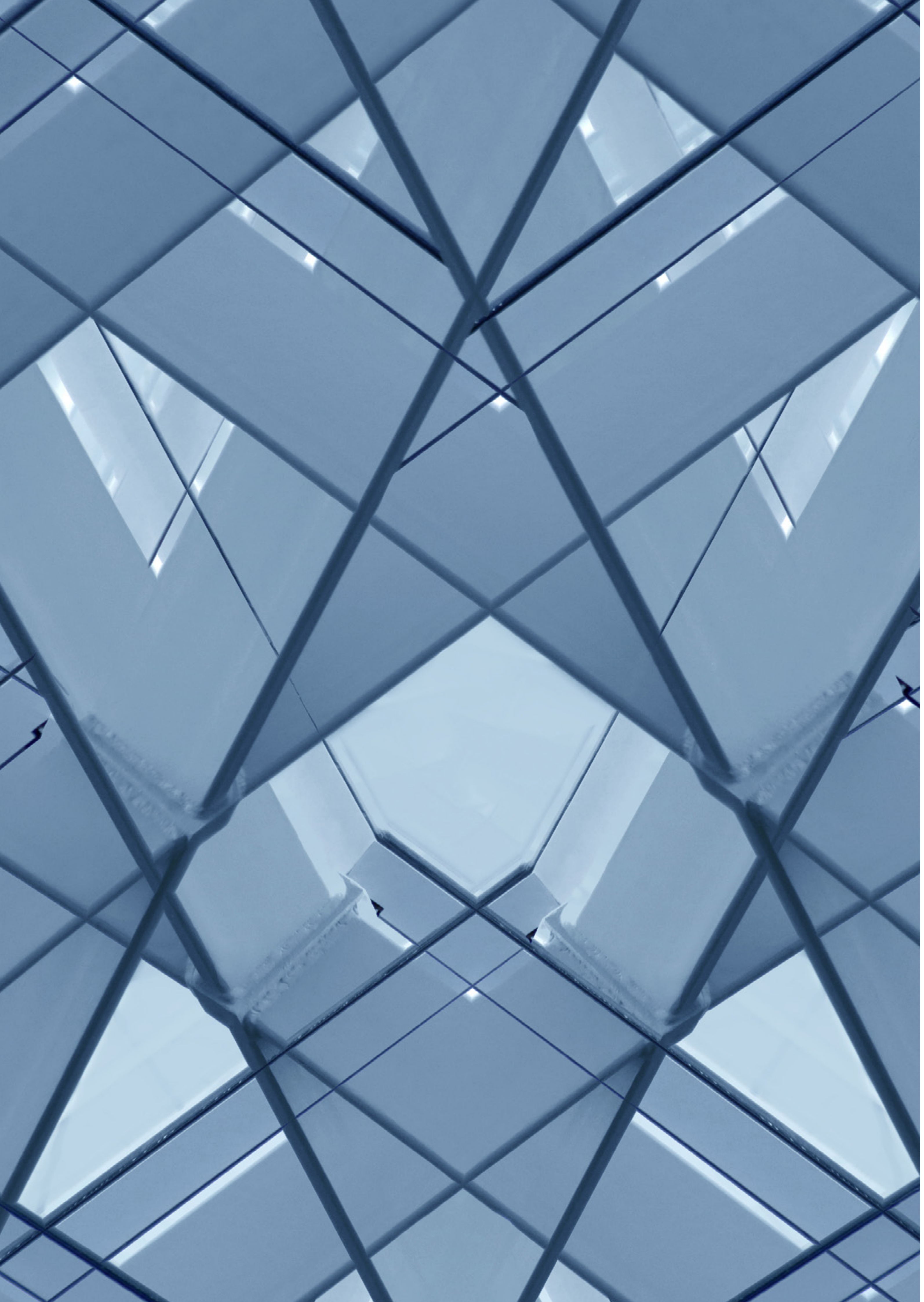
CBRE RESEARCH | SPAIN

REAL ESTATE MARKET OUTLOOK 2020

SPECIAL EDITION

JULY 2020

CBRE



EXECUTIVE SUMMARY

4 ECONOMY & POLITICS

- COVID-19 has dragged down GDP growth in 2020, with historic lows recorded in Spain and the rest of the world. The kind of recovery we will see in 2021 remains uncertain; among other factors, it will depend on both how well we control the pandemic to avoid further lockdowns and how well demand recovers – a fundamental prerequisite for the real estate sector to bounce back. Politically, the current coalition government must pour the greater part of its energy, as a matter of urgency, into a common strategy for reviving the economy.

