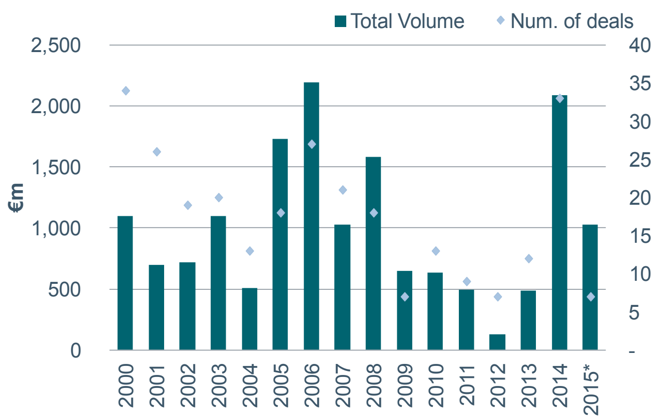
Market Report
Spain Retail

May 2015

GRAPH 1

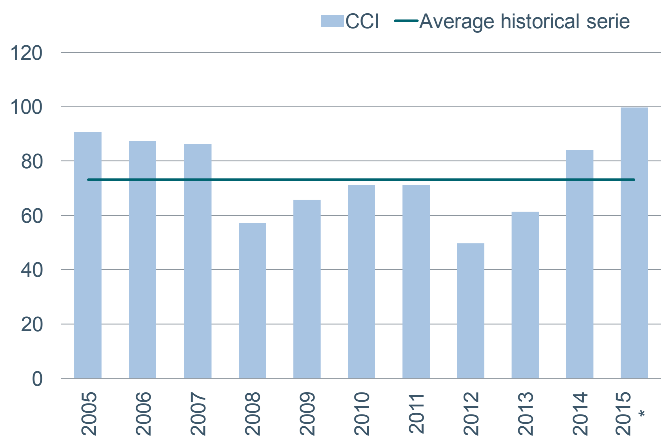
Retail investment volume and number of deals **



Source: Savills / *until April / ** excluding high street and bank branches segments.

GRAPH 2

Consumer confidence index



Source: CIS

SUMMARY

International capital is gaining ground again in the market

■ Around 260,000 sqm of new GLA is in the pipeline for 2015, which is almost eight times more than in 2014.

■ The increase in developer activity is primarily linked to the improvement in macroeconomic indicators and the market, a stronger economic outlook, a return of financing to the market, and greater occupier interest.

■ Looking ahead to 2017, almost 810,000 sqm of GLA is in the pipeline, although several projects are either being brought forward or pushed back depending on agreements made with retailers.

■ Increased levels of footfall and sales suggest that rents for the very best properties will start to rise, whilst we expect a gradual decline in the number of temporary rental discounts and short-term concession packages being offered.

■ Investment in 2014 amounted to almost €2.4bn, 89% of which related to 'traditional' retail properties (shopping centres and retail parks).

■ The frenetic investor activity seen over 2014 carried over into the first months of 2015, with investment in Q1 2015 reaching 61% of 2014's total investment volume.

■ The spike in demand and liquidity in the market has caused achievable yields to fall significantly. Between January and December 2014, prime yields fell by 150 basis points, to 5.25%.

■ Recent transactions completed at yields of around 5%, which is a clear indication that this downward trend is set to continue.

Economic outlook

At the end of 2013, the Spanish economy technically came out of recession and has registered continued growth ever since. At the end of 2014, y-o-y change stood at 1.4%, which is now above the Eurozone average.

Different economic organisations are optimistic about economic growth over the next few years, with GDP growth forecast to increase to over 2%. The central government is even indicating that the economy could grow by 3%.

As regards the job market, although unemployment remains very high (23.7% in Q4 2014, according to figures from EPA published by INE), it has continued to fall steadily since Q2 2013, when it recorded the highest figure on record (27%). In actual fact, net job creation has started to increase since Q2 2014, and by the end of 2014, around 440,000 new jobs had been created. In March, the number of unemployed registered in job centres was below the psychological barrier of 4.5 million, whilst 160,579 people signed on to Social Security, which is the greatest increase this month and a record high.

The signs of economic recovery and increased employment have had a notable effect on the Consumer Confidence Index, prepared by the CIS. The latest figures released for January, February and March 2015 (99.60, 99.00 and 100.4, respectively) are all-time highs and even exceed the levels registered prior to the crisis.

