Iberian Property

Publicación	Iberian Property General, 42	Fecha	22/11/2022
Soporte	Prensa Escrita	País	España
Circulación		V. Comunicación	ND
Difusión	ND	Tamaño	493,33 cm² (79,1%)
Audiencia	ND	V.Publicitario	--- EUR (ND USD)

Antonio Simontalero

CBRE INVESTMENT MANAGEMENT
Country Manager Iberia | Fund Manager

During the last 6 months we have witnessed one of the fastest increases in interest rates observed in decades. Only one year ago, Euribor was still negative and continuing the trend of the previous seven years, in which reference rates remained at abnormally low levels. However, during the second half of 2022, Central Banks have been taking measures in an attempt to control the rapid increase in inflation, recording reference rates unseen since 2011.

This fast increase in rates is still being digested by the real estate market. When analysing the impact, we should make a distinction between the effects in the operational performance of the assets and the effect in capital markets. In relation to the operational performance, most of the sectors are still performing well. So far, operational KPIs remain solid and above pre-covid levels: occupancy rates remain high and tenant demand is still strong. This is specially the case in the best performing and more core assets. However, we are already observing a slowdown in economic activity, and we should expect a deterioration in KPIs if high inflation remains or if unemployment increases.

The picture is very different when we look at the capital markets. In this case, the effects have been much faster as financing costs have rapidly reflected the increase in interest rates. This had an immediate impact on transactions due to the need of investors to revisit their underwriting assumptions. As a result, we should expect yields to increase until prices are rebalanced and reflect realistic expectations for both buyers and sellers. The duration and depth of such price adjustments in Iberia is still to be determined and can differ by sector, as low yielding sectors will likely be more affected than those in which values had been already adjusted during the last years.

Jon Armentia

LAR ESPAÑA
Corporate Director & CFO

Retail has always demonstrated its capacity for adaptation and resilience to a complex and changing market. Today, we are facing very high inflation which, together with contractionary monetary policies and the risk of recession, will have an impact on the entire productive fabric. The real estate sector will be no exception to this outlook, although it will continue to demonstrate its strength as a "*safe haven sector*" in the context of rising interest rates.

Forecasts indicate that, over the coming months, the European Central Bank will maintain the upward trend in interest rates that it has been applying since July. It is expected that, as a consequence of the rise in rates and the increase in the risk of default, fixed income will experience an increase in its profitability compared to variable income. Thus, a few days ago the ECB indicated that the yield on the Spanish ten-year bond stood at 3.31%.

Nevertheless, with the threat of recession looming, investors are looking to the real estate sector as a safe haven. It is worth noting that, in the case of the retail sector, shopping centres maintain a yield of around 5.30%, two points above the Spanish bond. Retail parks, meanwhile, have shown their resilience during the pandemic and maintain a yield of around 5.45%, making them one of the most attractive assets in real estate.

In addition, the Spanish retail sector, unlike other segments, does not have a regulatory constraint that prevents it from compensating for inflation. In the case of Lar España, almost 100% of the contracts are indexed to the CPI and our effort rate is the lowest in the sector, which gives us an additional margin for negotiation when considering rental agreements. Even in situations of adverse context, the dominant centres and parks (and ours are) are able to maintain their attractiveness, even in the case of hypothetical declines in consumption.

Iberian Property

Publicación	Iberian Property General, 44	Fecha	22/11/2022
Soporte	Prensa Escrita	País	España
Circulación		V. Comunicación	ND
Difusión	ND	Tamaño	492,16 cm² (79,0%)
Audiencia	ND	V.Publicitario	--- EUR (ND USD)

lar España Real Estate

Javier Martín

NUVEEN REAL ESTATE
Senior Portfolio Manager

Yields must move up and suffer an adjustment, reflecting lower prices due to higher finance costs caused by interest rate increases. It is not possible to maintain the same yield levels as we had some months ago. The higher interest rates and also the uncertain macro-economic environment must reflect the risk and affect yields.

We are now living in a period of price adjustment, it will not happen overnight, it will take some time for sellers and buyers [to match on price?] and will be reflected gradually in yields and pricing. In this period of uncertainty it is more difficult to assess from an investor perspective which could be the entry price and the underwriting behind each investment. We have to remain cautious and disciplined, more selective and analyse each opportunity on a case by case basis. But I am sure that there will be opportunities to invest in the following year.

Ariadna Nijssen

STONEWEG
Head of Acquisitions Southern Europe

We come from years of low interest rates, low inflation and lower than expected prospects for potential GDP growth. This has limited the capacity of property yields to increase, providing some protection to the asset on a portfolio allocation basis.

