REPORT

INVESTING IN SPANISH REAL ESTATE

MAY 2023

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GRI CLUB

GRI CLUB

GRI Club is changing the game for networking and providing key market insights with its event coverage that transforms the intimate discussions of C-level executives into digestible reports.

GRI Club events are a way to pick the brains of the leading figures in real estate. This report was created after España GRI 2023 in Madrid, which gathered 170+ of the top decision-makers in the business.

'The general sentiment we saw at **España GRI 2023** was that there is a 'wait and see' environment with many investors ready to deploy capital, but still awaiting new valuations or for signs of more economic stability.

Investors are not buying commercial real estate assets because they understand that prices do not reflect the rise of inflation and interest rates. Some reports indicate that prices could fall 40% until the end of 2024, with exceptions in Germany and Sweden, where prices have already fallen. This is not true in Spain, for now.'

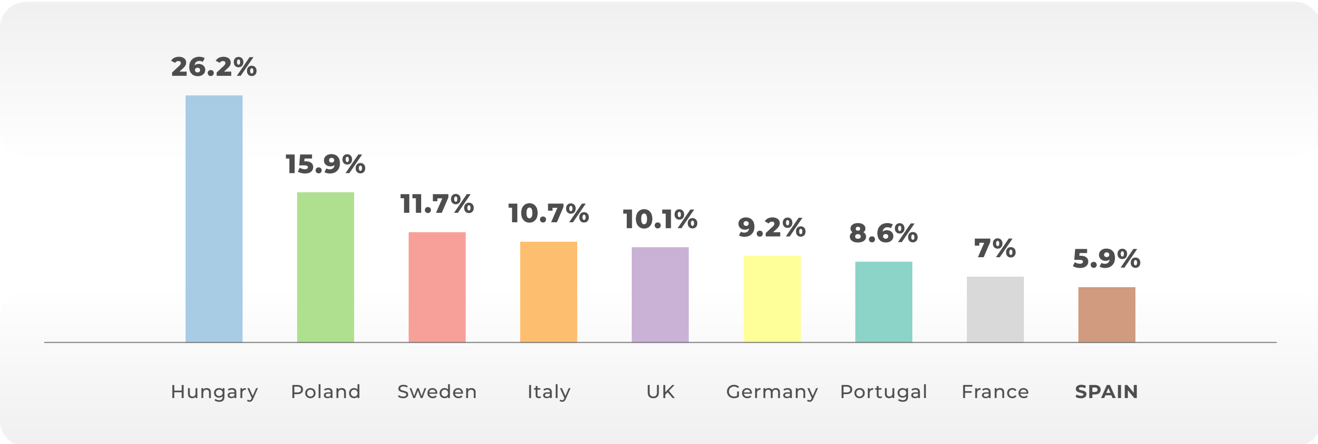
Gustavo Favaron
GRI Club CEO & Managing Partner

For more insights into the Spanish and European markets, attend **Europe GRI 2023**, GRI's flagship event for real estate leaders.

SPAIN'S MARKET

Spain is facing a new scenario with fewer, smaller-sized deals, and many are still waiting for price adjustments, which is something that was mentioned in GRI's first large European conference of the year in February. Overall, many believe that while yields have adjusted, asking prices for land have not.

INFLATION IN SELECTED EUROPEAN COUNTRIES, JAN. 2023



Source: Statista

Spain's outlook is positive for the most part, as tourism recovery has been strong and sustainable, inflation and energy are controlled and lower compared to other EU nations, and the GDP growth has been high.

The assets currently available in the market do not have the prices to match an 'opportunity' status. The biggest challenges are interest rates, inflation, and construction cost and with this high-interest environment, one cannot make sudden decisions. The attendees hope that this year interest rates will drop to the expected levels.

The consensus in the room was that in the next 6 months, the selling activities should begin and be to the advantage of buyers. Within the next 18 months, overall market conditions should improve. However, no one has a crystal ball to predict the future so one may take these predictions with a grain of salt.

