2012	2013	2014	2015	2016
CAE	0,9	-4,0	-0,9	-1,4	-2,9	-1,6	-0,4	1,4	1,2
Construction	-2,0	-6,6	-7,5	-7,4	-13,4	-19,2	1,5	-0,6	1,1
Industry	1,2	-11,1	-0,9	-0,8	-3,9	-6,7	-4,2	-2,4	2,2
Services	1,1	-0,4	-0,1	-0,8	-1,5	1,6	0,7	2,5	1,0

Source: PRA. Eustat

This slight recovery in employment in 2016 is barely reflected in the balance of the impact of the crisis on the Basque construction sector. **In relation to 2008, the sector has lost 35,600 jobs**, as the **sector of the Basque economy that has suffered the recession most strongly, by a wide margin**, in terms of job losses, registering an accumulated drop of 42.9%.

In this way, the impact of the 2008 recession on employment in the sector is far greater than that observed in the rest of the Basque economy, to the extent that:

- The rate of employment reduction in the sector (-42.9%), doubles the rate observed in the industrial sector (25.1%), while the tertiary sector is already in positive numbers, with 18,000 more jobs in 2016 than in 2008.
- More than four out of ten net jobs lost (42%) by the Basque economy between 2008 and 2016 are associated with the construction sector.

Working population by sectors in the CAE: The impact of the recession 2008-2016

	2008	2016	2008-2016	
			Thousands of jobs	% decrease
Total	**986.1**	**903.2**	**-82.9**	**-8.41%**
Agriculture-livestock-fisheries	12.2	9.6	**-2.6**	**-21.31%**
Industry	252.2	188.8	**-63.4**	**-25.14%**
Construction	82.9	47.3	**-35.6**	**-42.94%**
Services	638.7	657.5	**18.8**	**2.94%**

Source: P.R.A. Eustat

Despite the improvement in employment in 2016, **the relative weight of construction sector employment in the Basque economy stands at 5.2%**, slightly below the level represented by the sector in the Spanish economy (5.8%). **Since 2008, the relative weight of the sector has been reduced by 3.2 percentage points in the CAE** (it was 8.4% in 2008). The impact of the recession on employment in the Spanish State was even higher, to the extent that the weight of the sector has been reduced by half over these 8 years (from 10.9% of the total state employment in 2008 to 5.8% in 2016).

Evolution of the compared relative weight of the construction sector in the CAE and the Spanish State 2008-2016

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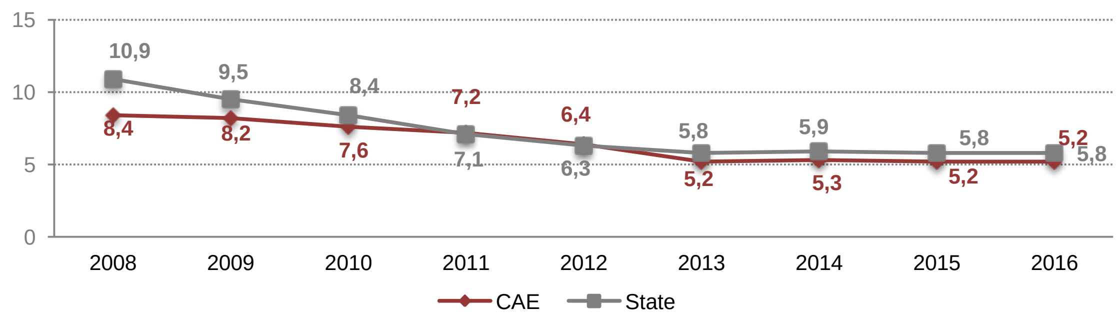


Source: PRA Eustat, EPA, INE

4. Housing demand: Recent indicators and forecasts

Despite the recovery of the Basque economy observed over the last two years, **the demand for new housing is not growing with sufficient strength to boost the sector's activity and increase its rate of growth more sharply.**

In the short term we can still see the weakness of effective demand from first-time home buyers

