

# Dealing with Construction in Spain

## Foreword

Modern Villas was originally created in Marbella, Spain, by Belgian entrepreneur Philippe De Smedt and his wife Lu de Castro Costa Smedt (Brazilian, architect), to address the shortage of modern quality villas in the area.

Philippe first moved to Marbella in 1996, and later become strategic director of the then leading Dutch developer La Perla Living (La Heredia, Monte Mayor, NonSuch Bay Antigua).

From 2003 to 2013 he moved to Brazil, creating Brazil Estates; sourcing investment and development land for hotels, developers and institutional investors.

Modern Villas originally was created as a brokerage focused on Modern Villas, but soon specialized in architecture and project management, as local providers couldn't match the high demands of their mostly Belgian and Dutch clients.

The portfolio now includes dozens of the most exclusive luxury villas around the world and a client base that includes many Belgian and Dutch captains of industry.

Since 2016, Modern Villas went global and slowly transformed into an architectural power house, with architects around the world, and specializing in cross-border development of modern luxury villas.

## Table of Contents

Foreword	0
<b>Building costs in Spain</b>	<b>2</b>
Costs per square meter: not all square meters are equal	2
Costs per square meter	5
<b>Managing construction companies</b>	<b>6</b>
<b>Construction contracts: traditional, turnkey and open book contracts</b>	<b>6</b>
First option: traditional construction (with separate architects)	6
Second Option: turnkey, or design-and-build	6
Third Option: open book	7
Careful with “Auto-promoción”	8
<b>Spanish construction techniques</b>	<b>9</b>
<b>Managing construction costs</b>	<b>10</b>
<b>Types of construction companies</b>	<b>12</b>
From low, to high overheads	12
From low, to high integration	13
Why showhouses and references are often misleading	14
Why most builders try and catch you with low initial budgets	14
Why the budgets (usually) are just rough estimates	15
<b>What profits can you expect?</b>	<b>21</b>
Investors and the need for speed	22
Investors and cost control	23
<b>Build, or buy from a developer? Why small is beautiful.</b>	<b>24</b>
<b>The VAT advantage of building: less exposure</b>	<b>26</b>
<b>Some rules of thumb</b>	<b>27</b>
<b>Selling off plan vs finishing the house?</b>	<b>28</b>

## Building costs in Spain

### Costs per square meter: not all square meters are equal

One of the first questions clients ask me is invariably: what is the cost per square meter of building in Spain?

I'll give you the answer, but I must warn you that this is probably the biggest source of misunderstanding, abuse and under-estimation in Spain.

One square meter in Spain is no bigger or smaller than anywhere else, but the definition is completely different.

First of all, in most northern/western/eastern European countries, it is common practice to count *indoor living space* only - the "noble" part of the house that includes living/dining rooms, kitchen, bedrooms and bathrooms. These are usually all "above ground"; the house may have a basement or not, but that is not usually included in the calculation.

Not so in Spain! Most developers, architects, agents and constructors will "include" a lot of square meters that are cheaper to build. Basements (whether finished or not), covered terraces, and even carports, pergolas and pool cabanas are all included in the "total build" number that is always advertised.

All too often the "650m<sup>2</sup>" house that a Spanish builder, architect or agent is talking about corresponds more to a "350m<sup>2</sup>" house in the eyes of an English or German buyer!

And of course, there are a lot of things to be built *around* a house in Spain that you aren't routinely built in our colder climates. Spanish villas may have hundreds of square meters of covered terraces, pergolas, poolside cabanas and outdoor kitchens. Sure, these are cheaper to build, but they do have a cost, and it does add up.

The tricky part is to understand the "balance" between noble/expensive "indoor living area" and cheaper basements. Spanish developers and architects often add as much "cheap" surface in the mix as possible, so they can sell a lot of "total" m<sup>2</sup>

*In the example above, are we talking of a 350m<sup>2</sup> home that costs €2000/m<sup>2</sup> to build (i.e. €700k) or a 650m<sup>2</sup> home that costs "only" €1075/m<sup>2</sup>? If you use the €1075/m<sup>2</sup> as a cost estimate for your "350m<sup>2</sup>" house you're in for a big surprise.*

*Note: developers and architects in some holiday markets are true masters at creating villas with a huge “size impact”: i.e. villas that look quite big on the outside, with (cheaper) terraces and pergolas stretching the visual perception of the house while the (more expensive) inside living areas are minimised. To some extent, that is justified (you’ll be living outdoors a lot of the time anyway), but it can be very misleading in terms of cost per m<sup>2</sup>.*

A second complication: outdoors living areas.

Swimming pools can range anywhere from 4x8m to 6\*20, with or without a walk.in “beach” área, with or without jacuzzi, infinity or not, with or without heating. Whether you spend €30k or €80k on all that will make a big difference in cost per square meter.

A third complication: non-construction items.