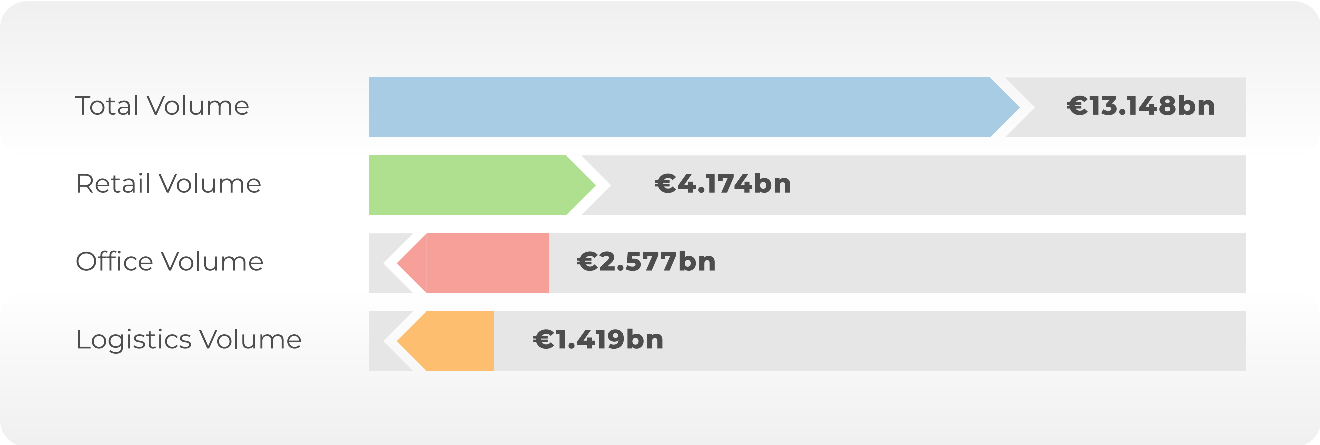
From the valuations available, many are noticing lower values; this drop in valuations, according to the executives, is coming from cap rate increases. In addition, margins are reducing, which then impacts value, leading to problems accessing finance and exit strategy issues.

INVESTOR LANDSCAPE

Currently, executives see a new real estate market. Many are seeing an increasing lack of strict processes in favour of more market-level deals. At the current moment, the main actors from the buyer side are more equity than finance, while some investors have started to move on from the wait-and-see approach and are buying at a discount because they need to act.

Land sellers are not constrained nor are they cash-strapped, which makes buying land difficult at prices where deals make sense. This comes after years of historical selling of land, but sellers now have surplus savings so they are not under pressure to sell.

SPAIN'S INVESTMENT VOLUME, 2022, AND Y-O-Y CHANGE



Source: Cushman & Wakefield

Many investors are observing a different risk perception in the market owing to general uncertainty, and investors are more conservative in risk appetite compared to 2022. This is delaying many deals and reducing market activity. Portfolio balancing between different asset classes is now underway, especially by institutional investors and other big players.

General real estate feelings are positive, however. The underlying performance of assets is generally good with rental yields increasing and vacancy levels decreasing. This sector seeing high demand is because unemployment is controlled, salaries have appreciated, and households have savings.

The upcoming regulations that involve rental caps based on indexes have made investors a little more cautious; the problem is not seen to be the rental cap but instead the indecisiveness of the government, and investors would appreciate fast, clear decision-making on these issues. Some point out that rental caps on indexation can be a positive development, particularly for institutional investors.

Real estate in 2015-2021 had no competition from government bonds but now with increased interest rates, bonds are competing with the market. Yield compression is interestingly higher than in historical periods.

IMPORTANT POINTS
OF CONSIDERATION FOR THE CURRENT MARKET

- More analysis is needed with **yield compression**
- **Quality is paramount:** ESG is mandatory with users and investors want compliant assets
- The impact of **urban policies**, and whether it is greater

VALUE ADD AND OPPORTUNISTIC

The conversation in this session started with all the executives agreeing on the difficulty in finding opportunities worth pursuing currently in the market. The solution to which is just to be patient and wait for new opportunities to come to the market, as right now land prices have not gone down and costs are up.

