MARKET IN MINUTES

Savills Research

Portugal – June 2020

Covid-19: Real Estate Market Impacts From The New Reality

savills

Contraction of economic activity reflects impacts of the Covid-19 pandemic

On 18th March 2020, the Portuguese government declared a state of emergency to combat the Covid-19 pandemic.

This declaration dictated, among many other measures, the closure of all commercial activities considered non-essential and stipulated the adoption of working remotely whenever possible in accordance with the employee's tasks and duties.

By the end of March 2020, the Portuguese government launched a package of economic measures to mitigate the impact of Covid-19 on the national economy. Among the measures established there was a credit line of 200 million euros to support companies and another line of 60 million euros for small businesses in the tourism sector.

There was also a moratorium on the payment of the credits loaned to families and companies through to September 2020, which provides for the suspension of certain contracted credit lines to prevent situations of default.

The package of measures also featured the launching of a new lay-off scheme as a protective measure to maintain jobs throughout the shutdown. Three months on from the implementation of this initial support package, further financing was approved for the measure by the Portuguese government under the auspices of its Economic and Social Stabilisation Program. This issued 6,800 million euros in credit lines with a state guarantee for both small and medium-sized enterprises and midcaps (companies with up to 3,000 employees).

Over the last three months, the intervention of the Portuguese state has received widespread praise and recognition from various entities, commentators and international publications for its fast response capacity, as well as the obedience across society regarding the lockdown measures imposed and supportive government action.

> **"Portugal has proven to be one of the countries in the world that has so far most successfully managed the coronavirus-related health crisis"**
>
> The Guardian (19 April 2020)

On the 4th of May, the state of emergency in Portugal was downgraded to that of calamity and the third phase of the ending of confinement is now underway. The obligation for working remotely has ended and the Portuguese government recommended the country advance with a "partial ending of confinement".

Despite this rapid response, the impact on the economy had already an impact by the end of the first quarter of 2020. According to the latest statistics released by the NSI – the National Statistics Institute, the first quarter of 2020 saw GDP fall back 2.4% year-on-year. Furthermore, this drop reflects the impact of the Covid-19 pandemic that only emerged in the last month of this quarter. Moreover, compared with the final quarter of 2019, GDP was down by about 3.9% in real terms.

The budget balance also underwent a downturn, recording a deficit of 2.5% of GDP through to the end of April, reflecting an increase in expenditure outstripping that of revenue. By the end of this month, the General Directorate of the Budget estimates Covid-19-related expenditure had topped 345 million euros.

Regarding the impacts of the economic support package, they should become more visible in the coming months as the planned support measures are implemented. The Portuguese government's own projections point to an economic contraction of 6.9% in 2020 and with the unemployment rate rising to 9.6%, forecasts that still come with a high degree of uncertainty.

On 27th May 2020, the European Commission presented a 750 million euro recovery plan called "Next Generation EU" in order to not only mitigate the impact of Covid-19 but also to focus on digital transformation and provide more social support and jobs.

Covid-19 impact on Investment Markets

As the confinement measures are lifted, the prospects for the growth and recovery of the transactional market are becoming more positive although this remains only slight progress marred by a degree of uncertainty. However, people are gradually returning to their places of work, commerce has re-opened and some countries have already re-established some air links.

2 March
First two cases of Covid-19 announced in Portugal

12 March
Schools closure, reduction in the maximum restaurant seating capacity, limitations on numbers visiting shopping centres.

17 March
All air links to and from the European Union suspended.

18 March
decretado o estado de emergência.

19 March
Disclosure of the measures and rules for the state of emergency..

30 April
Gradual lifting of restrictions on social and economic activity until 1 June.

2 May
End of the state of emergency.

4 May
Beginning of the state of calamity. Opening of local commerce for shops up to 200 sq.m

18 May
Re-opening of restaurants. Opening of street shops up to 400 sq.m

15 June
Re-opening of shopping centres in the Greater Lisbon Area.

Forecasts 2020

GDP Portugal	Inflation	Unemployment Rate	Private Consumption	Imports	Exports
-6,8%	-0,2%	9,7%	-5,8%	-10,3%	-14,1%

Source: Comissão Europeia

As the restrictions of the confinement phase are lifted, the market is slowly adapting to the new reality

In the first quarter of 2020, the national real estate commercial market investment totalled approximately 1.5 billion euros (value that represents 50% of the total investment volume of the last years), continuing the dynamic level of activity the market has been experiencing over the last two years.