"There are signs of economic recovery in the retail sector. Shopping centre footfall and the volume of sales increased slightly over the last few months of 2014 and the first few months of 2015." Gema de la Fuente, Savills Research

As a result of all the aforementioned factors, private consumption in Spain is expected to increase over the next few years, and is even forecast to exceed the European average. According to research undertaken by the Institute of Economic Research (Instituto de Estudios Economicos) based on forecasts by the European Commission, private consumption in Spain will increase by 2.7% in 2015, ranking it eighth in the EU, compared to 1.9% for Europe as a whole.

Footfall

According to the latest Footfall Index published by Experian, there has been a slight increase in the number of shopping centre visitors over the first three months of 2015 (accumulated growth of 1.5%). Although this is only a very minor increase, it nonetheless represents the first increase in the past three years.

On the other hand, despite the fact that there was a 0.3% decline in footfall at the end of 2014, this was significantly less than the figure for 2013, which was close to -4%.

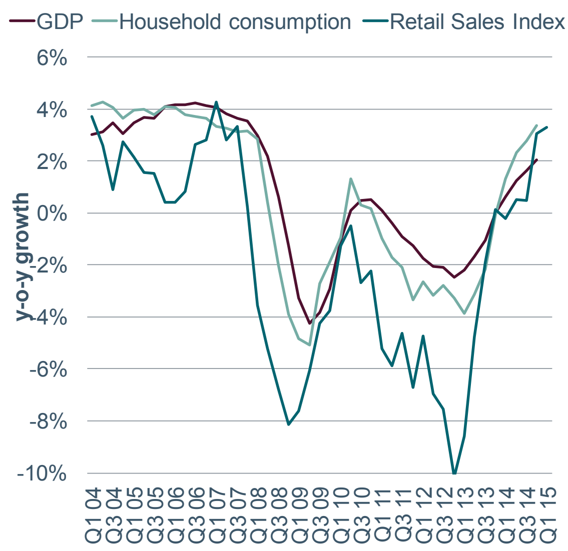
Shopping centre activity

The Spanish Association of Shopping Centres (Asociacion Espanola de Centros Comerciales - AECC) highlighted in its 2014 edition of its Shopping Centre Sector Yearbook that sales volumes had increased by 5%, which far exceeded €38bn.

This is in line with the projections made at the end of the year by other large retail sector associations,

GRAPH 3

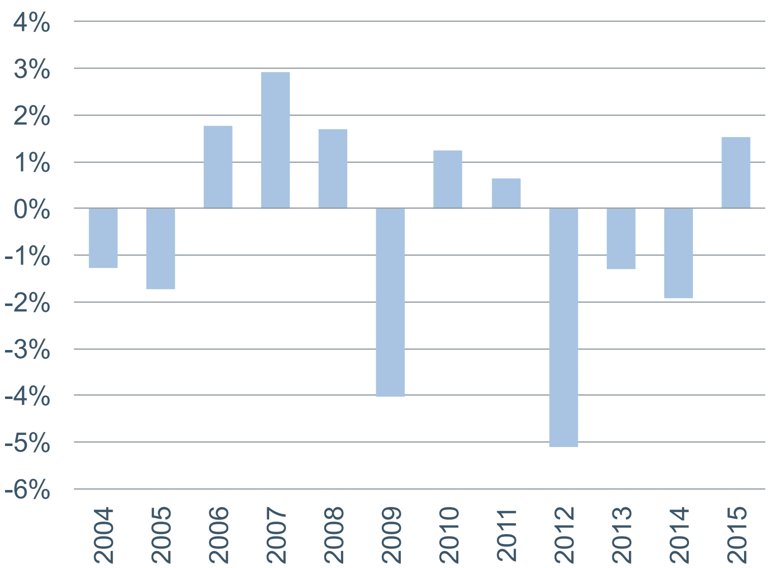
Economic indicators



Source: INE

GRAPH 4

Footfall index y-o-y variation (jan-mar)



Source: Experian

including the National Association of Large-Scale Distribution Firms (Asociacion Nacional de Grandes Empresas de Distribucion - ANGED), the Spanish Confederation of Commerce (Confederacion Espanola de Comercio - CEC) and the Business Association of Textiles and Accessories Trade (Asociacion Empresarial del Comercio Textil y Complementos - Acotex), which all suggest that sales are increasing.

The textiles trade association recently announced their outlook for growth for 2015 based on the strong sales achieved during the winter sales campaign, where sales increased by 6.1% y-o-y. This step in the right direction has instilled optimism after several years of on-going losses of up to 30% since the start of the crisis.

Expansion plans

The main retailers in the market have now finished restructuring their store networks and they are currently focusing on investing in growth strategies and upgrading their stores.

Generally speaking, large new build developments are considered to be a safe bet and the big name retailers who operate in these types of shopping centres have already confirmed their places.

