Devaluation and Real Estate Values: The Argentine Case

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ON JANUARY 7, 2002, ARGENTINA ABANDONED THEIR EXCHANGE BOARD, a law known as the Convertibility Act, that pegged the national currency on a par value with the U.S. dollar. This left the peso's value to be determined by supply and demand of the dollar on the free market. As a result, the peso lost nearly 66% of its value in a few months compared to the dollar.

What impact did this major currency depreciation have on the values of real estate assets in Argentina? What is the past and present relationship that such a tremendous devaluation has had and is still having on the value of real estate assets? In what manner did it influence the quotations and transaction prices of residential units? Were these values evenly adjusted to the new financial situation? What was the influence of the law, passed in December 2001, prohibiting the withdrawal of bank deposits to avoid capital flight from banks and a programmed permission for the later withdrawal of these funds?

This paper will describe the changes in the value of residential properties and the significance of their geographical situation in this period of post-convertibility.

BACKGROUND

From the year 1991 to December 2001, that is, for a full decade, Argentina was governed by a law that ensured the conversion of the peso at par value of one to one to the American dollar, known as the Convertibility Act.

Nevertheless, the price of home units, especially those located in Buenos Aires, the capital city of Argentina, was typically quoted in U.S. dollars. Common market practice held that real estate values were quoted in U.S. currency or pegged to the dollar exchange quotation on the date of valuation.

Memories of hyperinflation and previous devaluation experiences caused Argentine savers to seek protection under the American currency umbrella as a means of taking care of their capital in face of possible economic upheavals.

During the second half of the decade of the '90s an average of 1,000 USD per square meter for apartment units in Buenos Aires was the usual price. There were, of course, various quotations for the different areas of the city which were related to the quality of the environment, means of transport, availability of commercial supplies, homogeneity of architectural styles and socio-cultural level of the neighborhood.

The northern part of the urban area was the one with the highest values. The other end of the city, the southern area, had the lowest valuation figures. The existing gap between prevailing values in either location quoted for units of similar building quality was rarely higher than 33%.

About the Author

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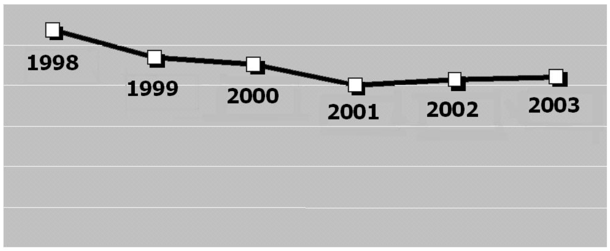
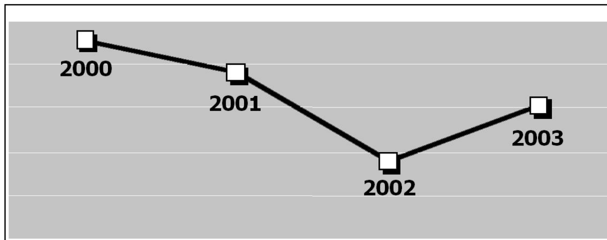
Figure 1—Demand, Buenos Aires 1998 - 2003



Source: Real Estate Registry

Figure 2—Supply, Apartments advertised in Buenos Aires years 2000-2003



Source: ReporteInmobiliario.com

POST-DEVALUATION PANORAMA

The process that resulted in the currency devaluation in the first days of January 2002, started during the last semester of the preceding year. Previous to this situation, a financial crisis that resulted in an official restricting of cash withdrawals from bank deposits and savings (known as "*corralito*") which would also effect the real estate market's performance.

One of the first consequences of the financial crisis was a credit restriction that drained liquidity from the marketplace.

Added to the restrictions on cash circulation, resulting from the "corralito," there was a general uncertainty about the magnitude of the depreciation of the peso value with respect to the U.S. dollar. Strategically, pesos were quickly traded directly for dollars if at all possible.