Builders and architects tend to quote prices for “construction”, conveniently forgetting to mention that kitchens, bathroom furniture, built-in wardrobes, landscaping, and the building permit (easily 5% of the budget) are not included. But whether you’ll invest €35k in a kitchen or €70k in a kitchen makes a difference of €100/m<sup>2</sup> for our 350m<sup>2</sup> house. (Or was it a 650m<sup>2</sup> house?) The same goes for landscaping, home automation.

A fourth complication: site works, retaining walls and foundations

In most of Europe, plots are flat and there will be limited costs to “prepare” it for building. But in Spain, steep plots may require expensive retaining walls, earth movement, and even depth foundations (piling) that can add €50k, €100k or even more to the bill, without any visible improvement to the house. (And much more for larger villas on larger plots!)

A fifth complication. high costs of building permits.

In Spain, this is not just an administrative fee - it is a real income generator for the local town halls. The cost depends, but you can easily spend 5% on the building permits alone (split over initial and final licence.) Was that included in your building cost?

A fifth complication: architects fees.

Sure, the architect usually quotes up front what he will charge you, 5%, 8%, whatever. But sometimes they forget to tell you that you’ll also have to pay the technical architect (1.5 to 2.5%), oh... and the security project. Did I mention the fees for the OCT that the bank may require, or the cost of the 10-years insurance you will need if you want to sell the house?

A sixth complication: different assessment values.

Often people get misled by the different costs/m<sup>2</sup> that the architects' association or the local townhall uses for (tax) assessment purposes. These are generally on the low side, representing "average" qualities for the Spanish market.

A seventh complication: density.

Every house needs a certain "kit" of installations: one kitchen, heating/cooling systems, solar. Also bathrooms concentrate a lot of cost on just a few m<sup>2</sup>. As a result, a 4 bedrooms house of 250m<sup>2</sup> (internal) will be more "expensive" per m<sup>2</sup> than a 4 bedroom house on 500m<sup>2</sup> internal living space.

An eight complication: local market pricing.

Most architects stick with "local" builders that may, or may not be cost efficient. In some high end locations like Marbella, costs simply are higher than elsewhere because everyone is used to it. As the selling prices per m<sup>2</sup> in these areas are exceptionally high, constructors have always been able to charge more and never felt the "need" to become more efficient. In other areas like Murcia or Alicante building costs are lower simply because the market demands it. Ibiza and Mallorca are 30-40% more expensive than average, and the "transport" cost of shipping materials to the islands cannot fully explain that difference!

*Note: we often work with efficient builders from "cheaper" areas that we put to work in more "expensive" areas.*

Ninth complication: basements

In many cases, builders have to go down 2-3 meters below the top soil to find "solid" ground for the foundation; so if this area has to be excavated, and structure has to go up to the ground floor, then you've already "built" one third of the basement and it is relatively inexpensive to add some outside walls and a floor, and create an "unfinished" basement. Upgrading part of it for a storage, and technical rooms or even laundry won't cost too much either.

But often, these "basements" evolve into a real "third" level with extra guest rooms, bathrooms, gyms, sauna's etc. with airco, heating, home automation, sliding windows, terraces, etc. - i.e. with a level of installations that are almost at par with the ones "above ground". Needless to say, in this case the "basement" can be almost as expensive as the areas above ground

Tenth complication: modifications "after licence"

Throughout the book, I've mentioned dozens of tricks that people use to "prepare" for modifications and add-ons that can only be executed after the final occupation licence is given. But of course, this results in some double costs - as some parts have to be built in order to meet final inspection... to be broken out after that when works have to be restarted. Architects and builders know lots of tricks to minimise this cost but the more tricks you (need to) use, the more extra costs.

## Costs per square meter

Well, I owe you an answer to that question - but not that fast. As the definition of “square meters” is so irrelevant, we simply refuse to make any “average” quotes for a “total” number of square meters.

Instead, we design a real project for a real plot, and our software allows us to easily measure the amount of m<sup>2</sup> that is going to be fully finished “internal living área”, the amount of m<sup>2</sup> that is going to be covered terraces vs pergolas vs uncovered terraces vs pools vs pathways etc.

We calculate the amount of basement that is unfinished, finished cheaply (garages, storage...) or finished to “fuller” specifications.

We calculate the (rough) amount of retaining walls that will be needed as well as perimeter walls.

We calculate the driveway that may be needed to access the underground garage and whether that will require retaining walls on one or both sides.

We then add a flat budget for kitchens, landscaping, pool and licence.

For all these different types of areas, we know the normal construction costs of the different builders we work with, and the different quality specifications that they work with.

In our opinion, this is the only way to get to a close estimate of the real budget! Without studying the plot and making an actual project, you can quote any number but it simply means nothing.

I'll give you an answer anyway - but you are reminded to use this at your own risk and peril!

