

# Real Estate Outlook

Peru

2011  
Economic Analysis

- **Economic growth and good financing conditions will continue to support the housing market in the medium term**, despite flagging demand in the first half of 2011.
- **Housing prices will keep upward trend in the medium term** supported by structural factor of both supply and demand.
- **Demand for prime offices should continue to fill new office space as buildings enter the market** in other parts of the city due to the lack of available office stock in the central districts.
- **Mortgage lending will keep high dynamism** due to good financing conditions and government support in the social housing sector.

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Closing date: June 1, 2011

## 1. Housing market

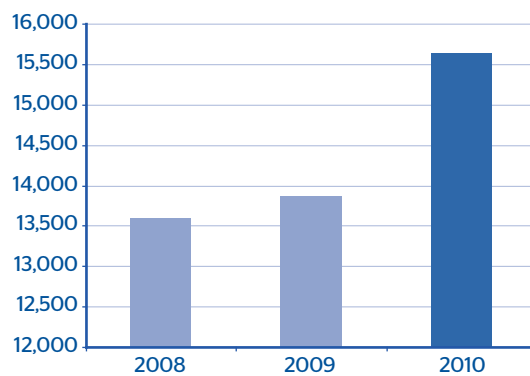
### Fundamental factors will continue to support demand in the medium term, following a slowdown in sales in 1H11

In 2010 home sales in the Lima Metropolitan Area and Callao grew 12.8%, after a decline in 2009 (see chart 1). This recovery has come against a background of rapid economic growth, formal job creation, increased consumer confidence and attractive financing conditions. Housing demand remains concentrated in the high-income sectors (A, AB and B), which accounted for 83% of sales.

In the year so far, housing demand has flagged, especially for luxury homes, coinciding with a decline in confidence amongst households in the AB socioeconomic level (see chart 2). It is worth pointing out that demand from these families is based on investment decisions that are more sensitive to changes in expectations.

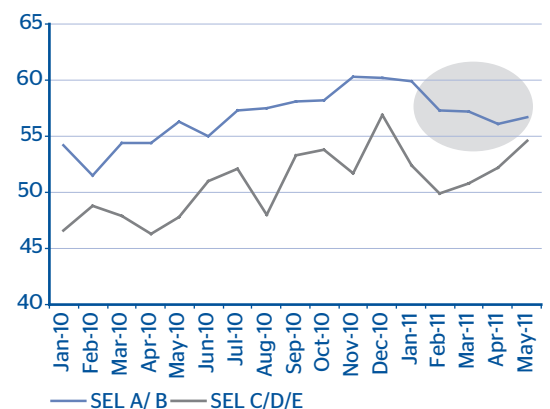
We believe that housing sales will grow faster in the second half of the year, reaching close to 2010 levels, due to the support of structural factors: i) sustained growth in effective housing demand in Lima, which in 2010 reached just over 400,000 homes; ii) attractive mortgage financing conditions (stable rates and longer repayment terms); and iii) the country's economic strength and buoyancy.

Chart 1  
**Housing sales in Lima Metropolitan Area and Callao (units sold)**



Source: Tinsa and BBVA Research Peru

Chart 2  
**Household finances prospects in 12 months time (% answering "Better")**



Source: Apoyo Consultoría and BBVA Research Peru

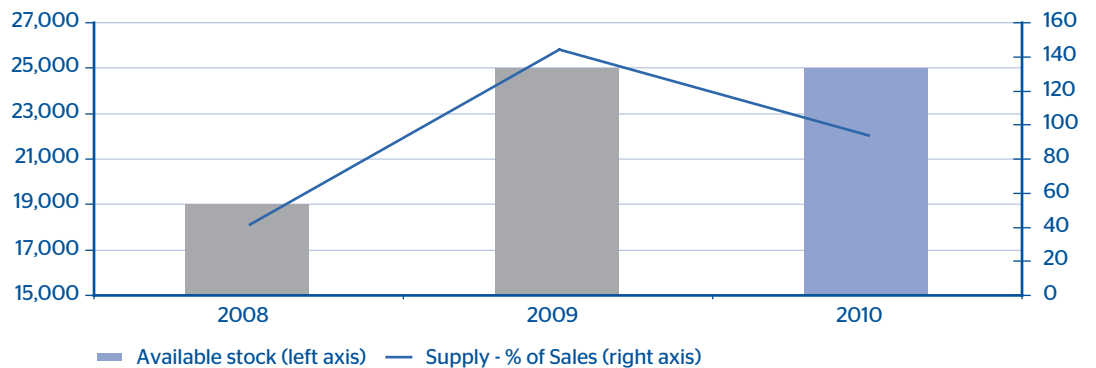
### Following normalization of housing stock levels in 2010, supply should move closely in line with demand