8 INVESTMENT

- After an outstanding Q1 2020, investment volumes will record the lowest levels seen in the last five years. Buyers and sellers stand on either side of a formidable chasm, as the market waits and watches for others to set the pace. Investors remain poised to pounce on the right opportunity – prime at one end of the spectrum and distressed, discounted assets at the other. Sector-wise, logistics and operational real estate are emerging as the new favourites.

13 FINANCING

- Overall, financing has become more selective and restricted compared to the beginning of the year, with greater margins and reduced leverage requirements. International debt funds are progressively gaining ground and will foreseeably heighten their advantage over the next few months as more and more borrowers opt to refinance and restructure their debt.

17 SECTORS

- In this section, we outline the key factors that will shape activity in each real estate sector over the coming months – the outlook having changed dramatically since Spain's declaration of a state of emergency in mid-March and in view of the impacts of placing the economy at a virtual stand-still to curb the spread of COVID-19.

ECONOMY & POLITICS

The outbreak of the COVID-19 pandemic and the lockdown measures put in place to curb its spread will have a major impact on economic growth in 2020.

UNCERTAINTY REIGNS AS GDP HITS HISTORIC LOWS IN Q2 2020

Despite the Spanish government's gradual relaxing of the strict lockdown and social distancing measures put in place to curb the spread of COVID-19, the economy has been hit hard since the national state of emergency was declared in mid-March. The collapse in domestic demand caused real **GDP** to fall by 5.2% in Q1 2020. Meanwhile, the economy is expected to have shrunk by 30% to 50% during the period affected by lockdown compared a normal year due to the importance of the tourism, hospitality, wholesale and retail industries in the Spanish economy.

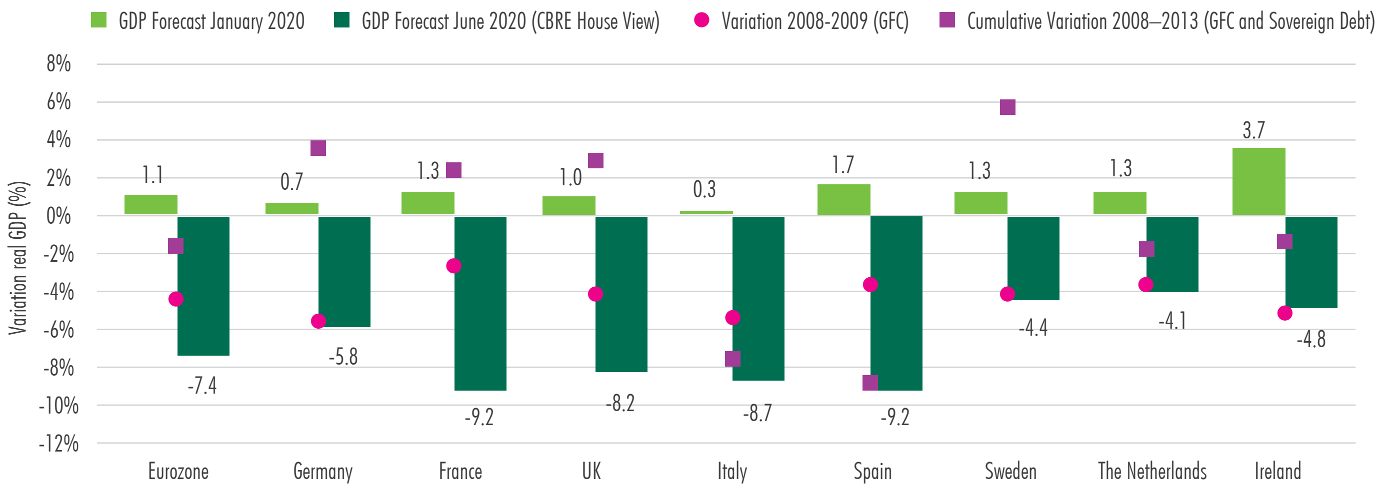
Furthermore, the predominance of SMEs in the country's manufacturing landscape – small firms that face greater challenges accessing financing when liquidity runs low – is the reason why Spain, along with France and Italy, is set to record one of the EU's sharpest drops in GDP in 2020.