As a base for “normal” construction, like the one used in most apartment developments, most builders around Spain end up at building costs around €1100-1200/m<sup>2</sup> (and that is using the Spanish, all-inclusive way of counting the m<sup>2</sup>). Villas are usually built to higher specifications, and construction costs of €1500-2000/m<sup>2</sup> are common for markets where villas may be sold for €1 or 2 million.

True luxury villas with all gimmicks may cost €3000+/m<sup>2</sup> but of course the sky's the limit.

Quality-wise, the increase in quality that is possible with a little more budget is dramatic. That is because the first €1200/m<sup>2</sup> represent the basic “necessities” to have a house built at all...

Whether you then add €300/m<sup>2</sup> for better finishes (€1500/m<sup>2</sup>) or add €600/m<sup>2</sup> (€1800/m<sup>2</sup>) will “double” the qualities you can get in terms of luxury floors, better painting, nicer bath tubs, kitchen appliances etc.

## Managing construction companies

### Construction contracts: traditional, turnkey and open book contracts

Once the design is decided, the bill of quantities is defined, you're ready to get a quote from the builder. If the architect knows his business, this quote shouldn't be far off the budget specified in the initial brief.

But you now can get the same house built in different ways that can affect the final cost dramatically.

#### First option: traditional construction (with separate architects)

In this format, you choose an architect; he will recommend a technical architect, and they will recommend the other engineers etc. required to make the project and get it approved. That's a lot of people to manage, a lot of potential miscommunication, and while it might work in your home country, I find it simply too risky to do that from a distance and in another language and culture.

It goes awfully wrong 9 times out of 10, and I simply won't do this nor recommend this for any client.

Usually, the architect makes a comparison between a couple of constructors he recommends; but you never know if you're not just being played and steered towards the ones that are his best friends or pay the best commission. That's not supposed to happen but... it happens all the time.

If something goes wrong during construction - a mistake in the plans, or in the structural plan, or in the bill of quantities, a game of finger-pointing ensues and in most cases it's the client that ends up holding the bag.

When talking to such "constructors", bear in mind that they usually take care of "construction" only. Kitchen and other built-in furniture, landscaping, architecture are not handled by them and not included in the price.

## Second Option: turnkey, or design-and-build

In this format, you choose one company that is responsible from A to Z - from design to delivery - i.e. a one-stop solution. One price, one person in charge, one contract.

Of course, within that company, all the same players are present. But the difference is, that they've been working together for years, sit in one room across the table, so chances are that communication and coordination are a lot better.

Even so, they're still human, and they still make mistakes. But it's not you that pays for mistakes: if they are made, it's the turnkey company that will have to pay for it, not you. People and companies tend to learn more quickly when they have to pay for bad decisions themselves, and a turnkey builder that's been around for awhile has learnt to avoid expensive mistakes: he'll be faster and cheaper and do things right from the first time.

Make sure that you're dealing with a *true* turnkey company, one that has everything vertically integrated from A to Z - not just a loose combination of a builder that just hires a local architect and offers "turnkey" prices. Promising a turnkey price is an easy thing to do, consistently delivering it is another thing entirely!

Yet in spite of all the above logic, turnkey builders, especially the cheap ones, are not always a sure bet.

Many try to make volume and reach economies of scale by aggressive marketing (and pricing), using an army of young, inexperienced but charismatic architects and great marketing materials. It usually works well in the beginning; but alas too often it's almost a Ponzi/pyramid scheme where the first clients get a good deal but the last ones lose most of their money.

## Third Option: open book

In the "normal" contract, the building company will charge you for the work after it's done, and this means they will have to finance the materials, subcontractors etc. themselves - these are hundreds of thousands of euros of their own capital that are at risk and at tied up for the duration of the construction, so they do logically have to add their overheads and a profit margin on top of the cost to cover this.

In an "open book" turnkey, the building company will work with the same bill of quantities and buy the same materials, subcontractors etc. But rather than having to "hide" their costs and the markup, they "open their books" and show you the real negotiated cost of all these materials, and you - the client - pays these costs directly to the factory or supplier - and *in advance*. This

way, they can get further discounts at the factories and suppliers, part of which are reflected to you.

The difference in cost can mean 5% or more of the total budget; so if you have the cash available and the discipline to handle and pay a few dozen invoices promptly, this is a great formula. Many investors opt for this formula; but if you're depending on bank financing for the construction it probably won't work.

### Careful with “Auto-promoción”

If builders or developers sell construction, they have to provide the ten year structural guarantee (backed by an insurance), and this costs money. They are the developer or “promotor”, and you are the client.

To avoid the bureaucracy and costs of the ten year insurance, clients can act as if they are the developers (“promotor”) themselves; so legally it is them contracting out all the jobs to one of more subcontractors and the “builder” only acts as a coordinator - say consultant.