THE 2 TRENDS SEEN IN THE MARKET ARE:

Photo: Tatiana_Mara / Envato Elements

Photo: iLixe48 / Envato Elements

Value Add options are being considered but vendors want to sell Value Add at Core/Core+ levels, so in terms of investor return demands, these opportunities do not make sense. Investors are instead looking to be extra opportunistic, so expectations aren't really matching the demand and supply side.

Clear visibility of the change in market volatility is needed as no one wants to make a risky move without knowing the eventual consequences.

While in 2011-2013, activity was concentrated in Retail, in the 2020-2023 period activity has been concentrated more in Residential assets such as Co-living, Student Housing and Affordable Housing, as over the next decade the housing supply needs to increase dramatically.

Alternative investment in Data Centres, Schools, and Universities is becoming a hot trend. Many are looking to these sectors to assess strategies in order to treasure hunt for deals with higher returns compared to risk profiles.

MADRID

In Madrid, demand for several asset classes is high due to the good performance of the education sector, particularly universities in the city centre.

From the Cross-border investment discussion, Madrid's Residential market emerged as a great opportunity - that is if the government does not interfere significantly in the market. However, as previously mentioned, some investors do not feel negatively about the introduction of rental caps.

There is also general consensus on Madrid being bullish about residential. Affordable housing is the key requirement for people who need it. It is important to work with the government, although Madrid's government has been good in general terms on the progress made on making affordable housing available. The role of regulation is important for its impact on rental growth - Barcelona will also be impacted but differently from Madrid as the regional government will play a role there too.

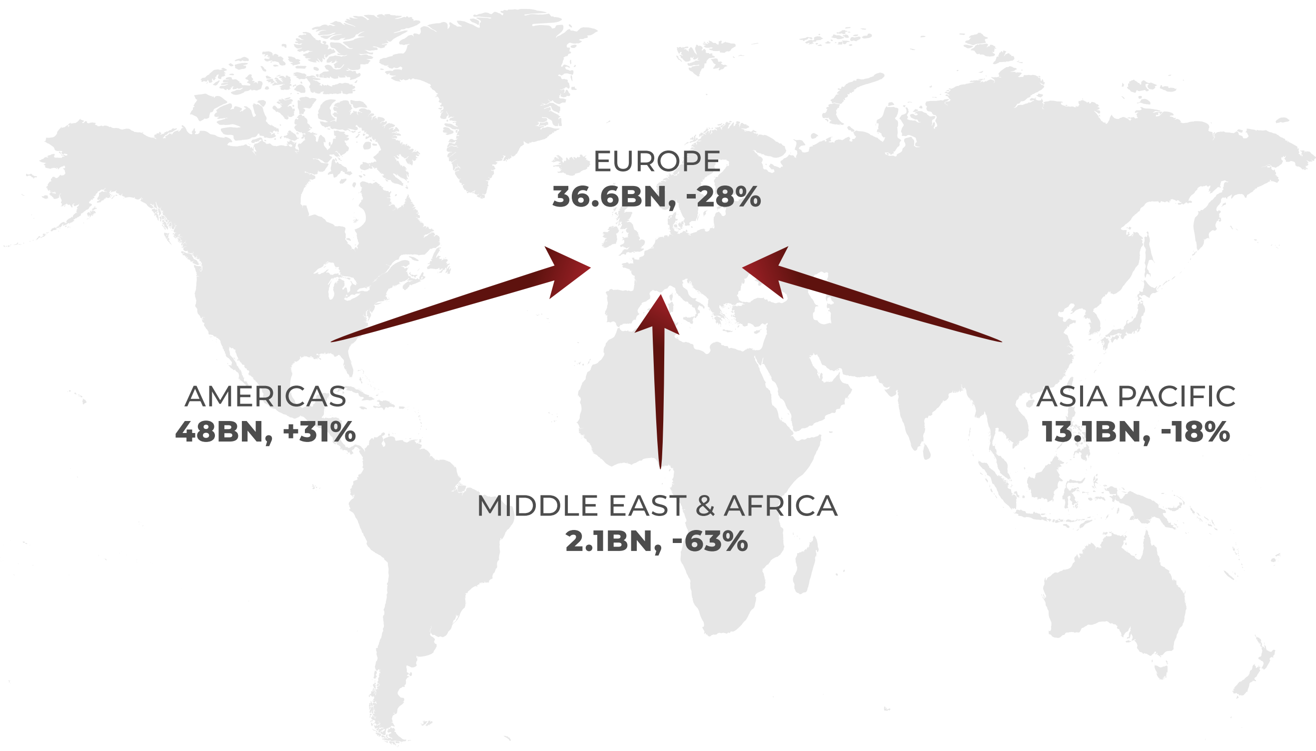
Co-working in Madrid is also increasing in popularity from both the investor and operator sides. Aside from this primary location, Barcelona has appeared as a new player in the Offices market in the form of subletting, especially from tech companies.