Consequently, brands such as Leroy Merlin, FNAC, Media Markt, Apple Store, Inditex, Primark and Mango will be amongst the retail operators that will be found in the new Parque Nevada shopping centre, which is scheduled to open in Autumn 2015.

With one year to go until the opening of S'Estada, Carrefour Property's new retail complex adjacent to its hypermarket in Es Coll d'en Rabassa (Majorca), and Palma Springs, Unibail-Rodamco's new shopping centre (also in Majorca), are both leasing up well. Since the Balearic Islands government lifted the ban it put on department stores, it has attracted the interest of large-scale national and international chains, who view it as an opportunity to enter a market with a great deal of potential.

Another factor to take into account is brands expanding their stores within the same shopping centre. Having more retail space enables them to increase the level of stock on the shop floor, which is a key element for many firms - generally those that operate within the fast fashion sector or have a high turnover of items.

In addition, the introduction of new business lines under the umbrella of a large brand will in many cases require retailers to expand the amount of retail space outside of their flagship store, which is where they generally start to market their products. H&M did just that - they expanded their retail unit in Parc Central, Tarragona, so they could add their Homeware line to the store. In other cases, organic growth via different business lines is viewed as a means of expanding retail units that offer different collections separately, such as H.E. or Violeta. Although these brands initially had space in Mango stores, they now have their own stand-alone network of stores.

Trends

It is becoming increasingly more common for big name retailers in the market to introduce new retail formats and increase their market share. Smaller retail formats have enabled them to move to shopping centres. Some of the brands that are now operating in various different formats are Media Markt and Worten in the electronics segment, Decathlon and Forum Sport in the sports sector and Bricoking in the DIY sector. Sometimes firms trade under the same name across all formats and in other cases they have launched a new brand that appears to be more approachable, such as Bricoking City.

There are also some retailers who up until now were focused on urban high streets, but are now appearing in various shopping centres. This is the case for Mulaya and Okeysi, two low-cost brands from Asia. We should highlight that according to a study by Kantar World Panel, the 'fast fashion' phenomenon is growing rapidly - the sector has grown by 54% over the past three years.

New retailers

The success of this business segment is reflected by the amount of new low-cost retailers entering the market.

Among the new arrivals is the British company Sports Direct, which opened its first store in Spain in Puerto Venecia (Zaragoza).

Another British brand, Shoe Zone, the 'Primark' of shoe shops, is looking to set up a network of stores in Spain. A key determining factor will be how the first Dealz stores perform, as their target market in the UK is similar. Dealz has recently announced that it will be opening 5 more stores in Malaga and Madrid, four of which will be on the high street and one in a shopping centre, although they have not yet indicated which.

The chain Z Generation, Zannier Group's low-cost fashion brand owned by Catimini also has an ambitious expansion plan - they are set to open 50 new stores over the next few years in order to build upon their presence in Spain. They currently have units on the high street and in shopping centres.

Ralph Lauren is set to launch its second brand Chaps in over 30 El Corte Inglés stores and its own stores in Parquesur (Leganés, Madrid) and Vallsur (Valladolid).

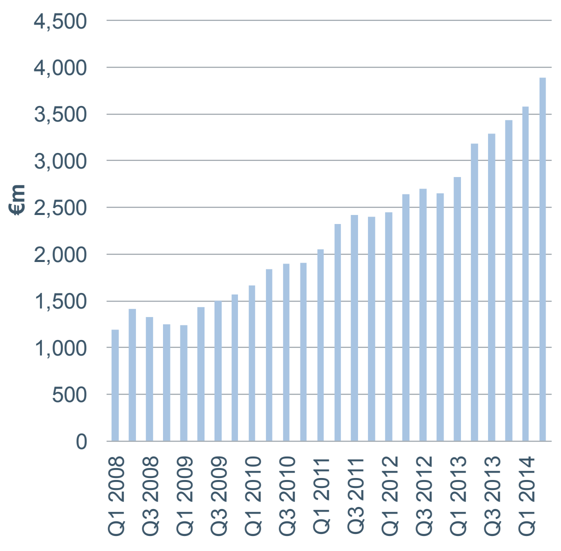
E-commerce

According to the latest e-commerce report published by the National Commission of Markets and Competition (Comisión Nacional de Mercados y de la Competencia - CNMC), in Q2 2014 sales in Spain reached €3.89bn, which is a 22.2% y-o-y increase.

As indicated in EY and the

GRAPH 5

E-commerce volume in Spain



Source: CNMC

E-commerce Observatory's report 'E-commerce - Outlook and Changes Report' - the online segment is doing well. The report highlights that e-commerce will continue to exceed record levels of turnover and will grow by around 10% in 2015.