The problem with this is that as “promotor” you then assume a lot of responsibilities. When subcontractors don't pay their social security, for instance, the promotor can end up being liable for it.

Needless to say, this is a risky proposal best left to experienced developers with good construction lawyers.

## Spanish construction techniques

In Spain, most construction is based on a “skeleton” of reinforced concrete - a combination of concrete pillars and beams that form the backbone of the construction and carries all the loads.

The whole usually rests on either a massive concrete foundation slab; or on a number of large foundation blocks - one below each pillar.

These structures are often built by specialized contractors; and the ‘builder’ only steps in once the concrete structure is completed, adding the brick walls inside the structure.

Many northern Europeans still prefer “brick” walls, even for construction in Spain, without realising we’re talking about a totally different animal here.

In countries like the UK and Belgium, where the bricks do have to support the loads, strong and massive bricks are used, and bricklayers have to lay them with a certain precision.

In Spain, the bricks do not have to carry any loads, so they tend to be really light and hollow, and bricklayers don’t worry too much about laying them really nicely. All in all, it’s a pretty low tech affair.

But being so light and hollow, the Spanish “brick walls” do not perform as well in terms of isolation (for heat nor noise) as their “solid” northern European counterparts.

When used for outside walls, without serious additional insulation the interior will heat up almost immediately and your airco will be on constantly. Usually a thin layer of PU isolation (3-5cm) is sprayed on the inner face of the outside wall; but this is actually pretty minimal.

When used for inside walls, their lack of “mass” means that sound easily travels from one room to the next. Especially after plumbers and electricians are finished cutting out the channels for their installations, nearly nothing separates one room from the next!

For true comfort there are several other solutions, from insulated concrete to even drywall/ light steel frame (Gyproc). If properly specified (*double* layers of gypsum board or cement board on each side, sound isolation in between) they are much better for sound and heat isolation. The building goes faster, installations can be added/changed/repared more easily, and the end result is smoother than the Spanish manual plastering of the walls.

## Managing construction costs

In principle, all construction costs are defined before construction and you should end up paying what you signed for.

Unfortunately, this is the exception rather than the rule!

Any tiny change during construction - upon request of the client or even his architect - gives the constructor and excuse to charge extra.

To be fair: making changes during construction IS a logistical nightmare, causing disproportionate delays and extra expenses

- materials that were ordered may have to be cancelled (or remain unused)
- new materials required may not arrive in time
- structural, electrical plans etc. may have to be redone (and each of these engineers will charge again) and material purchasing lists adapted
- works may have to be stopped, but overheads keep running (cranes, supervision, insurances)
- the plumber asked to come "one week later" may not be available then, but only three weeks later... causing a cascade

A lot of work has to be done under time pressure, and even "small" changes can end up absurdly expensive. New materials or subcontractors have to be contracted without time for optimization or negotiation.

Presented with a high quote for the "extra", the client too is forced to approve it under time pressure. If he doesn't say yes right away, work have to may be stopped, and planning and timing totally get out of hand.

In short: even with the most honest of builders, making changes during construction is an absolute no-no.



## Types of construction companies

### From low, to high overheads

The different types of construction companies are mostly defined by their **overheads** ratio.

In general, overheads in construction companies are around 20%: i.e. to make a 10% margin over the cost of materials and labour, they'll have to charge a 30% markup.

On one extreme, you have small "family type" construction companies with less overheads. In theory they can be cheaper, but it's a bit of a gamble. Yes, they have less overheads; but they also lack the buying power of larger companies to get building materials at lower costs. A little error or accident and their planning falls apart, leading to delays and extra costs.

Also, less overheads means that they may lack the financial, organizational and technical "brains" of a more structured company.

Financially, your cost advance may end up being used to finish another job - and your job may have to wait until the next client pays for yours. Technically, they may resort to the most basic construction methods, used traditionally in Spain, not reaching the level of comfort and finish that can be achieved with more modern methods.

On the other extreme, you have large, successful companies who build dozens of villas each year. These usually have their own technical architects and engineers. They have a finance department that controls all expenses. Planning managers and ditto software. A purchasing department that gets better prices and gets everything delivered just in time.

Most of these companies, however, seldom sell directly to the public: they get most of their projects from the dozens of architects operating in their area. There is a certain co-dependence; and to a certain extent, the architect is their main preoccupation although you are on paper the client.

## From low, to high integration

On one extreme, some contractors sign a contract with you and then subcontract almost all tasks to specialized subcontractors. This allows them to be flexible, and build in different quality levels. One client may need the cheapest construction, so they hire cheaper subcontractors; while the next client may want perfection - so they can hire the best specialists there are.

Their job is a mix of coordination, planning, supervision, purchasing; i.e. management! They're generally reliable partners.

Whether they are cheap or expensive depends largely on the industry cycle. In times of a construction boom, they'll have lots of work but so will the subcontractors; and they may end up having to pay top dollar for all subcontractors.

