Spain – country analysis: a real estate market on a growth trajectory

Source: Male Witch/Shutterstock

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1. Introduction

High demand in Spain's commercial real estate market

Ten years have now passed since the onset of the financial crisis. Back then, the Spanish economy fell into a period of deep recession. Fortunately, the country's ongoing recovery was most recently demonstrated by impressive economic growth of 3.1% in 2017. Fundamental forecasts predict that the Spanish economy will remain at an above-average level in 2018 and 2019.[1] In spite of considerable ongoing public debt and sustained high unemployment, Spain offers stable prospects for economic growth. Tourism is still an important driver of the Spanish economy. The market environment for commercial real estate investment is very transparent and is characterised by its international market players. Spain's appeal, especially in the major cities of Madrid and Barcelona, is reflected in high demand for prime commercial real estate. The supply of commercial real estate is becoming increasingly scarce, which is leading to a steady increase in prime rents. The political conflict relating to Catalonia's quest for independence provoked considerable uncertainty in late 2017, but the real estate market has so far been spared from any real negative fallout. Overall, the signs are pointing towards growth in the Spanish real estate market.

Aim of the study

The aim of this study is to examine current market developments along with the potential and challenges of the Spanish commercial real estate market. The investigation will focus on macroeconomic conditions and, in particular, current developments and trends in the sub-markets of office, retail, hotel and logistics real estate. Moreover, it will provide an overview of SOCIMIs (Spanish REITs) as a market driver.

[1] NORD/LB Economics

2. Macroeconomic conditions

Strong economic growth

As the fourth-largest national economy in the eurozone, last year, Spain showed tangible signs that it was recovering from the financial crisis (2009 to 2013) and the bursting of the real estate bubble. After gross national product (GDP) fell by a total of more than 10% during the five years of crisis, a process of economic recovery began in 2014. In 2015, Spain was able to significantly accelerate its pace of its expansion with real economic growth of 3.2%. This economic momentum continued unabated in 2016 and 2017, with GDP growth that was just as strong at 3.2% and 3.1% respectively. The economic upturn carried on in 2018 with above-average growth rates compared with the rest of Europe (Q1 2018: +0.7% Q/Q; Q2 2018: +0.6% Q/Q). Although GDP growth in 2018 (2.6%) will assumably remain below its forecast of 3.0%, itis still much higher than the euroland average of 2.1%. Alongside strong domestic demand, driven in particular by private consumption, Spain's economy is also benefiting from dynamic foreign trade. Moreover, mention must be made of the positive development in tourist demand as an important driver of economic growth.[2]

Key economic data

Economic indicators (change from prev. year in %)	2015	2016	2017	2018f	2019f
Real GDP growth	3.2	3.2	3.1	2.6	2.1
Unemployment rate*	22.1	19.6	17.2	15.2	13.6
Inflation rate (HICP)	-0.6	-0.3	2	1.6	1.8
Budget deficit**	-5.1	-4.5	-3.1	-2.5	-1.9
Current account balance**	1.1	1.9	1.9	1.6	1.7

Source: NORD/LB Economics, F = Forecast, *in % of workforce, **in % of GDP

Change of government in June 2018
Pedro Sánchez is new Prime Minister

At the beginning of June 2018, there was an unexpected change of government in Spain. Mariano Rajoy, who had been the leader of a minority government since autumn 2016, was voted out by the parliament in Madrid in a vote of no confidence, triggered by a corruption scandal. The new Prime Minster of Spain is the socialist Pedro Sánchez, who does not have a majority in parliament either. Carrying out the necessary reforms will remain difficult. The new government is also facing enormous challenges relating to the need to consolidate public budgets. Even as he took up office, Pedro Sánchez was considering to hold new elections.

Catalonia's quest for separatism without any significant negative impact so far

The conflict surrounding Catalonia's struggle for independence caused considerable political uncertainty in the autumn of 2017. Almost 3,000 companies moved their headquarters and some of their registered offices from Catalonia to other regions in Spain. Having said that, the economic collateral damage has remained manageable. The fraught situation has settled down again over the course of this year. Following a fresh election in December 2017, there has now been an independent separatist government led by Catalan regional president Joaquim Torra being in place since early June 2018. Although the new president is still pursuing the goal of an independent Catalonia, he has indicated that he is prepared to engage in dialogue with new Spanish Prime Minister Pedro Sánchez. Overall, the political situation in Catalonia is still

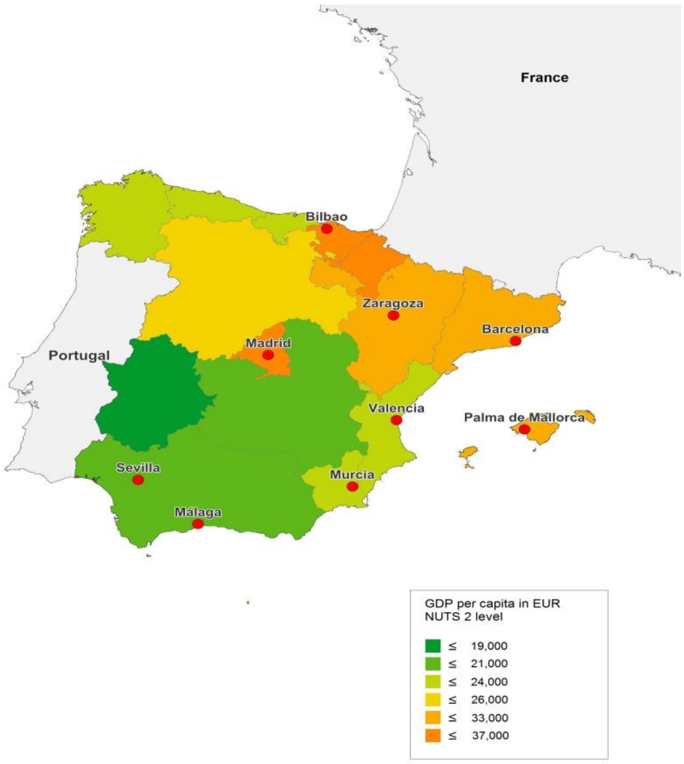
[2] Forecasts: NORD/LB Economics

marked by uncertainty, but Pedro Sánchez' willingness to engage in dialogue demonstrates that the fraught situation is easing.[3]

Economic strength by region

In administrative terms, Spain is divided into 17 regions (autonomous communities). National GDP per capita in 2016 amounted to EUR 24,034 (compared with German GDP per capita of EUR 38,114 in 2016). A look at the individual regions reveals a clear north-south divide. The strongest economic region is the autonomous community of Madrid (GDP per capita in 2016: EUR 36,400), which generates almost 19% of Spain's GDP, putting it well above the national average. It consists of the province of the same name and encompasses the metropolitan area around the Spanish capital of Madrid, which is the country's centre of services. In terms of area, it is Spain's smallest autonomous community, but it is the most densely populated. It is followed in second and third place by the autonomous communities of the Basque Country and Navarra, with GDP per capita of EUR 35,300 (2016) and EUR 33,300 (2016) respectively. The autonomous community of Catalonia takes fourth place (GDP per capita in 2016: EUR 32,000) and comprises four provinces, the capital of which is the tourist metropolis of Barcelona.

Economic power of the Spanish regions (2016)



Source: Eurostat, internal research

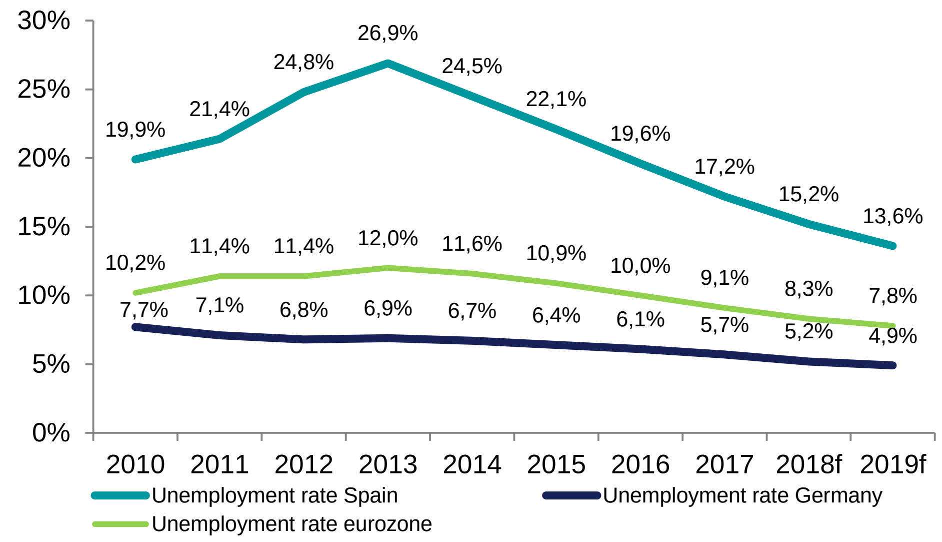
Unemployment rate in decline, but still high

In the few years since the end of the financial and economic crisis, the Spanish labour market has been able to gain considerable momentum. After reaching record unemployment of 26.9% at the height of the crisis in 2013, Spain was able to considerably reduce the unemployment rate to 17.2% in 2017. In light of this economic recovery, a further decrease has been forecast for the next few years.[4] However, even though the labour market development ap-

[3] NORD/LB: Economic Adviser
[4] Forecast: NORD/LB Economics

pears to be positive at first glance, reform efforts will need to be further intensified for long-term stabilisation. The consequences of the financial and economic crisis are still very tangible on the Spanish labour market. Although youth unemployment is in decline, at 33.8% (May 2018), it is still very high. This means that Spain is still in second place Europe-wide after Greece (May 2018: 43.2%; compared with Germany in May 2018: 6.1%).[5] Moreover, the proportion of precarious employment relationships casts a shadow over the Spanish labour market, especially in the hotel and restaurant industries. In particular, the number of seasonal, temporary employment relationships has increased due to the boom in the tourism sector. These forms of employment boost the labour market, but not sustainably enough to ensure stability.

Development of average unemployment rate[6]



Source: EU Commission, forecasts: NORD/LB Economics, internal research

Population decline expected

As of 1 January 2018 (according to preliminary calculations), Spain had around 46.66 million inhabitants. This means that, starting in 2012 (46.80 million inhabitants), the Spanish population saw a slight decline, but that it has been increasing slightly again since mid-2016 (46.45 million inhabitants). Together with an ongoing decrease in the birth rate, the factors responsible for this downward trend are high unemployment coupled with financial uncertainty. During the financial crisis, many immigrants returned to their homelands due to the extremely strained situation on the labour market with a high youth unemployment rate. Moreover, there was a wave of youth emigration from Spain to countries abroad. According to information provided by the Spanish Statistical Office (INE), with the economic recovery, the net migration rate for 2016 was once again positive for the first time since 2009. However, the INE's population forecast for the period 2016 to 2066 predicts that, by 2036, the population will have declined by one million inhabitants. By 2066, the population will have dwindled to approx. 41 million.[7]

Loss of real purchasing power due to increased inflation

Benefiting from the economic recovery and the accompanying positive development on the labour market, in 2016, consumer spending in private households rose at great speed (+3.0%). However, in light of increased inflation

[5] German Federal Employment Agency: Der Arbeitsmarkt im europäischen Vergleich
[6] In relation to all civil persons in gainful employment, annual average
[7] Spanish Statistical Office: Population Projection for Spain, 2016 - 2066

rates and, as a result, greater financial strain on households, the momentum of private consumer spending slackened somewhat in 2017 (+2.4%). The main reason for this was higher consumer prices for products such as petrol and household energy, as well as price hikes for some foods. Although it was still negative in 2016 at –0.3%, the inflation rate, at 2.0%, returned to clearly positive territory in 2017 for the first time since 2013. An inflation rate of 1.6% has been predicted for this year. By comparison, a rate of 1.4% has been forecast for the eurozone.[8]

