Housing supply and the limits of the market: Spain's path to an investable social stock

Spain faces a structural housing shortfall estimated at around 700,000 units, with social housing accounting for just 3.3% of the residential stock, well below the EU average. The EU's reclassification of affordable housing as a service of general economic interest opens a legally secure path for combining public and private financing, but only if authorities rigorously model funding gaps and design compensation that is sufficient without generating windfall returns.

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Abstract: Spain’s housing crisis reflects a structural supply-demand imbalance that has deepened over the past decade, pushing not only vulnerable households but middle-income groups out of urban rental and purchase markets. Net investment in social housing has been virtually stagnant since 2013, with much of the earlier public effort eroded as subsidised homes were deregulated back into the open market. Private developers have retreated from the affordable segment because regulated rents and price caps routinely fail to cover construction and land costs, producing a funding gap that, absent public compensation, makes investment unviable regardless of demand. The decisive regulatory shift comes from the revised EU SGEI Decision of late 2025, which formally designates affordable housing as a service of general economic interest, allowing public authorities to compensate developers without prior Commission notification, provided

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compensation does not exceed net costs plus a reasonable return. Activating this framework requires Spanish authorities to define public service obligations, model funding gaps precisely, and establish transparent compensation parameters, disciplines that would sharpen housing policy while giving patient private capital the legal certainty it has lacked. The framework's main virtue is that it integrates available instruments, allowing land transfers, subsidies, and construction grants from different levels of government to be bundled within a single project without triggering state aid accumulation rules.

Introduction: Housing as an economic challenge

Access to housing is one of the biggest concerns burdening the Spanish public today and a challenge with significant economic implications. The tension between house prices, both for owner-occupied properties and, increasingly, for rented accommodation, and households' purchasing power is not a temporary phenomenon, but rather the upshot of a structural imbalance between supply and demand that has worsened over the last decade. In the main urban areas, where economic activity and employment are concentrated, the growth in rents and property prices has far outstripped wage growth, driving not only vulnerable households but also large sections of the middle class out of the market. House price and rent increases have not been confined to large cities but have spread like an “oil slick” to municipalities in the metropolitan area, extending to the inner and outer suburbs.

The scale of the mismatch is well documented. Bank of Spain estimates put the cumulative housing shortfall relative to the formation of new households at around 600,000 units between 2022 and 2024, a figure that its most recent estimates raise to around 700,000 homes including 2025. Spain’s central bank has warned that this scarcity of supply, coupled with the rapid rate of household formation, could become a bottleneck for the economy. The pressure on prices is consistent with this assessment: according to Eurostat data, house prices in the European Union rose by nearly 48% between 2015 and 2023, with even higher rates of growth in many Spanish cities. The Bank of Spain’s own analysis of the residential rental market flags the limited share of social housing and lacklustre private institutional investment as causes.

A comparison with the situation in Europe is particularly revealing. In Spain, social housing accounts for just 3.3% of the residential housing stock, which is well below the European average of nearly 8% and far behind the leading countries, such as the Netherlands, at around 30%, and Austria, at around 24%. The share of the rental housing stock is also low, according to Eurostat, compared with the EU-27 and benchmarks such as Austria or Denmark. Aside from the low starting base, Spain presents a low level of investment — around four times below the European average measured in terms of expenditure per inhabitant — and the development of social housing has been at a virtual standstill since 2013. The result is

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a meagre stock which has, moreover, been shrinking: many of the subsidised homes developed have since been deregulated, so that the public investment effort has not created a permanent pool of housing.

This assessment has unequivocal implications for the economy. Affordable housing is not just social policy: it is a prerequisite for the smooth functioning of the labour market, channelling resources to the most economically dynamic parts of the country, as many of the people moving to these areas — young people and immigrants — have reduced purchasing power. In turn, affordable housing releases spending power and pent-up savings by not having to earmark a growing share of housing income to paying for housing.

The economic dimension: Market failure, shortage of financing and business model

Correcting this mismatch requires mobilising massive sums of investment which governments cannot shoulder alone and which necessarily require the involvement of the private sector. The underlying question, therefore, is not how much public investment to allocate but how to set up a scheme that is capable of attracting private capital without distorting competition or generating windfall profits.

The private sector, which has not been immune to the property crisis unleashed in 2008, which triggered changes in the development sector's ownership structure and ability to access finance, has focused in recent years on less risky business segments, namely buyers with access to credit and, often already on the housing ladder, implying significant prior savings. The sector has therefore shifted to higher-quality, more fitted out and larger housing than is available in the second-hand market.

The focus on the build-to-rent segment, which started off strong as a diversification strategy for the large developers and sparked interest among value-add managers, has petered out, overwhelmed by the appeal of reorienting properties for sale in a climate of rising prices and strong demand, a strategy dubbed “privatisation”.

The economic logic is undeniable. The growth in construction costs has made it unviable to develop housing for sale or rent at the income threshold levels set in the various regional governments' social housing schemes. One way of addressing the situation has been to increase affordable housing sales prices or rents by tweaking the price cap formulas or creating new specific regimes, in addition to providing aid for their development. There is evidence in numerous Spanish regions of privately-owned land that is not being developed as it is not economically viable to do so, although it is not easy to put figures on the amount of land in question or the number of homes that could be built on it.