Given the cloud of uncertainty hanging over the market, at CBRE Research, just as most research organizations, we have been working on different scenarios, estimating the pandemic's economic impact and projecting the shape of the recovery under varying degrees of infection control, bearing in mind the risk of new outbreaks requiring drastic measures like those we saw in the spring.

Our base-case scenario is a 'V-shaped' recovery – or an 'early recovery', to use the Bank of Spain's preferred term. In this case, economic activity would pick up over the course of Q2, assuming that the infection rate does not spike and force a new lockdown. In this single-impact scenario, the quarter-on-quarter GDP loss in Q2 would be around 14.3%, recovering gradually but fairly steeply in the second half of the year. This would result in an annual drop of less than 10% for 2020 as a whole. This outcome would lay a solid foundation for economic growth in the next two years (forecast at +7.8% in 2021 and +2.3% in 2022). At the end of the projection period (Q4 2022), GDP would stand 4.1 percentage points (pp) short of pre-pandemic forecasts.

The secondary scenario considered (a 'U-shaped' recovery) reflects the possibility that the infection rate could spike again before the end of 2020. Under this scenario, the impact on economic activity would be more severe and recovery would be pushed further into the future, resulting in a loss of GDP of 13.5% in 2020 and variation rates of 3.9% in 2021 and 7.7% in 2022. At the end of the projection period (Q4 2022), GDP would be 6.0 pp lower than forecast before the crisis hit.

FIGURE 1. GDP FORECASTS FOR 2020 BY EUROZONE COUNTRY (CBRE HOUSE VIEW V SCENARIO)



Source: CBRE Research

The recovery will be driven by a rebound in consumption and investment activity. Nevertheless, the more uncertain outlook and the substantial contribution of the tourism industry to Spanish GDP may act as a drag on economic improvement. In a U-shaped recovery, the damage to economic activity would be more severe and enduring, due to a greater number of insolvencies and longer stretches of unemployment, even with additional government support.