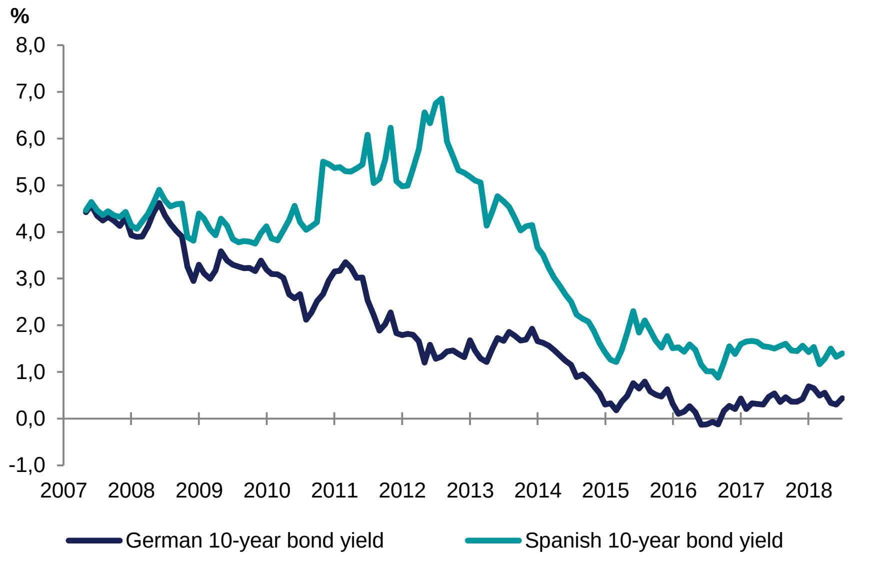
Public deficit still high, but improved

Although Spain recorded the highest deficit ratio of any EU country in 2016 at –4.5% of GDP, in 2016, it was able to stick to its target for new debt for the first time in years. For 2017, the government budget balance came to –3.1% (in percentage of GDP). A balance of –2.5% is expected for 2018. Alongside income tax, Spain intends to use measures such as tax hikes – for example, increased consumer taxes on tobacco, spirits and sugary drinks – and environmental levies to further reduce the debt-to-GDP ratio. Ultimately, scaling back the public deficit needs to be the government's priority, as it is the only way to make Spain's economy resilient in the long run, e.g. against higher refinancing costs due to an increase in the yields on government bonds.[9]

Rating upgrade

Due to the dynamic economic development and robust macroeconomic situation, at the beginning of this year, the rating agency Fitch upgraded its credit rating to A- for a stable outlook. Standard & Poor's (A-/positive outlook) and Moody's (Baa1/stable outlook) followed suit in March and April respectively. With the economic recovery, the yield gap between ten-year Spanish government bonds and German government bonds has reduced significantly. Moreover, yields on ten-year Bonos decreased in Q1 2018 as a result of the rating upgrade. There was a somewhat stronger spread increase in May due to political unrest. Spain's refinancing conditions are currently at 1.40% (in relation to 10-year bonds), although there is a spread of almost 100 basis points in relation to Bunds (ten year).[10]

Yield development of Spanish government bonds vs. German government bonds



Source: Bloomberg, internal research

[8] Forecast: NORD/LB Economics
[9] Ibid.
[10] Bloomberg (as of 31 July 2018)

Outlook for macroeconomic conditions

Demographic development	↘
Real GDP growth	↗
Number of employees	↗
Unemployment rate	↘
Inflation	↗
Real purchase power	→
Tourism demand	↗

Spain's economy is developing positively – even though unemployment remains high, and public debt and budget deficits are only decreasing slowly. After three years of strong growth with real GDP growth of over 3%, economic momentum is expected to tail off in 2018 and 2019 due to the increase in inflation and the accompanying impact on real purchasing power. Nevertheless, Spain's economic development remains in robust shape and at a high level. At a political level, Spain is still in a state of unrest. The new Prime Minister Pedro Sánchez has set himself the task of settling the strained political situation in Catalonia. In addition, even though it is steadily decreasing, high unemployment continues to present Spain with enormous challenges. Getting important reforms through will be of crucial importance for the further course of economic development. However, obtaining a majority that is able to reach a consensus will remain difficult under the new minority government. The potential impact of Brexit plans also remains uncertain. The United Kingdom is Spain's fourth most important trading partner and the largest foreign source market for tourism. Moreover, political developments in Spain's most important trading partner, Italy, and US trade policy are causing uncertainty. Overall, the outlook for Spain's economy this year and next year remains positive. After years of crisis, the Spanish economy is progressively recovering, which can be felt on the real estate market. This economic momentum has strengthened the real estate sector and enabled it to reclaim much of its appeal, which will be explained in more detail in the following chapters.

3. Office real estate market

Upturn on the Spanish office real estate market

The main focus of Spain's office real estate market are the cities of Madrid and Barcelona. Together, they recorded office real estate stock of almost 19 million m² in the first half of 2018.[11] These two markets are currently on a trajectory of growth in the expansionary phase of the office market cycle. Moreover, there are similarities in the way the office real estate markets in the two major cities are structured. Sluggish construction activity in the crisis years due to the recession led to a lack of modern office space in both Madrid and Barcelona, especially in urban areas. As a result, growing companies often have to make do with other sub-markets on their hunt for modern office space.

Major cities hold strong appeal for office workers

As a result of the ongoing positive economic development, demand for office space in major Spanish cities is steadily increasing. The most significant economic sector is the services sector. In Madrid alone, around 86% of the workforce is employed by this economic sector.[12] Excellent infrastructural provision with regional and long-distance transport is one of the benefits that this location offers national and international office workers. It includes one of Europe's best high-speed national train networks, the continuous development of the orbital motorways surrounding Madrid and a quick connection between the central business district (CBD) and the local airport.

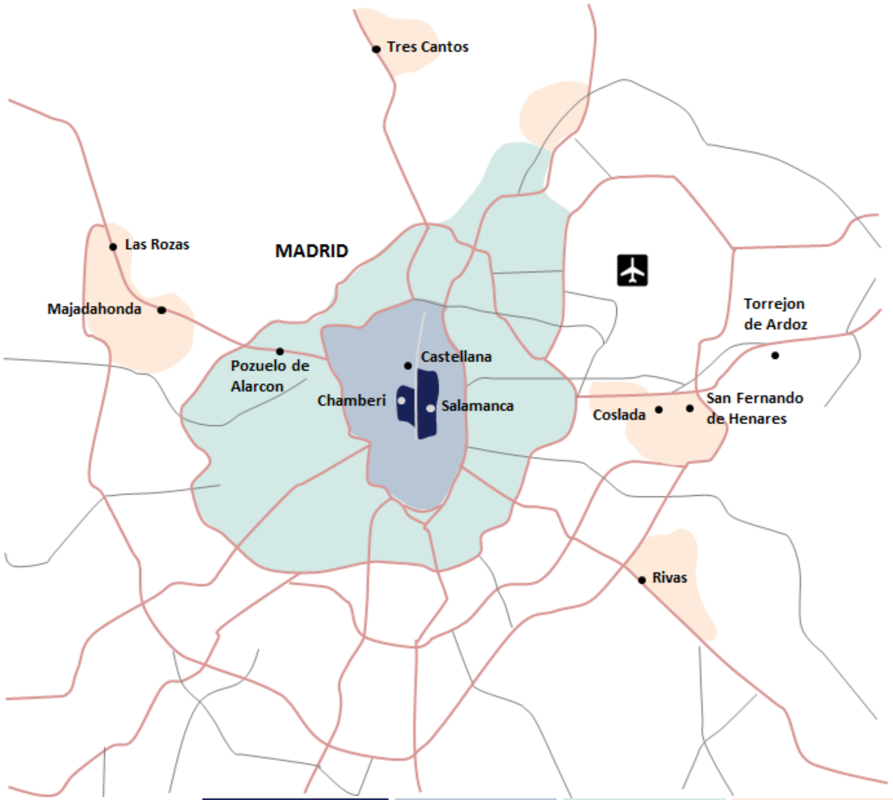
Madrid number-one office real estate market

As one of Europe's most important major cities, Madrid has Spain's largest office real estate market with an office stock of around 13.0 million m² (H1 2018).[13] In Madrid, the individual office locations are as follows: over 40% of the total office stock is located in the CBD and in the city. Madrid's CBD is

[11] Cushman & Wakefield: Spain Office Market Snapshot, Q2 2018
[12] EURES European Commission: Labour market information for Spain, March 2018
[13] Cushman & Wakefield: Spain Office Market Snapshot, Q2 2018

located on one of the city's most important main streets, the Paseo de la Castellana. Renowned developments such as the Cuatro Torres Business Area, a building complex comprising office space and a hotel that was completed in 2018, line this main axis. There are plans to keep extending this axis northwards in the long term. In particular, it is finance companies, corporate service providers and the Spanish government that use the central office spaces in the CBD and the city. Numerous foreign corporations also have their headquarters in Madrid. The city provides excellent connections to public transportation, even in the suburbs. Peripheral areas account for around 29% of the total office stock. There has been a constant increase in construction activity in peripheral office locations in recent years, and these areas now also boast a share of over 29%.

Structure of Madrid's office real estate market



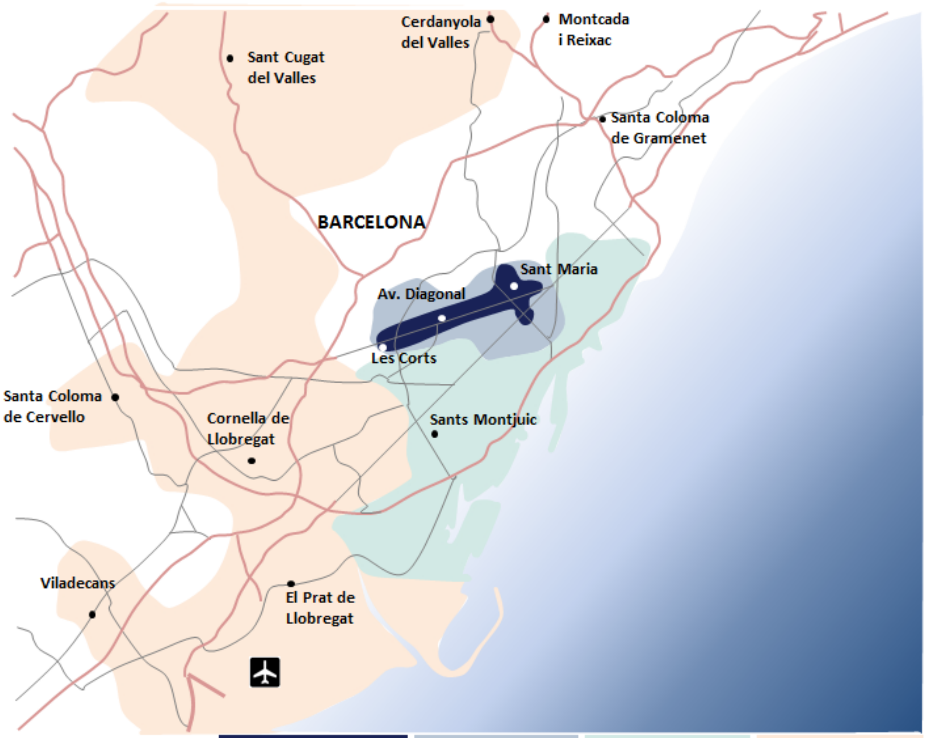
Data base Q2 2018	CBD (prime location)	City	Decentral	Periphery
Office space in m²	3,266,149	2,115,150	3,809,801	3,828,715

Source: Colliers International, Cushman & Wakefield, internal research

Barcelona's office real estate market catches up

As an international business location with an office stock of 5.9 million m² (H1 2018), Barcelona is Spain's second largest office real estate market. In Barcelona, the individual office locations are as follows: almost 61% of total office space is accounted for by locations in the CBD and the city. The city's prime property locations are to be found along one of Barcelona's most famous streets, Passeig de Gràcia. Metro Barcelona's underground line 3, which is part of a very dense public transport network, runs right beneath the street. Moreover, there are plans to expand the urban tram system in the long term. Most companies seeking office space are in the services sector. Most of the "New Business Areas" are located in the urban area. Due to the ongoing shortage of space in the city, construction activity in recent years has been concentrated in peripheral areas. This is reflected in the steady increase in their share (around 22%) of Barcelona's office stock.[14]