Current stock

Total supply of retail space in Spain has now reached 14.86 million sqm. This figure includes shopping centres, outlet centres, leisure centres and retail parks, excluding high street retail units and retail warehouses that are generally constructed around a retail area in out-of-town locations.

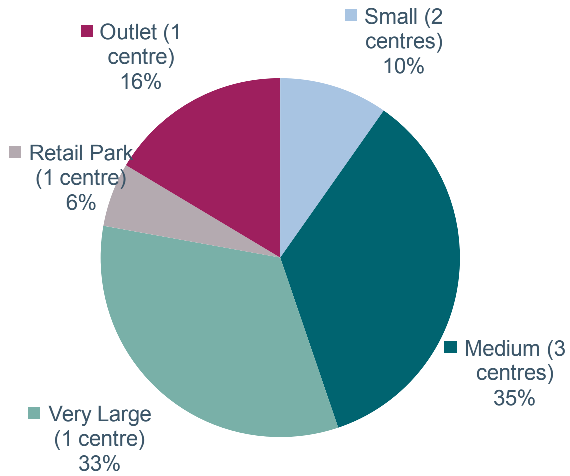
Retail space supply in 2014 rose by less than 3% yoy, as a result of a limited amount of new gross lettable area (GLA) coming onto the market - just 35,000 sqm of new build stock and around 30,000 sqm more for expansions in existing shopping centres.

In terms of new build retail space, we would highlight the Ciudad de la Imagen retail complex in Seville, not in terms of its size (20,000 sqm) but rather because Costco decided they would open their first store in Spain there (and in Continental Europe).

Retail density stands at 320 sqm per 1,000 inhabitants, which is a 2.2% y-o-y increase. This figure has grown at a more moderate rate over the past few years due to the drop in the construction of retail properties. The increase in retail density is not due to new build schemes coming onto the market in 2014 (which was marginal - just 30,000 sqm of new space was delivered, which related to new centres and expansions), but rather a decline in population, which has fallen for the second year running.

GRAPH 6

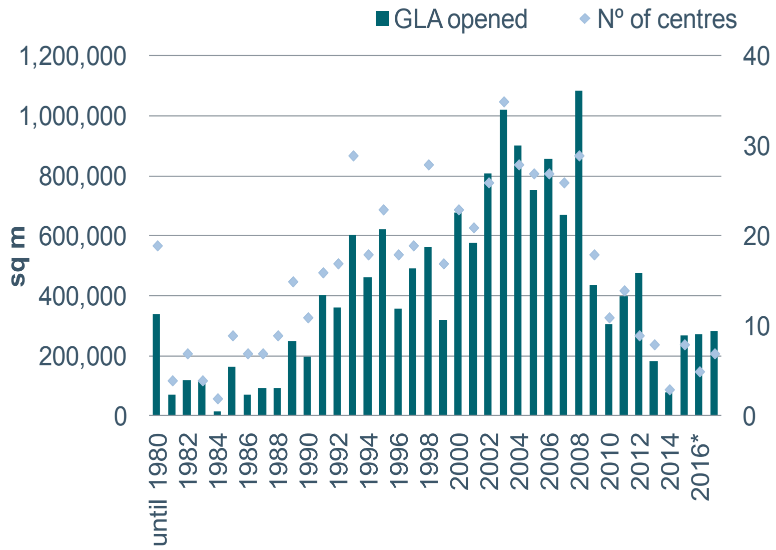
New GLA by type of scheme (2015)



Source: Savills

GRAHP 7

Openings by year (GLA and number of centres)



Source: AECC / Savills / * forecasts

Future developments

260,000 sqm of new space is in the pipeline for 2015. This is almost 5 times the figure registered in 2014. The signs of recovery, as well as the consistent improvement in forecasts for the main economic indicators have spurred on developer activity.

The sharp decline in the market over the past few years either stopped or delayed several schemes from moving forward, as these projects advanced in line with leasing progress.

The increase in consumption has pushed retailers to embark on more intensive expansion plans. Local firms also jumped on the bandwagon, as they know how large brands can attract customers and the synergies that are created from businesses in the surrounding area.

In any event, although leasing behaviour is improving, it still remains the key obstacle in getting new projects off the ground, as development financing is very hard to come by. For this reason, some projects are being brought forward or pushed back depending on the lease agreements with the main brands. This is the deciding factor as to whether the retail complex remains viable.