CROSS BORDER CAPITAL

At the Cross-border Capital discussion, the executives immediately noted that deal flow is stronger in Germany and Sweden at this moment as repricing has already taken place in these markets, and as previously mentioned, this has not truly taken place in Spain as of yet. In those markets, some companies need help with senior loans owing to the Loan-to-Value thresholds and pressures on refinancing.

However, inflation is lower in Spain compared to countries such as the UK and Germany, which makes the country more appealing; additionally, unemployment is under control and demand for residential is strong.

CROSS BORDER INVESTMENT VOLUMES, EUROPE
2022 volume vs average previous 5 years



Source: Savills Research

The executives also observe a change in occupier demand across major asset classes. Ground floor retail is dying, while there is a pickup in student housing, co-living and serviced living. Offices are moving from traditional to co-working models on the back of tenant demand and consumer use.

Overall, the Office outlook is positive. Some note that teleworking is not as popular in countries such as Spain due to cultural factors - it cannot be compared to the US market that has been affected more significantly, such as in San Francisco, which has been impacted by the majority of the tech sector not returning to offices as of yet.

SPAIN’S OFFICES RECAP, Q4 2022, AND ANNUAL COMPARISON

9.9%
VACANCY RATE

132,600
TAKE-UP (SQ.M)

€37.00
VALUE (SQ.M/MONTH)

Source: Cushman & Wakefield

Retail, Logistics and Residential all have exciting opportunities. Spain’s Residential market has been high performing over the last few years but still lags behind some such as Germany’s. Opportunity exists, and demand for the rental market is high in many cities with unemployment low and the barrier to buying property so high.

Retail and shopping centres were negatively affected by the pandemic, but resilience can still be seen in the market, and the circumstances have brought more creativity, awareness, and unity to the table. Retail operators and investors have been forced to rethink their strategies and focus on experience.

Logistic demand is strong but the **sustainability** of this demand is yet to be seen.

Office take-up is back at long-term levels in Madrid.

High street Retail has seen a progressive slowdown in activity compared to Q1 2022.

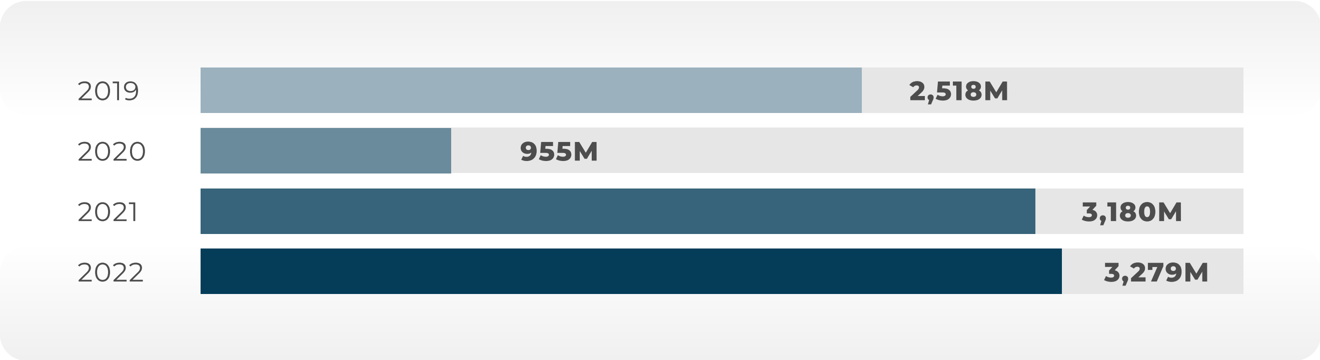
Some advice given to foreign investors interested in this market was to match risk profiles and appetites with the capital vehicle under their possession. Foreign investors who are IRR-driven should mitigate court decisions, as they are known to take significant time in Spain; it is best to find specific insights into the market, particularly from local experts.