At those times, construction companies who do almost everything in house can keep their costs better under control. Yet they may struggle to grow... as hiring new and good people is extremely hard in the middle of a boom.

They have less flexibility: they're usually good and extremely competitive on one given quality level. If they're high quality, they'll be expensive for a cheap project. If they're low cost, they'll be great at that but disappointing when you ask them to do high quality.

It's important to know what their strengths and weaknesses are - and if their profile fits your needs.

As a result, it's hard to say which builder will be the best for you: it depends on a) your priorities and b) on the *current* situation of the builder.

On top of that, there's a matter of timing: builders that were cheap in 2018 may be near bankruptcy in 2019. E.g. in Marbella we worked in 2016-2017 with a builder that was just starting up and aggressively recruiting clients with extremely low prices; and we had about 5 clients that did the deal of a lifetime. By begin 2018 those low prices had become unsustainable and we had to stop recommending him (yet in the market, everyone was talking about this successful builder! One year later they filed for bankruptcy).

On the other hand, builders that are normally expensive can be dying to fill a capacity gap if one of their clients delays or cancels a project. It's a matter of precisely matching client needs with constructor strengths, and choosing the right partner at the right time.

## Why showhouses and references are often misleading

We also work as real estate agents, and we know that clients tend to be pretty influenced by what they see in the show house or reference houses that the builder shows.

Showhouses are often located on amazing plots with amazing views, and are amazingly (and expensively) furnished. They create a “wow” effect that’s hard to ignore; and that’s of course why builders do build show houses.

Frankly all you can see in a show house is the quality of the last, superficial finish. Of course you can see the nice painting, plastering, flooring, and furniture. Of course you can see if the kitchen equipment is from Gaggenau or from Siemens.

But the actual quality of the construction is largely invisible. Even references are hard to check.

On top of that, the verbal information given out during these visits is hard to verify. “This house cost only €800k to build” (3 years ago. Excluding architect, licence, landscaping, home automation.) Anything will be said to seduce you into signing up with you.

## Why most builders try and catch you with low initial budgets

It’s only human: architects and builders want to sign you up, so any question about preliminary or orientative budgets will be answered in a very rosy way.

Most builders know that (unfortunately) the one who quotes the lowest initial price will usually get the job. Most jobs are officially tendered by the architects to 3-5 builders; so builders get asked for a lot of quotes - but they also know the architects will guide clients to their own favourite builders.

Yet most clients will find out that the final price, once the house is built, more often than not is wildly higher than the initial quote.

Most builders know that there will be ample opportunities to slowly inflate the prices after the contract is signed. They know that:

- most clients will make changes to designs and materials
- most “mediciones” are so vague that “corrections” can be justified (invariably upward)

- most architects will help them defend the extra's (as they have worked together before, and probably will work together many times after; while you will build only once.)
- in worst case, it's always possible to "discover" a big rock or weak spot in the plot that needs extra earth movement/foundation/structural reinforcement.

## Why the budgets (usually) are just rough estimates

You probably remember that the bill of quantities is like a 50-page long spreadsheet, with thousands of materials and jobs to be quoted.

It's made in a specific software, used by all technical engineers and builders; in which every tiny phase of the construction is numbered in a standard way.

Getting actual quotes for all this - in earnest - is a few weeks of work. Most builders do not want to invest that much time for a tender. So they just copy/paste their standard costs for all these numbered elements in the software and add some margins depending on their interest in the job. Done! In twenty minutes they are ready for a quote that may reach millions.

Is this realistic? No. What is realistic is that, once the client signs, they will do all the calculations and then start manoeuvring to either reduce qualities or charge extras, until a decent margin is reached.

Only then will they double check the bill of quantities and the technical architect's plans in detail. More often than not, both are vague enough and contain enough errors so that anything can be massaged until their objectives are met.

I know of no other industry where quotes for (sometimes) millions of euros are prepared so lightheartedly!

But builders that do try and take things more seriously (and do invest good time and money in preparing the quote) know they are often at a disadvantage: the builder with the lowest *initial* quote usually wins (yet at the end of the day, he may end up a lot more expensive).

The builder that spent weeks to study the project and made a quote that he can actually stick to, often doesn't get the job. Yet at the end of the day, their clients end up paying exactly what they were told; and often less than they would pay to the more frivolous builder.

As advisers and agents, we usually know pretty well which builders always end up "on budget" and which ones don't. We talk to so many developers, foremen, clients of ours and other builders that we simply get a better view on reality.

## Taxes

The two biggest taxes you'll pay on your property are the purchasing costs (either transfer tax or VAT) and the value gains tax.

If you buy new property from a developer, that VAT will be 10% - except on related services like architects, topographers, etc., where it is 21%.

