EthiFinance

Real Estate Sector Report

France & Spain confronted to opposing trends.

Anne Guy & Javier Lopez

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France & Spain confronted to opposing trends.

Executive summary

After the contraction of the real estate market in 2023 due to inflation and rising interest rates, the sector started to recover in 2024 thanks to a reduction in the cost of financing and a rebound in sales. By 2025, this trend is expected to consolidate, although limited supply will continue to drive prices upwards. In France, the recovery will be slower due to land and financing constraints, keeping pressure on developers. In both countries, the sector's profitability will improve, albeit accompanied by changes in leverage levels. At the sector level, we do not expect significant swings in our ratings.

Key factor	Sector impact 2025
Inflation and construction costs	Improving
Monetary policy and interest rates	Improving
Mismatch between supply and demand	Neutral
Conditions for access to financing	Neutral
Fiscal policy and regulation	Worsening
Housing price trends	Worsening
Profitability	Improving
Leverage and interest coverage	Improving

Key factors in 2024

Over recent years, the real estate sector in Spain and in France has been affected by **cyclical and structural factors that have in turn influenced the evolution of the residential housing market**; i) higher costs of raw materials due to a period of unusually high inflation; ii) a tighter monetary environment that put upward pressure on interest rates and indirectly made mortgage lending more expensive; and iii) the mismatch between supply and demand on both sides of the Pyrenees, albeit for significantly different reasons.

Regarding the **rise in raw material prices**, the war between Russia and Ukraine triggered an escalation in inflation, initially in energy, in both countries, directly affecting construction costs as these inputs, either directly or indirectly, are highly sensitive to fluctuations in gas prices, as for example in the case of the ceramics industry. Although these costs were initially borne by companies through margins, EthiFinance Ratings has observed that from 2023 onwards, developers passed on this increase to selling prices to mitigate the impact on their margins given the escalation in financing costs.

The **European Central Bank's response** to this inflationary period did not help the sector's recovery, as the historic rise in interest rates - which in barely twelve months moved from negative territory to a maximum of 4.5% - postponed consumers' investment decisions pending a normalisation of this monetary policy. This rise in interest rates, together with the tightening of conditions for access to financing, led to lower mortgage demand and, as a result, the sale and purchase of new homes in the Spanish market fell by more than 6% year-on-year in 2023. Demand in the French market maintained a similar trend, although with the administrative aggravation caused by the delay in adapting the usury rate to the new interest levels, which further slowed down the signing of new mortgage contracts.

However, in 2024, inflation control and improved market expectations of monetary normalisation in the euro zone favoured the recovery of the Euribor, encouraging the signing of mortgage loans and thus allowing the recovery in new home sales to a year-on-year high of 20.5% in the Spanish market. In contrast, in France, the sector continued to

deteriorate - as reflected in the drastic drop in the requests for building permits and developer activity. This was the result of the ending of several fiscal measures, such as the Pinel one, which encouraged investment in new housing while enabling tenants to rent at a lower fare, or the entry into force of the 'zéro artificialisation nette' law, which has led to a shortage of land and by extension an increase in prices. In this context, EthiFinance Ratings downgraded one of the most significant developers in the sector in France, Nexity, from BB to BB- in 2024, following our previous downgrade from BB+ to BB in 2023.

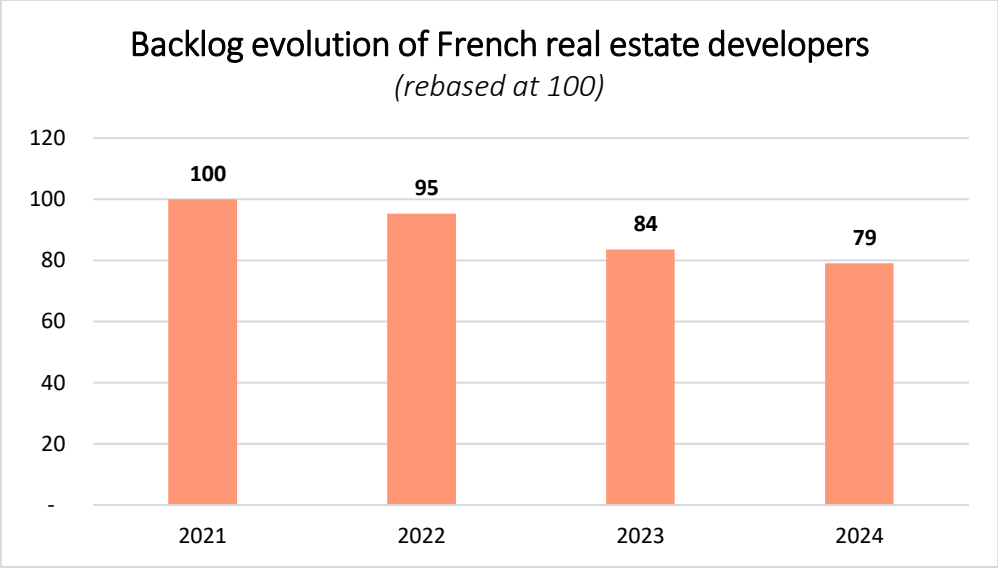
Finally, regarding structural factors, it is worth noting the **mismatch between supply and demand in Spain**, where the annual production levels of new housing represent approximately 50% of the formation of new households. However, despite this, the rise in property prices in comparison with the evolution of household disposable income makes access to housing difficult in certain high-demand population centres. In France, the situation is different. Demand for new housing has slowed sharply because of rising interest rates. Developers found themselves with a high volume of unsold new homes. In 2024, the stock of new homes represented about 12 months of sale on the market compared to 3-4 months for the period 2018-2021.