On the whole, demand, structural, and cyclical changes can be overcome by being creative and innovative in decision making. Thinking differently is important and building a new perspective is key.

HOTELS

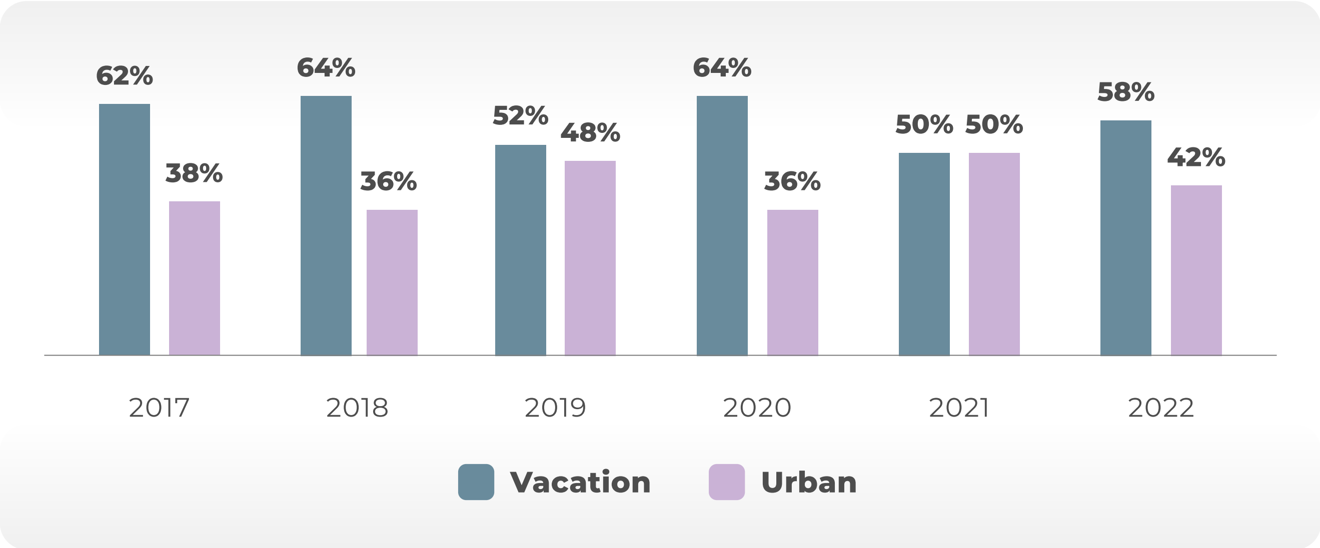
The Average Daily Rates for Hotels in Spain are at a record high, and this is expected to continue next year as tourism continues to thrive post-pandemic. Meanwhile, repositioning and upgrading are key as Hospitality develops and 'living concepts' enter the market; the asset repositioning that has taken place so far has been successful. Hotels are considered a winner in these challenging times.

EVOLUTION HOTEL INVESTMENT VOLUME 2019-2022



Source: Colliers

EVOLUTION OF URBAN VS VACATION HOTEL TYPE, EUROPE, 2017-2022



Source: Colliers

GRI CLUB SPAIN

Aside from España GRI, the members of GRI Club Spain meet at club meetings throughout the year in order to discuss new trends and maintain their real estate connections while making new deals.

This year, GRI Club Spain has aimed to create a strong network of players in the Spanish market as well as interested international players in order to facilitate the injection of new capital into the country.

Our club meetings have allowed GRI members to get insights into macroeconomic developments and market changes for the main asset classes while exploring up-and-coming assets such as Co-Living.

SOME OTHER **CLUB MEETINGS** IN THE PAST YEAR

MEMBERS OF GRI CLUB SPAIN WILL ALSO ATTEND **EUROPE GRI 2023**

SEPTEMBER 12-13, PARIS

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