As a private buyer, this VAT can not be recuperated so it is to be added to your cost. But many of our clients buy their plot via a specially created "development company". Such development company will still have to pay the VAT on the plot; but will recuperate it when the villa is sold. (It is practically impossible to reclaim the VAT *before* the property is sold, as the VAT authorities presume you are "guilty until proven innocent" and it will take you a court case, with numerous agents as witnesses that you are really a developer, in order to - maybe - get the VAT back.)

But the interesting and slightly unexpected part is that construction companies in Spain will not have to charge you VAT on the construction. When the "development" is ready, the "development company" will charge the VAT to the end buyer, but until then, no further VAT has to be paid up.

The scenario is even more favourable when the investor buys a plot already "owned" by a development company - as long as this was properly created as a separate SPE with a reputable lawyer and accountant (so you are sure there aren't any hidden debts)..

In the below three charts you'll see the comparison between building a house with a cost of €1.5m (€500k for the plot + €1m for the construction) either privately, via an SPE that buys the plot, or via takeover of an existing SPE.

<b>PERSON BUYS</b>	Plot	Construction	Total Cost	
plot price	€500k	€1000k	€1500k	
VAT	€105k (21%)	€100k (10%)	€205k	
total investment upfront			<b>€1705k</b>	
villa sales price			€2000k	
transfer tax on villa sales 9-10% <sup>1</sup>			€190k	

**End result:**

The private buyer will receive €2m from the buyer (the transfer tax is paid directly by the buyer to the state).

Taxable profit: €2000k - 1705k = €295k. On this profit a 19% value gains tax (for non residents) will be paid in Spain or approx. €55k<sup>2</sup>.

**Net profit after tax is €240k for an initial cash outlay of €1705k (or 14%)**

**Note:**

- > If the person owns a property as second residence he will probably pay taxes over an assessed rental value
- > Possibly value gains tax will be applied in one's home country (depending on double taxation treaties)
- > For wealth tax, inheritance/gift tax treatment of real estate may be different from that of shares

<b>COMPANY BUYS</b>	Plot	Construction	Total Cost	
plot price	€500k	€1000k	€1500k	
VAT	€105k (21%)	(€100k - not paid until sale of the asset)	105k up front (+€100 upon sale of the villa)	

<sup>1</sup> In Andalucia 8% on the first €400k, 9% on the next €300k, 10% on the remainder. These rates vary by region.

<sup>2</sup> in fact, for non-residents Hacienda will retain 3% of the villa sales price i.e. €60k. You are supposed to be able and recuperate the difference but...

total investment upfront			<b>€1605k</b>	
villa sales price			€2000k	
VAT on villa sales 10%			€200k	

**End result:**

The upfront investment is lower by €100k, as the company will not pay VAT on the construction.

The development company will charge/receive €200k of VAT from the buyer of which it gets to keep €105k (as €105k of VAT was already paid on the plot purchase).

Net profit: €2105k - 1605k = €500k. On this profit a 25% corporate tax will be paid or approx. €125k.

**Net profit after tax is €375k for an initial cash outlay of €1605k (or 23%)**

Note: even if the profit is “cashed out” and dividend tax is paid, the end result stays favourable

Note: buyers may be happy to take over the company; thus saving about 10% themselves - which may result in a) a better sales price and b) possibly avoidance of the value gains tax.

Note: instead of owning “real estate”, the investor owns shares... which may be more interesting taxwise in regards of inheritance or gift tax.

Note: the development company may of course have “expenses” which will reduce the profit

Note: the development company may also be financed via a loan from the buyer (or a company he owns) thus reducing taxes in the company and creating an interest stream which may be less taxed.

<b>BUY PLOT IN DEVT. CY</b>	Plot	Constructi on	Total Cost	
plot price	€500k	€1000k	€1500k	
VAT	(€0 - not paid until sale of the asset)	(€0 - not paid until sale of the asset)	(€0 - not paid until sale of the asset)	
total investment upfront			<b>€1500k</b>	
villa sales price			€2000k	
VAT on villa sales 10%			€200k	

**End result:**

The upfront investment is lower by €205k, as the buyer will not pay VAT on the plot nor construction.

The development company will charge/receive €200k of VAT from the buyer which it will transfer to the state.

Net profit: €2000k - 1500k = €500k. On this profit a 25% corporate tax will be paid or approx. €125k.

**Net profit after tax is €375k for an initial cash outlay of €1500k (or 25%)**

In these numbers we are assuming the villa is sold for a “healthy” markup of 33% which should be acceptable.

Note: often buyers may be happy to take over the company; thus saving the 10% of VAT - which may result in a) a better sales price and b) possibly avoidance of the value gains tax.

Note: instead of owning “real estate”, the investor owns shares... which may be more interesting taxwise in regards of inheritance or gift tax.

Note: the development company may of course have “expenses” which will reduce the profit.