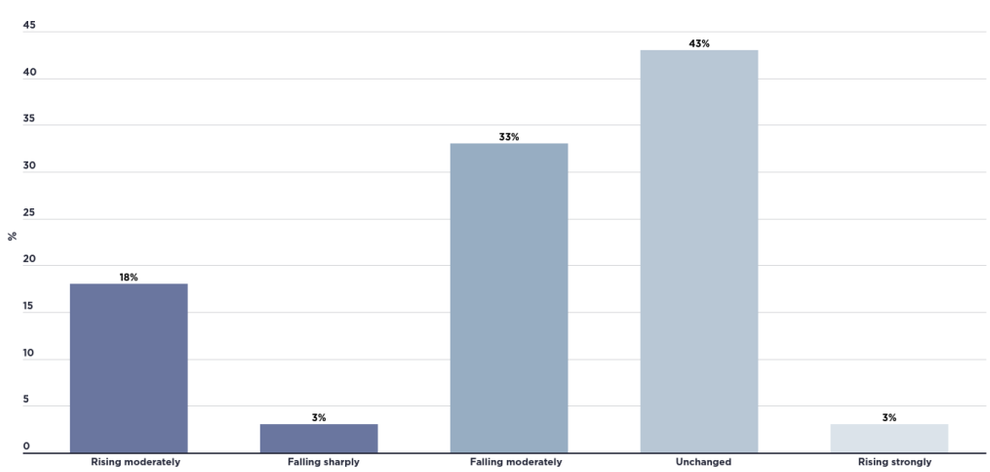
It is important to emphasize that this result does not yet reflect the impact of the Covid-19 pandemic that hit Portugal in the middle of March as these are transactions that would have been in the process of analysis and acquisition since 2019. In the first three months of the year, the retail, office and hotel sectors observed the largest investment transactions. The sale of 50% of the Sonae Sierra Fund, with an estimated value of 750 million euros, including some of the largest national shopping centres, which was the largest transaction in this quarter.

Going into April, the retraction in the domestic and international market began to emerge more clearly.

Throughout Europe and according to data released by Real Capital Analytics (RCA), the figures for April slumped by about half when compared with the same period of 2019. This result derives from several factors caused by the confinement measures, such as travel restrictions that cancelled air traffic and correspondingly rendering physical visits to properties impossible.

In Portugal, although opinions divide into more conservative or more optimistic strategic positions, most investment plans have been put on hold. Nevertheless, this does not represent a crisis of economic origins, like the one in 2008, as investment intentions remain in place as do the new opportunities potentially arising from the impact of Covid-19 on the real estate market.

Office Investment Transactions



Source: Savills Research

Global Savills Sentiment Survey
(results as of June 2020)

Demand

30% increase since the lifting of restrictions in the markets analysed.

Logistics & Healthcare

Emerging as the most resilient sectors.

Financing

Less favourable terms of access in 58% of markets.

Investiment

Only 18% of the markets analysed recorded an increase in transactional activity.