In 2010, the housing stock available for sale in the Lima Metropolitan Area and Callao remained stable reflecting fewer units entering the market (supply) and a higher initial available stock level. As a result, housing inventories (supply as a percentage of sales) were down to the average levels of the last few years (see chart 3). It is worth noting that since 2009 supply has been higher than in previous years, partly due to government incentives for the construction sector (such as accelerated property depreciation) and the support provided by state housing programs for low-income families under the government's Economic Stimulus Plan (PEE in its Spanish acronym).

Multifamily housing projects and residential complexes for lower income segments have been buoyant (12% of available stock is aimed at this segment). Thus, in 2010 the number of social homes per housing project averaged 42 units against 33 in 2009. In addition, 52% of total stock could be financed through 'MiVivienda' loans (state-backed financing). This year will be no exception, with the best-performing projects in 1Q11 being those aimed at mid-low sectors (see Table 1). In the medium term, supply should move more closely in line with demand as housing stocks normalize.

Chart 3

Available stock\* and Stock turnover\*\* in Lima Metropolitan Area and Callao



(\*) Initial balance + units added.

(\*\*) units added (supply) / units sold (demand).

Source: Tinsa and BBVA Research Peru

Table 1

Ranking of best performing projects in 1Q11

Project	District	Company
Ciudad Sol de Collique	Comas	Consortio Dhmont
El Dorado de Torreblanca II	Carabaylo	Total Inmuebles
Las Torres de Santa Clara II (phase 2)	Ate	Grupo Acuario
Villa Club 2	Carabaylo	Paz Centenario
Los Jardines de Ventanilla 1st phase	Ventanilla	Vidarmonia
Parques de la Huanca 2nd phase	San Miguel	San José Perú
Surco Nuevo Manu (Phase I)	Santiago de Surco	Parámetros Inmobiliaria - Activos Peruanos
Las Torres de Santa Clara II (phase 1)	Ate	Grupo Acuario
Alameda San Juan	Carabaylo	Urbana Perú
Concepto Urbano	Lima center	Imagina
Condominio Paseo del Sol (Phase 1)	Ate	Lider Grupo Constructor
Valle Verde Condominio Residencial (Etapa 1)	Puente Piedra	Enacorp S.A.
Paseo El Mirador	Santiago de Surco	Arteco
Parque Garezon 2nd Phase	Lima center	GMV Graña y Montero
Condiminio Los Girasoles (Blocks 1 and 2)	El Agustino	Besco Edificaciones S.A.

Source: Tinsa and BBVA Research Peru

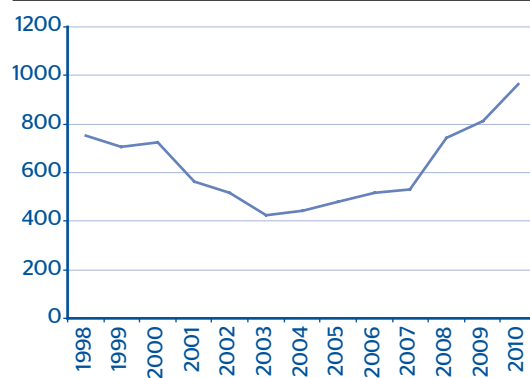
Although there could be some slowdown in the short term, prices are expected to continue to rise in the future

Over the last year the price per m<sup>2</sup> in Lima Metropolitan Area increased 19%, from USD 814/m<sup>2</sup> in 2009 to USD 966/m<sup>2</sup> in 2010, according to data from the Peruvian Chamber of Construction (Capeco in its Spanish acronym) (see chart 4). This augment is explained by higher costs and greater unmet demand (see chart 5). This price dynamic continued in 1Q11 with a 12% yoy increase, according to the Central Reserve Bank of Peru (BCRP in its Spanish acronym). Prices in middle class districts have been the most buoyant, with most unmet demand coming through segment.

