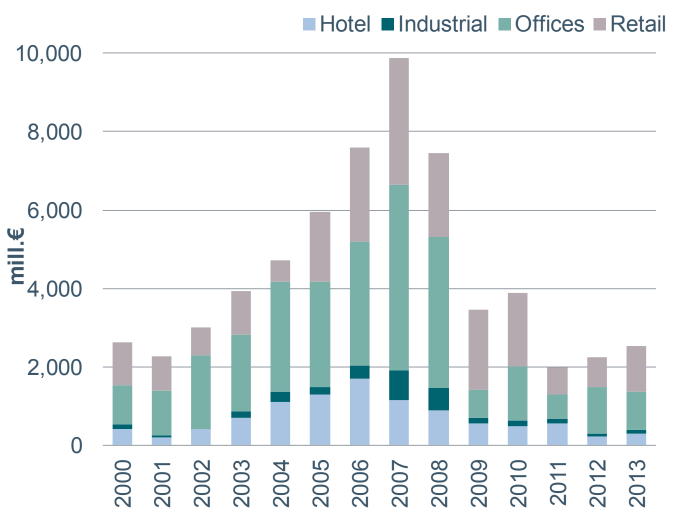
Market report
Spain Investment

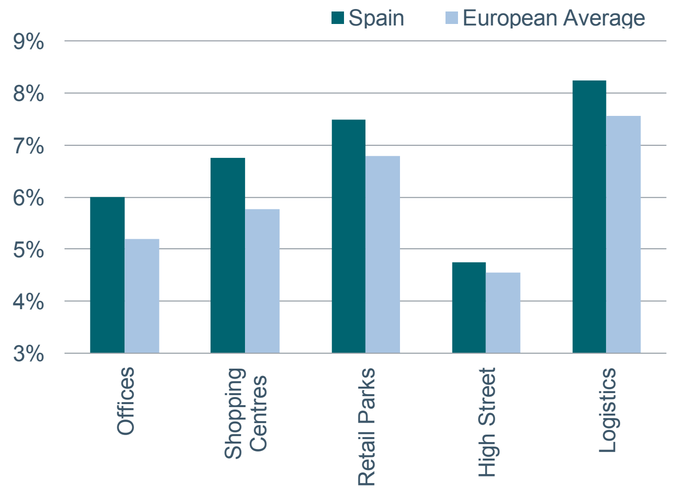
February 2014

GRAPH 1
Investment volume by sector



Source: Savills

GRAPH 2
Prime yields Q4 2013



Source: Savills

SUMMARY

The real estate market has started to see investments being made by overseas investors

■ The forecast of economic recovery in 2014 has increased international investor confidence and Spain is now back on their radars.

■ The annual investment volume in the office market exceeded just over 2.5 billion Euros, which is a 12% year-on-year increase.

■ Overseas investors made up 80% of the total, representing a sharp increase on the 40% average registered over the past few years.

■ International investors came from various different locations from around the globe, but the majority were European, many of whom were regulars in the marketplace prior to the crisis. Among the most noteworthy newcomers were large Latin American wealth.

■ The retail segment registered the highest amount of commercial property investment. After two years with a market share of 30%, in 2013 that figure rose to close to 50%. Hotels also improved compared to 2012.

■ Opportunistic funds, attracted by the the perception that market prices have bottomed out, decided to concentrate on the residential market after having ascertained that the price correction on commercial properties does not meet their expectations.

■ The most in demand properties in all of the sectors are prime properties, but they are also the ones in shortest supply. This situation, along with the forecast for prime property rents in the short-medium term, could drive yields to harden, although they will still remain above the European market average.

Economic overview

The Spanish economy is currently at a turning point. The latest GDP data published indicates a 0.1% quarter-on-quarter increase in Q3 2013, after nine consecutive quarters of decreases. Despite this, year-on-year growth continues to be negative at -1.1% compared to -1.6% the previous quarter, although forecasted figures for 2014 are now expected to be positive.

In addition, it is important to point out that for the first time since 1998, the Spanish economy has financial standing. Over the first ten months of 2013, a financing capacity of €9.9803bn was registered, compared to the need to finance €10.3438m over the same period in 2012.