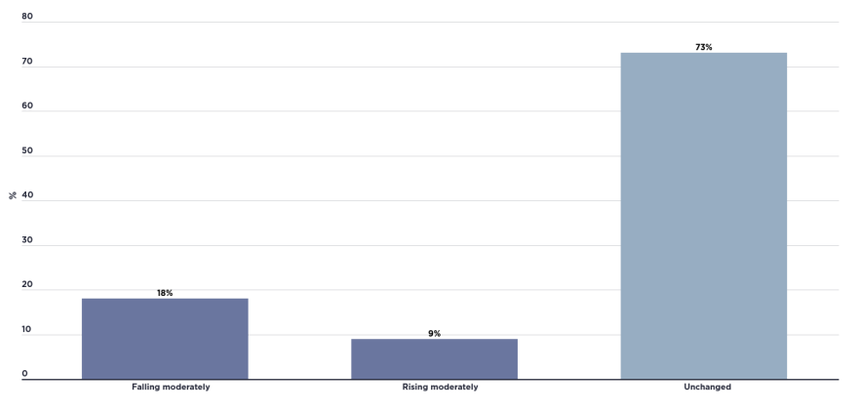
Forecast

Transactional activity should gradually resume its pace in the second half of 2020 and return to more stable growth in 2021.

Pricing

Most of the markets analysed did not report price corrections.

Investment Transactions - Multifamily, Student Housing, Senior Living



Fonte: Savills Research

In an internal survey conducted by Savills international research team and covering 33 global investment markets*, the aim was to measure the sentiment prevailing in real estate markets. On June 3rd, the easing of the restriction measures was already having an impact, albeit slight, on occupational demand with 30% of the markets analysed recording rises in this indicator. In Portugal, we are still in an ending of confinement phase that has not yet produced significant effects in terms of an increase in demand even though the office segment is beginning to show the first signs of a slight upturn in activity. Nevertheless, it remains difficult to predict how the office market will behave all the way through to the end of 2020. However, the second half of the year should see a slight recovery even if not at the pace observed in the previous years which have exceeded the absorption rate threshold for over 200,000 m2 properties.

With regard to demand in the retail segment, and noting only the results obtained for Italy, Spain, France, the United Kingdom and Portugal, these markets registered a moderate or sharp (in the case of the United Kingdom) fall confirming that this segment is among those most exposed to the fallout caused by Covid-19.

However, if the pandemic has exposed the weaknesses of some real estate segments, it has also exposed the strengths of others, such as the industrial & logistics sector, and led to the creation of new market opportunities.

Such is the case for the Multifamily segment, which has seen increases in demand in Spain, France and the United Kingdom. In Portugal, there are still no changes in demand, this is justified by how it still remains an embryonic segment and requiring further study by some investors. However, the changes to lifestyle, the necessary restructuring of consumer habits, the living and financial conditions of the young professional class may prove a driving force able to boost to this segment in Portugal.

Regarding the rent values in effect, these remain unchanged for the office segment and are falling moderately or sharply in the retail segment (with the exception of Portugal where the lack of operations does not yet allow any clear measurement of rent behaviours in this period).

Transversally and without exception, in Italy, Spain, France, the United Kingdom and Portugal, there was less mortgage lending available on June 3rd.

However, this more restricted access to credit is expected to impact only on smaller property transactions and not causing obstacles to players with higher levels of liquidity. Hence, the core market fundamentals of the real estate investment market remain unchanged, with the high liquidity capacity leading.

Global Savills Sentiment Survey

Rental Values

In most of the markets analysed, rents remain unchanged or with slight falls recorded.

Investment Values

According to information from Real Capital Analytics, since the beginning of 2020 there has been a 60% decrease in business transactions of below 20 million euros all over Europe. A large proportion of these businesses may be dependent on the provision of funding.

Cross Border

69% of the markets analysed foresee that around half or more of their total investment volume in the second half of the year may originate from domestic investors.

Prime Product

Remains on the radar of cross-border investors. About 50% of the markets analysed expect to see an increase in transaction volumes in the office sector. 75% of the markets believe that 2021 will witness a more significant recovery in this segment.

* Savills Global Market Sentiment: internal survey conducted by Savills in 33 markets. The survey was conducted between 3 and 5 June 2020.

Markets analysed: Czech Republic, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Norway, Poland, Portugal, Romania, Spain, Sweden, Switzerland, Netherlands, United Kingdom, UAE, Australia, Hong Kong, India, Indonesia, Japan, China, Malaysia, New Zealand, Singapore, South Korea, Taiwan, Thailand, Vietnam, United States and Canada.

