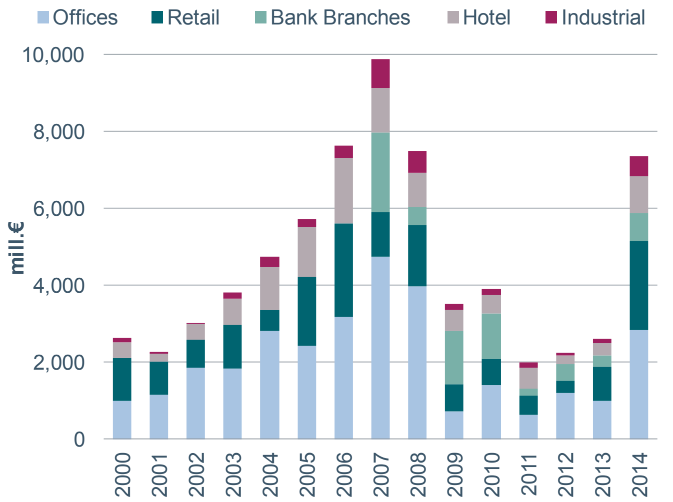
Market Report
Spain Investment

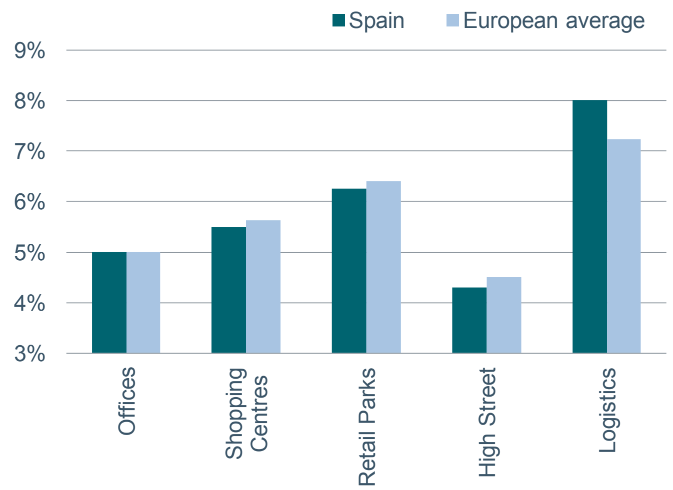
February 2015

GRAPH 1
Investment volume by sector



Source: Savills

GRAPH 2
Prime yields 2014



Source: Savills

SUMMARY

Annual investment surpassed all expectations and tripled that of 2013

■ 2014 will be remembered as the year when the market turned. Since the end of 2013 the improvement in economic forecasts increased confidence in Spain, which then resulted in greater interest from international capital. Low risk investors saw it as the ideal moment to purchase, taking advantage of the bottom of the cycle.

■ Offices and retail saw the greatest amount of investment accounting for a combined total of 71% of the total investment volume, which demonstrates that institutional investors, which have deeper pockets, are actively back in the market.

■ SOCIMIs (Spanish equivalent of REITs) were one of the main factors behind the upturn in the market, accounting for almost a third of the total investment volume and close to three quarters of domestic investment.

■ The excess of liquidity and the lack of product on the market that meets investors' requirements have meant that office yields have generally hardened, particularly with regard to prime yields. The strongest segments are now at similar, or lower levels than the European average.

"Despite the marked contraction in yields in 2014, the expected macroeconomic improvement, coupled with greater access to financing and the potential uplift in rents, suggest that the investment volume in 2015 will be similar to that of 2014" Salvador González. Retail Investment

Economic outlook

Various economic indicators suggest that the Spanish economy continues to grow and is leaving the recession years in its wake. According to the latest figures provided by Eurostat, in Q2 2014 Spain was above the Eurozone average for the first time in the past 19 quarters.

In addition, data for Q3 published by INE, shows the third consecutive y-o-y growth in Spanish GDP (1.6%). If we also take into consideration that various international bodies do not have favourable forecasts for some other European countries, Spain could well be above the Eurozone average as well. However, one must also take in to consideration that these other countries form part of the driving force behind our economy.

The continued fall in oil prices will also go towards helping Spain's economy grow. It has been calculated that the fall in oil prices (fully imported) will allow Spain to save around 1.5% of GDP.

With regards to the danger of entering a continued cycle of falling prices, it appears that the Spanish economy still does not perceive this as a threat (deflation). Despite the fact that the direct knock-on effect of a fall in prices generally implies a slowdown in consumption (consumers waiting for further price falls), the current tax reform (which equates to a fall in taxes for households), coupled with the fall in interest rates and the increase in lending, will help to offset this. Furthermore, this decrease could have an effect on external demand, which would benefit from cheaper Spanish products.