In this regard, and despite the normalisation of inflation and financial conditions, EthiFinance Ratings has observed that pressure on housing supply has pushed prices up in both countries. In Spain, the new home price index (HPI) averaged 183.8 in the first three quarters of 2024, compared to 128.8 in 2019, 42.7% higher in just five years. This contrasts with the evolution of household disposable income and lower housing supply between 2022 and 2023 as a direct consequence of tighter financing conditions and lower land availability in certain densely populated urban centres. The trend in France is exacerbated by a combination of high costs and land restrictions resulting from the legislative processes and governmental uncertainties that conditioned political life in that country during 2024.

Sector prospects for 2025

At EthiFinance Ratings, **we expect the improvement of 2024 to be confirmed in 2025** due to the interest rate cuts implemented by the ECB in 2024, and those expected to come throughout 2025 - we expect the deposit facility rate to close 2025 around 2%. Additionally, demand will support the market with the improvement in disposable income.

For Spain, we expect the **increase in new housing stock and the rise in building permits,** which we have observed since the last quarter of 2024, to be sustained at the start of this new year. However, for France, the offer of new housing is expected to start recovering in 2025, but with some lag, given the limited backlog at end-2024 as well as the low stock of units.



Source: EthiFinance Ratings, sample inferior to 10 French real estate developers, some of which are not directly rated by EthiFinance Ratings but have been added for benchmarking purposes.

Regarding prices, we do not expect a significant improvement, **with real estate inflation in Spain likely to exceed 5%** per year in 2025 and 2026, and a similar figure for France, although this is conditioned by factors such as the availability of land, the speed with which licences are processed and the evolution of construction costs. Moreover, we should not forget the territorial differences within each of the countries around the urban centres of greatest demand, such as Madrid, Barcelona, Malaga or Valencia for Spain, and Paris, Lyon or Bordeaux for France.

Finally, EthiFinance Ratings expects developers' performance to focus on two factors: **profitability and leverage**. In Spain, we are likely to see profitability levels improve to the 12%-18% range as a result of lower construction costs and economies of scale generated by increased sector activity. However, this increased activity will bring with it a necessary increase in leverage levels to sustain this market expansion. Regarding France, we expect the situation of sector players to be similar: improving profitability whereas sector indebtedness will continue to be a risk factor, along with **interest coverage.** Although we expect the latter to improve to around 4x EBITDA, it will remain far from previous levels (16x in 2022) due to the increase in the cost of debt since then.

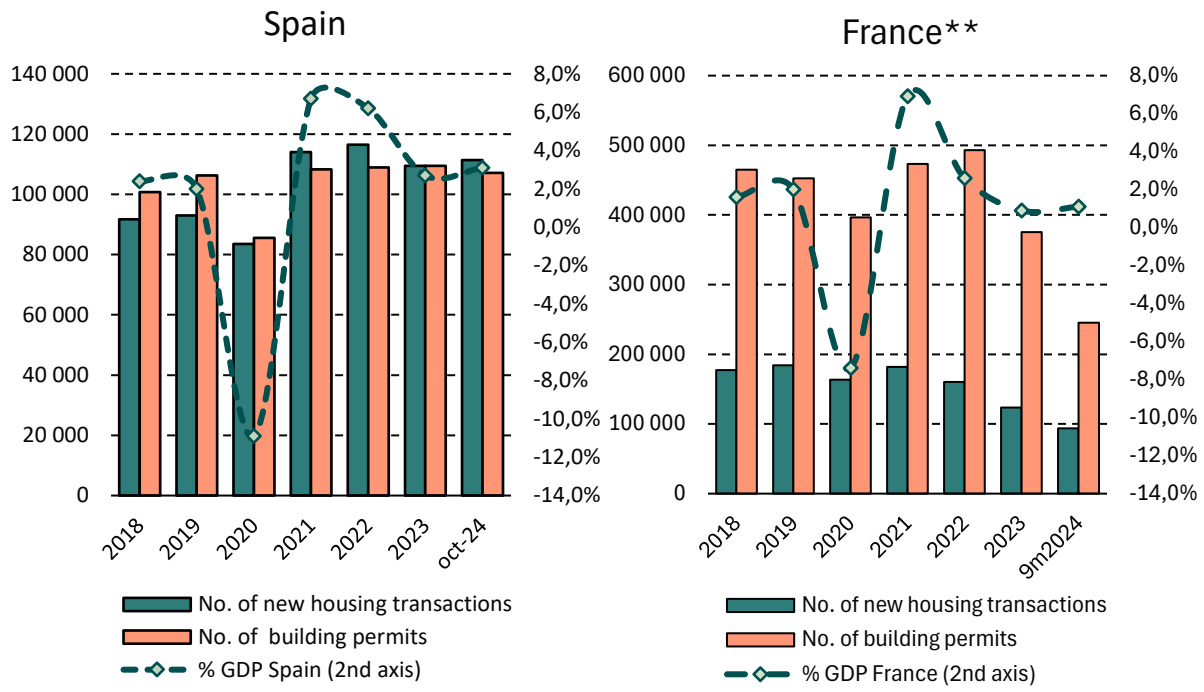
For both markets, the evolution of the sector will depend on structural and regulatory factors. The shortage of developable land, the slow pace of licensing and the implementation of new building technologies will be key challenges in the coming years. In Spain, the need for government measures to promote access to affordable housing remains one of the main challenges for the sector. In France, land use policies and financing constraints will continue to be key drivers for the recovery of the housing market.