Structure of Barcelona's office real estate market



Data base Q2 2018	CBD (prime location)	City	Decentral	Periphery
Office space in m²	900,330	2,714,250	1,307,375	1,019,771

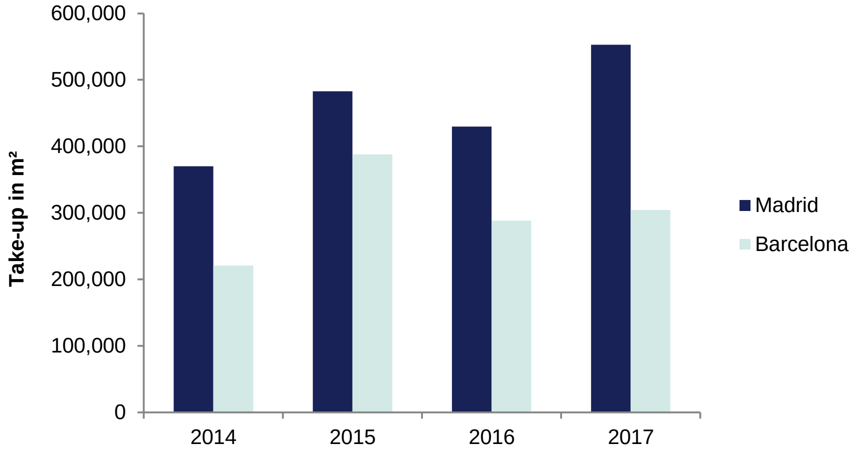
Source: Colliers International, Cushman & Wakefield, internal research

Buoyant demand for office space in major cities

In 2017, there was 552,982 m² of take-up in Madrid and 304,345 m² in Barcelona. This corresponds to year-on-year increases of around 29% and around 6% respectively. This was Madrid's best result since 2007. This result shows that Barcelona was able to counter the political unrest relating to Catalonia's quest for independence and record a moderate increase in take-up.[15] Compared with the same quarter in the previous year, even the first quarter of 2018 got off to an extremely positive start with increases in take-up in both Madrid, where it increased by 32% to 131,200 m², and Barcelona, where it grew by 7% to 85,500 m².[16] The strongest demand was still for office spaces of up to 1,000 m², which accounted for 69% and 74% of the office space in Madrid and Barcelona respectively in Q1 2018. Due to the shortage of office space in Barcelona in particular, take-up in the segment of office spaces of 4,000 m² and above in the districts close to the city centre will also remain limited going forward. In Madrid, the recovery has led to high demand from SMEs, primarily for smaller office spaces. Another factor driving demand has come in the form of co-working space providers (e.g. WeWork), which are extremely attractive in terms of the flexibility and prices that they offer.[17]

[14] Colliers International: Spanish Office Market Second Half 2016/Cushman & Wakefield: Spain Office Market Snapshot, Q2 2018
[15] BNP Paribas Real Estate: European Office Market Edition 2018
[16] BNP Paribas Real Estate: At a glance Offices Barcelona Q1 2018; At a glance Offices Madrid Q1 2018
[17] Ibid.

Development of take-up

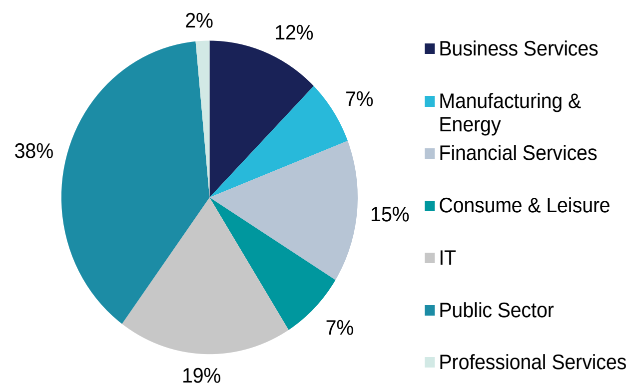


Source: BNP Paribas Real Estate, internal research

Structure of demand focussed on services

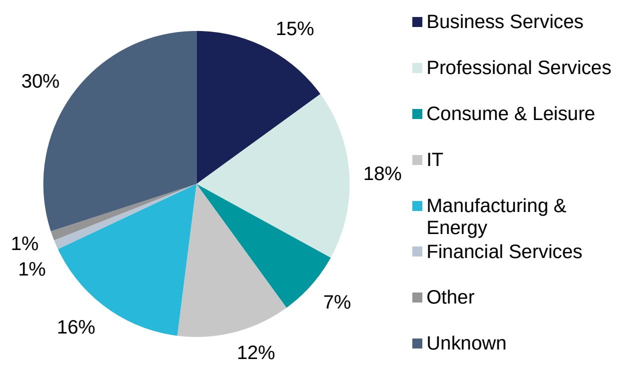
An examination of take-up by industry reveals somewhat different pictures for Madrid and Barcelona. In Madrid as an administrative stronghold, the public sector performed especially well as usual with a 38% share of take-up in 2017. The IT and financial service industries were also clearly represented with around 19% and 15% respectively. In Barcelona, the “professional services” (businesses such as auditing companies, management consultancies and law firms) accounted for 18% of the demand for office space. The manufacturing and energy sector followed in second place with a 16% share of total take-up.

Madrid: take-up by industry 2017



Source: CBRE, internal research

Barcelona: take-up by industry 2017



Source: CBRE, internal research

Vacancy rate continues to fall

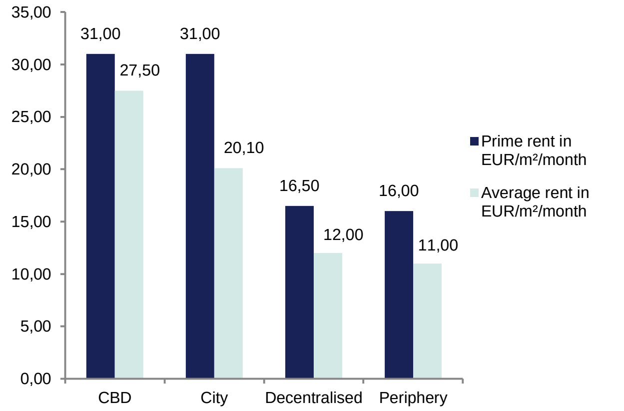
Increasing demand for prime office space in both cities continued to have an impact on the development of vacancy rates in 2017. The average vacancy rate throughout all urban districts reached a figure of around 10.2% in Madrid in 2017 (2016: 12.0%) and around 10.1% in Barcelona (2016: 11.4%). In both cities, peripheral urban districts continued to catch up, with the vacancy rate decreasing from around 26.5% (2015) to 13.1% in Madrid and from around 18.1% (2015) to 11.7% in Barcelona. The lowest vacancy rates in 2017 were recorded in the CBDs at around 5.6% in Madrid and around 3.2% in Barcelona. The highest vacancy rates were observed on the periphery at around 14.9% in Madrid and around 20.8% in Barcelona.[18] At the beginning of 2018, the average vacancy rate remained stable in both cities at 10.1%.[19]

[18] BNP Paribas Real Estate: At a glance - Offices Barcelona Q4 2017; At a glance Offices Madrid Q4 2017

Rental prices continue to rise

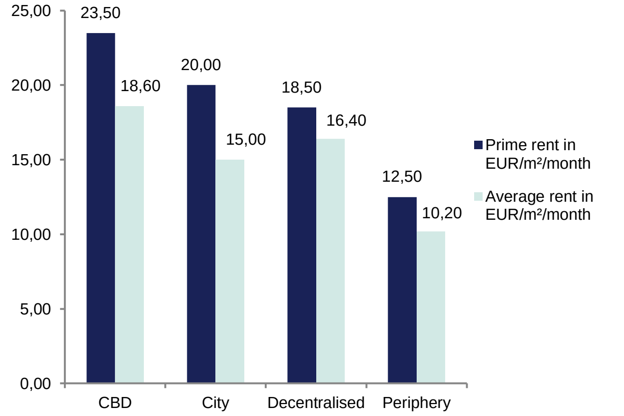
The rental prices for office real estate have been continuously increasing in the major Spanish cities since 2013. This can be attributed to the increasing business activity of the companies based there and renewed, growing interest from market players in the Spanish office real estate market following the recession years. In 2017, the CBD and the city recorded the highest prime rents in both Madrid and Barcelona, although the highest rent in the capital's CBD of EUR 31.00 per m² per month (2016: EUR 29.00 per m² per month) was well ahead of Barcelona's highest rent of EUR 23.50 per m² per month (2016: EUR 21.50 per m² per month). In 2017, the lowest prime rents generated in the peripheral urban areas in the two cities were EUR 16.00 per m² per month in Madrid and EUR 12.50 per m² per month in Barcelona. Average rent across all city areas came to EUR 17.60 per m² per month in Madrid and EUR 15.10 per m² per month in Barcelona. The ongoing upward trend therefore continued in 2017.[20] Another increase in prime rents was recorded at the beginning of 2018. In Madrid, the prime rent in Q1 2018 came to EUR 32.50 per m² per month and in Barcelona to EUR 24.00 per m² per month.[21] Compared with the peak office rents in major European cities such as Paris at EUR 70.80 per m² per month and London at EUR 117.00 per m² per month, prime rents in the Spanish cities are low, although Madrid's prime rent comes close to places such as Berlin at EUR 33.00 per m² per month and Amsterdam at EUR 32.40 per m² per month. Barcelona's prime rent is on par with that of cities like Warsaw (EUR 22.00 per m² per month).[22]

Madrid: Average and prime rent 2017



Source: BNP Paribas Real Estate, internal research

Barcelona: Average and prime rent 2017



Source: BNP Paribas Real Estate, internal research

Madrid's office real estate popular with investors

In 2017, demand from the investment market for office real estate in Madrid and Barcelona was marked by a supply shortage of prime properties. In Barcelona, the transaction volume was close to that of the previous year at around EUR 752 million. Due to political uncertainty in Catalonia, investors in Barcelona were more cautious in the last quarter of 2017, waiting to see what would happen following the parliamentary elections in December 2017. In Madrid, the transaction volume ran to around EUR 1.224 billion. This means that Madrid continues to hold a dominant position nationwide as an office location, with a share of 61%. Prime yields have been experiencing a noticeable

[19] BNP Paribas Real Estate: At a glance Offices Barcelona Q1 2018; At a glance Offices Madrid Q1 2018
[20] BNP Paribas Real Estate: At a glance - Offices Barcelona Q4 2017; At a glance Offices Madrid Q4 2017
[21] BNP Paribas Real Estate: At a glance Offices Barcelona Q1 2018; At a glance Offices Madrid Q1 2018
[22] BNP Paribas Real Estate: European Office Markets Edition 2018

downward trend since 2013 (Madrid: 6.00% and Barcelona: 6.5%), although Barcelona has felt the impact of slight upward pressure due to the political uncertainty in Q4 2017. At the end of 2017, net prime yields were at 3.25% in Madrid and 4.25% in Barcelona.[23]

Outlook for office real estate market

Demand	↗
Supply	↗
Office employees	↗
Vacancy rate	↘
Prime rent	↗
Investment volume	↗
Prime yield	↘

We expect that demand for Spanish office real estate will remain high in the major cities. This is likely to be spurred on by the positive economic development and the decrease in unemployment figures. Both in Madrid and Barcelona, as in other major European cities, flexible workplaces such as co-working spaces are gaining in significance, which will continue to have a positive effect on the development of take-up. We believe that take-up will continue to increase in 2018 as a result, even though there will still be a lack of prime properties. First and foremost, this supply shortage is likely to lead to a further increase in the number of renovation projects being carried out on existing office properties. In Madrid, the continual expansion of the orbital motorways, including the M-50, should gradually facilitate access to peripheral areas, creating additional potential space for new projects outside the city centre. In Barcelona, the spread of office space in the outskirts of the city will be limited due to its macro-location as a coastal city next to the Serra de Collserola mountain range. We expect there to be a further rise in prime rents in both Madrid and Barcelona. We predict that there will be an especially dynamic development in Madrid. By 2022, we anticipate an average increase in prime rents of 6.0% p.a. This will put Madrid in first place in Europe. For Barcelona, we expect average growth of 3.0% p.a., which will put the city in seventh place Europe-wide.[24] The current market situation in Barcelona is likely to remain marked by uncertainty due to the political situation in Catalonia, even though it has not had any significant negative impact on the office real estate market so far. In terms of the investment market for office real estate, we expect prime yields to continue to drop, combined with an increase in the investment volume.