The economic rationale for public intervention lies with the existence of a clear market failure when regulated rental income is insufficient to cover construction costs, let alone the cost of land in the locations where housing is needed the most, and does not generate an adequate return for the developer. In that scenario, private developers will not undertake the investment, no matter how strong demand is. The market quite simply does not provide the good in the quantity and, above all, at the price consistent with affordability.

Quantification of this market failure translates into the funding gap concept: the difference between the total cost of the project, including development and long-term operation, and the income it is capable of generating, given the affordability constraints. Well-designed public aid is that which, essentially, covers that gap. No more and no less. If it falls short, the investment will stall; if it is too generous, windfall gains are generated, distorting competition. Hence the importance of precisely modelling the underlying property market, which is very different in nature for affordable rental housing than the traditional build-to-sell model: long horizons, modest and stable returns, inflation impact and sensitivity to cost and financing terms. In addition, many affordable rental housing projects are

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developed on land provided by the public authorities under arrangements for which, despite being around for a long time, there is no liquid market to provide investors with a clear exit strategy. The uncertainty around the potential exit route and price prompts investors in these models to demand a higher return than for other developments even though they often gain access to the land free of charge, which implies not facing permitting risks (as the land provided is permitted as ready to build) and demand is already pent-up.

This combination determines the kinds of investors that fit in this segment. The provision of social housing has fallen almost exclusively to public players, although private actors are beginning to get involved in affordable housing thanks to public-private partnership arrangements designed to mobilise public land. A number of strategies abound: from investors looking to exit in the medium term to very long-term, non-profit or quasi non-profit property managers. The international experience tells us that building a solid and sustainable sector requires a coherent and stable combination of support measures; sporadic or unclear measures attract opportunistic capital rather than patient investors. The transfer of land, arranged through public concessions or surface rights, is necessary but not sufficient: access to finance, its cost and controlled construction costs ultimately determine viability.

The rollout of aid in Spain: State housing policy and state-sponsored credit

Spanish housing policy has intensified sharply in recent years. It is currently articulated around the 2026-2030 State Housing Plan, approved by Royal Decree 326/2026 and in effect since 2026, the first plan formulated under the auspices of Spanish Law 12/2023 on the right to housing. It has a budget of 7 billion euros, of which the state will provide 60% and the regional governments the other 40%, 2.8 billion euros, which is triple the funding allocation under the last budget. The funds are being allocated to three major lines: around 40% to lifting the supply of social and affordable housing; 30% to urban and rural regeneration and refurbishment; and the other 30% to lowering the housing cost burden and helping young people move out of home.

Beyond the figures, the plan ensures that publicly funded social and affordable housing remains permanently protected, rather than reverting to the private market after a fixed period. This fixes the biggest flaw in the previous model, in which public investment was diluted when the homes were returned to the open market. The state is assuming a leadership and coordination role, creating new instruments such as a state-owned housing company and the mobilisation of public land, while day-to-day management falls to the regional governments, which are largely responsible for housing policy in Spain.

The host of measures that can be tapped to increase the supply of housing is extensive and they can be used in combination with other aid, necessitating a thorough analysis not only of how to implement aid for public and private players, but also of how to quantify the appropriate level of aid. The Plan contemplates the possibility that the amount of aid needed could exceed the 7 billion euros allocated; the aid can take the form of land transfers, equity or debt financing and there is scope for providing non-repayable tranches of debt or planning incentives.

Spain's official credit institute, the ICO for its acronym in Spanish, has so far played a key role in driving and enabling the development of affordable rental housing. Under the scope of the addendum to Spain's Recovery and Resilience Plan, the ICO is managing a 4 billion euro Housing Facility comprising loans to public and private developers, supplemented by a 2 billion euro guarantee scheme from the Ministry of Housing covering up to 50% of the principal, to support the creation of around 40,000 social or affordable rental homes, through new-build and refurbishment projects. In addition, it has introduced innovative instruments in the housing sector, such as calls for investment in the capital of vehicles set up to develop and manage social rental housing, backed by InvestEU guarantees and aimed at mobilising private capital, as the ICO is only allowed to take a minority stake in the capital of the selected vehicles.

It is likely that ICO will continue to play a key role in promoting affordable housing, by developing new instruments in line with the guidelines set out in the State Housing Plan, adapting its financing to market needs, creating blended finance instruments that combine debt with non-repayable concessional tranches and promoting industrialised or offsite construction, an area where private banks do not generally offer financing solutions.

The role of the regional governments

Responsibility for housing lies with Spain's regional governments and it is at this level that policy is formulated and implemented. This will be particularly important for taking advantage of the new European framework because, as we will see, any regional government can formally entrust a service of general economic interest. It is, therefore, the regional governments that can make use of the new flexibility available, by designing support schemes and selecting players on an equal footing, taking into account the possible accumulation of aid under other arrangements.