As from the repeal of the legal exchange "corset," the value of the American currency at the free exchange market went quickly from par up to double the value of the Argentine peso, reaching different levels that even quadrupled and later stabilized at 2.85 / 2.95 pesos per dollar unit by the first quarter of 2003.

The above situation was expected to cause a remarkable drop in real estate transactions but, in fact, that did not happen. The market had suffered a lot in the course of 2001; values had started a gradual decrease owing to the effects of consecutive years of economic recession, the political crisis resulting from the collapse of the financial system, and the local currency devaluation.

It was obvious that the devaluation was a point of inflection for assets but the number of transactions was kept relatively constant, experiencing a very positive peak when people were allowed to acquire properties with the money withheld in the banks. This was a result of fear and mistrust on the part of savers who felt that they would only in the very long term, or perhaps never, recover their capital (April and May 2002; Figure 1).

During the first months following the devaluation and prohibition to withdraw money from bank deposits, the real estate market was in a state of chaos. Many local real estate operators as well as potential customers were completely mystified.

Prices of residential units went down about 30 to 40%. Initially, values were very unpredictable. Publications were quoting very contradictory prices and consequently, nobody knew the actual price of a property at the moment of valuation.

In fact, transactions were taking place for similar properties at prices differing about 50%; in addition, property offers dropped very quickly due to the discrepancy in values (Figure 2).

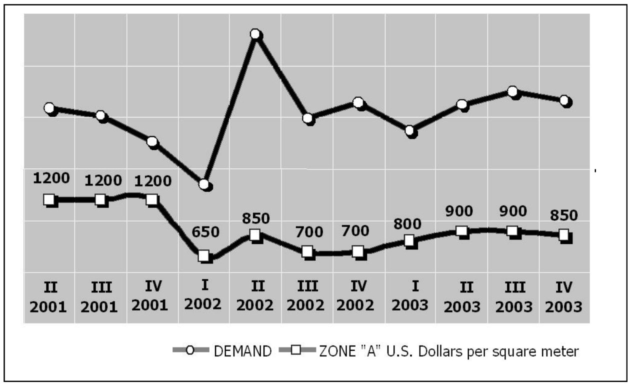
The price drop was larger in Greater Buenos Aires than in the rest of the provinces. In some places, properties practically maintained their peso value with the resulting huge U.S. dollar loss for the owners.

In Greater Buenos Aires (or areas in its periphery) and in the rest of the country, the number of purchase and sale transactions decreased: this was clearly noticeable from offer values. This market suffered a lot more than that of the Federal Capital. Values were adjusted more naturally to a domestic consumption economy.

The best locations in the country maintained their previous U.S. dollar value.

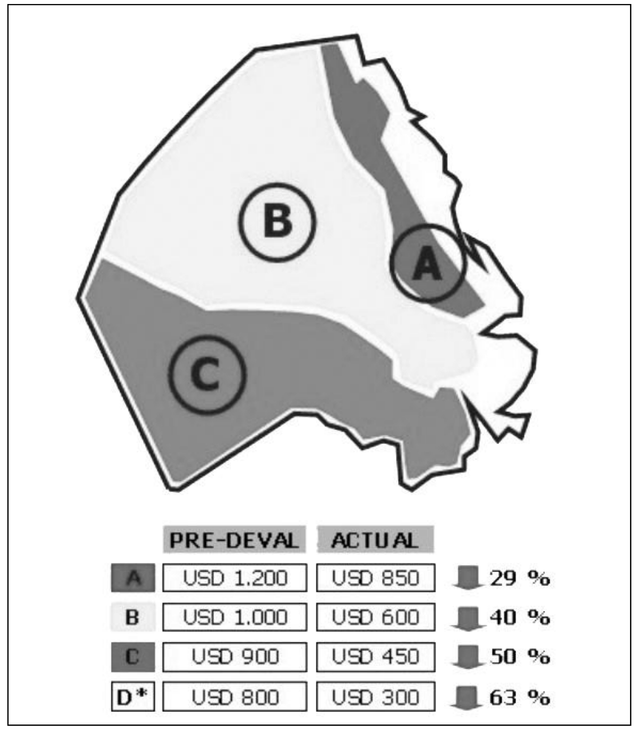
It is rather difficult to find a logical explanation for the above events but, basically, there were some significant factors. From the onset, it was widely held that foreign investors attracted by the drop in prices would come and buy property. In fact, that only took place on a minor scale. This leads us to think that this statement of "expec-