4. Retail real estate market

Conditions remain favourable

Spanish retail, which is another important factor driving Spain's upturn, has been benefiting to an exceptional degree from the economic recovery taking place since the end of 2013. In 2017, private consumer spending increased by 2.7%, and further growth is expected for 2018 (+2.3%) and 2019 (+1.9%). In addition, bricks-and-mortar retail sales developed extremely positively in 2017 with an increase of 3.0%. In 2018, Spain's bricks-and-mortar retail sales are expected to continue to grow. A 2.9% increase in sales growth has been forecast for 2018.[25] In August 2017, Spanish consumer confidence (Consumer Confidence Index) reached its highest value since 2004 at around 109 index points. Due to the political instability in Catalonia, the index retreated to just under 100 points in October 2017, although it had stabilised again at around 103 points by the end of 2017. The Consumer Confidence Index is currently back at around 107 points.[26] This positive development is not least due to robust macroeconomic conditions and successive improvements to the labour market situation and the country's economy. Moreover, as a popular holiday

[23] CBRE: Madrid Offices Marketview Q4 2017; Barcelona Offices Marketview Q4 2017
[24] CBRE: 2018 Spain, Real Estate Market Outlook
[25] GfK GeoMarketing GmbH: European Retail 2018
[26] CBRE: Spain 2018, Real Estate Market Outlook

destination, Spain benefits from international tourism figures that continue to grow.[27]

Retailers focus on Spain's important major cities

In 2017, Spain's sales per unit area[28] were on par with that of Portugal at EUR 4,000 to below EUR 4,500 in gross sales per m² of retail space. Germany followed just behind at EUR 3,500 to EUR 4,000 per m², and France was slightly above Spain in terms of sales per unit area at EUR 4,500 to EUR 5,000 per m².[29] In international terms, Madrid and Barcelona are extremely attractive European shopping destinations. This is facilitated by factors such as the cities' excellent connections to the rest of Europe. Major retailers proceed very selectively on their hunt for prime retail spaces in established main shopping streets and important shopping centres in the cities. There is an increasingly acute lack of high-quality retail space, which is reflected in the progressing shortage of retail space in top locations.[30] For local operators of smaller shopping centres, above all in secondary locations, this has meant increased competition for some time now. As a result, high street shops and major shopping centres in the best locations in Madrid and Barcelona are still considered to have the most potential. Nevertheless, momentum in this market segment is defined by the availability of local retail space.[31]

Madrid has highest density of shopping centres in 2017

In 2017, Spain had over 615 retail complexes spanning a total of around 16.5 million m² (+1.4% yoy) in retail space.[32] Shopping centres as a building type usually account for the largest proportion of retail space (approx. 66%), followed by retail parks (approx. 17%). However, in 2017, Spain only took 16th place in Europe for shopping centre density with 302 m² per 1,000 inhabitants, putting it below the European average of 312 m² per 1,000 inhabitants. This can be attributed to factors such as the major significance of additional retail space in the established main shopping streets in Spanish cities. Madrid had the highest regional density of shopping centres last year, with 501 m² per 1,000 inhabitants. With a retail space of 38,931 m², the opening of the Plaza Rio 2 retail and leisure centre (on the banks of the the Manzanares River) in October 2017 made a particular contribution to this increase. By contrast, Barcelona has a much lower density of shopping centres. In 2017, the national density of overall retail space was 353 m² per 1,000 inhabitants. This corresponds to a year-on-year increase of 1.1% and a rise of 2.2% relative to 2015. A nationwide increase of more than 500,000 m² in retail space has been predicted for 2018, which would mean a considerable increase year on year. The density of retail space would accordingly increase to 364 m² per 1,000 inhabitants by the end of 2018.[33] The degree to which new scheduled retail projects will be absorbed by the market will depend on the speed with which they can be leased and on the expansion plans of retailers on the demand side. It is likely that the focus will continue to be on the fashion segment for the mass market. In Madrid, the AZCA quarter,[34] a bank and skyscraper quarter on one of the city's most important main streets, the Paseo de la Castellana, has the

[27] See chapter 5: Hotel real estate market
[28] Sales per unit area to assess the sales potential of retail locations: this indicator is based on factors such as the quality of the location, the intensity of competition and purchasing power in the catchment area (information according to GfK GeoMarketing GmbH).
[29] GfK GeoMarketing GmbH: European Retail in 2018
[30] CBRE: How active are retailers in EMEA? 2017
[31] Cushman & Wakefield: Spain HS Retail Market Snapshot Spain, Q2 2018; Spain Shopping Centres Snapshot, Q2 2018
[32] Savills: Spain Retail Market Report, January 2018
[33] Savills: Spain Retail Market Report, January 2018
[34] Asociación Mixta de Compensación de la Manzana A de la Zona Comercial de la Avenida de La Castellana de Madrid

potential to be leased to further international retailers.[35] In the direct vicinity, the shopping street that runs parallel to it, Calle Orense, is home to numerous shops belonging to various fashion labels. Overall, the project pipeline for 2018 reveals a clear focus on Madrid, Barcelona and Seville.

Spanish shopping centres have high potential for refurbishment

More than half of the shopping centres in Spain were built after 2000, in particular during the period 2007 to 2009. The overall potential for modernisation is over 70%. Specific measures include not just structural and architectural improvements, but also new technologies and all kinds of improvements to their surroundings. As a result, the ratio of shops and leisure elements to restaurant and food offerings is likely to keep changing. The latter has been gaining in significance in recent years. Its share in the gross rental area of a shopping centre can now be quantified at at least one fifth – and there is an upward trend.[36]

Dynamic online retail with upward potential

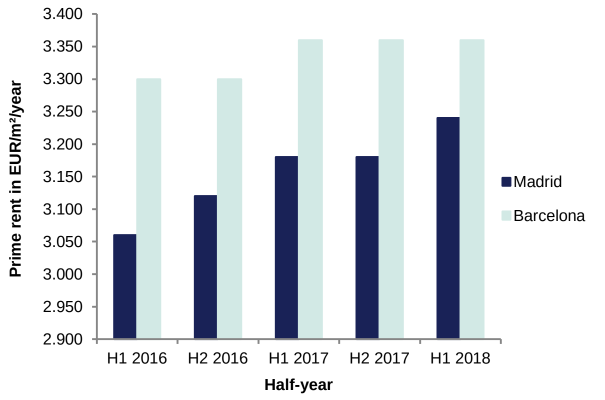
The e-commerce market has been gaining momentum in Spain. In 2016, online retail sales amounted to around EUR 24.185 billion, which corresponded to a year-on-year increase of 21%. 2017 got off to just as positive a start with a year-on-year increase in Q1 2017 of 25%. However, the share of online retail sales in overall retail sales was recently just 4%. This puts Spain in fourth place in Europe, which means that it has quite a lot of catching up to do. By contrast, the UK took first place in Europe with a proportion of 17%.[37]

Prime rents in Barcelona's high street shops take the lead

Improved retail conditions have also had an impact on the development of rental prices in recent years. Nationwide, the average rent for new leases in prime shopping centres in 2017 was around EUR 90 per m² per month.[38] Elsewhere in Europe, the highest prime rent for a shopping centre in 2017 was generated in the UK (EUR 530 per m² per month). The European average was EUR 153 per m² per month, 70% higher than in Spain.[39] Moreover, the rental price for high street shops and retail parks also recorded a positive development. Since mid-2016, there has been a noticeable stabilisation in prime rents for high street shops in Barcelona. In the first half of 2018, this remained at the high level of EUR 280 per m² per month. The coastal city's prime rent therefore exceeded that of Madrid, which was EUR 270 m² per month during the observation period. For retail parks in Madrid and Barcelona, the development of prime rents in the first half of 2018 also remained stable at EUR 21.50 per m² per month for Madrid and EUR 18.00 per m² per month for Barcelona. Here, the prices in the capital tower over those in the coastal city.[40]

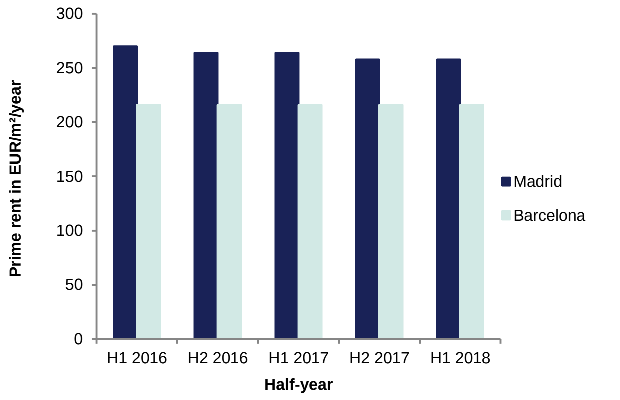
[35] Cushman & Wakefield: Marketbeat Retail Spain 2016
[36] Ibid.
[37] Savills: Spain Retail Market Report, January 2018
[38] Ibid.
[39] Savills: Spain Retail Market Report, January 2018: The observation of comparable rents for prime shopping centres is based on a shop size of 100 to 200 m².
[40] Cushman & Wakefield: Spain HS Retail Market Snapshot Spain, Q2 2018; Spain Shopping Centres Snapshot, Q2 2018

High street shops: prime rents



Source: Cushman & Wakefield, internal research

Retail parks: prime rents



Source: Cushman & Wakefield, internal research

Highest prime rents in Spain on Portal d l'Àngel

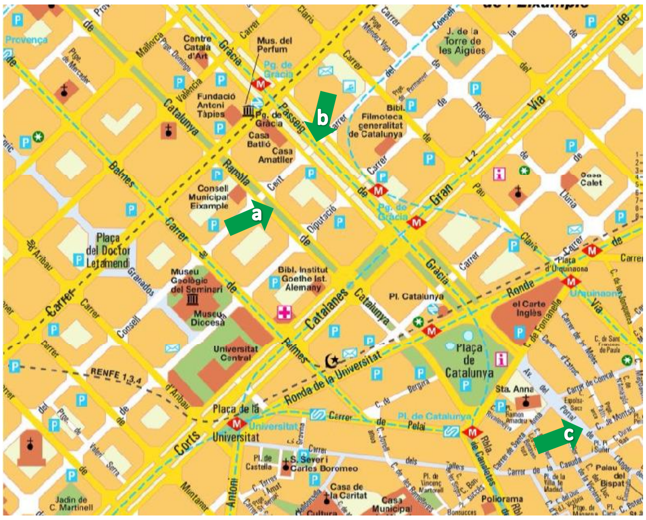
Barcelona's main shopping streets are concentrated in the city centre. They include streets such as Rambla de Catalunya (a), Passeig de Gràcia (b) and Portal de l'Àngel (c).[41] The stretch of Avinguda Diagonal around Placa de Francesc Massià is another such location. Of the urban locations, Portal de l'Àngel has the highest prime rent for high street shops (2016: EUR 275 per m² per month). This is also where the highest national prime rent in this segment is generated. The shopping street is home to the largest selection of mass market fashion brands. The Passeig de Gràcia has the largest range of luxury items on any of Barcelona's main shopping streets. Rambla de Catalunya, which runs parallel to it, has a comparatively low prime rent (2016: EUR 100 per m² per month), even though the largest proportion of high street shops (29% share), mainly mass market brands, can be found there. Passeig de Gràcia takes second place in a comparison of local shop numbers with a share of over 20%.[42]