In the short term, the rising trend of prices may slow somewhat with elections, at least temporarily, putting the brakes on demand growth. However, some factors indicate that there will be a return to faster growth: i) higher land prices due to a shortage of space; ii) soaring building material prices due to rising international steel prices; iii) higher wages in the construction sector due to a lack of skilled labor; and iv) the increased purchasing power of families.

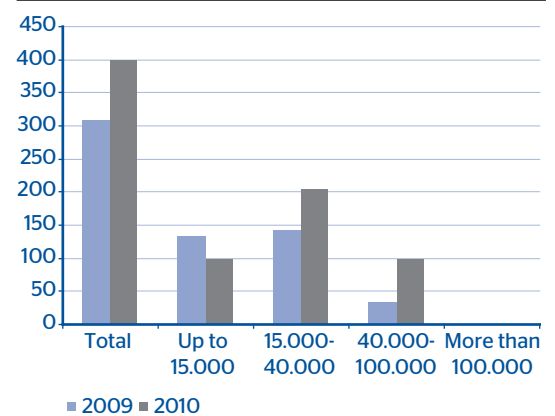
Given the costs structure at construction companies, housing sales prices could rise up to 10% in 2011. This growth would affect housing for all socioeconomic levels. Thus, an increase in the price of land available for housing construction, particularly luxury apartments, will drive up prices in exclusive districts. Likewise, a shortage of land available for construction could be driving developers to look to outlying areas of the city, which would increase prices per m<sup>2</sup> in middle and lower socio-economic districts, as new housing zones emerge with better basic services. All of this in a context of unmet demand, particularly in the middle sectors.

Chart 4  
Prices per square meter in Lima (USD)



Source: Capeco and BBVA Research Peru

Chart 5  
Unmet demand in Lima Metropolitan Area and Callao, by price range (thousands of homes)



Source: Capeco and BBVA Research Peru

### Housing market in provinces

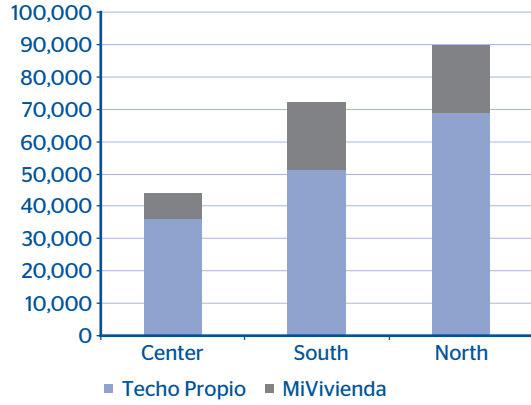
In recent years the housing market in provinces has recorded strong growth. This development has been partly reflected in the growing value of both housing and land. For example, data provided by Capeco shows that in Arequipa housing prices per m<sup>2</sup> have increased 45% over the last three years.

One fundamental factor behind growth of the housing market in inland areas of the country has been rising income levels, linked to quality jobs created by boom in mining and agro-industry. This has also led families to make a permanent move to cities where companies in these sectors operate. A further key factor has been a surge in shopping centers and department stores (modern retailing). They have created new property hubs and driven up demand for housing close to such developments, offering better quality services, particularly in the north of the country.