SHARP RISE IN UNEMPLOYMENT, FALL IN INFLATION AND A DEEPENING PUBLIC DEFICIT

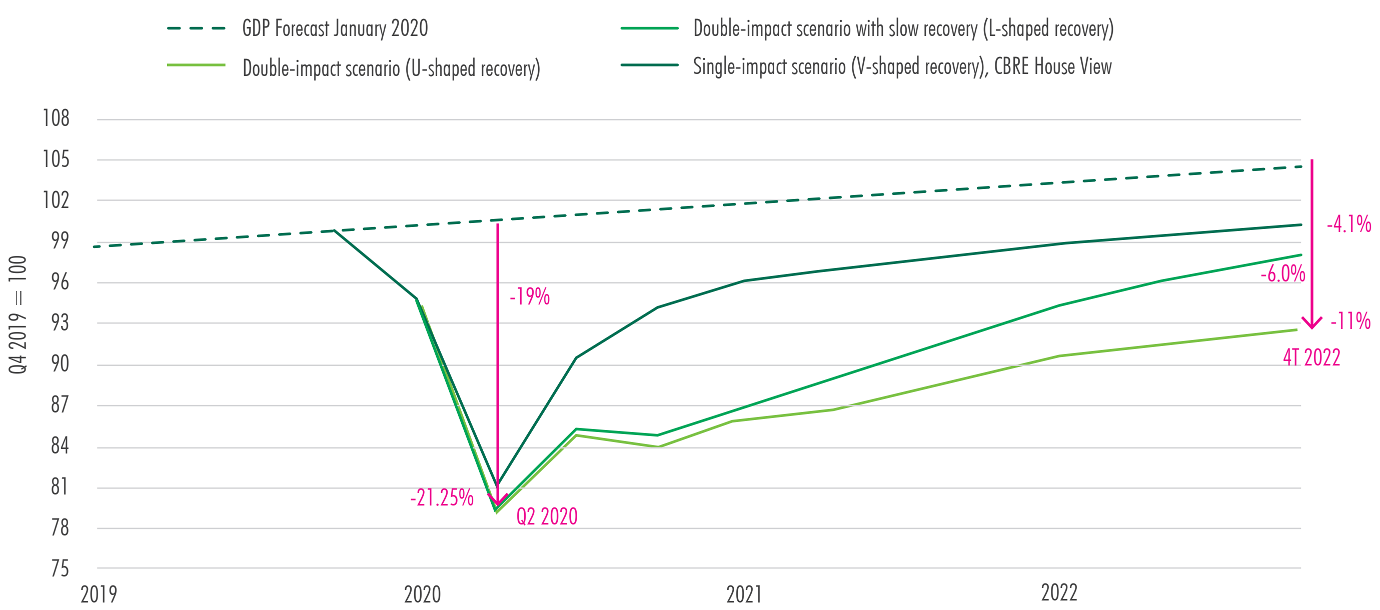
In the **labour market**, we expect the unemployment rate to rise sharply this year in both scenarios, reaching 18.6% if there is an early recovery from a single outbreak and up to 21.9% if there is a second outbreak, to then remain above 17% throughout 2021.

It is worth pointing out that these unemployment rates do not include workers affected by ERTEs (the Spanish furlough equivalent), of whom there were approximately 2.2 million in June. Those on temporary contracts are most at risk of layoffs, due to the drastic impact of the crisis on the tourism and hospitality sectors.

Inflation is expected to keep falling until the start of 2021, when energy and fuel prices may rally strongly following the marked drop at the start of 2020. Under a single-impact scenario, inflation should start to edge up again from 2021 onwards. In terms of average annual rates and according to our forecasts (CBRE House View) inflation will tick up from -0.7% in 2020 to 2.1% in 2021, again assuming a single-impact scenario (a V-shaped recovery from COVID-19). In the event of a double impact (a U-shaped recovery), our projections indicate a continued downward trend in inflation throughout 2020 and 2021 (-1% and -3%, respectively), driven primarily by lower oil prices that will last until the end of 2021.

The health crisis will gravely deplete the **public purse** in the short term, although this too will show signs of a gradual recovery as we move through the next two years. The budgetary deficit and the debt-to-GDP ratio (according to the Maastricht definition) is likely to jump sharply in 2020, reaching -10.9% and 134.9% respectively in a single-impact scenario (V-shaped recovery) and -13.2% and 145.1% in a double-impact scenario. The equivalent percentages for 2019 were -2.8% and 114%. As economic activity picks up pace in 2021, and the temporary burden imposed by pandemic response measures lessens, the deficit should shrink to -5.0% (V-shaped recovery) or -9.0% (U-shaped recovery) of GDP.

FIGURE 2. FORECAST GDP GROWTH IN SPAIN 2020–2022, BY SCENARIO



Source: CBRE Research

EXCEPTIONAL ECONOMIC POLICY MEASURES TO SAVE SPAIN'S MANUFACTURING AND PRODUCTION BASE

The Spanish government has launched a raft of **economic policy measures** aimed at softening the blow dealt by COVID-19. The priority has been mitigating the impact by providing liquidity to SMEs and the self-employed and in those sectors that have taken the most direct hit. It has also sought to stimulate financing to support these more vulnerable actors. One of these measures is a series of government-backed loans for companies and the self-employed, with a total value of €100,000 million. Of this sum, 67.5% has been allocated to SMEs and self-employed workers.

At the European level, too, policies have been put in place to keep a lid on loan and financing costs. The European Central Bank (ECB) has held **interest rates** in the Eurozone steady at 0%, and no short-term increases are expected in 2020 or 2021 in either scenario considered.