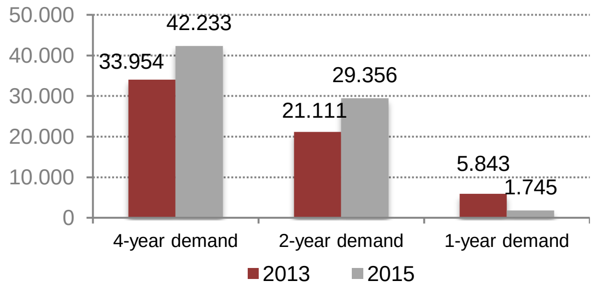
According to the Basque Government Survey of Housing Needs and Demand, in which the most recent data available on the demand from first-time home buyers corresponds to 2015, **a significant increase in the effective demand for first-time home buyers has not yet appeared, at least not in the short term.**

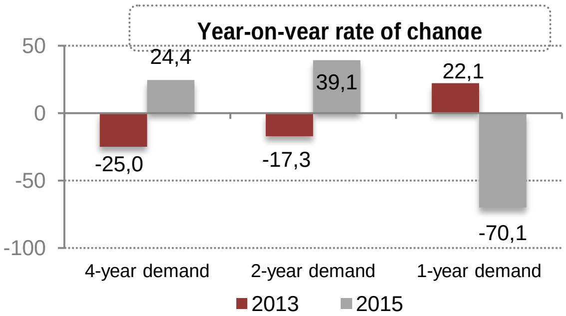
Although the number of people needing to become first-time home buyers was 72,836 in 2015 and increased by 6.8% compared to 2013 (which would mean an estimated demand of 64,290 homes), two events of special interest are detected, linked to strong impact of the crisis on the youngest age groups, showing the weakness of the effective demand for new housing:

a. The small proportion of people with sufficient income to satisfy this need to become first-time home buyers.
Only 15,645 people who express the need to become first-time home buyers have sufficient income to address this need, which would represent a demand of 13,338 homes in an estimated period of 4 years.

b. The plan to purchase a home and the expected time to become a first-time home buyer are postponed.
If we analyse the estimated time to respond to this need, we can see that demand is reduced to 1 year and reaches a total of 1,745 homes demanded (3.3% of total housing demand in 2015).

Evolution of the demand to become first-time home buyers in the CAE. 2013-2015





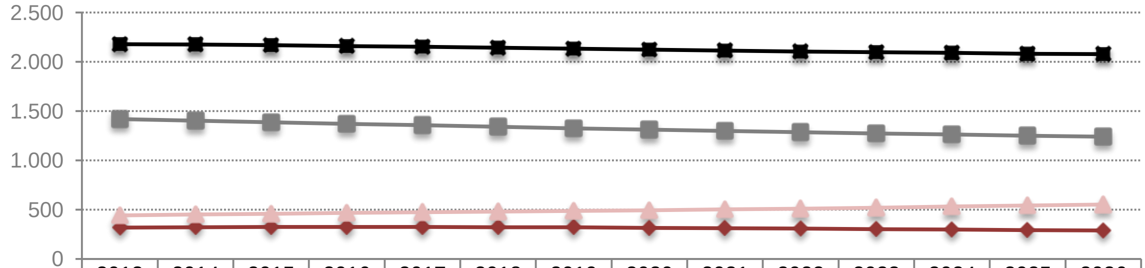
Source: Dept. of Environment, Territorial Planning and Housing. Statistics on Housing Needs and Demand. 2015 *long-term demographic projections are not very optimistic in guaranteeing a consistent housing demand for new homes for the sector*

Eustat's long-term population projections (2026) point to a significant drop in population in the CAE in the coming years. Thus, **it is expected that in 2026 there will be a little over 2,077,000 inhabitants in the CAE, representing a drop of almost 102,000 people compared to 2013** and an average drop of 3,700 people per year.

The two key factors that explain this evolution are associated with:

- The **notable reduction of women in the 25 to 39 age group**, ages which are responsible for about 85% of fertility. This group will be reduced by 40% until 2026, (from 225,000 women in 2013 to 139,000 women in 2026, **considerably affecting the creation of new homes** and the generation of housing demand.
- The forecast of a **slightly positive migratory balance that will not be able to compensate the increasingly negative vegetative balance** associated with the drop in birth rate.