**Other considerations.**

> The development company can of course also make expenses, reducing the tax base. Car, office

costs, reasonable entertaining, interest on loans...

- > The VAT advantage is even a bit larger as some professional fees (architects, topographers...) which are treated as part of the building cost are subject to 21% of VAT.
- > One can also make a loan to the company; the interests are costs for the company while interest income may be treated more favourably. Even if one offsets the other, it creates an income stream from the company to the investor.
- > One does not "own" a second residence (which may be taxed as "supposed income") but a financial asset - shares.
- > Shares may be easier/cheaper to gift, transfer or inherit than real estate and may be treated differently for (wealth) tax
- > In some countries, there is no value gains tax on the sale of the shares
- > A buyer may be happy to purchase the company hence saving about 10% in VAT or transfer taxes
- > One family member (or holding cy) may own the company/land while another may make the loan, or make a J/V agreement to develop (funding construction)
- > The company will have a maintenance cost of around €5k per year (mostly social security for the administrator).
- > Even if the company eventually sells the property to a family member, the VAT payable at that time is still largely offset by the profit and it is delayed in time by many years.
- > To avoid wealth/inheritance tax, it may be wise to "own" only part of the property while the rest is financed by a mortgage; this way the liability offsets the asset and there may be "nothing to declare"

## Building for investment

### What profits can you expect?

In most European countries, people can easily build their “own” villas themselves, as the perceived (and real) risks are quite low. So a villa developer in Belgium or the U.K. can only expect a small premium for the “convenience” of buying a villa that’s already built for you, often not more than 10 or 15%.

In Spain, the same is true for the local market - inland. But in coastal areas, where most homes are *second* homes, built for foreigners that live far away, don’t have time or inclination to deal with the Spanish system, don’t speak the language and don’t know the legal and practical systems, the picture is different.

The risks are higher, and are *perceived* to be much higher, so developers are often able to add 30-40% on top of their costs (and in 2016-17, even 50-100% as the demand of modern villas is high while the supply was still small). In 2019, profit margins of 15% B/T seem more realistic and 30% is exceptional.

As an investor, these margins make it pretty interesting to overcome fear and learn how the system works.

In fact, almost half of our clients are investors - and they expect only to things: speed, and cost control.

Speed is essential: as it is great to make 30% in one year, but poor to make 30% in two years, and a disaster if it takes three years!

So we, and some of the builders we work with, are specialized in making both architecture and construction go extremely fast.

Cost control is just as important: if €1 million invested returns €1.3m, you don’t want to run over budget and spend €1.1m... which would oblige you to do 50% more business to get the same profit!

The next two chapters go a little further into detail.

## Investors and the need for speed

Every real estate investor knows. speed is the name of the game.

As mentioned, 30% in one year is of course a lot better than 30% in two years. Duh.

But the effect is even more important as these profits get compounded over time. Real estate cycles only last so long... historically around 7 years. So in seven years, if your investment is turned around 7 times, €1 million in equity can turn into €1m x 1.3<sup>7</sup>

That's a cool €6.2m, and it explains why real estate developers can get so rich.

But if the investment is turned around only 3 times, the result is a paltry €2.19m.

Since 2008, investors have also realized that “black swan” events can make markets collapse almost from one day to the next. So although real estate “boom” cycles may on average have lasted 7 years in the past, they also may get cut short unexpectedly.

For this reason, getting “in and out” of the market quickly has become more important than ever. If you're able to get out quickly, you may be able to salvage most of your profits. If you're stuck in a project for two or three years, the risk of getting caught by an unexpected crisis are a lot higher.

## Investors and cost control

Investors of course want to achieve good costs - and most importantly: predictable costs. Even a “small” budget overrun will eat “big” chunks out of the profit - so having the costs totally under control are a must. Low costs help, and buying power gets you that - but not at the expense of risk. As an investor, you’ll want to do business with a “lean and mean” constructor that is efficiently organized, with just the right amount of overheads. Not too little, as you want the builder to be “in control” of everything and have all the project management know how in house to be “on time” and “on budget”.

Not too much, as many of the bigger construction firms have multi-layered hierarchical systems that add overheads - it is quite common for large construction firms to have 20-23% of overheads, if their margins are less than that they lose money.

Investors in villas are at an advantage here, as they can use professional builders that can easily handle a couple of dozen villas a year. They won’t use the small “mom and pop” builders that are cheaper but work on a make it or break it basis. And they don’t need to go to the really giant builders that have thousands or bricklayers on the payroll but have the overheads and delays that go with that.

At this level, the builder is big enough to have economies of scale. Once they get to a level of around 30 villas a year, they get the lowest costs, being “national accounts” at the key materials suppliers.

## Build, or buy from a developer? Why small is beautiful.

Private clients and investors are often attracted by the perceived “safety” of buying an off-plan villa in a larger development, rather than having one or a few villas built themselves.