In keeping with its expansive **monetary policy**, the ECB has allocated more than €1,300 million to 742 financial institutions – the largest sum it has ever released through a refinancing mechanism. In fact, the Bank has expanded its Pandemic Emergency Purchase Programme (PEPP) by an additional €600,000 million up to June 2021, and European asset purchasing is expected to reach €1,350 million. This decision is a response to more recent forecasts that have downgraded predictions for inflation over the projection period.

The profound uncertainty of the current situation means that more challenging scenarios, with poorer economic outcomes than predicted under either a single- or double-impact scenario, cannot be ruled out. A key question is how quickly a vaccine can be developed or an effective treatment found; the sooner this happens, the easier it will be to prevent fresh outbreaks and control or eradicate COVID-19. Until then, there is a real risk of recurrent spikes severe enough to weigh down economic activity for quite some time. In this case, we would see a slower, 'L-shaped' recovery, with even more pernicious effects for the economy, companies and households (figure 2). Consequently, GDP loss could reach -13.7% in 2020, with a variation rate of 1.8% in 2021 and 5.0% in 2022. Under this scenario, at the end of the projection period (Q4 2022) GDP would come in 11 pp below pre-pandemic forecasts.

POLITICAL CONSENSUS VITAL TO KICK-START THE ECONOMY

Given the prevailing uncertainty, there is an urgent need for **political consensus** to shore up the economic recovery if these risks are to be kept in check. Intense hostility between opposition parties and the coalition government was the dominant theme throughout the lockdown period. Once the restrictions have been lifted, the priority focus of all parties should be galvanising the economy, rebuilding the country's manufacturing and production base and supporting the hardest-hit sectors. Support from the European Fund will be crucial in this respect.

OUTLOOK 2020-2021

- The Spanish real estate sector took a severe battering in Q2 from the economic impact of the long, austere lockdown imposed by the government in March and April in a bid to keep COVID-19 cases as low as possible.
- Heightened uncertainty over the behaviour and containment of the pandemic, and the future performance of the Spanish and Eurozone economies, compels us to consider two alternative scenarios. Depending on how the situation evolves, the economy is expected to end 2022 with GDP down by between 4% and 11% on forecasts released in early 2020.
- If infection rates remain under control and we avoid a second lockdown, our forecasts will be refined as more information comes to light over the next few weeks and we gain a clearer sense of the speed and scope of the recovery in demand. This is an essential prerequisite for the real estate sector to bounce back.

INVESTMENT

Investment volumes have slumped as the appetite for both prime, top-quality property and sale-and-leaseback transactions grows.

A SCREECHING HALT FOR ACTIVITY

After an outstanding Q1, when the Spanish real estate market posted an investment volume of over €4,000 million, Q2 barely scraped €1,100 million. These kinds of quarterly figures have not been seen since 2013.

In mid-March, as the state of emergency ushered in some of the toughest restrictions imposed by any country in the world, ongoing negotiations ground to a virtual standstill and hardly any new deals were being brought forward. According to CBRE's own data, by the close of Q2 40% of in-progress investment transactions were disrupted by the declaration of the state of emergency. On a more positive note, only nine transactions fell through altogether, the majority being merely postponed.

One of the most notable transactions of Q2 was AXA's €150 million acquisition of a portfolio of built-to-suit social rented housing units, a deal that serves as an indication of one of the trends that we will see in the market going forwards. However, the largest deal to be closed in Q2 was Generali's acquisition of the Puerto Venecia shopping centre for €475 million, even though the terms were negotiated in 2019. We estimate that investment volume will fall by around 30% y-o-y in 2020.