Figure 3—Value, US dollars per square meter in Zone "A" - Demand



Source: ReporteInmobiliario.com, - Real Estate Property Registry

Figure 4



*Peripheral Areas; Greater Buenos Aires area

Source: ReporteInmobiliario.com, - Real Estate Property Registry

tations" was a ploy to induce uninformed customers to pay values that were unsustainable.

By November 2002, the relaxation of the freeze on bank deposits resulted in an increase in property demand and a rise in building activity levels, as a part of the 25 billion pesos freed from financial restrictions were channeled to the purchase of properties in better locations or private developments. Also, due to the rise in value of the dollar, construction costs were lower and the number of square meters that could be built with the same investment increased.

As a result of the lack of confidence in the financial system, a sum of approximately US$7.5 billion was employed in the acquisition of well located properties in central areas, properties that were recognized by buyers for their high liquidity and unproblematic letting capability.

The flow of funds into real estate was increased by information and articles that, through the press, confirmed the advantages of "buying bricks" as a strategy for conserving values. This, combined with a total lack of faith in the financial system and a complete disappearance of low-risk investment options, kept values relatively stable (or depreciating at a very slow pace) in certain areas for a period of 28 months (December 2001 - March 2003; Figure 3).

These conditions, which encouraged demand, caused an important value polarization and the price of well-located residential units decreased less than those of inferior location.

In this manner, the gap in prices per square meter widened between the southern areas and those in the northern districts of Buenos Aires corridor, rising to 65%, doubling the difference in quotations existing in 2001. The map of values changed showing a general drop, with higher prices being maintained in better locations (Figure 4).

At present, prices in the best-located areas are quoted at 80% of their dollar value previous to the devaluation, notwithstanding the fact that the peso lost approximately two-thirds of its value in respect of the American currency.

Even today, values keep at levels that are higher than would be expected by any theoretical standards, if one bears in mind the fact that a property can only be sold on the local market.

CONCLUSION

■ Real estate in superior locations maintained its value to a reasonable extent in the first two years following devaluation, enabling operators to reconsider and adapt their sales strategies.

■ The location of a property became the fundamental issue when purchasing decisions were made.

■ The scarcity of financing did not hinder the market as much as anticipated.

■ A substantial change in the profile of buyers occurred, from homeowners to non-resident investors.

■ Clients with no knowledge of the market too readily accepted as definitive values what was published in the press.

■ Values in the market became polarized more than ever.

■ If one measured the market in pesos (the Argentine currency) it generally went up and devaluation benefited the real estate market—if measured in foreign currency (assets in euros or dollars)—depreciated, but not in proportion to the Argentine currency devaluation.

The Argentine experience of devaluation, in respect of situations such as the one underwent and its impact on the real estate sector, is quite rich in lessons. The varied responses exposed the weakness of simplistic analysis that does not consider the multiple factors at work in a crisis. Many issues are not related to the area of economics, but are more closely linked to cultural, sociological and subjective behavior. Perhaps operators in certain other world markets will be able to recognize patterns similar to those observed during the Argentine devaluation when reviewing the events that took place in our country. ■

SOURCES

Reporte Immobiliario, a weekly publication of real estate trends in Argentina. Can be found at www.reporteimmobiliario.com.ar