However, it is actually safer and faster to be on your own.

First of all, you can buy “end user” plots with all urban infrastructure in place, so all you have to do is get your design and building permit and in two to three months you may be ready to start building.

*The developer will buy larger areas, but will have to apply for licences for the infrastructure, put this all in place (using money from the first, “off plan” buyers, and have the infrastructure approved, before they can start building their first villa. This large-scale licences and investments take up considerable time during which your money is at risk but not “working”.*

Second, the minute you have your licence, you can start building and selling, knowing that the final product will be ready in as little as 9 months.

*A developer will invest the funds from the first buyers into the infrastructure. He'll then have to wait for the funds from a second wave of buyers to get started; he cannot start just one villa but will invest the money that comes in over the whole project (or at least, one phase). Your money is tied up in a half-built “phase” instead of in your “own” fully built house.*

Third, “on your own” you can start building and immediately sell off-plan, knowing that the house can be ready in just a few months. That’s attractive for you and for buyers! Or you can wait nine months and then sell the house, fully built, so you can get the top price for it.

If you can buy a few adjacent plots, you can get the best of both worlds. Say you can buy 4 adjacent plots: In this case, you can build just one house, which will act as your “show house” - an important sales tool - while you can have the profits of 4 villas without having to pay for all of them! You’ll still have the advantage of speed while enjoying the leverage that a bigger developer can get.

One fourth advantage: when selling, you won’t have to *compete* with the developer. All too often, if you buy off plan, by the time your house is ready to be put on the market, the developer is just launching phase 2 or 3... You’ll have to compete with their launch prices, and quite frankly, some developers are as “unhelpful” as possible as they don’t *want* you to compete with them.

In the past boom, investors often did well as prices kept rising and rising. But there’s no guarantee that this will happen again, and we’ve all seen that booms can go bust.

It's safer to make your investment on your own, and make your business plan *at today's prices*. If prices have risen by the time you're selling next year, great, what a fantastic bonus! If not: no problem, you'll be making a profit as expected. Even if prices fall, you'll probably get out just over cost, and can decide whether it's time to reinvest.

At least you won't be stuck for years in a big scheme without the possibility to exit.

## The VAT advantage of building: less exposure

If you buy a new build in a development, you are going to pay 10% of VAT on all payments you make for the whole project; plus stamp duty, notary costs etc. Even as an investor, it is virtually impossible to claim (or at least) get this VAT back before you sell, so your investment is by definition 10-12% higher.

If you act as a developer yourself, you will only have to finance the VAT on the plot but the builder will NOT charge you VAT! That's 10% you can invest elsewhere.

When you sell the villa, the buyer will pay the 10% of the total (and at that time, you will recuperate the VAT, if any, paid on the plot.)

## Some rules of thumb

In Spain, villa developers usually try and keep the cost of land down to 30-35% of the market value of the finished house. If you keep to this ratio, you'll usually make a good profit!

*If you think that, in a given neighbourhood a finished modern villa can be sold around €1 million, as investors you should try and keep your plot costs down to around €300k. If a finished villa can be sold around €2 million, you*

The construction will usually cost more; but in "good" markets, your total costs shouldn't be more than 70% of the final product's market price. So if you invest €700k, you should expect to sell around the million, or over; generating 40-50% of profit over your total investment.

## Selling off plan vs finishing the house?

Of course, that amount wasn't invested all the time, so your actual return on the equity invested is often higher.

In the beginning, your exposure is only limited to the plot; and then for the next 6 months, only the architects and building permit will need to be paid. Once the licence is obtained, that is a huge added value...

## Dictionary of building terms

m2 sobre rasante: “above the baseline”: the amount of m2 a building occupies above ground level (ground floor, first floor, etc.)

m2 bajo rasante: “below the baseline”: the amount of m2 a building occupies below the ground level (basements)

edificabilidad: the amount of m2 that townhall allows you to build “sobre rasante”; a fictional number that may (partly) include covered and/or enclosed terraces

proyecto preliminar: a preliminary “design” of a house, usually a sketch or 3D rendering and some floor plans, to give an idea of what is possible on a plot, *without* having resolved all technical details needed to cost the house

proyecto basico: a precise design with real sizes executed on a real topography, but limited to the elements that town halls require for their initial approval

proyecto definitivo: the full set of documentation (a 10cm thick box) required to build the house, including structural, electricity, sanitary, safety, home automation plans etc. etc.

mediciones: a complete (100 page!) spreadsheet-like book that lists every single item required to build the house, and used as a basis for the builders to define their quote

seguro decenal: the 10-year structural guarantee that developers have to provide; backed by an insurance company

OCT (organismo de control tecnico): an outside, independent quality control company. It’s role can be limited to the minimum requirements of the insurance company, or extended to provide additional security that the buyer’s interests are covered

forjado: (floor) slab

cimentaciones: foundation