Finally, employment, which has been one of the worst hit figures during the crisis, has begun to improve, not just in absolute terms, but also in terms of quality. This has been confirmed by the latest figures published by the EPA. Q4 2014 registered the third consecutive period of growth, both in terms of full-time jobs, as well as permanent jobs (respectively 2.6% and 1.98%). The unemployment rate continues to fall, standing at 23.7% in Q4 2014, although this is still higher than pre-crisis figures.

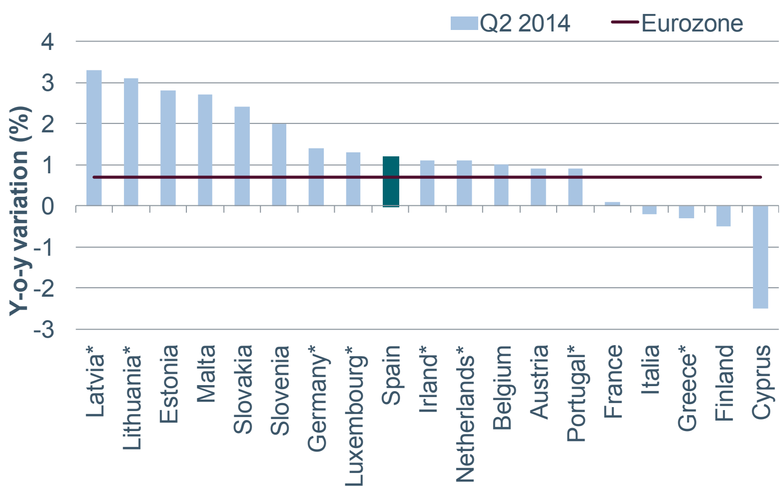
Despite this, the recession years appear to be behind us. However, austerity measures must continue to be adopted in order to correct what the crisis has brought about over the past few years.

Frenetic investment activity

2014 ended with more than €7 billion transacted in the commercial property market. The property cycle has clearly moved up a gear, given that investment volumes tripled compared to 2013. Since the end of 2013, forecasts for the main macro economic indicators began to show signs of improvement, which made investors more confident in Spain and attracted the interest of international capital, which

GRAPH 3

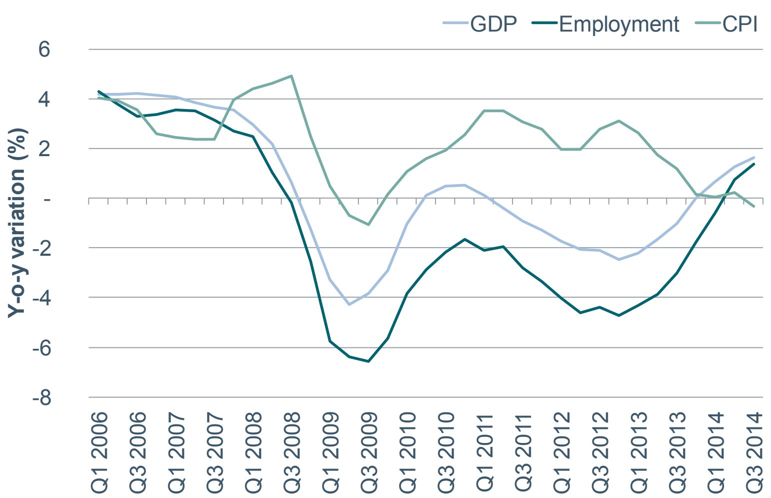
Economic growth in Eurozone



Source: Eurostat / *National staditics offices

GRAPH 4

Main economic indicators



Source: INE

gravitated towards Spain with the intention of capitalising on the low prices and gaining from the impending upward growth cycle. It was the perfect moment for low-risk investors with a five to seven year investment horizon to acquire properties.

This huge wave of interest translated in to voracious investor appetite and a glut of liquidity. In addition to the return of the usual pre-crisis international investors, others, primarily from the USA and Latin America also joined the market. Furthermore, the addition of listed SOCIMIs to the market was a major catalyst, as they accounted for a third of all commercial property investment.

Investment by sectors

The most active property segments in the investment market were offices, with 39%, and retail, with 32%, which demonstrates that institutional investors, which have deeper pockets, are actively back in the market.

We would also particularly note the stunning return to glory of the retail market, with an annual volume of slightly more than €2.3 billion, which is in line with the same figure registered in 2006 (top of the market), which stood at around €2.4 billion.