Projection of the population of the CAE by major age groups. 2013-2026 (in thousands)



	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
0-15	319,1	321,8	323,8	323,9	323,2	321,8	319,6	316,1	311,9	307,6	303,0	297,8	292,1	286,9
16-64	1419,7	1404,1	1387,7	1371,5	1356,6	1341,0	1326,3	1313,3	1300,5	1287,5	1274,0	1261,7	1250,0	1239,0
65+	440,1	449,9	458,4	465,7	472,1	479,8	487,3	494,5	502,3	511	520,7	530,6	541,2	551,4
Total	2178,9	2175,8	2169,9	2161,1	2151,9	2142,6	2133,2	2123,9	2114,8	2106	2097,7	2090,1	2083,2	2077,3

0-15 16-64 65+ Total

Source: Eustat Population projections 2026

If these forecasts are met, the average age of the population will increase by 3.5 years, from 44 years in 2013 to 47.5 years by 2026 and the median age, which in 2013 was 43.2 years, will increase by 6.2 years, in such a way **that in 2026 almost half of the Basque population will be 50 years of age or over.**

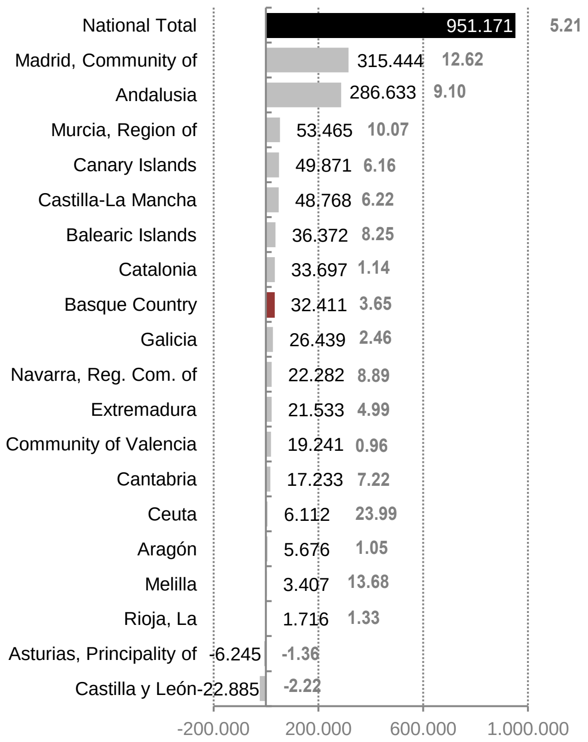
Likewise, according to the INE's 2014-2029 Housing Projection, the number of homes will increase by 3.6% until 2020, from 888,557 homes currently to 920,968 in 2029 **(2,000 new homes/year).**

Therefore, 32,000 new homes would be created between 2014 and 2029, **which would represent a moderate demand for new housing construction associated with first-time home buyers.**

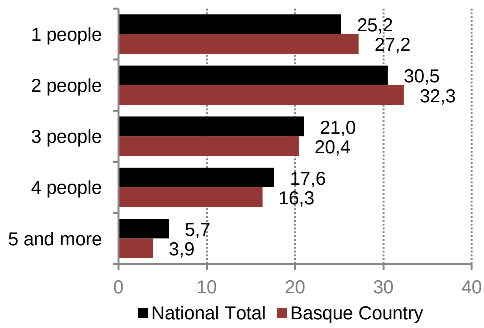
This slight growth in the number of Basque homes is also linked to the growing relative weight of smaller homes:

- **59.2% of households in the CAE in 2016 have only one or two members**, while the percentage of households with 4 or more members barely exceeds 20%.
- **By 2029, the relative weight of single-person households is expected to grow significantly** (from 26.4% in 2014 to 33.1% in 2029).
- **The average size of Basque households will continue to decrease** significantly in the coming years, from 2.14 people/household in 2014 to 2.2 people in 2029.

Growth of the number of homes per Autonomous Community 2014-2029



Percentage of households according to size. 2016



Source: INE.

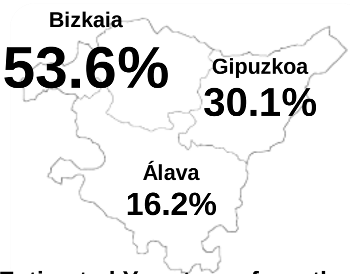
After this slight increase in the projection of the number of homes by 2029, there is a **very significant change in their composition and in accessibility and housing needs of the housing stock in the CAE**, especially in the case of those inhabited by older people, **which is a great opportunity and, at the same time, a fundamental challenge for the future of the construction sector**.