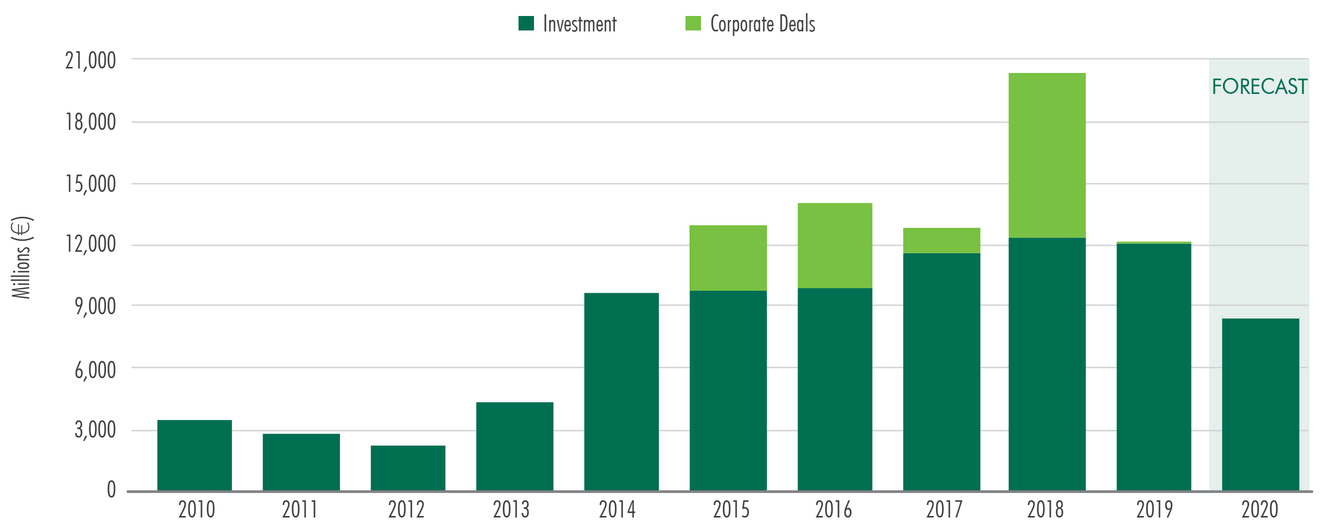
WIDENING GAP BETWEEN BUYERS AND SELLERS

Deals involving retail properties (with the exception of supermarkets, in which interest is surging) and hotels have been the worst affected by far. All through Q2, the majority of actors have held to a wait-and-see position in response to profound uncertainty.

The investment market is currently in uncharted waters, and our view is that this will put a damper on transactions, at least in the next three to six months. That said, there are some sellers who are unwilling to wait and have already resumed their search for buyers. Underwriters face a challenging task given the ambiguity surrounding the pandemic's impact on cash flow and rental prices, and this will pose a considerable obstacle.

With interest rates low, liquidity high and leverage far from the levels reached after the 2008 financial crisis, sellers are resistant to lowering prices for the time being, whereas buyers tend to feel that the prevailing uncertainty ought to be reflected in the asking price.

FIGURE 3. INVESTMENT VOLUMES AND 2020 FORECAST



Source: CBRE Research

AN INCREASINGLY POLARISED MARKET

The disjuncture between buyer and seller varies greatly depending on the sector, location and property type. Core investors are still showing a keen interest in prime properties that meet all the right criteria (good location, good covenant and high build quality). Limited opportunities in the prime market are keeping prices at or very close to pre-COVID-19 levels, and the offers coming in are largely satisfying sellers' expectations. Income security is highly prized at present and rewarded accordingly, and properties let to long-term, solvent tenants are edging up in price. By way of example, in the logistics sector properties let to e-commerce operators are changing hands with yields of around 4.00–4.25% or even lower, depending on the occupier. At the other end of the scale are properties that now look like riskier prospects, such as vacant and value-add properties or projects still in development. In these cases, buyers now expect more substantial discounts.

That said, there is very little in the way of distressed assets on the market at the moment, and this is unlikely to change in the short term. However, there is a risk that the economic recovery (and the return to form of consumption, tourism, job creation, etc.) will turn out to be slower or weaker than anticipated, and this will put over-geared property owners at a disadvantage just as financing channels are tightening.