However, despite the general growth in overall investment volume in each segment, the greatest y-o-y increases were seen in the logistics and hotel segments. The growth of e-commerce, which continues to

TABLE 1

Main investment deals 2014 ≥€100m

Market	Asset	Province	Vol. inv. (mill.€)	Vendor	Purchaser	Type of deal
offices	70 Andalucian government buildings	several locations	300	Junta de Andalucía	W.P. Carey	portfolio
retail + hotel	Marineda City Complex	La Coruña	260	Invest Cost	Merlin Properties Socimi	single
retail	Islazul	Madrid	232	Grupo Lar e Ivanhoé Cambridge	TIAA Henderson Real Estate	single
hotel	Resort Sotogrande	Sotogrande (Cádiz)	220	NH	Cerberus	single
offices	13 Generalitat buildings	Barcelona	201	Generalitat de Catalunya	Zurich	portfolio
offices and retail	Four office buildings+ one retail warehouse	Madrid , Barcelona and Tarragona	180	Credit Suisse	Axia Real Estate Socimi	portfolio
retail	Vastned Portfolio (8 centers)	several locations	160	Vastned	Baupost Group / Green Oak Real Estate / Grupo Lar	portfolio
retail	El Boulevard	San Sebastián	157	CBRE Global Investors	REI Investment IBV	single
offices, retail and hotel	Paseo de la Castellana, 200	Madrid	140	Reyal Urbis	Drago + PSP Investments	single
offices	Santa Hortensia, 26-28 - IBM *	Madrid	>130	Morgan Stanley	Finacess	single
industrial	Six logistics actives	Madrid and Guadalajara	133	Gran Europa	Logicor	portfolio
offices	Levitt Portfolio	Madrid	130	Levitt	Merlin Properties Socimi	portfolio
offices	Eight buildings	Madrid and Málaga	120	Oncisa	Hispania Activos Inmobiliarios	portfolio
offices	Avda. de América, 115	Madrid	117	Solvia	London Regional	single
retail	Gran Vía de Vigo	Vigo (Pontevedra)	115	ING Real Estate developments	Oaktree	single
industrial	Portfolio SABA	Madrid y Barcelona	100	SABA	Prologis	portfolio

Source: Savills / *advised by Savills

see even higher business volumes year after year - €14.61bn in 2013, which is 18% higher than the same figure in 2012, according to figures published by Ontsi (Observatorio nacional de las telecomunicaciones y de la Sociedad de la Información) - means that purchasing and delivery procedures need to be much faster, which is pushing up the number and proximity of distribution points to city centres. Tourism is also going through a golden era. According to Coyuntur's figures, Spain closed with near to 65 million international tourists in 2014, beating the previous record set in 2013.

Average lot sizes

The financial strength of investors now in the market, has meant that the average lot size transacted rose by more than 30%, touching on €40 million, compared to hardly €30 million in 2013. We should point out that this refers to the average lot size per transaction, and not per property. In addition, portfolio sales quadrupled, accounting for almost 45% of the total investment volume, compared to 28% in 2013.

The improved investment capacity of active investors in the market was also reflected in the increase in the number of deals completed for over €100 million, which have continued to increase for four consecutive years. In 2014, they accounted for 9% of the total amount invested.

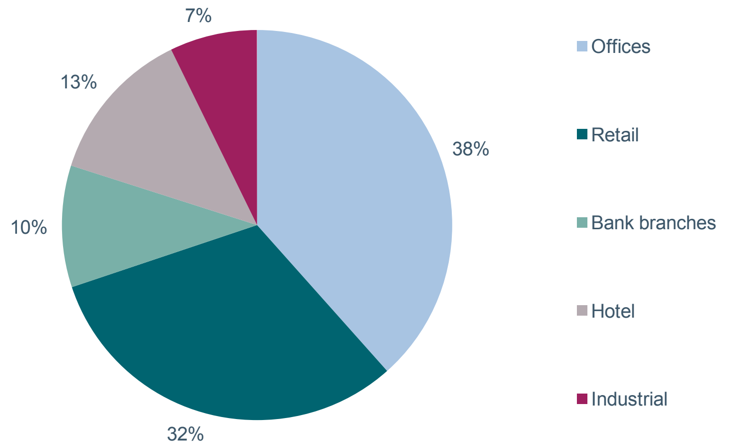
Origin of investors

In terms of where investors come from, national investors are regaining market share, accounting for a total of 44%, but one should point out that 72% of the volume attributed to Spain, corresponds to SOCIMIs, which are considered to be Spanish, despite a large number of their shareholders being overseas investors. These overseas investors have taken stakes in SOCIMIs as they see them as a safe way of accessing an unknown market.