Another positive indicator is the consolidation of the tourism sector which is a key driver behind the recovery. According to the latest report by Turespaña, 2013 registered a record number of tourists (€60.7m), which is a rise of 5.6% on the previous year, and, according to the World Tourism Organisation, Spain has beaten China for third place in number of tourists, just behind the US and France.

The job market is the most worrying area, although it is also beginning to show minor hints of improvement. The Q3 2013 unemployment rate fell slightly and the figure for Q4 remained relatively stable, with an increase of 0.05%. Furthermore, the number of unemployed registered at job centres fell by over 107,500 in December. Net job creation is expected to be achieved from 2015 onwards, but with continued declines in the quarterly rate from Q1 2014.

Confidence in Spain

Spain is en vogue and the real estate market has started to see investments being made by overseas investors, via various formats: taking stakes in companies (listed and non-listed), purchasing debt, purchasing real estate servicers, as well as various types of properties. Since 2012 large international funds have been competing with each other for the best product, which has resulted in an injection of billions of euros in to the system.

Although some parameters will still take some years to reach healthy levels, forecasts for economic recovery in 2014 have contributed to an increase in international investor confidence in Spain, which is once again of interest to large corporations.

As of January, Spain's sovereign debt held by foreigners has gradually increased, whilst credit rating companies such as Moody's, Fitch, and Standard & Poor's improved their outlook on the country. The Spanish premium has gone from 640 basis points in July 2012 to an average of 200 in January 2014.

The fear of investing in Spain has now been replaced with a fear of missing out on an opportunity to invest in the country.

Annual volume

At the end of 2013 the commercial property investment volume reached approximately 2.5 billion Euros, which is a 12% year-on-year increase. Investor activity returned mainly due to the change in international investor perception trying to get a piece of what they consider to be a market with upside potential, as everything would suggest that the market indicators for prime and consolidated product are at their lowest levels of the economic downswing.

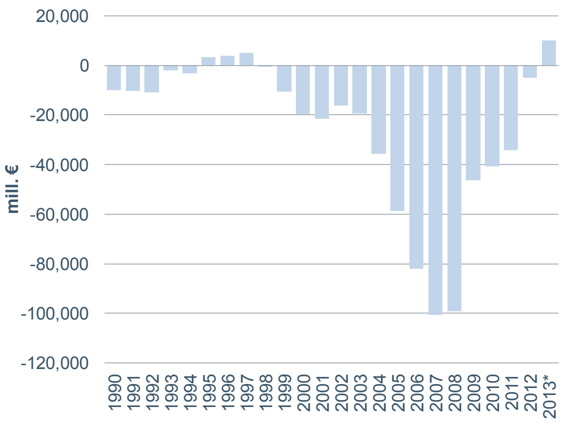
Who is buying?

In 2013 overseas investment accounted for 80% of the total, representing a sharp increase on the 40% average registered over the past few years. After monitoring the market for a few months, American, French, British, and German funds, who up until the crisis were frequently active in the market, have returned. They are not alone either, as new players have emerged, who do not want to miss the opportunity of partaking in a recovering market with growth potential. Among these newcomers, it is worth mentioning large Latin American fortunes who have been testing the market in recent years, and who between 2012 and 2013 accounted for 16% of the total investment volume.

52% of overseas investment, just over €1bn, originated from various European funds, followed by Latin American companies with 16%, just over €315m, 92% of which came from the purchase of the Sabadell bank branch portfolio by Fibra Uno (Mexico).