Exclusivity in Madrid's Salamanca district

An analysis of Madrid at a city level reveals that the high street shop segment is spread throughout the central urban area and the Salamanca district. The central area is home to the shopping streets Gran Via (d), Preciados (e) and Fuencarral (f), as well as Madrid's most famous square, the Puerta del Sol.[43] The wealthy, expensive district of Salamanca is the city's second area for high street shopping. The important streets here are Goya, Serrano and José Ortega y Gasset. The latter is where customers will find the most exclusive brands. However, the highest prime rent (2016: EUR 255 per m² per month) was recorded for retail spaces in one of the most important shopping streets in the city, the Calle de Preciados, in the central urban area. Calle de Serrano in Salamanca followed with the second most expensive prime rent (2016: EUR 240 per m² per month). Calle Fuencarral has the lowest prime rent of Madrid's most important main shopping streets (2016: EUR 175 per m² per month). This shopping street alone accounts for 51% of the high street shops in the central urban area. In Salamanca, the streets Goya and Serrano dominate the district's supply of retail space with a share of over 40%. Both in the city centre and in Salamanca, fashion chains make up the majority of the total retail supply.[44]

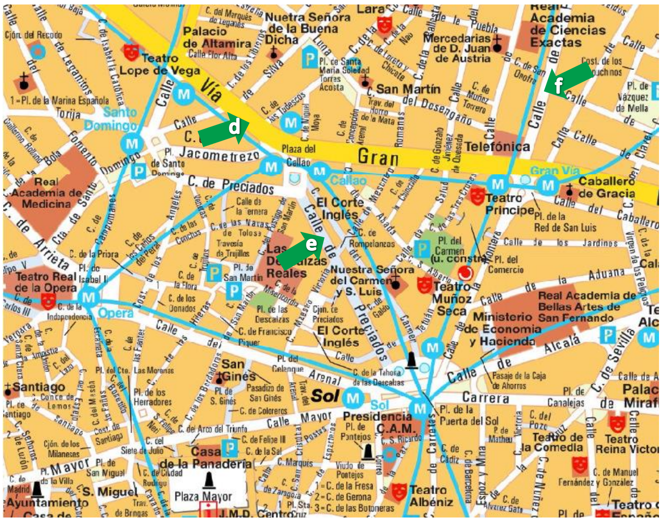
[41] (a) to (c) see diagram of selected main shopping streets
[42] Cushman & Wakefield: Marketbeat Retail Spain 2016
[43] (d) to (f) see image of selected main shopping streets.
[44] Cushman & Wakefield: Marketbeat Retail Spain 2016

Barcelona: selected main shopping streets



Source: http://www.hot-map.com/de/barcelona, internal research

Madrid: selected main shopping streets



Source: http://www.hot-map.com/de/madrid, internal research

Retail investments in Spain are still on trend

In 2017, the investment market for retail real estate in Spain recorded a very positive development. Booming tourism and the country's economic recovery had a positive impact on investment demand. In 2017, the Spanish retail real estate market recorded a transaction volume of around EUR 3.5 billion (2016: EUR 2.9 billion), which corresponds to a share of around 38% of the total commercial transaction volume in Spain.[45] With a transaction volume of over EUR 2.0 billion (+42% yoy), shopping centres dominated by far.[46] This means that, without a doubt, the upturn in Spanish retail is being felt on the investment market. This is also demonstrated by the development of prime yields. Since 2017, these have continued to drop both in Madrid and in Barcelona, from 3.40% to 3.30% for high street shops (Q2 2018).[47] In the second quarter of 2018, prime yields on retail parks in both locations had decreased to 5.00% (Q2 2017: 5.50%). At 4.25%, prime yields for shopping centres remained stable nationwide year on year.[48]

Outlook for retail real estate market

Demand	↗
Supply	→
Prime rent	↗
Retail sales	↗
Investment volume	↗
Prime yield	↘

Buoyant demand on the Spanish retail real estate market in top major city locations will continue for the rest of the year. In anticipation of increasing retail sales, great interest from investors and retailers is still expected, primarily in retail spaces in high street shops and shopping centres. Demand for retail space is being driven in particular by international fashion chains and by the food and luxury items industry (food and beverage), with prime micro-locations in Madrid and Barcelona. There is a growing focus on flagship stores for national and international retailers. We believe that online retail, which is also advancing in Spain, will complement bricks-and-mortar retail in major cities, although more significant growth is expected in the e-commerce market due to the current catch-up potential. Bricks-and-mortar retail will have to intensify how they respond in order to ensure that shopping in the city or in shopping

[45] Savills: Spain Retail Market Report, January 2018
[46] Savills: Spain Investment Market Report, January 2018
[47] Cushman & Wakefield: Spain HS Retail Market Snapshot, Q2 2018
[48] Cushman & Wakefield: Spain Shopping Centres Snapshot, Q2 2018

centres remains attractive. Further occasional rent hikes can be expected for top city locations and established shopping centres. Otherwise, rent looks set to continue stabilising. As the supply of retail space remains limited on the main shopping streets, selected secondary locations close to top locations should experience an upturn. New projects and/or the modernisation of shopping centres is expected both in Madrid and in Barcelona. The provincial capitals of Bilbao, Valencia and Seville are also likely to remain sought-after retail locations due to factors such as their economic power and popularity with tourists. Brisk demand from investors will therefore be reflected in ongoing pleasing investment volumes and in another slight drop in prime yields. Moreover, increasing wealth in Spanish households and the creation of jobs will play an important role in national consumption. In addition, Spain's tourist attractions should help to sustain high consumer demand from abroad. The Spanish retail real estate market will therefore remain heterogeneous and on trend for investors and retailers.

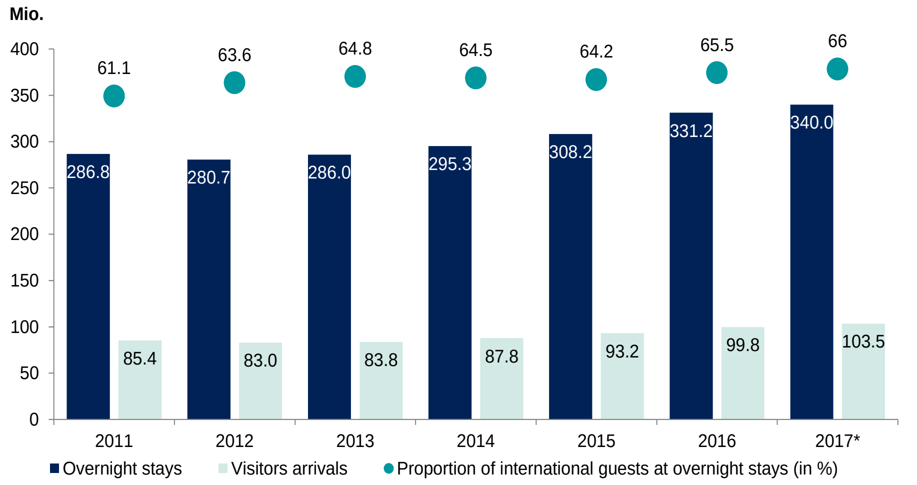
5. Hotel real estate market

Great momentum in the hotel market

The Spanish hotel market is setting more and more new records. With a total of around 103.5 million (2016: 99.8 million) domestic and international guests and around 340.0 million overnight stays (2016: 331.2 million), a new highest value was achieved in 2017. Since 2012, this has meant a rise in guest numbers of about 25% and an increase in the number of overnight stays of about 21%. Spanish tourism is therefore in extremely robust, dynamic shape. Firstly, the Spanish hotel market has benefited from the economic recovery, favourable foreign currency developments and low oil prices. Secondly, the Spanish tourism sector has profited from sustained geopolitical unrest and the strained security environment in popular holiday regions such as Turkey, Tunisia and Egypt. As a result of the increase in visitors numbers, hotel capacity has continuously expanded in recent years. In 2017, the Spanish hotel market comprised around 1.5 million beds spread across 14,659 hotels.[49] In the global tourism ranking prepared every two years by the World Economic Forum, Spain took first place in spring 2017 for the second time in a row.[50] Factors such as Spain's cultural treasures, its natural environment and landscape, and its infrastructure and services contributed to this. Moreover, the ranking emphasises the Spanish tourism sector's ability to survive in times of crisis. Spain received another, less positive review for its relatively high prices.

[49] Spanish Statistical Office
[50] The Travel & Tourism Competitiveness Report 2017: The Travel & Tourism Competitiveness Index examines 14 different topic areas from the tourism sector in 136 countries and then calculates an average value.

Spain overall: overnight stays, arrivals and proportion of international guests



Source: Spanish Statistical Office, 2017*: preliminary figures, internal research

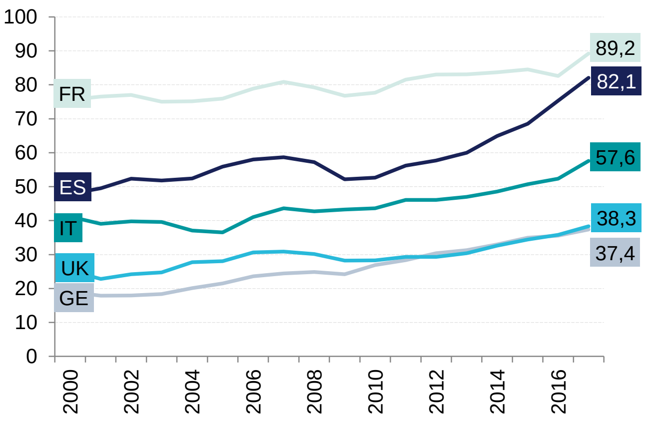
Arrivals of international tourists constantly on the rise

In 2017, the number of international tourists came to 82.1 million, which corresponded to a year-on-year increase of 8.3%. This put Spain behind France as the second most popular travel destination worldwide going by the number of international tourists. The USA was pushed into third place.[51]

First place for international tourist revenue

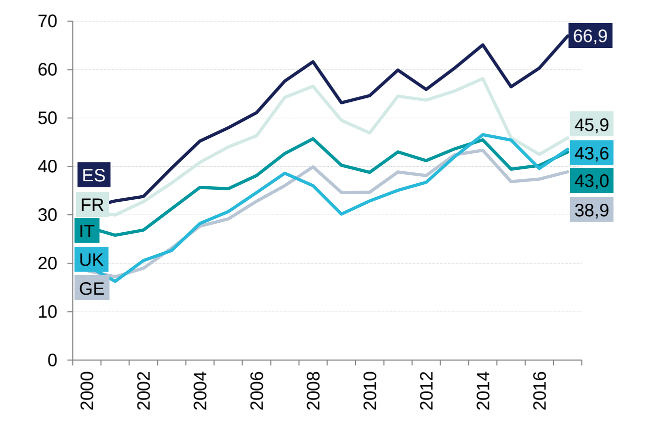
In 2017, Spain took third place for international tourist revenue on the world stage, behind the US and China, and was once again well ahead of France and the UK, taking first place in the European ranking with USD 66.9 billion (+11.0% more than 2016).[52]

International tourist arrivals in millions



Source: World Tourism Organization (UNWTO), figures from 2017 preliminary, internal research

Tourism revenue in USD billion



Source: World Tourism Organization (UNWTO), figures from 2017 preliminary, internal research

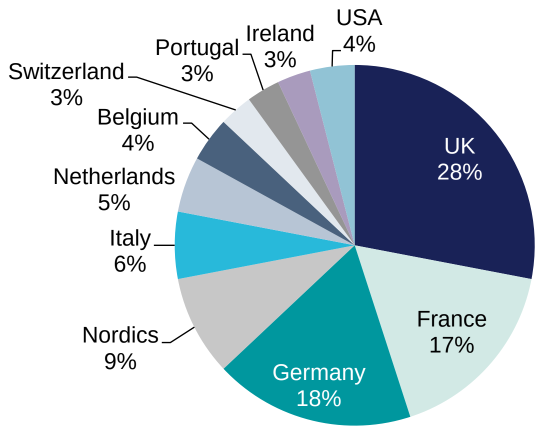
Brexit impact already tangible

The most important countries of origin for international tourists are the UK (with a share of approx 28%), Germany (with a share of approx. 18%) and France (with a share of approx. 17%).[53] In light of the fact that the United Kingdom is the most important source market for Spain, it remains to be seen what kind of impact Brexit will have on the Spanish hotel market going forward. In 2017, the drop in the value of the British pound against the euro was reflected straight away in a decrease in holiday budgets. The number of British guests staying

[51] BNP Paribas Real Estate: At a Glance - Hotels Spain 2017/Spanish Statistical Office
[52] World Tourism Organization (UNWTO): Tourism Highlights 2017 Edition
[53] BNP Paribas Real Estate: At a Glance - Hotels Spain 2017

overnight in hotels decreased by 4.5%. Accordingly, it is anticipated that the length of stay and local spending of British tourists will decrease in 2018 as well.[54] Overall, there is still an atmosphere of extreme uncertainty. However, we believe that the current Spanish tourist boom could compensate for what might be a significant decline in British tourists.