Retail

For the last three months, retail operators have been the most directly affected by the measures imposed by the state of emergency. Only food retailers, pharmacies and some activities considered essential to the normal functioning of society were able to remain open.

On May 4th, local shops with an area of up to 200 sqm were allowed to re-open and the same measure was postponed to shops with an area of up to 400 sqm from May 18th. Also on this latter date, esplanades, cafes and restaurants were allowed to re-open when complying with the respective maximum occupancy, safety and hygiene measures. Shopping centres in the Lisbon Metropolitan Area were allowed to re-open on June 15th after a period in which the government opted to postpone the lifting of some of the third phase of the end of confinement restrictions and prolonged the closure of shopping centres.

The restrictions imposed are expected to put a strain on sales volumes, leaving small local retailers more exposed to economic difficulties as they already enter the phase of the end of confinement in very fragile positions due to the amount of time that they were closed for. Therefore, we may see an increase in the rate of availability of street shops and greater pressure on rental values as a result of business closures. However, it is still too early to make any estimate given that the lay-off support system is still in place and now extended until the end of July.

Covid-19 came to challenge the Omni-channel strategies

We are indeed living through unprecedented times that have completely changed the operational models and led to a strategic reorientation. The Omni-channel approach was certainly already one part of the marketing and sales strategy of many retailers. However, from a strategic choice to differentiate the consumer experience, the Omni-channel strategy now itself presents a challenge across a larger mass of operators in response to the constraints caused by the Covid-19 pandemic.

The retail universe now blends more deeply into the universes of logistics and e-commerce.

While digital was formerly seen by many as an additional sales channel, it now gains both a more prominent place and a greater weighting in the turnover of retailers.

In 2019, 81% of the population had access to the Internet. According to the DPD group e-shopper 2019 barometer, despite the high rate of Internet penetration, e-commerce accounts for only 9.8% of consumer purchases in Portugal, way below the European average of 13.5%. With the fashion sector leading online shopping, the vast majority of purchases are cross-border, with China accounting for 70%, followed by Spain on 61% and the United Kingdom with 50%. In general, online purchases in the food and retail sectors have increased when compared to the pre-pandemic period but we must not forget that online channels are still not particularly significant in most retail activities ongoing in Portugal and have failed to compensate for the loss of volume in physical sales.

Although shopping centres in Portugal are already back in operation, the e-commerce figures are expected to begin gaining a greater weighting as a result of the new consumption habits acquired during the confinement period. Furthermore, it plays an important role in helping the country's economic recovery.

Hotels

Along with the retail segment, the tourism sector is clearly one of the most deeply affected by Covid-19. Social isolation, flight suspension and cancelled bookings are generating historic falls in the hotel industry throughout Europe and significant falls in hotel transaction volumes are expected. In the European context, the figures for March were already illustrative of this reality, having plummeted a 77% drop when compared to the three-year average for March and with the volume for April reporting a slump of 63%.

For Portugal, the figures suggest that companies linked to the tourism sector are to register 50% decreases in their invoicing volumes when compared to 2019. At this point in time, the internal market will be essential to underpinning tourism sector activities all the way through to the end of 2020.

What to Expect?

This new normality to which we are all adapting has brought new measures and rules that reflect in new lifestyles and consumption habits. The role of technology will be more pronounced and present in the daily lives of all of us but without replacing all of the physical spaces and experiences, which will drive owners and occupants into rethinking their strategies.

From an investment perspective, the strength of the location and the solidity of the market fundamentals will provide the basis for selecting the next investment hotspots.

By the end of this year, it is expected that slowdown in transactions closures maintains. Investors will be more cautious about the retail and hotel sectors as well as others with operating models relying on flexible and short-term leases, such as office co-working spaces and student residences.

The office sector will continue to be resilient while having to take into account the effects that successful teleworking might play in future company strategies.

High levels of liquidity, a more capitalised banking system and a more restrictive pipeline will contribute to a faster recovery of positive investor sentiments, enabling equity players and private investors to obtain a competitive advantage.

Sale-leaseback operations in sectors such as tourism and retail might provide the strategic solution for refinancing activities.