With regard to new shopping centres that are projected to open over 2015, in terms of size, the Nevada shopping centre in Armilla (Granada) is particularly noteworthy. Comprising 85,000 sqm of GLA, it will be the largest retail complex in the province, and the fourth largest in Andalusia, after La Cañada in Marbella (Malaga) comprising 110,000 sqm, Luz Shopping in Jerez de la Frontera (Cadiz), extending to 95,000 sqm and Malaga Nostrum in Malaga, which comprises just over 91,000 sqm.

Looking ahead to 2017, around 890,000 sqm of GLA is in the pipeline, 90% of which corresponds to new build schemes.

The survival of the fittest rings true in the retail market and this remains the case for new retail complexes, as 48% of space is located in large or very large schemes. We would also highlight the importance of retail parks, which account for almost a third of the total.

In terms of distribution of new space

based on autonomous communities, 28% of new space will be located in Andalusia, followed by Madrid (18%). The Balearic Islands take third place, with 17%.

Retail density will increase in these three regions. Retail density will increase slightly in Madrid and Andalusia, by 5% and 10% respectively, whilst the greatest increase in the total amount of GLA, and as a result, retail density, will be in the Balearic Islands (70%), where the removal of administrative barriers on department stores has enabled retail complexes to be developed.

Consequently, two projects comprising 70,000 sqm each will be delivered in 2016. With the opening of S'Estada (Carrefour Property) and Palma Springs (Unibail-Rodamco) GLA in the Balearic Islands will increase by almost 60% in just 12 months and will push the retail density figure up from just 180 sqm/inhabitant to around 290 sqm/inhabitant.

Rents

It is very much a two-tier market. On the one hand, after having remained stable over the past few years, rents for new leases in prime shopping centres, which are leaders in terms of their direct catchment area and have occupancy rates of up to 100%, are beginning to increase slightly. Many national and international brands are aspiring to become part of the tenant mix of the most consolidated shopping centres, although the lack of vacant space is pushing rents up and is restricting current tenants' abilities to negotiate.

It is a very different story for secondary shopping centres. Higher vacancy rates, stepped/variable rents and incentives for tenants have become powerful tools in order to attract big name players in the sector, who cancelled or postponed their expansion plans over recent years and are now looking to make the most of the favourable economic conditions in order to strengthen their position in less key locations.

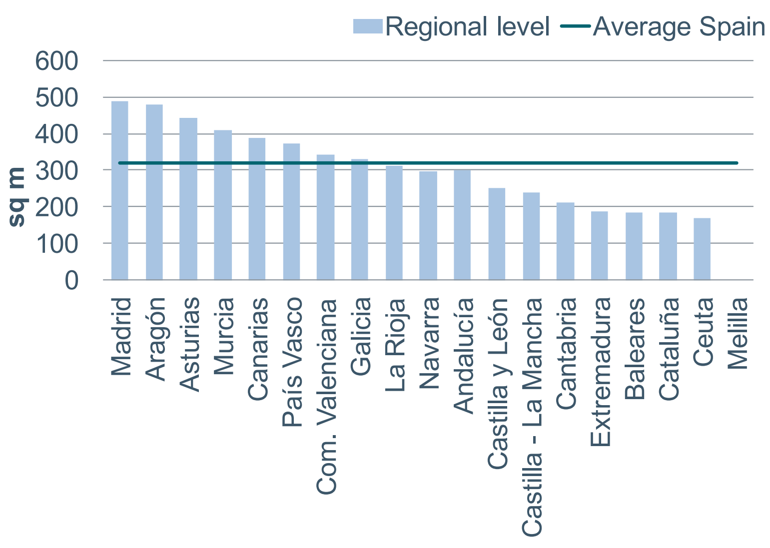
According to Savills' database, rents for the 2012-2015 period creased by 18% compared to rents over the 2008-2011 period. If we just consider new leases, they have decreased by -30%.

There has been a gradual decline in the number of rent reductions via temporary rental discount and short-term discount packages.

If we use retail units of between 100 and 200 sqm as a benchmark to analyse achievable rents in prime shopping centres, the average rent for new leases stands at €90 per sqm/month.

GRAPH 8

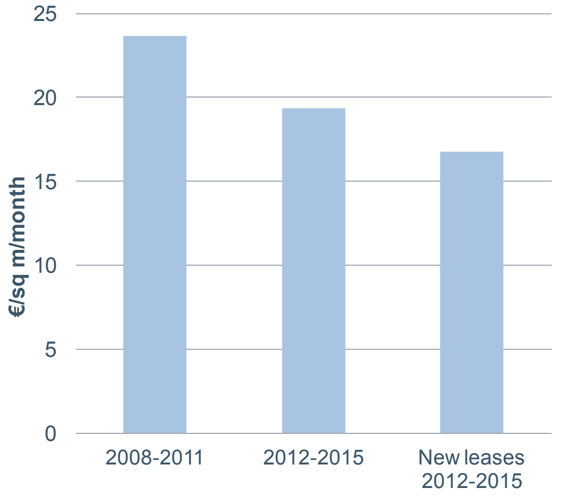
Commercial density by region (sq m/1,000 hab.)