What do we expect for our ratings?

Overall, it should be noted that our corporate ratings for this sector have a ‘Stable’ outlook, which means that we do not expect significant changes for up to 18 months. These ratings currently range from BBB at best to B+ at worst.

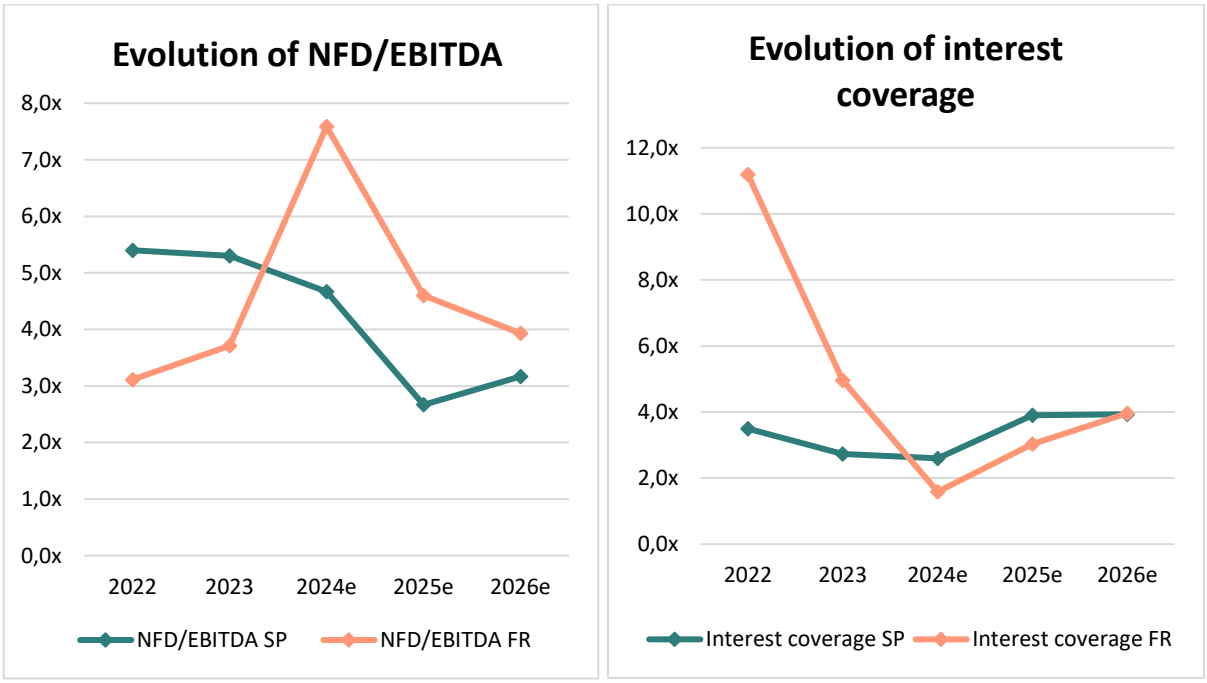
Concerning credit ratings, the Spanish real estate market shows signs of stability, and therefore no significant changes are expected in the ratings of companies in the sector in 2025. For France, the sector could start to recover in 2025 in terms of activity, after the low point observed in 2024, with sales down c. 10% in average in FY24 (compared to FY23). Regarding the ratings, pressure on leverage and profitability could still affect them, especially in a context of still high interest rates.

Chart 1: No. of transactions and building permits vs GDP growth (%)*



*For 2024, GDP is based on the estimate provided by EthiFinance Ratings.
**For France, building permits are inclusive individual and collective housing
Source: INE & INSEE

Chart 2: Leverage and interest coverage



Source: EthiFinance Ratings, sample inferior to 10 ratings between France and Spain, some of which are not directly rated by EthiFinance Ratings but have been added for benchmarking purposes.

Contact



France
153 Boulevard Haussmann, 75008 PARIS
bertrand.potier@ethifinance.com

Spain
C. Velázquez nº18 - 3ºDcha - 28001 – MADRID
adolfo.estevez@ethifinance.com

www.ethifinance.com