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# Newly Built Ghost Towns Haunt Banks in Spain

By **SUZANNE DALEY** and **RAPHAEL MINDER**

YEBES, Spain — It is a measure of Spain's giddy construction excesses that 250 row houses carpet a hill near this tiny rural village about an hour by car outside of Madrid.

Most of these units have never sold, and though they were finished just three years ago, they are already falling into disrepair, the concrete chipping off the sides of the buildings. Vandals have stolen piping, radiators, doors — anything they could get their hands on.

Those few families who live here keep dogs to ward off strangers.

Yebe is hardly unique. The wreckage of Spain's once booming construction industry is everywhere. And much of it sits as bad debt on the books of Spain's banks, which once liberally offered financing to developers and homeowners alike.

Just how big a loss the banks are facing is unknown, at least publicly, and that has investors worried — the cost of financing Spain's debt rose 18 percent in the last month alone. But the potential costs of failure go far beyond that. Spain's economy, the fifth largest in Europe, is much bigger than Ireland's or Greece's, and a bailout of its banks **could be far more costly**, an event that could push the government into default and end up dooming the euro itself.

The Bank of Spain says the banks have about \$240 billion in "problematic exposure" out of \$580 billion invested in real estate and construction, a situation, they say, the banks are capable of handling.

But not everyone believes that. Unlike American banks, Spanish banks have done little to open their books. Along with other banks in the euro zone, they underwent a stress test last July, and all but five of Spain's smaller savings banks passed.

The trouble is that some Irish banks that also got a clean bill of health in that round of tests subsequently collapsed, raising a threat to the country's solvency that has still not been quieted — on Friday, Moody's **slashed** Ireland's credit rating to near-junk status and warned of further downgrades — despite a bailout. Those failures undermined the credibility of the whole stress-test exercise and forced regulators to announce recently that the results of further tests would be published early next year.

The Bank of Spain is moving to lift confidence in its banks by forcing them next year to disclose

more details about their holdings and to start acknowledging troubled assets faster. But just how much are those assets worth?

Rafael Valderrabano, who founded the Básico real estate company 18 months ago to help banks sell property they are repossessing from developers, says the country is full of situations like Yebes. Right now, he says, he is trying to sell units in 40 apartment blocks near Cuenca, an area southeast of Madrid that is sparsely populated.

“Who went to develop in this place?” Mr. Valderrabano asked. “Who did this? Worse, who financed this?”

A better known real estate debacle is a sprawling development in Seseña, south of Madrid, one of Spain's “ghost towns.” It sits in a desert surrounded by empty lots. Twelve whole blocks of brick apartment buildings, about 2,000 apartments, are empty; the rest, only partly occupied. Most of the ground floor commercial space is bricked up.

The boom and bust of Spain's property sector is astonishing. Over a decade, land prices rose about 500 percent and developers built hundreds of thousands of units — about 800,000 in 2007 alone. Developments sprang up on the outskirts of cities ready to welcome many of the four million immigrants who had settled in Spain, many employed in construction.

At the same time, coastal villages were transformed into major residential areas for vacationing Spaniards and retired, sun-seeking northern Europeans. At its peak, the construction sector accounted for 12 percent of Spain's gross domestic product, double the level in Britain or France.

But almost overnight, the market disappeared. Many immigrants went home. The national unemployment rate shot up to 20 percent. And the northern Europeans stopped buying, too. But government officials now say the worst is over, with housing prices down a modest 12.8 percent from the peak, according to the Bank of Spain.

“Most of the adjustment in housing prices has already taken place,” José Manuel Campa, Spain's deputy finance minister, said recently, though he allowed that there was a lack of good information on real estate sales.

Still, skeptics abound. One is Jesús Encinar, the founder of Spain's most popular property Web site, Idealista.com. He says that the Spanish authorities are striving to engineer a soft landing of the housing market that would give more time to offload surplus housing at reasonable prices.

But he believes prices still have a long way to fall, by 30 or 40 percent, maybe more. “Some people who said there was no housing bubble are now saying we are at the bottom,” Mr. Encinar said. “But I say we have several years to go.”

He is not alone in scoffing at some of Spain's numbers. In a report last April, the French bank Société Générale dismissed many of the assertions made by Spain's banks, pointing out that Spain had one of the fastest rates of expansion in construction, had the largest number of

mortgages per capita and was the most overbuilt among its peers. Yet prices had fallen the least. “We find it impossible to reconcile the banks’ claims of asset quality stability and the macro facts,” the report said.

There is also little agreement even on the number of housing units for sale. José Manuel Galindo, president of Madrid’s association of real estate developers, noted that one of Spain’s leading property appraisers, Tinsa, recently estimated that there were 10,000 unsold housing units around Spain’s capital city. Government figures, however, put the figure as high as 50,000 units, he said.

“What is amazing to me is that nobody is investing in doing a very thorough and reliable study of what is the exact supply and demand,” Mr. Galindo said.

There is, however, broad agreement that many of Spain’s empty units are in areas where there is little demand for them, particularly along the southern coastal areas where hills have disappeared under vast housing developments. Practically overnight, Spain’s banks have been forced to begin managing vast real estate portfolios, a role most were ill equipped to take on.

“They do not know how to take care of this housing stock or how to rehab properties,” said Raúl García García, from Tinsa.

While some banks have set up networks to sell property, many others are floundering, having trouble just keeping track of the keys. “They take the old guys who are sitting around and say: ‘Hey, you are in charge of real estate now,’ ” Mr. Encinar of Idealista.com said. “Some are not even answering the phone.”

Experts say that whatever is on the market now is only a piece of what is in the pipeline from distressed homeowners and developers. Mr. Encinar says the banks are holding back on putting property on sale, afraid to bring prices crashing down.

Fernando Acuña, co-founder of [Pisosembargados.com](http://Pisosembargados.com), a Web site that sells housing on behalf of the banks, said as many as 100,000 repossessed units were now for sale in Spain, a number that “could double or triple.”

Still, eager to begin getting some of the property off their balance sheets, some banks have been offering deep discounts and special mortgage rates.

Experts say the banks are being slightly more choosy these days about who lend to. But the new loans — almost all of which are at variable rates — could create a second wave of defaults down the road when interest rates rise. Next year may produce a new round of defaults from developers as well. In the early days of the crisis, many banks renegotiated their loans. But experts say many of those deals will expire next year, and without any significant change in the economy, most developers will be no better off.

The tension between banks and developers, once happy accomplices in a booming business, is palpable. Mr. Galindo says that the banks are not lending to developers who have half-built

projects and that they are favoring customers who want to buy bank-owned property when giving out mortgages.

The biggest challenge for the banks is that they are likely to end up owners of vast amounts of undeveloped land. José Luis Suárez, an expert on real estate at the IESE business school, said 65 percent of bank lending to developers is tied up in land, enough to build 758,000 more housing units. "That gives you an idea of how long it could take for the market to digest all this," he said.

*This article has been revised to reflect the following correction:*

***Correction: December 18, 2010***

*Because of an editing error, an earlier version of this article misstated Spain's economic ranking within Europe.*