Although most effective demand for social housing is found in Lima, there is also significant demand in the provinces (see chart 6), with around 200,000 families capable of buying a home, particularly in the north and south of the country. It is worth to mention that just 25% of the housing deficit of some 2 million homes is in Lima, meaning there is much room to expand housing supply in the provinces. There is also room to make more MiVivienda loans and 'Techo Propio' (Own Roof) housing bonds available to finance social housing in the provinces. In fact, one of the challenges facing state housing programs is to reach the country's interior regions, where the lowest-income population resides, and in particular the central region, where penetration of home-owner loan products has been low (see chart 7).

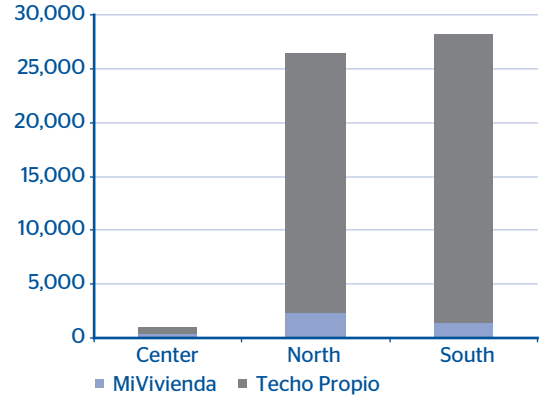
With household income increasing, employment levels rising and better implementation of property projects (according to market sources, Trujillo has around 160 projects, while Arequipa holds near 50), housing market in the provinces has good growth prospects.

Chart 6  
Effective housing demand\* (housing units)



(\*) excluding Lima and Callao.  
Source: MiVivienda Fund and BBVA Research Peru

Chart 7  
MiVivienda loans and Techo Propio bonds (units, Aug'06 - Apr'11)



Source: MiVivienda Fund and BBVA Research Peru

**Box: Improving institutional aspects should help boost housing demand**

While housing supply has grown rapidly over the last few years, particularly for lower-income sectors with the support of state programs, it is still insufficient to cover demand in the medium term due to existing housing deficit (2 million homes nationwide), affecting around 25% of homes in Peru. Peru's neighbors Chile and Colombia, for example, each build around 140,000 homes every year, while in Peru around 40,000 are built in the formal sector. The government could implement measures to increase housing supply in the private sector for low-income households, particularly megaprojects that would help drive down unitary costs faced by constructors. This would also reduce construction in the informal sector (2 out of every 3 homes is self-built). Such incentive measures could include:

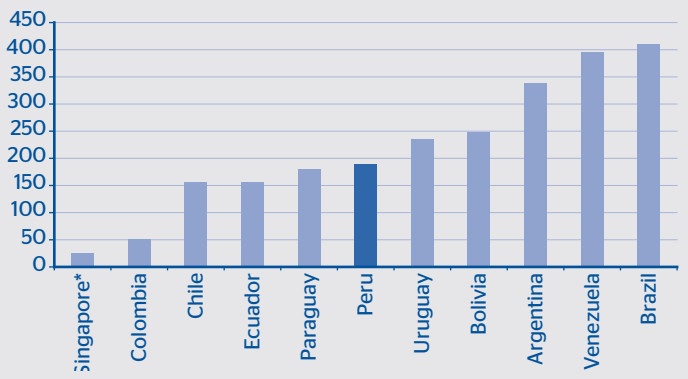
1. The elimination of bureaucratic barriers to obtaining building permits. According to the World Bank's "Doing Business 2011" report, in Latin America Peru is the fifth ranked country by how long it takes to obtain a building permit, at 188 days, and is eighth in terms of the number of procedures required to obtain the permit, at 19 procedures (Colombia is first with 50 days and 10 procedures respectively). There is clearly room to improve in this respect (see chart 8 and 9).

2. Schematic land use zoning by local governments would allow improved use of space within districts, while zoning changes in certain districts could permit areas of high-density housing. It is estimated that 65% (in 2009) of local governments have no land-use zoning plan, just 18% of districts have any urban planning and only 35% of these have a cadastre (in 2005). Such plans would allow buildings with more floors to be built, thus increasing the supply of multifamily housing. This would mean tackling the problem of available land by promoting vertical city growth.

3. Cutting the time it takes to resolve litigation over land available for construction, providing more admissible land, which would help the land scarcity problem. The judiciary should act to simplify the process.