Source: Savills

GRAPH 9

Average rents in shopping centres



Source: Savills

In Europe, the highest rents are in the UK and stand at over €700 per sqm/month. The average achievable rent for prime properties in Europe (excluding London at the top of the scale) stands at around €105 per sqm/month, which is 15% above the figure for Spain.

Investment market

The long-awaited commercial property market recovery has started. Around €7.5bn was invested in 2014, which is triple the amount invested the year before.

The tentative improvement in macroeconomic indicators at the end of 2013 and optimistic forecasts that consolidated over 2014 have put Spain firmly back on international investors' radars.

However, low interest rates and falling bond yields have increased the attractiveness of the real estate market.

Around €2.400 bn was invested in the retail market by the end of 2014, which is just 3% lower than the amount invested at the peak of the market in 2006 (€2.42bn).

Rents are also expected to increase, although at the moment rents are only rising for the very best properties located in the best locations.

"The economic climate and favourable conditions in the retail market, coupled with improved access to finance and better terms will enable investors to be more aggressive on price, meeting the expectations of vendors and enabling them to maintain the returns they require." Salvador González, Retail Investment

Activity in the traditional market

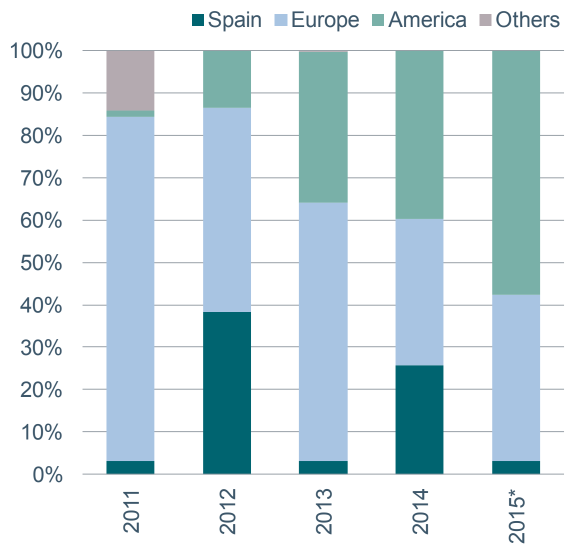
It is also important to point out that, unlike the situation seen in recent years, when the market was predominantly comprised of private players in the high street unit sector, 89% of total activity now relates to traditional products (i.e. mainly shopping centres and retail parks), which amounted to almost €2.100 bn.

This figure does not include bank branches, which in the commercial property market is a sector in itself. In this regard, BBVA's office portfolio acquired by Merlin Properties was the largest portfolio purchase of the year, at just over €700 million.

In terms of the number of transactions, 2014 will be remembered as the year where there was a record level of investor activity. 33 deals were signed, which is similar to the amount signed in 2000, where an all-time high of 34 transactions were completed. However, we should take into account the considerable number of property portfolio deals that have taken place, which means that we have reached an all-time high in terms of the number of deals signed in 2014.

GRAPH 10

Investment volume by buyer origin



Source: Savills / * until April

Cross border investment

International investors are leading the way once more - accounting for 75% of the total investment figure. The number of investors originating from Europe and America was fairly equal, but we should indicate that amongst the investors from the American continent, (almost all of which are from North America), many of them have moved into the Spanish market for the first time. The average investment lot size for these newcomers amounted to circa €55 million and they focused their attention on consolidated centres that are key players in secondary locations.

SOCIMIs are also in the retail market

The remaining 25% related to domestic capital, with the lion's share relating to SOCIMIs (75%). These are classed as national firms despite the fact that some of their shareholders are international.

SOCIMIs have not just been involved in the retail market in recent months - as several large retail complexes have set up as SOCIMIs, which, amongst other factors, is due to the tax benefits that these investment vehicles provide.

Buyer profile

Yet again investment funds dominated the market, accounting for 55% of the total transacted. Amongst these, almost two thirds related to international firms, which were headed up by firms originating from the US. Since the middle of last year, American companies have eagerly entered the Spanish market, encouraged by the competitive advantages of a strong Dollar against the Euro. In the second half of the year, 65% of total investment came from the US. In addition, the investment figure for Q1 2015 is over 5 times the amount registered in the same period in 2014, which indicates that American funds are continuing to operate in the market by acquiring properties with capital values (€/sq m) that are favourable to them.