Distribution of international tourists 2017

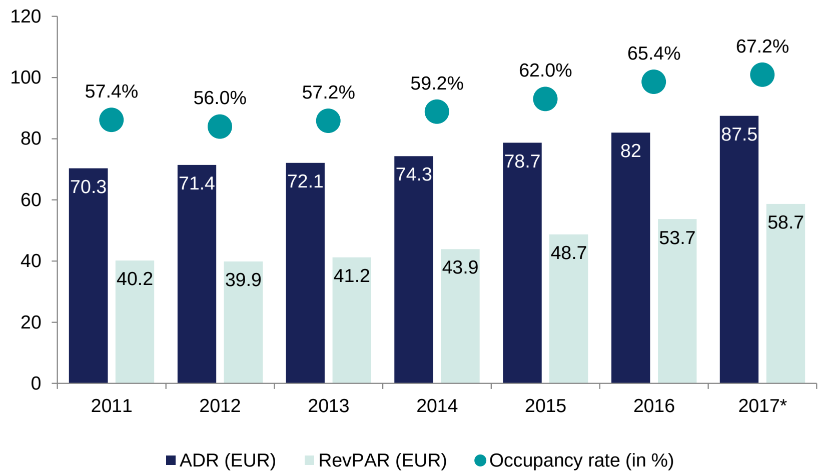


Source: BNP Paribas Real Estate, internal research

Robust hotel performance

Performance figures also show that the Spanish hotel market is developing robustly. Revenue per available room (RevPAR) increased from EUR 39.90 to EUR 58.70 between 2012 and 2017. This corresponds to an increase of 47%. In this period, the average daily rate (ADR) also increased from EUR 71.40 to EUR 87.50. Occupancy also improved from 56.0% (2012) to 67.2% (2017).[55]

Development of the Spanish hotel market



Source: Spanish Statistical Office, 2017*: preliminary figures, internal research

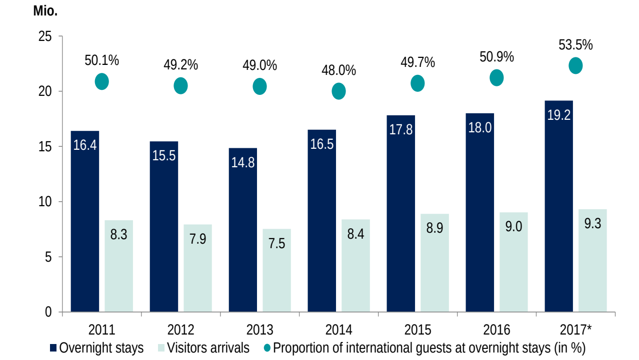
Madrid and Barcelona most important hotel markets

Madrid and Barcelona are two of the most important Spanish hotel markets. In 2017, the number of overnight stays came to 19.7 million in Barcelona and 19.2 million in Madrid. As the most important business travel destination, the

[54] Christie & Co: Hotel Investment Overview Spain 2017
[55] Spanish Statistical Office

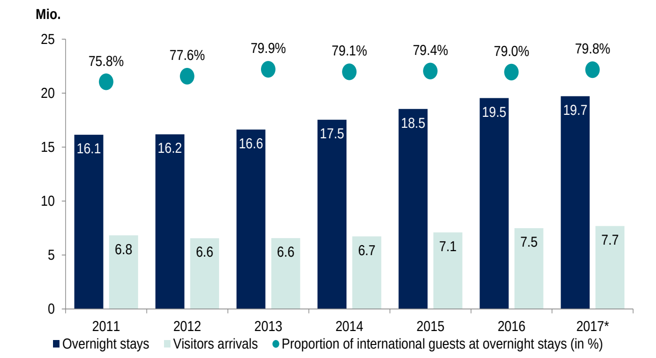
length of stay in Madrid is generally shorter than in Barcelona; however, at 9.3 million, Madrid recorded a larger number of guests in 2017 than Barcelona at 7.7 million. Overall, tourist demand has been developing very positively in Barcelona since 2011 (that is, throughout the crisis years as well). By contrast, the Madrid hotel market felt much more of an impact during the crisis years than Barcelona due to its importance as a business travel destination, but has been demonstrating stronger momentum than Barcelona since 2013 with the ongoing economic recovery.[56]

Madrid: tourist demand



Source: Spanish Statistical Office, 2017*: preliminary figures, internal research

Barcelona: tourist demand



Source: Spanish Statistical Office, 2017*: preliminary figures, internal research

Barcelona combats mass tourism

With its proximity to the sea and its distinct restaurant and cultural scene, the Catalan metropolis holds powerful appeal for international tourists (proportion of international tourists in 2017: approx. 79.8%). Barcelona is now being confronted by veritable mass tourism. In 2015, Mayor Ada Colau pulled the emergency brake and passed a moratorium on new hotels and tourist apartments. High financial penalties are the punishment for marketing illegal tourist accommodation without a license. Although Catalonia's quest for independence led to a year-on-year decrease in international tourist figures in October (-4.7% yoy) and November (-2.3% yoy) of last year, Catalonia remained Spain's most popular travel destination.[57]

Madrid most important business travel destination

Madrid generally has a lower proportion of international tourists than Barcelona, as it is the key trade fair and congress capital and a popular destination for domestic tourists. In 2017, 53.5% of visitors to Madrid were international tourists. Due to Madrid's great importance as a business travel destination, seasonal hotel occupancy is higher in spring and autumn. By contrast, tourist magnet Barcelona is a popular travel destination throughout the year.

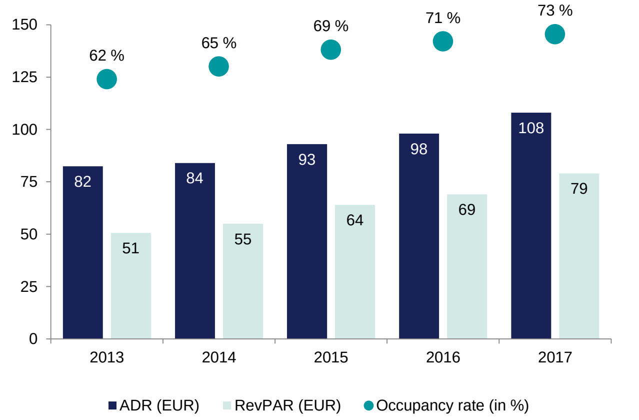
Dynamic hotel performance in both major cities

The hotel performance figures for Madrid and Barcelona also reflect the positive market developments that have been taking place since the end of the real estate crisis in 2013. In Barcelona, another increase in ADR and RevPAR can be expected in light of the hotel moratorium together with a higher room occupancy rate. Prices in Madrid are more moderate than in Barcelona, but there is a markedly positive upward trend in performance figures due to Spain's economic recovery. Overall, the hotel markets in both cities are likely to feel the impact of additional international tourist momentum due to the introduction of

[56] Spanish Statistical Office
[57] Spanish Statistical Office

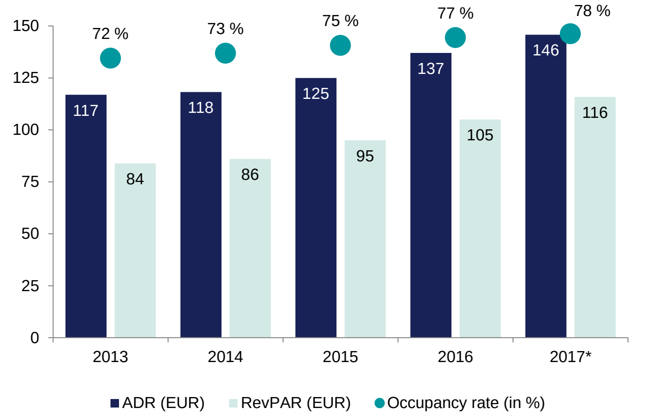
new flight routes (such as direct flights to Seoul and Hong Kong).[58]

Madrid: hotel performance



Source: STR Global, Jones Lang LaSalle, internal research

Barcelona: hotel performance



Source: STR Global, Deka, 2017*: Jan. - Nov., internal research

Hotel real estate popular with investors

In financial year 2017, Spain led the European hotel investment market behind the United Kingdom (EUR 5.4 billion) and Germany (EUR 4.2 billion) with a transaction volume of around EUR 3.9 billion (2016: EUR 2.1 billion). This corresponded to a year-on-year increase of 81%. The resort and urban segments accounted for 65% and 35% of the market respectively. Madrid and Barcelona had the largest shares in the urban segment with around 16% and 9% respectively. Foreign investors accounted for around 49% of the transaction volume, dominated by the US (23%), the UK (12%) and France (6%). SOCIMIs (Hispania in particular; see chapter 7) recorded a market share amongst hotel investors of 16%.[59] The current result of the Hotel Investment Attractiveness Index (Europe 2017) also demonstrates that Spain is extremely popular with hotel investors. Barcelona took third place amongst the 20 major European cities behind Paris and London. Madrid took fifth place behind Amsterdam.[60]

Outlook for hotel real estate market

Demand	↗
Supply	↗
RevPAR	↗
ADR	↗
Occupancy rate	↗
Investment volume	↗

Due to record tourist numbers, the Spanish hotel real estate market will continue its trajectory of growth in 2018. Spain will continue to benefit from geopolitical instability in competitor markets, although tourist demand is beginning to increase again in places such as Turkey and Egypt. After the terror attack in Barcelona in August 2017, the figures show that tourists are defying terror. The booking platform Airbnb has created more competition. Moreover, Catalonia's unresolved quest for independence could cause uncertainty amongst international tourists, although the feared slump in tourist figures has yet to materialise. For this reason, the overall hotel supply in Spain is expected to increase. In particular, there is an observable trend towards four- and five-star hotels, which we believe could result in a continuous increase in room prices. Looking at the major cities Madrid and Barcelona in particular, we believe that there will be an increase in prices and revenues in both hotel markets. Both cities benefit from their proximity to airports and their good infrastructure. However, in light of the moratorium and ongoing political uncertainty, we expect the development in

[58] PwC: Standing out from the crowd, European cities hotel forecast for 2017 and 2018, March 2017
[59] Christie & Co: Hotel Investment Overview Spain 2017
[60] The Colliers Index comprises 12 weighted study variables such as GDP per capita, number of employees, room occupancy, ADR and RevPar.