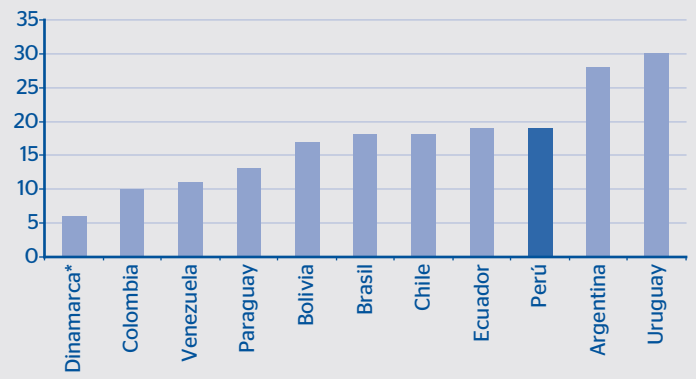
4. Promotion of closer coordination between the state and private business to create new property hubs and/or urban areas with basic water and sewage services. In this respect, state programs such as MiVivienda and Techo Propio must play a key role through the construction of social housing, with a clear legal framework for the allocation and auction of state land via government tenders to attract further interest from developers and/or construction companies.

Chart 8  
Time required to obtain a building permit (days)



\* Leader in the world ranking  
Source: Doing Business 2011 and BBVA Research Peru

Chart 9  
Procedures to obtain a building permit (number of procedures)



\* Leader in the world ranking  
Source: Doing Business 2011 and BBVA Research Peru

## 2. Office market

### Demand factors: demand begins to diversify towards new areas of the city

Demand in the Lima Metropolitan Area for prime office space closed 2010 at a record level (see chart 10). Demand was concentrated among small offices of less than 500m<sup>2</sup>, following the same trend as seen over the last 9 months, while the East Lima Metropolitan Area has begun to register a significant number of transactions (41% of total transactions in 1Q11).

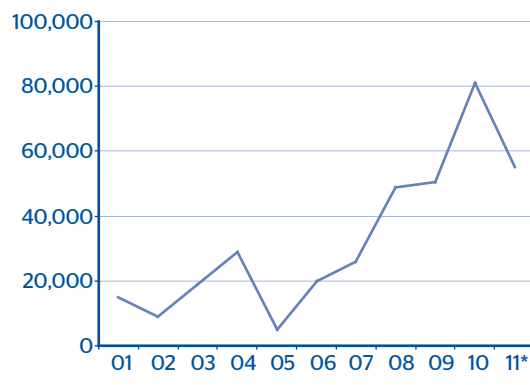
This year demand is estimated to be around 55,000 m<sup>2</sup>, below 2010 figures due to slower supply growth. Growth in the office market is expected to shift towards new areas in the city, due to the steady rising value per square meter in San Isidro and Miraflores (central districts) as a result of shortage of space.

### Supply factors: new buildings delayed from entering the market

In 2010, the supply of prime offices declined, with fewer new buildings entering the market. The shift towards the development of LEED certified projects (green buildings) continued, mainly in the San Isidro district, which is planned to be the city's financial hub, complemented by commercial and services projects.

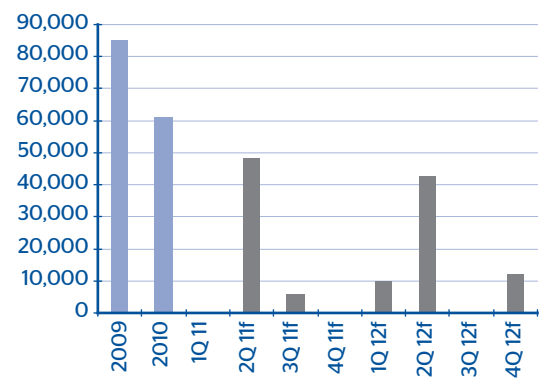
According to Colliers, in 2011 approximately 55,000 m<sup>2</sup> is expected to enter the market, which is less than the supply added in 2010 (see chart 11). The trend will be marked by supply growth in new areas of the city. Indeed, in 1Q11 most available prime office space was in the East zone (47% of vacancy in the period).