The key importance of the restoration activity and the challenge of Building Inspections

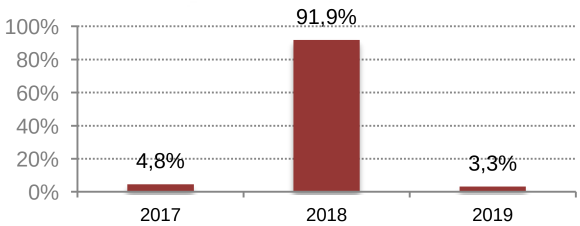
In the framework of its innovative Big Data projects, the Basque Housing Observatory has recently published a detailed analysis of the number of Building Inspections carried out and, what is particularity interesting, the forecast for the next three years due to the age of the building stock in the CAE[1].

Up to January 2017, a total of 8,238 Building Inspections had been registered throughout the CAE, the result of which had a considerable impact on the sector's activity, to the extent that, **in more than half of the cases (4,444 Building Inspections, 53.7 % of the total), technicians identified the need to urgently address** (in a period of less than a year) **some type of restoration work**.

Total number of Building Inspections planned for 3 years. 2017-2019



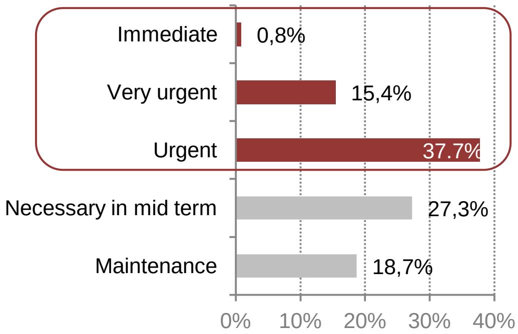
Estimated Year to perform the next Building Inspection, of the Building Inspections planned for 3 years



Source: Basque Housing Observatory. Basque Government

It is worth noting the **importance of the work to be carried out, which is of remarkable significance**, as it is linked, to a large extent, to the restoration of façades, roofs and the actual foundations of the buildings.

Final result of the Building Inspections carried out until January 2017



Source: Basque Housing Observatory. Basque Government

Along these lines, **the forecasts for the period 2017-2019 show a considerable increase in the buildings that the Building Inspections will have to inspect**, to the extent that 75,000 Building Inspections will have to be completed by 2019, most of them (91%) in 2018. Although the proportion of works and interventions to be carried out until 2017 (53%) cannot be projected linearly, the large increase in the number of Building Inspections would lead us to consider **a strong growth in the demand for restoration works for the sector in 2018 and 2019**.

[1] http://www.garraioak.ejgv.euskadi.eus/r41-ovad03/es/contenidos/informacion/bigdata_ites/es_def/index.shtml

The demand from the public sector is still very relevant: in 2016, 936 million Euros were tendered by the Public Administrations as a whole in the CAE.

In 2016, the volume of public tenders in the CAE was reduced by 15.8% to 936 million Euros. In any case, this magnitude is very relevant for a sector that has suffered a large drop in demand from traditional residential activity associated with the private sector.

The large drop in investment from the Central Government (-55.4%) explains this reduction to a large extent, while the local Public Administrations increased by 28% the volume of tenders after the record low recorded in 2015.

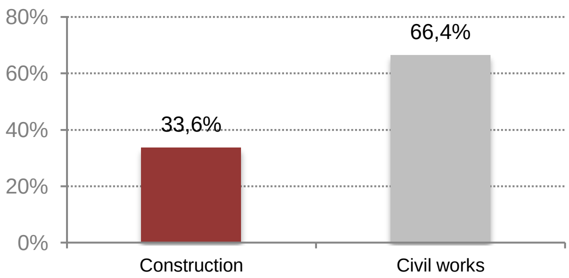
Construction and public works in the CAE. Official tender by agencies. 2000-2016