The focus is now on re-establishing links with the key source countries for the national tourism market. Bearing in mind that 70% of the 26 million tourists registered in 2019 were of international arrivals, this factor is extremely important.

A questionnaire conducted by the NSI during April and the first week of May recorded how 78.9% of tourist accommodation establishments indicated that Covid-19 was responsible for the cancellation of bookings scheduled from March to August 2020.

The local accommodation sector represents one of the most affected tourist segments with predictions of the level of contraction reaching as high as 90%. In April, local accommodation establishments registered average occupancy rates of 18% and 17% respectively.

For the owners or operators of local accommodation units, it is already time to embrace alternative strategies to cope with this phase of the crisis. With revenue levels close to zero for the coming months, local housing rentals have the opportunity to migrate to the "mid-term" regime with medium-term contracts with a duration of up to 12 months.

Despite being one of the sectors most affected by the consequences of Covid-19, interest in the national hotel investment market remains unchanged with the market fundamentals remaining both solid and attractive.

Since 2018, Portugal has been the scene of major transactions in the hotel sector with the largest investors arriving from the United States, China and Korea.

Despite these uncertain times, the interest in expanding hotel chains to Portugal continues due to the recognition of Portugal as a safe tourist destination and the increasing professionalisation and specialisation in terms of supply.

Evidence of this is the resumption of activity in Portugal of some hotel groups. Stay Hotels is expected to open two new hotels, in Lisbon and Oporto by the end of the year. The Belgian group KREST has also invested 15 million euros in the first hotel under the Moxy brand in Portugal, which is to be managed by the Portuguese group Hoti Hotéis.

Offices

The demand for prime product in the office segment continues to occupy a leading position in investor preferences. Although the Covid-19 pandemic is producing contractionary effects on the volume of investment transactions ongoing, the pace of the resumption of transactional activities is expected to be proportional to the pace of resumption of activities by occupiers as restrictions on activities get lifted. Prime yields should remain stable until the end of 2020.

Between January and May 2020, the Lisbon office market recorded a total absorption rate of 79,000 sqm, which represents an increase of 12% compared to the same period in 2019.

The results observed in the first five months of the year have confirmed the downward trend in occupational activities, already forecast since the beginning of the year. The months of April and May were marked by the state of emergency and the prevailing climate of uncertainty. May was the period that better reflected the impact of Covid-19 on the office occupational market, with a total absorption rate of 5,271 sqm, confirming a year-on-year decrease of approximately 70% and a contraction of 82% when compared to April 2020. The second half of the year is expected to see greater activity compared to the confinement phase even though the climate of uncertainty is expected to linger until the end of 2020. During the first five months of this year, the market has been experiencing fluctuations in its level of occupational activity, justified by the conclusion of several large-scale projects. The termination of these operations should be analysed beyond the pandemic context given that they involve negotiations with extensive timelines and that were already taking place in the pre-Covid period.

Although the pandemic situation has led to the cancellation of decisions over relocating or opening new facilities, the significant shortage of quality space available along the main axes of the city of Lisbon combined with demand that is beginning to display the first signs of recovery suggest a more dynamic second half of the year.

Flexibility: the factor of change

Much has been written about the change in workplaces brought about by the restrictive measures imposed by Covid-19. Teleworking has gone from a work practice applied to a restricted range of companies and sectors of activity to being compulsory for all workers whose activity could be exercised under this regime.
As the state of emergency and the end of the obligation to continue with remote working have been lifted, the question now faced is just how the dynamics of returning to offices, the safety and hygiene measures necessary for application and the management of social distance within the scope of office space layout may best be managed. Covid-19 does not at all dictate the end of office spaces but has nevertheless unleashed a new dynamic that puts a great deal more emphasis on aspects related to flexibility, technology, creativity and efficiency.