The most active international investors were the North American funds, with 40.2%, followed very closely behind by European investors with 37.3%. Latin American investors continue to be

GRAPH 5

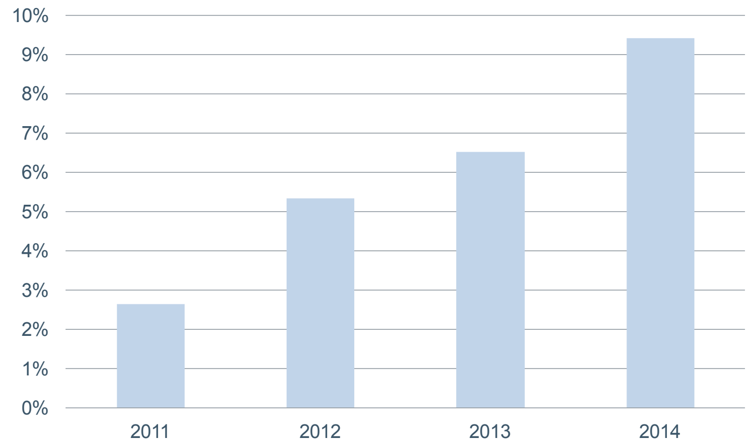
Investment volume by segments - 2014



Source: Savills

GRAPH 6

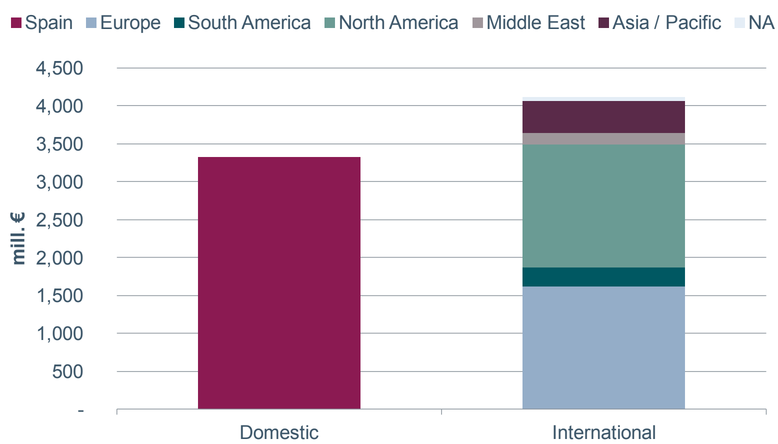
Evolution of investment deals ≥€100m in commercial property market



Source: Savills

GRAPH 7

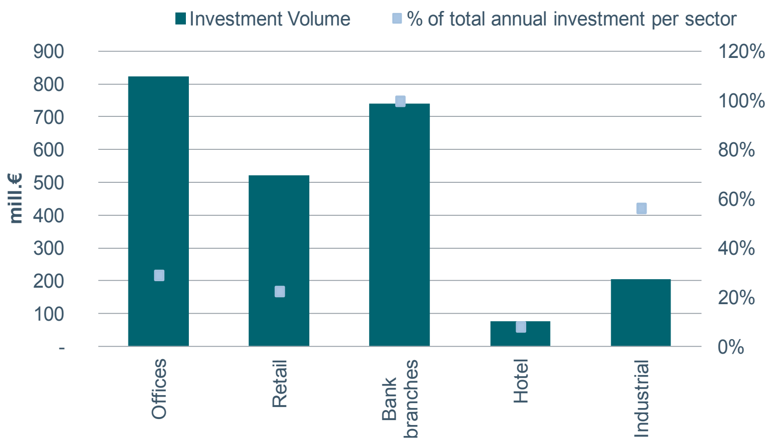
Distribution of investment volume by origin - 2014



Source: Savills

GRAPH 8

SOCIMIs in commercial property market - 2014



Source: Savills

active in the market, particularly focusing on offices with a lot size of circa €20 million, although much larger transactions were carried out, such as the IBM headquarters in Madrid, acquired by a Mexican group for more than €100 million. They were also active in other segments, with the Brazilian investor Global Phobos acquiring the Vialia shopping centre in the María Zambrano station in Malaga, for approximately €63 million.

Special mention should be made with regard to Asian investors, as despite only comprising 10.6% of total investment, this segment accounted for one of the largest transactions of the year: The Dalai Wanda Group acquired Edificio España for €265 million. Abandoned since 2006, the property was one of Madrid's first skyscrapers and housed the former Crowne Plaza Hotel, offices and apartments. It will now undergo a full refurbishment and conversion and will again house a hotel and residential apartments, as well as a retail gallery. The property is located at the end of one of the main retail and tourism high streets in Madrid (Gran Vía) and various public/private initiatives are in the pipeline for the area around the Plaza de España, which will revitalise and add value to the area.