We would also note that opportunistic funds, now classed as private equity, remain in the market, as access to finance has enabled them to obtain higher returns and relax their initial yield expectations.

SOCIMIs took second place in terms of the volume per type of investor, accounting for 25%. These real estate investment vehicles (Spanish equivalent of REITs) have left their mark on all segments of the commercial property market and they will continue to invest in the market in 2015.

Main transactions in 2014

In terms of the main deals by size, of particular note are Marineda City (A Coruña), acquired by the SOCIMI Merlin Properties for €260 million, Islazul (Madrid), that became part of the TIAA Henderson Real Estate portfolio for slightly more than €230 million, El Boulevard (Vitoria, Álava), which CBRE Global Investors sold to REI Investment IBV for €157 million and Gran Vía de Vigo, which Oaktree acquired from ING Real Estate Developments for €115 million.

Two more deals exceeded €100 million and both were portfolio sales. Carrefour once again took control of part of the assets transferred to Klépierre in 2000 and Vastned transferred 8 shopping centres to the joint venture comprised of Baupost Group, Green Oak Real Estate and Grupo Lar.

Main transactions in 2015

The frenetic investor activity seen over 2014 carried over into the first months of 2015, with investment in Q1 2015 reaching 50% of 2014's total investment volume. However, a few things must be taken into consideration, as the majority of negotiations commenced prior to the end of 2014, and amongst the transactions that have been signed, these include the sales of Puerto Venecia and Plenilunio, both were sold by Orion Capital and between the two of them amount to almost €800 million, which is 75% of the total figure registered until March 2015 (just for retail properties).

There has been a 22% y-o-y increase in the number of transactions completed.

Pipeline

After the sale of Plenilunio, there is around €900 million in the pipeline to invest in products that are currently on the market. Whereas in the past there was a lack of supply, things have drastically changed. The renewed confidence amongst investors in the market has meant that there has been a significant increase in demand, which has been a significant driver of new product for sale.

Banks have also started to lend again and have relaxed their financing requirements given the improvement in both macroeconomic indicators and forecasts, as well as improved confidence in the market.

Expectations that private consumption will improve, will translate in to an increase in retailers' sales. This in turn will mean that the temporary rental discounts that we have seen since the beginning of the crisis will gradually disappear, which will mean an increase in net revenues.

This, together with the increase in available capital, will mean that investors can be more aggressive on price, and they will be able to meet the expectations of the seller, whilst making the same level of returns, which will be the catalyst for an increase in the number of non-prime transactions.

Yields

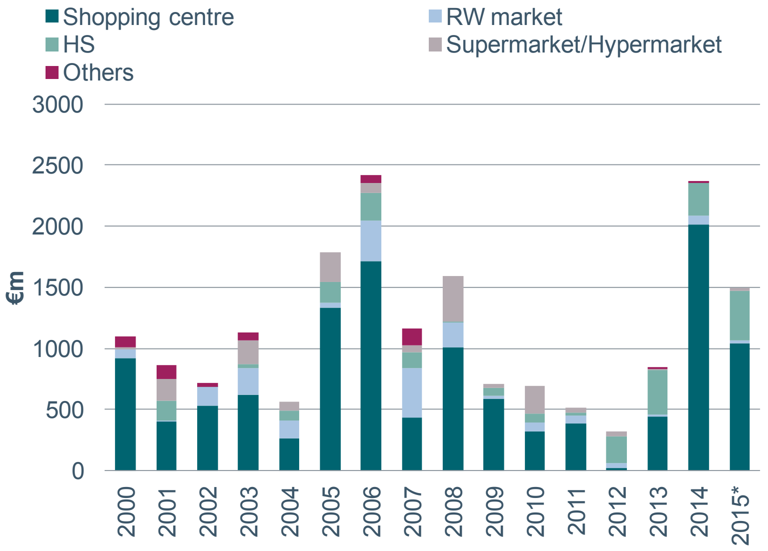
The mass influx of investors, some of whom are new to the market, as well as excess liquidity caused a considerable decrease in achievable yields. -150 basis points between January and December 2014 for prime product, which meant that yields stood at 5.25% at the end of 2014.

The recent Puerto Venecia and Plenilunio deals have caused yields to fall by a further 25 basis points, meaning that prime yields currently stand at 5%. There is still room to reach an all-time low and we will have to wait and see if the downward trend will continue - at least this is what the macroeconomic indicators and the market are suggesting. The defining factor will be the supply of prime product comparable to the two megadeals that have set the prime yield, both in terms of the type of product and the lot size.