. Easily adaptable spaces;

. Greater connectivity between teams;

. Greater mobility through recourse to technologies;

. Focus on the employee experience as a tool to increasing productivity;

. Cost optimisation as a result of redefining work spaces and models;

. Greater focus on the attractiveness, creativity, efficiency and safe spaces that retain talent;

. More flexible rental agreements

Covid-19 emerges as the great dynamic opportunity for the industrial & logistics sector

In the beginning of 2020, we focused both on the continuing recovery in logistic activities and on the emergence of new trends and occupation needs resulting from the restructuring of logistic chains and the integration of Omni-channel strategies into this process.

Some retail sectors have seen their turnover increase exponentially, providing a higher degree of resilience to a real estate segment that has been marked by a lack of dynamism in recent years.

The increase in consumption of food and consumer products considered non-essential (books, computer equipment and sports equipment) has led to an increase in the volume of online trade and forced a restructuring of the operational processes of many logistics operators.

Although Portugal has a lower e-commerce penetration rate compared to other European markets, the pandemic has acted as a trigger for accelerating the growth of the e-commerce channel in the national market.

Locations closest to urban centres will allow for the last-mile stage to be delivered with greater efficiency, which is fundamental in this pandemic scenario where delivery times and customer service constitute a factor of differentiation.

As we had anticipated in early 2020 and before the pandemic hit Portugal, we continue to see growth in interest in the prime assets allowing for the installation of production units able to ensure greater proximity to their intended markets. Furthermore, the process of introducing new technologies and robotisation will now act as a disruptive factor exerting still greater pressure on those involved in logistics chains.

It is therefore imperative that the capacity to respond increases through the provision of quality facilities that are 100% prepared to accommodate the new automated processes while simultaneously large enough to allow for a return on the investment made through the introduction of these new technologies.

Moreover, the first evidence of the trend for nearshoring is expected to emerge as the pandemic scenario has brought an additional boost to the return movement of productive units back to the consumer markets they are intended to serve.

Thus, this movement is forecast to trigger the changes necessary to the entire supply chain and generate the expected positive impact on the demand for industrial and logistics assets.

Regardless of the resilience displayed by this sector, demand levels have not changed significantly with some operators also adopting a wait-and-see strategy driving a slight slowdown in the annualised absorption rate against forecast expectations.

On the supply side, we expect to witness an increase in product diversification and the greater availability of quality facilities better targeted to 3 PLs and end-users (e-commerce) operators in conjunction with a greater focus on last-mile solutions.

In these first six months of the year, the prime rent values until now have remained unchanged even though the market is showing signs of some negotiating flexibility on the part of the owners.

Hence, by the end of this year, prime yields may be subject to slight compression but offset from increased demand for products in strategic locations for the last-mile stage, which allows for the optimisation of costs and delivery times.

Residential Market: New ways of life

The Covid-19 period will shape the residential market and the way we traditionally perceive it.

In Portugal, the effects of Covid-19 may generate new buying habits, new living needs and lifestyles that break with the more traditional vision of the residential market. The millennial and future generations that will enter the labour market in the coming years also defend different values to the previous generations which will reflect in the emergence of new housing models. Generations that firmly value the factor of mobility, forcing the residential sector more than ever before to reinvent itself and keep up with this trend. The increase in single-parent households, the rise in sales prices and the degree of uncertainty about the future have all led to greater demand from the rental market that goes unparalleled in the supply market.

As a result of the closure of a high percentage of local accommodation, the housing supply market may see an increase in the supply available in the coming months, especially in urban centres.

In the sales market, prices may have embarked on a downward trajectory. The May data for the Housing Sales Volume Index reported a 14% decline compared to the same period a year earlier. Despite the reduction in activities triggered by the restrictions on face-to-face visits to properties, a significant and continued fall in market values is not expected, based on the resilience of this segment which should fully recover after the end of the pandemic crisis.

Savills Webinar: Live Poll Results

On 11th of May, 2020, Savills Portugal hosted a webinar dedicated to the investment market, which was attended by 180 people. Throughout this webinar, we asked the audience twelve questions with the results presented in this report.

40% of the audience believes that the real estate investment market will take longer than twelve months to resume its level of transactional activities while 32% believe the recovery will take place within six to twelve months.