Chart 10  
**Demand for prime office renting in Lima Metropolitan Area (meters squared)**



Source: Colliers and BBVA Research Peru

Chart 11  
**Future prime office supply in Lima Metropolitan Area (meters squared)**



Source: Colliers and BBVA Research Peru

### Prices: the delay in new projects should temporarily increase rent prices

In 2010, rental prices closed at USD 16.5 m<sup>2</sup> (USD 16 in 2009), due largely to buoyant demand and fewer new buildings entering the market. In 1Q11, prices grew 13.2% against the previous quarter to USD 18.6 m<sup>2</sup>, largely due to delays of projects deliverable in the quarter. As supply does begin to enter the market, demand should absorb the available space and lead to a price increase in 2011. Against this backdrop, higher investments will be required if healthy vacancy levels are to be achieved (currently at 2.8%) and to relieve some of the pressure that has driven up rental prices for some years.



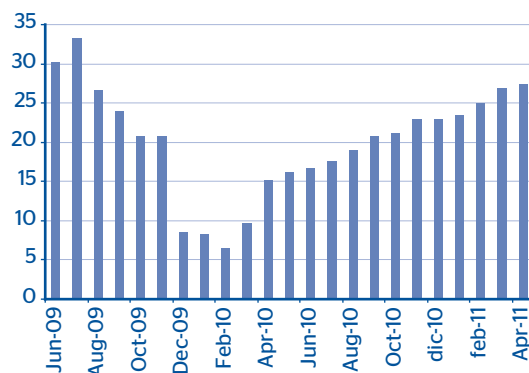
### 3. Financing

As per April of this year, growth in total mortgage lending was 27% (see chart 12), totaling PEN 16,921 million (3.9% of GDP). This performance is the result of: i) increased housing demand; and ii) interest rates falling below pre-crisis levels (see chart 13), due to lower risk perception as public debt ratings improve and increased competition between banks for customers through new products. This has opened the market to new population segments (e.g. young people, unmarried couples, and mortgages for those with the backing of a savings account).

As for the currency used in mortgage loans, at the close of April 52% was denominated in foreign currency (around 70% at the close of 2008), while the rest was in the national currency. As a result, the level of mortgage loan dollarization declined further, reducing FX risk. It is noteworthy that the default ratio for mortgage loans has stabilized at around 1% in the last year, after an increase in 2009 (see chart 14).

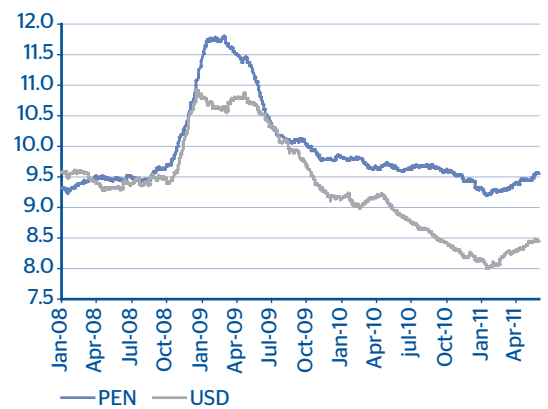
Over the next months, financing conditions will keep attractive with the introduction of new financial instruments that will facilitate the funding requirements and portfolios risk management of the bank entities, for example, covered bonds.

Chart 12  
**Mortgage loan balance (% change yoy)**



Source: SBS and BBVA Research Peru

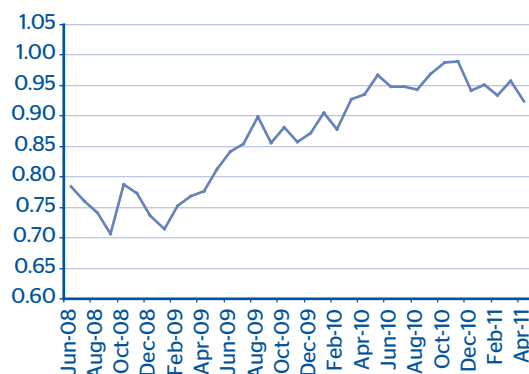
Chart 13  
**Interest rate on mortgage loans (%)**