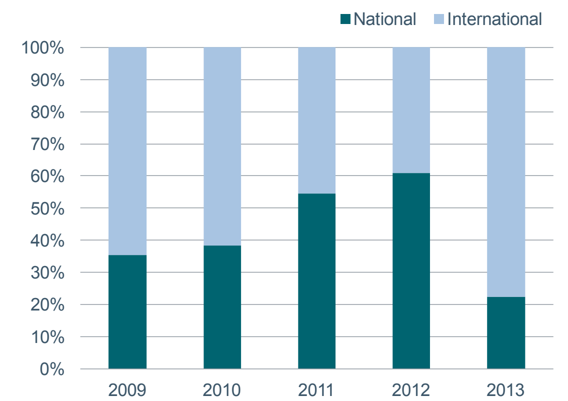
We must also highlight that several companies have reached various purchase agreements. In this respect, IBA Capital Partners (France) has been the most active fund, with the completion of four transactions: two El Corte Inglés retail buildings in Madrid and Barcelona, the ABC Serrano shopping centre which was part of the Reyal Urbis portfolio, the current Unidad Editorial (El Mundo) headquarters, and the temporary Ministry of Foreign Affairs headquarters in the North of Madrid's office market. In total more than €300m, almost 13% of the annual total.

GRAPH 3
Balance of payments



Source: Banco de España / * accumulated January - October

GRPH 4
Investment by purchasers origin



Source: Savills

National investors remain present, although their limited investment capacity has reduced their market share. However, the lack of financing and the rising price of loans gave them a clear competitive advantage for lot sizes of up to €30-40m. Today the picture seems to be changing, credit lines are beginning to open up for very specific clients with proven solvency, and for transactions with a high degree of success, albeit, at a very high price.

Market segments

The retail market is back in the commercial property sector's top spot. After two years of accounting for around one third of the total volume, in 2013 the retail market accounted for 45% of the volume registered and five of the ten largest transactions this year were in the retail sector. In addition to the agreement between Fibra Uno and Moorpark for the acquisition of the Sabadell Bank Branch portfolio, we must also highlight the purchase of Parque Principado in Oviedo (Asturias) by Intu Properties, in association with Canada Pension Plan Investment Board, for €162m.

The hotel sector has also improved on its 2012 figure. The close to €300m registered is almost 33% more than was registered the year before. This study does not include hotel chain transactions, only the purchase of operational properties or vacant properties with the intention of resuming hotel activity. The largest transaction in this category, and indeed this year, was the acquisition of the Hotel Vela by the Qatari fund Diar for €200m, almost two thirds of the annual total. We must highlight that transactions for properties with the potential of being turned in to hotel use are included within the current use category, as was the case with one of Barcelona's landmark properties: Torre Agbar. The Aguas de Barcelona headquarters has been acquired by a group of investors, who over the next one to two years plan to reconvert it into a hotel operated by Hyatt under the Grand Hyatt brand.

Type of deals

All this suggests that opportunistic investors have been exploring the market attracted by the significant fall in prices. Despite the significant declines in commercial capital values, pricing has not met their expectations. As a result these funds have primarily concentrated on SAREB's residential portfolios and other public institutions's portfolios and servicers belonging to various financial institutions.

Over the past few years Spain has projected an image of being a country with heavily discounted prices, but a study of the deals completed proves that this is not the case. Over 2013 opportunistic deals have barely accounted for 24% of the total, 71% focused on the office sector.
Within this category we would highlight the sale of 13 offices belonging to the Catalonia

TABLE 1

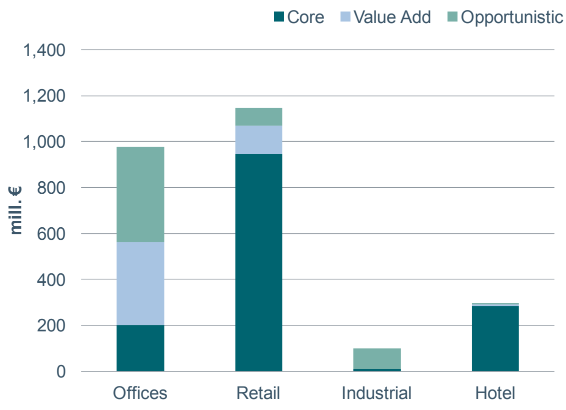
Main investment deals 2013

Market	Asset	Inv. vol. (mill.€)	Vendor	Purchaser
Bank branches	278 Banco Sabadell bank branches	290	Moor Park CP	Fibra Uno
Hotel	Hotel W	200	FCC, Comsa and Grupo Podia	Qatari Diar
Offices	13 Generalitat buildings	172	Generalitat de Cataluña	AXA REIM
Retail	Parque Principado	162	Sonae and CBRE Global Investors	INTU
Offices	Torre Agbar	150	Agbar	Emin Capital
Offices	Torres Ágora	75	Colonial	IBA CP

Source: Savills

GRAPH 5

Investment 2013 by type of deal



Source: Savills

Government (*Generalitat de Catalunya*) to Axa Reim for €172m.