For 41% of the participants, the main obstacle pointed out for the completion of transactions is the general economic recovery of Portugal while for 28% this will arise due to the existence of a mismatch between the buying and selling intentions.

Any possible adjustment of prices has been greatly hampered by the sharp slowdown in the completion of transactions. For 44% of participants, the market may register a price adjustment over a period of between six and twelve months and with approximately 26% believing this adjustment will occur in a shorter period; between three and six months.

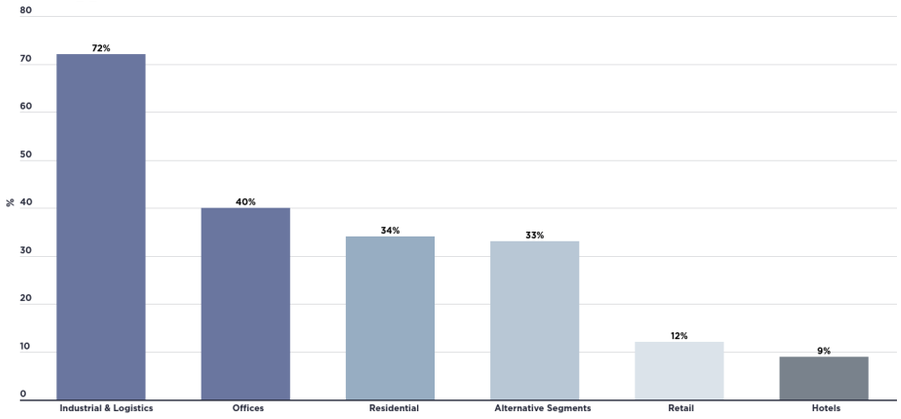
Hotels are unanimously, with 83% of responses, the real estate segment that will take the longest to resume their normal pace of activities followed by the retail segment (with 53% of replies).

When asked about the sector that at this stage emerges as holding the best investment opportunities, the industrial & logistics segment, with 72% of the answers, is identified as the most resilient sector due to the increase in the logistical operations of food and other non-essential products that are now getting retailed through e-commerce channels.

Portugal's high exposure to cross border investment and the impact on the recovery of the transactional market generated a division of opinion, with 39% of participants believing in a positive impact and 39% arguing that this exposure will return a negative impact.

With almost 90% of the national transactional market attributed to cross-border transactions, Portugal is correspondingly exposed to a greater degree of dependence on the pace and solidity of recovery of its peer European economies.

Given the current context, which real estate segments are the best investment opportunities?



Source: Savills Research

40%

Believe the investment market will take more than twelve months to resume its level of transactional activities.

44%

Believe that the market will take between six months to one year to register an adjustment in the transaction prices.

83%

Agree that the hotel segment will be the sector taking the longest to resume the normal pace of activity.

72%

Believe that the industrial & logistics segment presents the best investment opportunities.

44%

Believe in a general rise in yields.

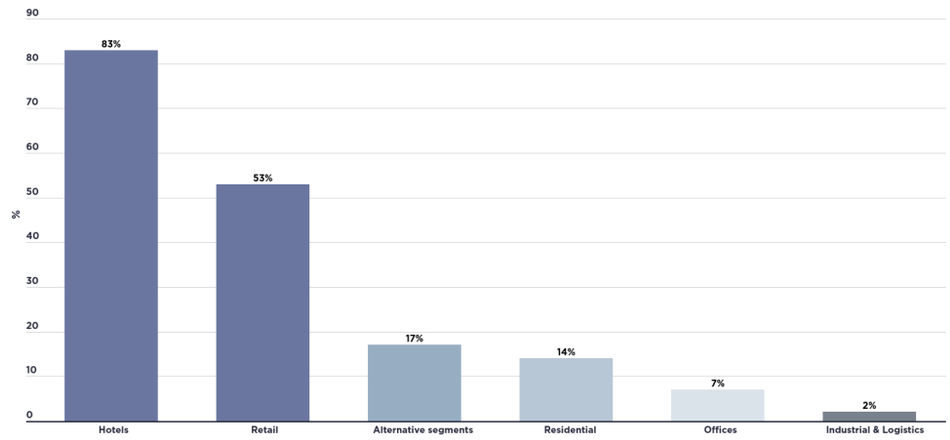
44%

Intend to complete the acquisition processes that were already under way.