Source: SBS and BBVA Research Peru

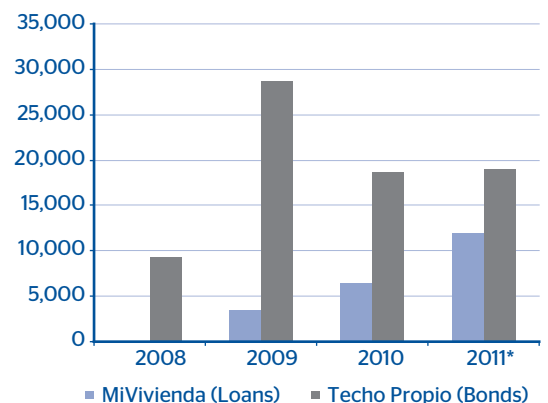
In the social housing sector, MiVivienda loan growth continues to accelerate. An average 738 loans have been granted each month so far this year. The target this year is to grant 12,000 mortgage loans (see chart 15), for which a budget of USD 950 million is available. The government has also increased the Techo Propio budget in 2011 to PEN 350 million (PEN 332 million in 2009), which should be enough for around 19,000 family housing bonds.

Chart 14  
**Mortgage loan default rate (%)**



Source: SBS and BBVA Research Peru

Chart 15  
**Supply of social housing loans**



Source: MiVivienda Fund and BBVA Research Peru

## 4. Conclusions

Economic growth and good financing conditions will continue to support the housing market in the medium term. Demand for prime offices should continue to fill new office space as new buildings enter the market. These buildings will be located in the Lima East Zone, due to a lack of available office stock in the central districts such as San Isidro and Miraflores. Mortgage lending should move towards more sustainable growth levels as mortgage interest rates increase due to monetary tightening.

In the medium term, preserving macroeconomic balances (sustainable fiscal and foreign balances) and low inflation will be key to ensure a positive performance by the real estate sector. Against this background, economic agents (both households and corporate) should have a better outlook for their long-term spending decisions, and may benefit from more attractive financing conditions.

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## This report has been produced by Peru Unit:

*Chief Economist for South America*

**Joaquín Vial**  
+562 351 1200  
jvial@bbvaprovida.cl

*Chief Economist for Peru*

**Hugo Perea**  
+51 1 2112042  
hperea@grupobbva.com.pe

**Francisco Grippa**  
+51 1 2111035  
fgrippa@grupobbva.com.pe

**Rosario Sánchez**  
+51 1 2112015  
rdpsanchez@grupobbva.com.pe

**Jasmina Bjeletic**  
+51 1 4142518  
jbjeletic@grupobbva.com.pe

**Isaac Foinquinos**  
+51 1 2111649  
ifoinquinos@grupobbva.com.pe

## 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**

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

China  
**Daxue Wang**  
daxue.wang@bbva.com.hk

India  
**Sumedh Deorukhkar**  
deorukhkar@grupobbva.com

South America  
**Joaquín Vial**  
jvial@bbvaprovida.cl

Argentina  
**Gloria Sorensen**  
gsorensen@bancofrances.com.ar

Brazil  
**Enestor Dos Santos**  
enestor.dossantos@bbva.com

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

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

Macroeconomic Analysis Mexico  
**Julián Cubero**  
juan.cubero@bbva.bancomer.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@grupobbva.com

Financial Systems  
**Ana Rubio**  
arubiog@bbva.com

Pensions  
**David Tuesta**  
david.tuesta@bbva.com

Regulation and Public Policy  
**María Abascal**  
maria.abascal@bbva.com

*Global Areas:*

Financial Scenarios  
**Sonsoles Castillo**  
s.castillo@bbva.com

Economic Scenarios  
**Juan Ruiz**  
juan.ruiz@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  
Teléfono: + 56 26791000  
E-mail: bbvaresearch@bbva.com