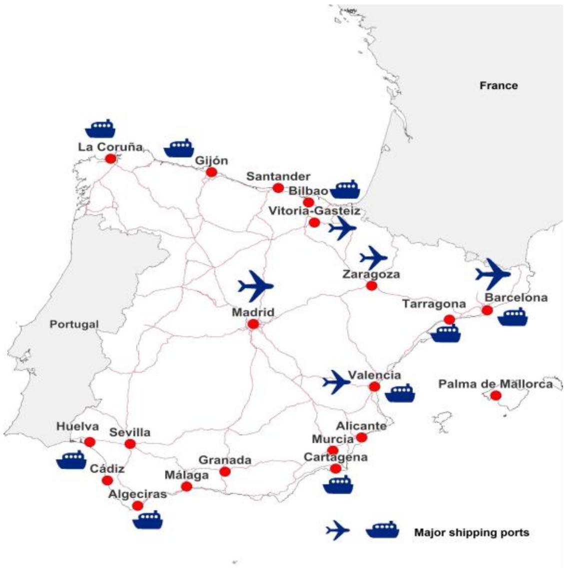
Barcelona to be somewhat less dynamic than that in Madrid. Moreover, Madrid's hotel market is likely to feel the impact of increasing positive momentum as a result of the ongoing economic revival combined with an increase in business travel activity. As a result, we expect that the hotel performance of both markets will continue to converge in the years to come. Moreover, we believe that the current dynamic growth in the Spanish hotel market will drive growth in alternative hotel markets such as Seville and Valencia.

6. Logistics real estate market

Logistics real estate market growing

After the end of the real estate crisis and with the onset of economic recovery, the Spanish logistics real estate market is currently recording an upwards trend. Spain is benefiting from its excellent infrastructure network. For example, the country has Europe's longest motorway network. The largest, most important Spanish logistics markets are Madrid and Barcelona. Other significant locations include Valencia (Mediterranean port, airport and proximity to Madrid and Barcelona), Zaragoza (favourable transport location between Madrid and Barcelona) and Bilbao (proximity to the Atlantic).

Spanish logistics regions



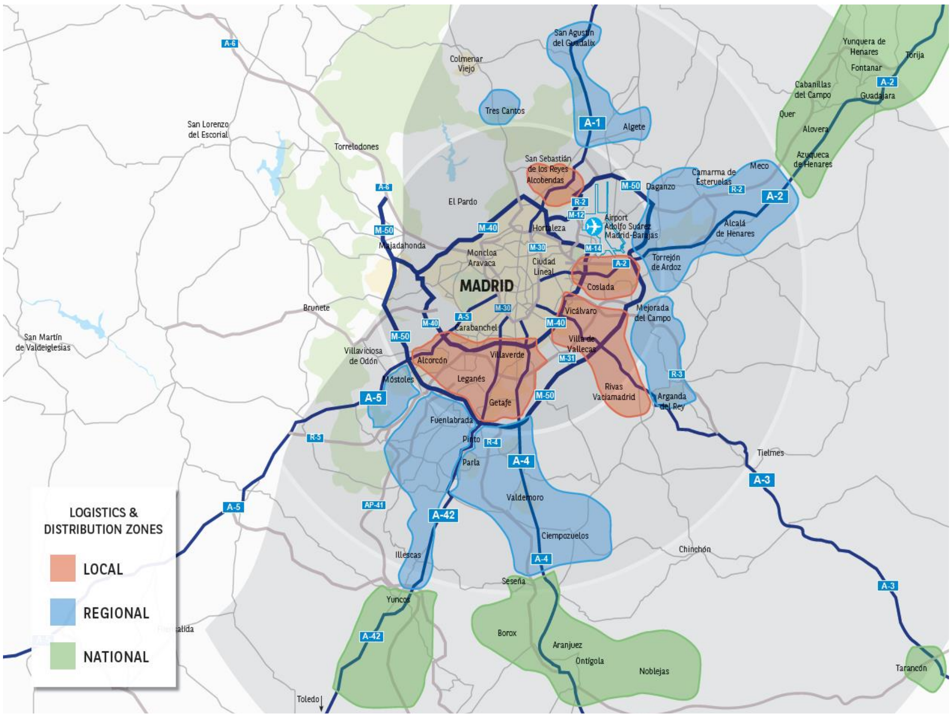
Source: NORD/LB Sector Research, internal research

Madrid Spain's most important logistics market

Madrid is located in the heart of Spain and, with its radial traffic network, is an especially important strategic location in terms of logistics. Madrid's logistics activities predominantly stretch along the motorways A2 and A4,[61] and the logistics market is divided into three rings. The first ring (local) is located in Madrid's centre. The main focus of logistics activities here is local distribution. In the second ring (regional), there is a focus on warehouse storage and the distribution of consumer goods. The third ring (national) is located between 30 km and 70 km from the centre and encompasses storage areas at more affordable rents for products with lower turnover rates, etc.[62]

[61] BNP Paribas Real Estate: Logistics Madrid, Q1 2018
[62] Jones Lang LaSalle: Logistics Market Report 2016, Madrid and Barcelona

Logistics sub-markets in Madrid



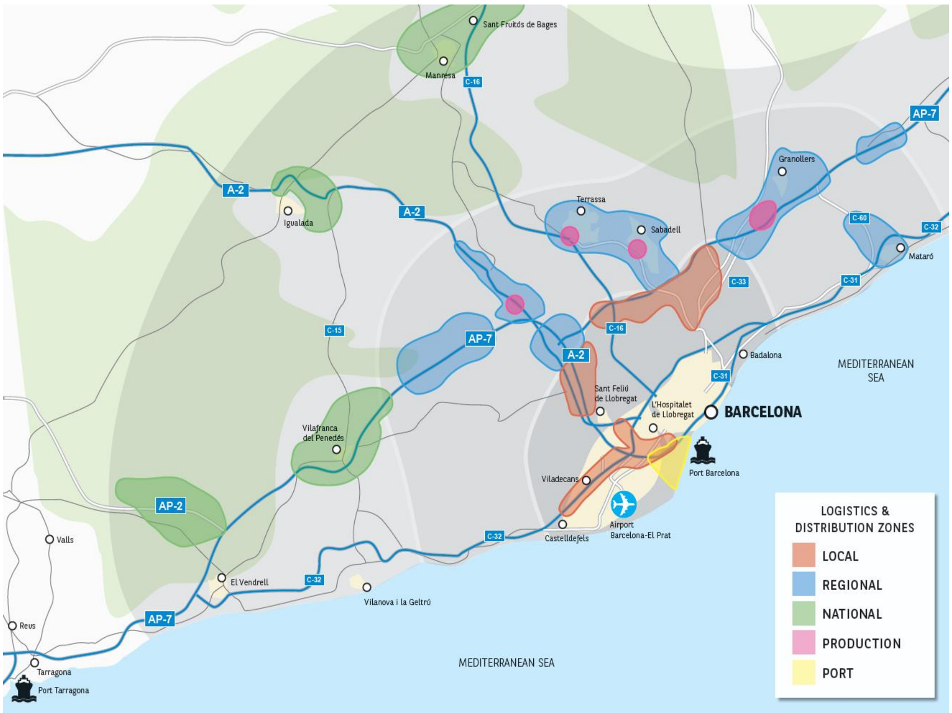
Source: BNP Paribas Real Estate

Barcelona logistics market boasts Spain's third-largest harbour

Situated between the sea and the mountains, Barcelona has a less favourable strategic location than Madrid. The supply of logistics space is therefore limited, especially in the centre, and companies are increasingly switching to the periphery. On the other hand, the city has an advantageous proximity to the Mediterranean. Barcelona has Spain's third-largest harbour.[63] Its logistics activities are focussed in particular along two motorways: the A2 (heading towards Zaragoza) and the A7 (heading south-west towards Tarragona and north towards Girona). Like in Madrid, Barcelona's logistics market can be divided into three rings. The first ring (local) is within a 10 km radius of the centre and includes the port and the airport. The adjoining second ring (regional, up to 40 km from the centre) has the third highest density of logistics real estate. The third ring (national, between 40 and 100 km from the centre) is primarily home to sprawling logistics spaces for national and international distribution.[64]

[63] Jones Lang LaSalle: Logistics Market Report 2016, Madrid and Barcelona
[64] Ibid.

Logistics sub-markets in Barcelona



Source: BNP Paribas Real Estate

Buoyant demand for logistics space

With improved confidence in the Spanish economy, demand for logistics real estate has been steadily increasing in recent years. An important factor driving demand is the growth in online retail, which is increasing demand for extensive storage warehouses and distribution centres. Other factors driving the Spanish logistics market are the increase in private consumption and higher export volumes. Because less and less space is available, particularly in city centres, continuously optimising suitable logistics space is of crucial importance.

Madrid's take-up more than doubles in 2017

In Madrid, take-up came to 866,405 m² in 2017. Due to the exceptionally high number of transactions, take-up increased by 120% year on year. Take-up of 224,570 m² was achieved in the first quarter of 2018, which was the best result in ten years.[65] Since the end of the real estate crisis, the vacancy rate has been falling rapidly due to increased demand for logistics space. After dropping by significantly more than half to 6.1% between 2012 and 2015, the vacancy rate came to 4.2% in 2017 and 3.7% in the first half of 2018. There was a total of approx. 945,286 m² of logistics space under construction at the end of the first half of 2018 (focus on second logistics ring), of which 90% was being built speculatively.[66]

Barcelona's take-up at record level

Take-up in Barcelona has set records for the last two years in a row. After recording take-up of 564,273 m² in 2015, the city saw take-up in 2016 increase once more to 659,064 m². In 2017, take-up came to 450,060 m². This decline can be attributed primarily to a lack of products and to transactions for smaller spaces. In the first quarter of 2018, a new record take-up result of 185,890 m² was achieved.[67] As in Madrid, the vacancy rate has been demonstrating a clear downward trend in recent years. After falling by more than half to 4.3% between 2013 and 2015, in 2016, it remained at a stable level at 4.4%. However, in 2017, the vacancy rate dropped even further to 3.2%. In fact, in the first ring, it

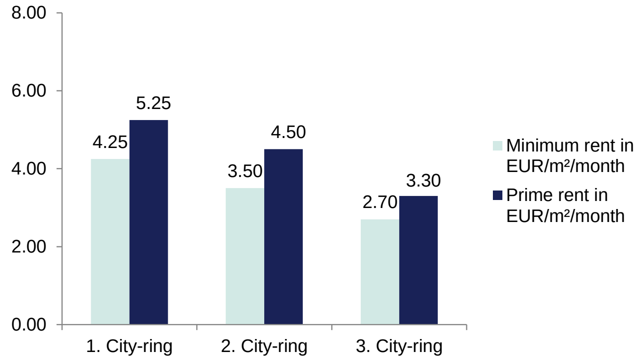
[65] BNP Paribas Real Estate: Logistics Madrid, 2017 and Q1 2018
[66] Jones Lang LaSalle: Logistics. The revolution of a rising market, March 2018 and Spain Logistics Fundamentals, Q2 2018
[67] BNP Paribas Real Estate: Logistics Barcelona, 2017 and Q1 2018

was as low as 1.5%. This trend continued in the first half of 2018. The average vacancy rate dropped to 2.8%. Unlike in Madrid, most, i.e. 78%, of the logistics space under construction (Q2 2018: 316,602 m²; focus on second ring) has been pre-leased.[68]

Buoyant demand causes rents to rise

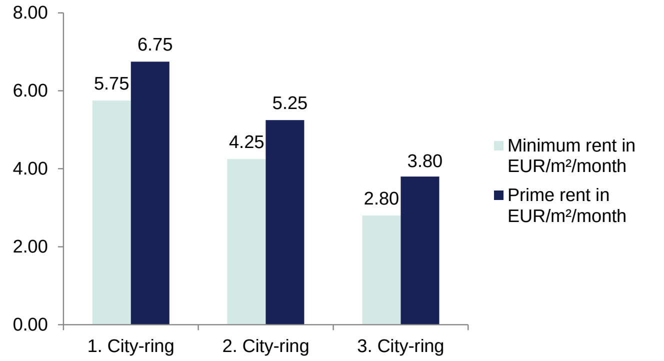
By 2014, there had been a drop in rents in the Madrid logistics market. Since 2015, the market has again been recording a moderate upwards trend. In the second quarter of 2018, prime rents ranged between EUR 5.25 per m² per month in the first ring and EUR 3.30 per m² per month in the third ring. Barcelona reached the lowest point in its rental development in 2013. In 2014 and 2015, a significant rent hike was recorded in the Catalan capital. The rental level then remained stable. After the first six months of 2018, maximum rent was between EUR 6.75 per m² per month in the first ring and EUR 3.80 per m² per month in the third ring. In spite of increased demand, rental prices for both logistics markets are still well below the pre-crisis level of 2008. In the next few years, we expect moderate rental price increases for both markets, although more momentum is expected in the Spanish capital. After Manchester, London and Dublin, Madrid is one of the top five cities in Europe in terms of the highest rental growth forecasts on the logistics markets for the years 2018 to 2022 (Madrid: +3.3% p.a.). In this ranking, Barcelona is in 29th place with an expected rental increase of 0.4%.[69]