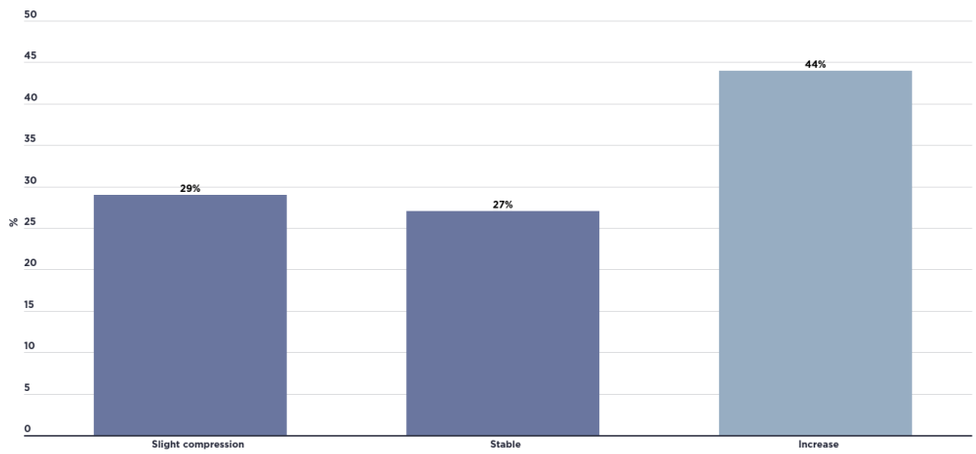
40%

Have adopted a wait-and-see action strategy.

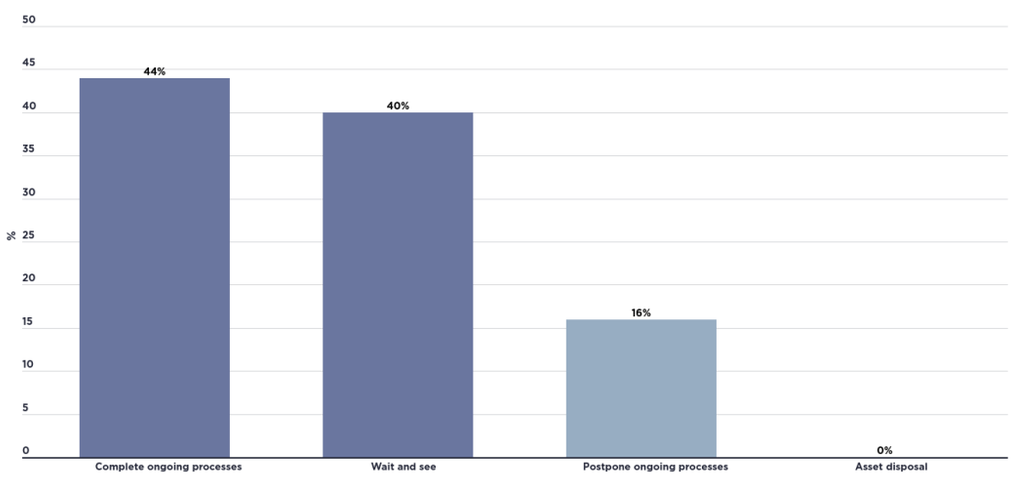
Which real estate segments will take the longest to recover ?



Until the end of 2020, what will be the expected yields evolution?



Given the current context, what strategy has your company adopted?



Source: Savills Research

The Savills Team

For further information, please contact:

Paulo Silva
Head of Country
paulo.silva@savills.pt

Alberto Henriques
Associate Director
Capital Markets
alberto.henriques@savills.pt

Bennett Ricks
Associate Director
Capital Markets
bennett.ricks@savills.pt

Alexandra Portugal Gomes
Associate
Market Research
alexandra.gomes@savills.pt

savills