It is often believed that increases in interest rates negatively impact real estate assets and their performance, pushing yields up and troubling existing business plans. This has been the case but, historically, the impact of increases in either interest rates or bonds has sometimes been mitigated through inflation or economic growth, both of which can push the top line of operating real estate assets.

Focusing on Spain, the rapid increase in rates – reflected in Spain's Sovereign Bonds, which have broken the 3.5% barrier vs their 0.4% level only a year ago – has naturally put pressure on property yields, which already started expanding before the summer. Again, inflation is playing an important role in alleviating such impact, as real estate can be inflation-linked (contrary to bonds), allowing top lines to fluctuate accordingly, which provides stability to returns.

Overall, we believe that despite the rise in yields, Spain remains an attractive destination for foreign investment, with a total of €12.7bn invested in real estate in Q3 2022, c.60% of which is overseas origin. Fundamentals in most asset classes remain strong, with positive metrics such as rental prospects supported by a structural lack of supply in the living and logistics sectors, strong hotel trading performance and a systemic lack of investment in alternatives. As such, Spain should remain a solid contender for international funds looking at allocating part of their portfolios to real estate both on a European but also global basis.

Iberian Property

Publicación	Iberian Property General, 46	Fecha	22/11/2022
Soporte	Prensa Escrita	País	España
Circulación		V. Comunicación	ND
Difusión	ND	Tamaño	419,04 cm² (67,2%)
Audiencia	ND	V.Publicitario	--- EUR (ND USD)

Thibault Coatanea
FREY
Head of Iberia

The rise of interest rates will not impact all the asset types with the same pace. FREY is a pure player of the investment of open-air retail and owns a portfolio of well-let and performing retail parks generating strong cash flow returns. The premium offered by our asset class over Spanish bond yields imply a very attractive risk return profile, thanks to the secured and recurring cash flows and low OCR of our tenants.

We can say that FREY has an extremely sound balance sheet in support of the deployment of its growth strategy – a strategy that is based on the development of assets perfectly in line with the aspirations of a more sustainable society. With the ambition to become the European leader for sustainable retail, FREY has strengthened its position in Iberia this year through acquisitions in Spain.

Augusto Lobo
JLL SPAIN
Director de Capital Markets Retail

After a solid start to the year, retail investment activity is slowing. Various transactions have been halted or pushed into next year. The increasing cost of debt and inflation are impacting underwriting, yields and returns around the world, although consumer spending and higher relative yields continue to prop up investor sentiment in the retail sector. Consumers have become more cautious in their spending habits, as inflation has started to squeeze real disposable incomes. While the volume of retail trade is edging lower, it remains above pre-pandemic levels.

During this new phase of price discovery, buyer pools are shrinking in the transaction market, and bidding intensity is moderating.

We can expect outward yield shifts for prime retail assets because of rising financing costs and higher risk to cash flow. Furthermore, the outlook for 2023 has become more uncertain. It will partly depend on how retail sales volumes develop between the autumn and Christmas trading period. Affordability of rents has become key.

Retail real estate, supported by affordable defensive income, linked to inflation, will likely continue to benefit from solid investor demand. For retail assets, with a larger proportion of income coming from retailers with a discretionary product offer, investor demand is expected to vary by quality of assets.

Iberian Property

Publicación	Iberian Property General, 48	Fecha	22/11/2022
Soporte	Prensa Escrita	País	España
Circulación		V. Comunicación	ND
Difusión	ND	Tamaño	461,01 cm² (74,0%)
Audiencia	ND	V.Publicitario	--- EUR (ND USD)

Alberto Larrazabal

CBRE SPAIN
Director Industrial & Logistics

Paul Santos Robson

CBRE SPAIN
Senior Director IP Retail

In the Industrial and Logistics sector, the increase of 25 basis points in prime yields in this third quarter (35 bps since January) stands out, both in the Central Zone and in Catalonia. Thus, and despite the positive performance of the occupational rental market, prime yields continue their upward trend, driven especially by the increase in financing costs. In addition to Madrid and Barcelona, we see how the market has gained a lot of importance in other cities such as Valencia, Bilbao, Malaga and Seville, which are becoming more interesting for institutional investors who focus on operations in the first crowns and last mile assets. where the yields are higher.

For its part, in the Retail sector, prime yields have increased to 35 basis points in shopping centers and 50 in the High Street during the third quarter since the beginning of the year. And during the month of October it has already been observed that the expansive trend is maintained in all the subsegments of the sector, due to the macroeconomic context and despite the increase in foot traffic and sales in the different establishments.

The onset of the war in Ukraine and subsequent global supply-side shocks have accelerated and exaggerated the inflationary shift. Monetary policy decisions to raise interest rates during Q3 2022 have now come to bear on global real estate activity, which slowed in Q3 2022.