Location

Madrid continues to be the most mature and solid market in Spain, however, the difficulty of entering the market due to the aggressiveness of the main players, made Barcelona the most consistent alternative over the first half of the year. It accounted for 35% of the total annual investment volume (in 2012 it only accounted for 22%) although a large difference between the first and second half of the year was detected with an average of 60% and 23%, respectively. Portfolio transactions have also re-jigged the geographical distribution of investment figures, as properties are located in various cities, amounting to 35% as opposed to 27% the previous year.

Socimis

The introduction of Socimis into the market (*Sociedades Cotizadas Anónimas de Inversión en el Mercado Inmobiliario* - The Spanish equivalent of REITs) has been one of the most noteworthy events this year. These are the Spanish version of a REIT, an investment vehicle that was created in the US during the 60's and which was then later brought over to Europe. They were approved in Spain by Law 11/2009 just over four years ago, however, the regulations did not fit with investors' requirements and at the end of 2012 the government made some changes.

Initially, the tax advantages seemed to be the main reason for their creation (they are exempt from corporate income tax and have a large tax rebate (95%) on property transfer tax and stamp duty), but in time it is hoped that these will become an alternative, secure, profitable, transparent and liquid form of investment, for both large and private investors.

The first Socimis to emerge were Entrecampos Cuatro, with a property portfolio valued at almost €100m, and Promorent, with a portfolio of just under €6m. Unibail Rodamco created a Socimi with its 16 Spanish assets, valued at over €2.4bn, however it will be listed on the French market, not the Spanish market.

Around 20 more are in the process of being set up, and the first Socimi expected for this year promises to be immense, at 1.3 billion Euros, comprised of a thousand offices sold by BBVA in 2009 to RREEF Alternative Investment, a Deutsche Bank real estate fund.

Yields

The most in demand properties in all of the sectors are prime properties, but they are also the ones in shortest supply. Yields continue to be stable as very few prime property transactions have been registered. Owners without liquidity issues are keeping prime properties in their portfolios, gaining revenue from good results even during times of recession. However, owners in need of liquidity have decided to begin disposing of their less strategic products, waiting for the market to recover to begin selling those assets that will bring them the most profit.

The lack of prime properties on offer and the growing interest these have created could force yields to harden, although they will still remain above the European market average.

The achievable yield level for prime assets in the Madrid office market is currently 6% and it is showing a clear downward trend, as are prime shopping centres, that currently sit at 6.75%. Prime product in the retail park sector remain stable, at around 7.50%. Logistics yields are currently in the region of 8.50%, with further increases expected.

Spain has demonstrated that it is a country that is willing to change, has the capacity to grow, is now ready to exit the crisis and is a country in which it is now a perfect time for investors to look for investment opportunities.

OUTLOOK

2014

- International investor perception regarding Spain has changed thanks to its improved economic expectations. We are beginning to see signs of recovery, although this may yet take a while to filter down to the domestic economy, which will be the main catalyst behind driving a market recovery.

- The difficulty in acquiring financing is no longer seen as a death knell. Little by little banks are renewing lender activity, albeit for very specific transactions, at high prices and with a credit limit of around 50%.

- The market will continue to be active in 2014 and will also be marked by investor appetite and the lack of open sales processes (this applies to all sectors), which will be made up for by the large amount of off market product. International investors, some of them newcomers to the market, continue to monitor the market indicators and are actively looking for core product.

- Rents are expected to grow in the short-medium term in the best properties within each market and this has increased interest for prime product, which remains the most desirable but also the shortest in supply. Consolidated properties located in secondary areas will be a good alternative.

- Investor activity will dictate how yields will fare.

- Good results in tourist data will consolidate the hotel sector as one of the most robust.

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