	Central Administration	Basque Government	Local administration	Total	
2001	132.0	182.2	786.5	1,100.7	
2002	103.5	203.9	909.5	1,216.9	10.6%
2003	81.4	144.4	805.2	1,031.0	-15.3%
2004	124.6	373.9	1,135.3	1,633.8	58.5%
2005	158.7	324.5	1,337.9	1,821.1	11.5%
2006	623.6	303.3	2,334.1	3,261.0	79.1%
2007	584.5	570.2	1,795.5	2,950.2	-9.5%
2008	205.2	767.2	1,390.1	2,362.4	-19.9%
2009	269.4	846.4	1,631.7	2,747.5	16.3%
2010	137.1	1,173.2	1,276.6	2,586.9	-5.8%
2011	230.1	632.6	588.5	1,451.1	-43.9%
2012	121.0	620.0	629.0	1,370.0	-5.6%
2013	14.0	126.0	477.0	617.0	-55.0%
2014	436.0	214.0	493.0	1,142.0	85.1%
2015	420.0	303.0	388.0	1,112.0	-2.8%
2016	187.2	249.3	499.7	936.2	-15.8%

Source: SEOPAN

The volume of tenders registered in 2016 comes more from the civil works tenders (two out of three Euros), while tenders for public housing and construction works and fitting out have a lower relative weight (one in three Euros).

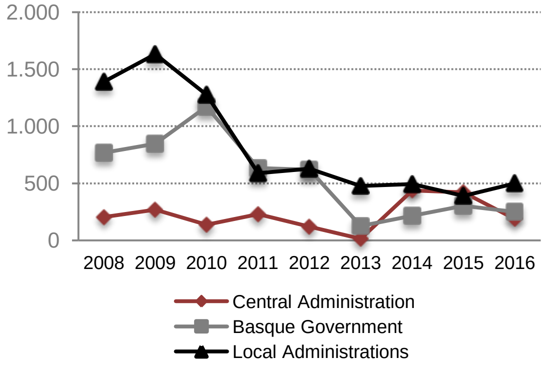
Construction and public works in the CAE according to the type of tender in 2016



Source: SEOPAN

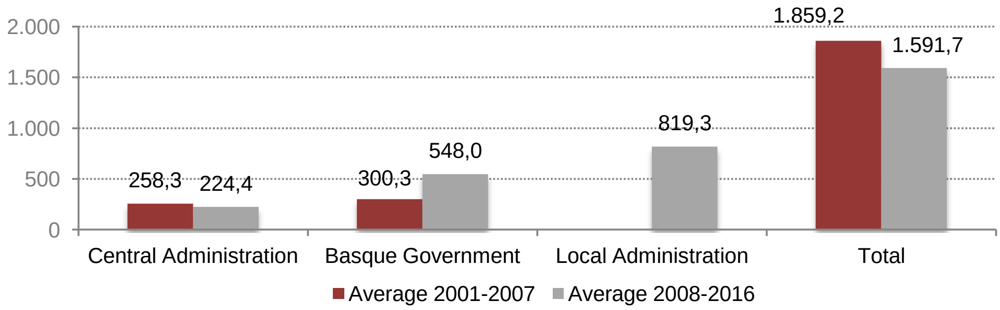
From a long-term perspective, tenders from local administrations have experienced the greatest drop since 2008.

Evolution of the tender by type of Public Administration in the CAE 2008-2016



In this way, assessing the recession period from a long-term perspective, we can highlight that **throughout the recession it was the public sector that slowed down and tried to counteract the sharp drop in private demand**. Thus, in the first years of the crisis (2009 and 2010) the volume of tenders exceeded the level of 2,500 million Euros. It was from 2011 when the budgetary restrictions linked to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, signed by the Government of Spain, and the notable drop in public revenue, led to drastically reducing the investment of the Public Administrations.

Annual average of the volume of official tenders in the CAE by type of Administration 2001-2007 vs. 2008-2016



Source: SEOPAN

5. Conclusions and trends

Throughout 2016, we witnessed the consolidation of the change in trend detected in 2015, representing the first increase in productive activity after the major crisis of 2008-2014. In this way, a generalised improvement of the main sector activity indicators was observed in 2016:

1. **The added value generated by the Basque construction sector significantly increased in 2016:**
   - Sector added value increased by 1.6% in 2016, which is three times the growth rate of 2015 (0.5%) after eight years of continuous decreases.
   - Activity related to construction is what is driving the sector (+3.9% in 2016), while the activity associated with civil works continues to show a clearly negative trend (-10.9%).
   - The evolution of building permits confirms this positive evolution in building activity, both in the case of new build building permits (+16.6%), and in the case of those related to restoration works (+14.5%).
   - The number of new home purchases also increased by 5.5% parallel to a slight rise in sales prices in 2016, reaching a total of 2,495 transactions, the largest since 2013.