Yields for secondary properties also fell significantly in 2014, at just 100 basis points below the level at the beginning of the year, at 6.75%. The yield remained unchanged in Q1 2015. The growing interest in secondary properties will also push yields for these properties downwards.

GRAPH 11

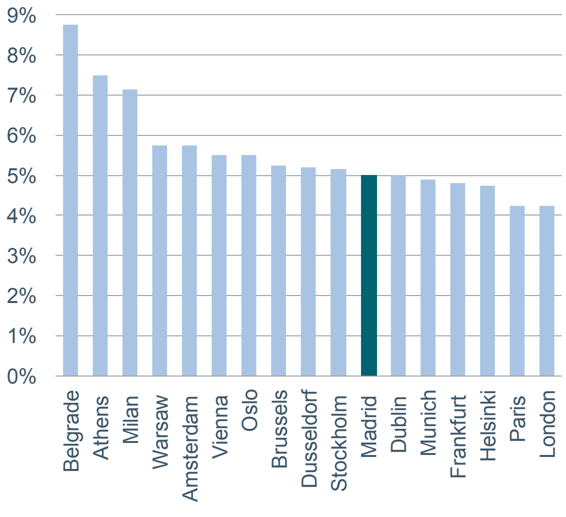
Investment in retail market by type of asset



Source: Savills / *until April

GRAPH 12

Prime shopping centres yields in Europe

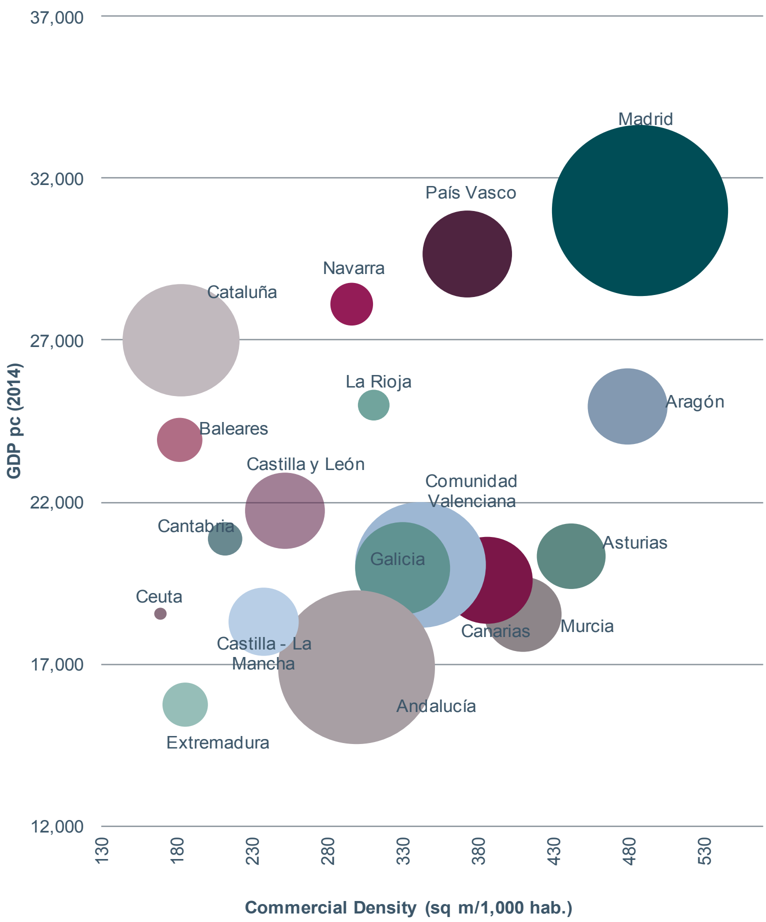


Source: Savills

GRAPH 13

Spainsh retail market

Distribution of regional GLS by GDP per capita and commercial density



Source: INE (Regional contability 2014 1st estimation) / AECC

OUTLOOK

2015

■ We expect both footfall and sales to increase in the shopping centre sector.

■ This will mean that retailers will want to open stores in the main shopping centres.

■ The short/medium term effect will be an increase in occupancy rates, which will be reflected in an increase in rents and a decline in the amount of temporary rental discounts and short-term concessions offered.

■ There has also been an increase in lending, making it easier to acquire financing and on less strict terms.

■ As a result of all of the above, investors will achieve the same returns as a few years ago, but at more aggressive prices.

■ The spike in demand and liquidity will continue to push yields down.

■ It looks as if now is the right time to sell. There is increasingly more product on the market that will satisfy the requirements of a wide range of investors, which will ensure that investor activity remains buoyant in 2015.

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