Most sought after product

The greatest amount of commercial property investment was carried out in Madrid (41% of total volume), followed by Catalonia with 14% and the remainder of locations accounted for 45%, which was primarily due to the large number of portfolio sales.

In terms of property type, prime property in prime locations is the most sought after in each of the sectors analysed, however, due to the lack of these types of properties on the market, many investors have redirected their search to prime properties in secondary or decentralised areas. The value-added strategy continues to be one that many are following, via the refurbishment, repositioning and improvement of the management of the property.

Yields harden

The excess of liquidity in the market and the lack of product on the market that meets investor requirements have meant that prime office yields have generally hardened.

When compared to other European countries, only the logistics market remains above the average, whilst offices have aligned with other countries and retail yields are below the European average.

Madrid offices stand at circa 5%, although specific properties with lot sizes of below €30 million, could reach 4.5%. Barcelona's CBD office market is 50 basis points above that of Madrid. In terms of the retail market, the prime yield for shopping centres will be determined by the sale of Puerto Venecia. Everything suggests that the sale will be completed in January and that the yield will stand at around 5%. Retail units on prime high streets will continue to stand at 4.5% and 4.75%, but for super prime properties with super prime tenants (luxury goods sector) the yield could drop to 3.25% or 3.50%. In terms of retail warehouses, prime properties that meet all investment requirements stand at between 6% and 6.5%. Finally, logistics properties reached 8% and are trending downwards.

Financing returns

Although the norm is for full equity transactions, there are tentative signs of financing beginning to reappear in the market. Financial institutions are now open to lending again, although they are being very selective in terms of product, as well as clients and at LTVs of circa 60%. Some transactions may be acquired with full equity and the investor may then subsequently search for financing.

For example, some SOCIMIs, after investing all of their capital raised from their flotations, are now looking at financing in order to continue their investment activity. This is the case with Axia, who would not otherwise have been able to acquire the Credit Suisse property portfolio (four offices, three in Madrid and one in Barcelona and one retail warehouse in Tarragona).

Merlin Properties also completed a 10 year loan for €940 million, which will be secured by its subsidiary Tree Inversiones's property portfolio (bank branches let to BBVA), but assures that it is working on the financing of another two properties for more than €150 million.

Outlook

2015

■ Greater access to credit will be a key factor in order to further stimulate investor activity. In addition, the macro economic improvement will begin to be noted in more local economies. The tentative signs of improvement in job creation announced by the Ministry of Employment and Social Security for 2014 as a whole, coupled with the marked annual increase in the Consumer Confidence Index (37% higher than in 2013, much higher than the historic average and in line with pre-crisis figures), would suggest that we can expect to see a gradual recovery in consumption. Furthermore, continued confidence in Spain is demonstrated by the fact that the risk premium continues to fall, which now stands at 100 basis points, a long way off its high of 600 basis points back at the end of 2012, which has been a driving force behind international investors continuing to back Spain.

■ However, despite this optimistic backdrop, there are certain socio-political risks both from national and European standpoints.

■ In terms of national players, new SOCIMIs will appear in the market, which will ensure an interesting level of activity in the market. Some of the new SOCIMIs will be specialised in a specific property segment, whilst existing SOCIMIs are creating separate divisions by property type for the properties acquired over recent months.

■ SOCIMIs are becoming evermore established in Spain and the Madrid Stock Exchange has now created a specific sub-sector index named 'SOCIMI' in the Financial Services and Real Estate sector.

■ In terms of product on the market, various agreements put together in 2014 will be completed in 2015 and in the short/medium term more properties will be put up for sale. Open-market sales are gaining ground on off-market sales, given that owners do not now see there being any form of added value in carrying out off-market negotiations. Despite this increase in supply, the lack of prime properties in prime locations will continue to be the order of the day.

■ The short/medium term forecast for prime yields is that they will continue to harden, due to a lack of product in the various different segments, the increase in demand and the expected uplift in rents. The difference in current yields for prime shopping centres and prime offices in Madrid, as compared to the top of the market (in 2007), now stands at 100 basis points.

Savills Team

For further information, please contact:

Luis Espadas
Capital Markets
+34 91 310 10 16
lespadas@savills.es

Pablo Pavía
Investment Offices
+34 91 310 10 16
ppavia@savills.es

Salvador González
Investment Retail
+34 91 310 10 16
sgonzalez@savills.es

Gema de la Fuente
Research
+34 91 310 10 16
gfuente@savills.es