In practice, the regional governments have been developing different strategies that can now be integrated and reinforced. Regional programmes for the development of affordable housing on public land through surface rights or public land concessions, grants for the construction of such housing, the creation of new social housing schemes aimed at ensuring financial viability, authorisation of changes in land use, increases in buildable area or density or reduced requirements for amenities such as parking spaces, or other measures aimed at mobilising vacant housing, to name a few.

This diversity is both an opportunity, by creating space to tailor the various instruments for the reality of each market, and a challenge, in ensuring that regional implementation is suitably adapted for local needs and effective in mobilising additional private capital. Coordination between the state and the regional governments, together with stable and transparent regional regulations, is essential for long-term private capital to find the certainty it craves.

A paradigm shift: EU recognition of housing as a SGEI

All this support, however, relies on a fundamental regulatory development that redefines the rules of the game. For years, public support for social housing in Spain and across much of the European Union operated on the basis of a tacit assumption: that subsidies for social housing did not, strictly speaking, constitute state aid subject to the European Commission's scrutiny.

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Moreover, the convention was that all subsidised housing fell under the category of social housing, whereas in reality — and increasingly so in recent years, with increases in price and rent caps, as well as the creation of new schemes — certain categories of social housing have come to be targeted not at the most vulnerable households, but at middle-income groups struggling to afford housing. This area of legal ambiguity created room for manoeuvre, but it also introduced uncertainty regarding the scope, accumulation and limits of the support that could be granted, particularly when that support was directed beyond the most disadvantaged groups.

That framework has changed substantively. Decision 2012/21/EU, which regulated the compatibility of public service compensation with the internal market, was repealed and replaced at the end of 2025 by Decision 2025/2630/EU, or the revised SGEI Decision, which expressly expands the service of general economic interest (SGEI) concept to include social housing and, in a major new development, affordable housing, whether for purchase or rent. As a result, member states, regions and local authorities may entrust the provision of this service to public and private operators and compensate them with public funds without the need for prior notification to or individual authorisation from the Commission, provided that the Decision terms and conditions are met. It is precisely this power that provides shape and legal certainty to the range of support measures described in the preceding sections.

The new SGEI framework, however, requires a change of approach. The structuring of public support for affordable housing under the SGEI regime requires compliance with a series of formal and substantive requirements which the Spanish authorities have not addressed systematically to date: formal definition of the public service obligations with which the beneficiaries of the compensation must comply; precise identification of the end beneficiaries of the SGEI, including both housing developers and managers as well as end-users; the establishment of pre-defined and transparent parameters for calculating compensation; performance of a cost analysis to determine the level of support necessary and sufficient to make the service viable without providing the beneficiary with disproportionate advantages; and the provision of mechanisms for monitoring and recovering overcompensation.

This set of requirements may seem bureaucratically burdensome, but in reality represents an opportunity to substantially improve the design and efficiency of housing policy in Spain. Conducting a rigorous analysis of the affordable housing market failure and funding gap, as required by the SGEI framework, will oblige public authorities to gain a detailed understanding of the characteristics of the market in which the support measures will operate — including land prices, construction costs, market rents and financing costs — and to accurately quantify the level of support required to make the affordable housing developments viable. That information is essential for designing efficient support instruments and for assessing their impact. This requirement shifts the analysis to the economic terrain.

The SGEI framework as a tool for integrating different support mechanisms

The main virtue of the new framework is not that it expands the suite of support measures,

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many of which already existed, but that it provides a tool for integrating them around a common objective. The entrustment of a SGEI allows for the allocation of land, interest rate subsidies, tax incentives and subsidies for construction or operating costs — provided by different bodies and levels of government — to be combined within a single project without the need for a case-by-case analysis of compatibility with state aid and without the complex rules on accumulation that have hampered such arrangements in the past. The result is to increase legal certainty and lower the administrative cost of putting complex support packages together.

Equally important is the nature of the limit imposed by the SGEI. By setting the sole limit that compensation must not exceed net costs plus a reasonable profit, and by eschewing an absolute monetary cap, the framework recognises the true scale of the investment required and, at the same time, offers private operators something they previously lacked: the prospect of a reasonable and stable return over the long term. This is the precise combination — the absence of overcompensation coupled with the guarantee of a sufficient return — that stands to draw the patient private capital that the sector needs, without turning public support into an unjustified transfer of income.

In short, Spain faces the affordable housing challenge with a structurally limited social housing stock, a need for investment far exceeding available budgetary resources and, for the first time, a European framework that enables a coherent and legally secure support scheme. The paradigm shift implied by the twin December actions — the revised SGEI Decision and the European Affordable Housing Plan — essentially consists of moving away from treating housing support as exceptional aid with an uncertain legal framework to treating it as remuneration for a strictly defined service of general interest. Success will depend on articulating the instruments within a chain of funding, from the EIB to the ICO and from there to the operators; on the State Housing Plan and regional programmes precisely covering the shortfall for each project; and on the regional governments activating SGEI status with stable and transparent rules. If this framework is implemented with financial discipline, affordable housing could cease to be a recurring aspiration and instead yield a stock of housing that is permanent and, above all, investable.

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