Madrid: rental range in sub-markets Q2 2018



Source: Jones Lang LaSalle, internal research

Barcelona: rental range in sub-markets Q2 2018



Source: Jones Lang LaSalle, internal research

Increasing demand in investment market

In financial year 2017, a new all-time high was recorded in the overall Spanish market for logistics real estate, with a transaction volume of around EUR 1.41 billion. The last quarter of 2017 was especially dynamic, with a transaction volume of EUR 833 million. The most important players were SOCIMIs (see chapter 7) and international funds. At 93%, foreign investors accounted for nearly all of these investments in 2017. In the first half of 2018, the nationwide transaction volume in the logistics real estate market came to around EUR 424 million, of which Catalonia accounted for 35% and Madrid 52%. Although the transaction volume was 13% lower than H1 2017, but it needs to be considered that the previous year's result had been unusually high. Due to high demand, in particular for core products, prime yields in Barcelona and Madrid decreased from 6.10% (Q4 2016; both cities) to 5.75% and 5.40% respectively (Q2 2018).[70]

[68] Jones Lang LaSalle: Logistics. The revolution of a rising market, March 2018 and Spain Logistics Fundamentals, Q2 2018
[69] Ibid.
[70] Jones Lang LaSalle: Logistics. The revolution of a rising market, March 2018 and Spain Logistics Fundamentals, Q2 2018

Outlook for logistics real estate market

Demand	↗
Supply	→
Vacancy rate	↘
Prime rent	↗
Investment volume	↗
Prime yield	↘

The Spanish logistics real estate market is developing dynamically and demonstrating further potential for growth in 2018. Demand is steadily increasing, which is reflected in growing take-up. We currently expect that the political uncertainty in Catalonia will continue to have no significant impact on the logistics real estate market. One important market driver is the expansion of online retail, which will have an increasingly positive impact on the Spanish logistics market in the years to come (e.g. due to a growing need for large-scale warehouses). In light of this development, we also anticipate that there will be a further decline in the vacancy rate and a moderate increase in rental prices. According to our market evaluation, the upward trend on the investment market should therefore continue in 2018 as well, although the supply shortage is likely to become more acute. The probable result of this will be continuing pressure on yields, meaning that a decrease in prime yields can be expected for both Madrid and Barcelona. However, compared with other important European logistics locations such as Paris, London and Berlin, with some prime yields well below 5%, the Spanish market offers attractive investment opportunities. The shortage of suitable logistics space, especially in the centres of Spain’s two largest cities, means that other logistics locations such as Valencia, Zaragoza and Bilbao are likely to continue to gain in significance.

7. Side note: SOCIMIs

Importance of SOCIMIs

SOCIMIs (Sociedades Colectivas de Inversión Inmobiliaria) are real estate funds, the Spanish version of REITs (real estate investment trusts). The goal of an SOCIMI is to directly or indirectly invest in real estate assets such as office, retail, residential, logistics or hotel real estate. SOCIMIs are traded on the BME (Bolsas y Mercados Españoles) stock exchange or using the MAB (Mercado Alternativo Bursátil) trading system. SOCIMIs have existed under Spanish law since October 2009. However, they only became relevant to the market in January 2013 as a number of regulatory barriers were removed, increasing investment appeal.[71] Since then, SOCIMIs have been popular with both domestic and international investors as investment vehicles. This is illustrated by the fact that the number of SOCIMIs has now risen to almost 60.[72] By comparison, the German market currently has just five REITs: Alstria Office REIT-AG (approx. EUR 2,344 million), Hamborner REIT-AG (approx. EUR 728 million), Deutsche Konsum REIT-AG (approx. EUR 297 million), Deutsche Industrie REIT-AG (approx. EUR 169 million) and Fair Value REIT-AG (approx. EUR 113 million),[73] although there are a number of other companies in the German “REIT pipeline”.

Appeal of SOCIMIs

Firstly, the appeal of SOCIMIs has to do with the supply side of things. In Germany, supervisory regulations, distribution specifications and investor restrictions are more stringent than the relatively flexible stipulations of the Spanish MAB and Spanish law. Secondly, the tax system (especially for legal persons) is less complicated and more affordable in Spain.[74] Investors who meet the legal requirements of an SOCIMI will benefit from a Corporate Income Tax (CIT) rate of 0%. This makes SOCIMIs just as appealing to investors as the REITs in other West-

[71] Judgement: V2759-12 and V2760-13 in conjunction with Law 11/2009, from 19 September.2013
[72] BNP Paribas Real Estate: Investment Spain Q1 2018/Bolsa de Madrid
[73] Bloomberg: Stand Marktkapitalisierung: 2 August 2018
[74] PwC: Compare and contrast, Worldwide Real Estate Investment Trust (REIT) Regimes, November 2015

ern countries.[75]

Legal framework

The legal requirements include the following[76]:

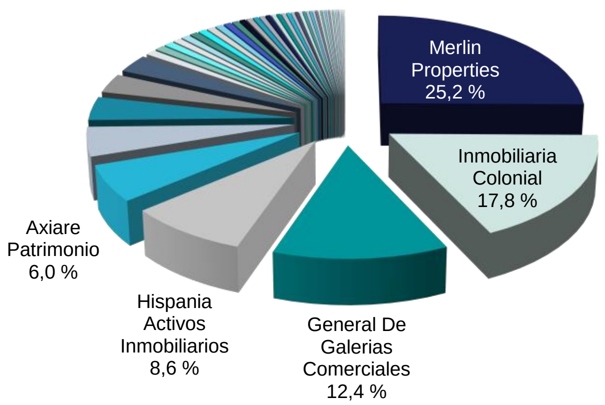
- Minimum share capital of EUR 5 million
- At least 80% must be used in metropolitan areas for rental purposes, building plots or holdings in other SOCIMIs.
- At least 80% of SOCIMI revenues must be generated from qualifying assets.
- The asset must have a minimum holding period of three years.
- Distribution of profits to the shareholders: 100% of the profits derived from investments in other SOCIMIs, 80% of the rental income and 50% of capital gains

Oligopolistic market distribution

Even though many new competitors have entered the market as mentioned, the SOCIMI market is oligopolistic. The five largest market players account for around 70% of market capitalisation. This is demonstrated by the strong associated accumulation of asset values in the largest five registered real estate portfolios.

Top five SOCIMIs

Top 5 SOCIMIs	Market capitalization (in TEUR)	Market share (in %)
Merlin Properties	5,820,460	25.2
Inmobilaria Colonial	4,100,689	17.8
General de Galerias Comerciales	2,860,000	12.4
Hispania Activos Inmobiliarios	1,989,069	8.6
Axiare Patrimonio	1,375,687	6.0



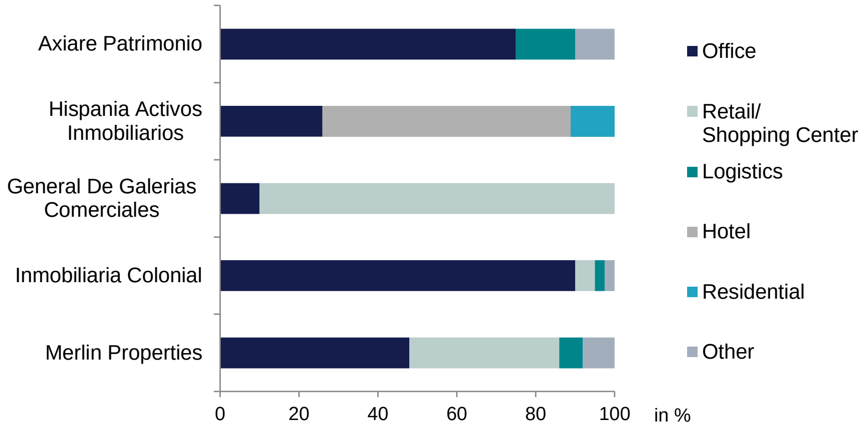
Source: Bolsa de Madrid (accessed: 28 June 2018), internal research

Heterogeneous investment strategies of top five SOCIMIs

There are significant differences between the investment strategies of the top five SOCIMIs when it comes to the asset classes that they invest in. Whereas office real estate usually accounts for a certain proportion in every one of the top five, the other asset classes are quite heterogeneously distributed. Overall, there is a trend toward portfolio specialisation. Regionally, the main focal points are Madrid and Barcelona.

[75] Ashurst LLP: SOCIMIs: A great success story that began with a failure, in: Built Environment Insights, Issue 1, from 1 March 2017
[76] Latham & Watkins: New Legal and Tax Regime for the Spanish REITs, in: Client Alert, No. 1454, from 17 January 2013

Investment focal points of the top five SOCIMIs



Source: Company presentations of the SOCIMIs, internal research

SOCIMIs are market drivers

The new regulations, which have primarily created certain tax incentives for SOCIMIs, have contributed to a considerable intensification of interest from international investors and real estate companies in the Spanish real estate market. SOCIMIs are now driving the Spanish real estate market as tax-privileged investment vehicles.

8. Outlook

Outlook for Spain's real estate market

Demographic development	↘
Real GDP growth	↗
Unemployment rate	↘
Number of office employees	↗
Retail sales	↗
Tourism demand	↗
Demand for logistics real estate	↗

Since the end of the crisis years, the Spanish economy has been experiencing a significant upturn. Spain has been able to once again develop into an attractive real estate market that offers further potential for growth. The economy is steadily expanding, and unemployment continues to drop. The outlook for further economic development is also positive. This economic momentum is likely to continue, even though political uncertainty presents a negative factor. For example, the new minority government under Pedro Sánchez is facing enormous challenges, as there is still great need for reform. Moreover, although the conflicts relating to Catalonia's quest for separation have calmed down, they have not been resolved. The international environment, including factors such as the Brexit negotiations and US policy, is also causing uncertainty. Overall, we anticipate that Spain's positive economic outlook will continue to provide the real estate market with tailwind. The main focus here is on the capital, Madrid, and the tourist metropolis of Barcelona, although alternative locations such as Bilbao, Valencia and Seville should continue to gain momentum.

In particular, the office real estate market is experiencing a continuous increase in demand, although the supply of core properties has clearly dwindled, and prime rents have risen. Take-up is expected to keep growing. Retail in Madrid and Barcelona has undergone a considerable revival due to the positive development of the domestic economy. Demand is developing extremely buoyantly. For this reason, it is likely that rents will continue to increase in the top locations in the cities of Madrid and Barcelona. The hotel real estate market is also on a trajectory of growth due to record tourist numbers. The performance of hotel markets in Madrid and Barcelona has steadily improved in recent years. This trend looks set to continue. Madrid in particular will feel the positive effects of the increase in business travel activity as a result of the economic recovery. Barcelona is and will remain a tourist magnet, even if the political unrest at the end of last year has led to a slight decline in international visitors. The logistics real estate markets in

Barcelona and Madrid also promise further prospects for growth. Demand is steadily increasing, which means there is also a shortage of prime locations in these centres. One significant driving force is online retail, which is increasing the need for large warehouses. SOCIMIs (Spanish REITs) have become important market players in the Spanish investment market. The reform of the Spanish REIT law in early 2013 has made investing in the Spanish real estate sector much more attractive. Ultimately, this has facilitated the recovery of the real estate sector. Even though political events are presenting the Spanish real estate market with a certain degree of uncertainty, the good economic framework means that the signs are pointing towards growth.

Contact at NORD/LB Group

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