2. **The activity associated with new builds is still far from the numbers prior to the crisis:**
   - In 2016 the sector managed to generate two out of every three Euros produced in 2007 (61.5%).
   - The number of new-build building permits in 2016 (518 permits) is only one third (31%) in relation to the record highs of 2006 (1,654 permits).
   - The 2,495 purchases registered in 2016 are far lower than the 6,667 corresponding to 2016.

3. **On the other hand, on the most positive side, the restoration activity continues its positive trend:**
   - The number of building permits reached 2,567, the record high since records began in the Basque Government's EDYVI, and it has registered a positive evolution since 2013.
   - However, the budget for the execution of permits for restoration works shows a significant drop in relation to 2015 (-30.2%), which would be linked to the smaller size of the type of works carried out in 2016.

4. **In 2016, the Basque construction sector generated net employment at a significant rate:**
   - The working population in the construction sector increased by 1.1%. This increase contrasts with the fall in employment observed in 2015 and consolidates the change of trend in the sector.
   - Despite this moderate growth, the crisis has a very negative outcome for sector employment, to the extent that 35,600 jobs have been lost compared to 2008, almost 43% of employment at that date.

5. **For the first time since 2008, the business fabric linked to property activity has increased. On the other hand, the number of businesses in the construction area continues to decrease.**
   - The year 2016 is the first since 2009, in which there is an increase in the number of businesses in the case of property activity (4.1%), while in the construction area the negative trend continues.
   - There has been very considerable destruction of the business fabric since 2008, showing drops of 40 and 48% in the construction and property sector, respectively.

6. **The weakness of the effective demand for housing and the challenge of Building Inspections for restoration activity.**
   - The demand from first-time home buyers continues to show signs of weakness associated with the precarious employment situation of a large part of the younger population of the labour market and difficulties in accessing credit.
   - The medium and long-term demographic projections are not particularly optimistic regarding the configuration of new households in the CAE, with the INE estimating the creation of 32,000 homes by 2029, 3.6% of the homes currently in existence.
   - Behind this moderate increase there is a major change in the morphology of Basque households, associated with the greater reduction in the average size of households that will reach 2.2 people in 2029 due to the very significant increase in single-family homes. In this context, the restoration and improvement activities of the building and housing stock are essential in guaranteeing the quality standards of habitat, accessibility and social-sanitary care of people in the own homes.
   - Recent information on the projections in Building Inspections provided by one of the Basque Housing Observatory's Big Data projects confirms the significant potential of these inspection processes for the sector's activity: between 2017 and 2019, 75,376 Building Inspections must be carried out across the CAE. Up to now, 53% of the Building Inspections carried out have required urgent works within a period of less than one year.

Therefore, from what we have analysed in the report, we can confirm that **the year 2016 was a positive and important year for the sector, as it confirmed the start of a new cycle after a major recession, which is attested by the sector production indicators, such as market activity and building permits.** All this has contributed to the generation of net employment at a rate of 1.1% in 2006. In any case, recovery is still associated with moderate growth rates.

In this way, the business model of sector companies is adapting to the lower weight of the traditional activity of new-build construction, which was the basis of the property boom, to focus on different parameters associated with the greater predominance of restoration, as well as on the new challenges and opportunities posed by the regulations associated with Building Inspections. Thus, 2016 has seen the highest levels in terms of the number of restoration permits since the statistics on this area began.

Looking to the future, the next two years will be fundamental to confirm and assess the potential of this new model and its impact on the sector in terms of creating new jobs and new companies. In the process of restructuring the sector and the commitment to generate greater added value, the coming into force of European regulations linked to the highest standards of efficiency (regulations on buildings with almost zero energy consumption -NZEB-) will also be very relevant for public buildings in 2019 and for private buildings in 2021, which will affect the whole building stock in the CAE.