Considering a scenario of rising interest rates in Spain our vision is different depending on the assets. Speaking about Core product yields are predicted to move out between 50 and 75 basis points, which converts to a 10% to 15% reduction in capital values, according to the asset class and its location. For the non-core product discounts could be higher as yields and prices readjust. The assets that would hardly be *"for sale"* under other financial and market conditions will come now onto the real estate market and this will arise the interest of investors to access these properties. Finally, we believe that there will be another type of assets that will not find a buyer, even at heavily discounted prices.

It should be noted that the strong appreciation of the dollar is favoring investors who traditionally operated in other markets, such as Mexican capital, now put their focus on the Spanish market. Contracyclical investment, such as sale and leaseback opportunities will also arise for investors, which will allow companies to obtain liquidity at a lower cost than corporate bonds or bank financing.

Investors will need to look at their planned investment approach and revise their strategies to reflect current market dynamics. Many opportunities will arise for savvy investors who are willing to diversify their approach and take action. Now is time of opportunity. Cash is king and equity-driven investors, notably private buyers can bid for assets in an environment with limited buy-side competition.

Alberto Díaz

COLLIERS
Managing Director | Capital Markets

Publicación	Iberian Property General, 50	Fecha	22/11/2022
Soporte	Prensa Escrita	País	España
Circulación		V. Comunicación	ND
Difusión	ND	Tamaño	422,26 cm² (67,7%)
Audiencia	ND	V.Publicitario	--- EUR (ND USD)

James Cowper-Coles
KNIGHT FRANK
Director of Logistics Capital Markets

Simón Palazon
KNIGHT FRANK
Capital Markets Senior Consultant

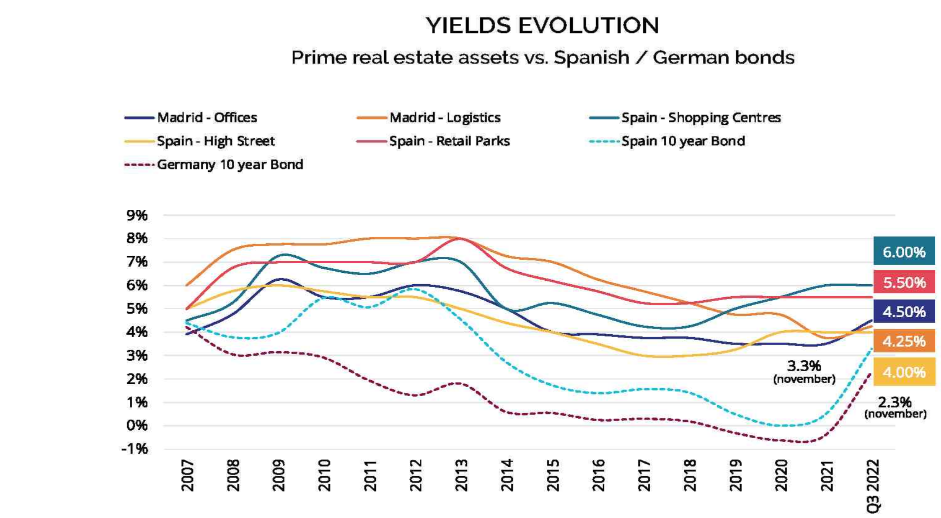
Although Russia's invasion of Ukraine in March 2022 has created further upward pressure on inflation, due to the *"explosion"* of natural gas and oil prices, inflationary pressures have already existed since 2021, mainly due to the increase in global demand for raw materials and commodities as well as the transportation and supply chain problems and collapses originated by the Covid-19 pandemic.

These factors have caused the cumulative CPI in Spain in 2021 to be 6.5%, and 7.3% so far in 2022. In this context, the European Central Bank has raised interest rates up to 3 times since the beginning of 2022, with the latest increase bringing the rate to 2%, with the aim of reducing CPI growth and ensuring the timely return of inflation to its 2% target in the medium term.

For the first time since 2009, borrowing costs in the euro area real estate sector are now higher than the return that investing in many prime assets offer . The average cost of debt currently stands at 4.5-5.5% (Euribor + Margin), while the yield on prime office buildings in cities such as Madrid was around 3% at the end of 2021.

Historically, prime yields have been between 200-250 basis points above the yields offered on Spanish government bonds, as can be seen in the graph.

Nevertheless, in times of economic uncertainty, this spread may be reduced, and therefore we expect this difference to stand between 150-200 basis points. As of today, prime yields in major real estate markets, such as the Industrial-Logistics sector, have been adjusted upwards from 3.75% to 4.50%. Indicators from other European countries, such as UK and Germany, suggest that this correction has not yet fully materialised in Spain, which is likely to imply a price adjustment of between 10-20% versus Q4 2021 pricing levels.



SOURCE: : Knight Frank Research | Eurostat | Bank of Spain | Investing.com