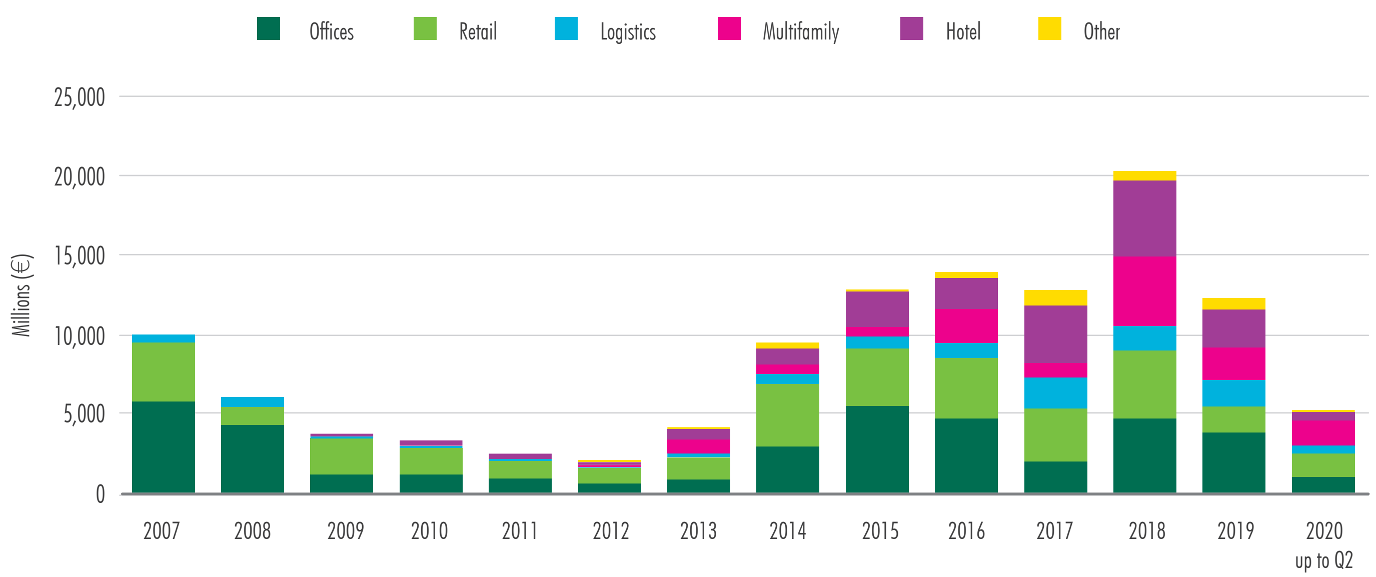
UNCERTAINTY TAKES A TOLL ON PRICES

It is clear that owners are concerned about the impact of the crisis on property values at a time when a lack of visibility and comparables is slowing market activity. In this respect, depleted cash flows could bring the value of retail and hotel properties down by between 5% and 15%, depending on the asset. In the logistics and residential sectors, property values seem more resilient; the same is true of offices, where prices are holding steady thanks to the much more modest impact on cash flows. The office sector was the star of the real estate market in 2019, rivalled only by multifamily housing — not only in Spain but throughout Europe. Almost overnight, its prospects were cast into shadow by the immediate success of remote working during the lockdown, proving a viable option for many companies.

We must not overlook the fact that the Spanish and Italian economies are currently in a weaker position to weather a recession than much of northern Europe, and this will only intensify the upward pressure on their long-term bond yields. In turn, this pressure will affect the yields demanded in the real estate sector.

Prime yields hit historic lows in practically every sector in 2019 and are now under pressure from heightened risk aversion among investors and the downgrading of rental growth forecasts put forward at the beginning of the year.

FIGURE 4. INVESTMENT VOLUMES BY SECTOR



Source: CBRE Research

SLIGHT UPLIFT IN PRIME YIELDS

Investors are currently more wary than market data would warrant, and although the picture is not uniform across sectors, locations and properties, by the end of Q2 prime yields were up by an average of about 25 pp across all sectors, with the exception of logistics. Prime logistics platforms dedicated to e-commerce are a notable exception. This niche ended Q2 on lower yields than shopping centres for the first time since records began, and above those of supermarkets, which actually fell. Secondary shopping centres are perceived as the riskiest asset class at present, with COVID-19 hitting this segment hard, right in the midst of profound structural change.

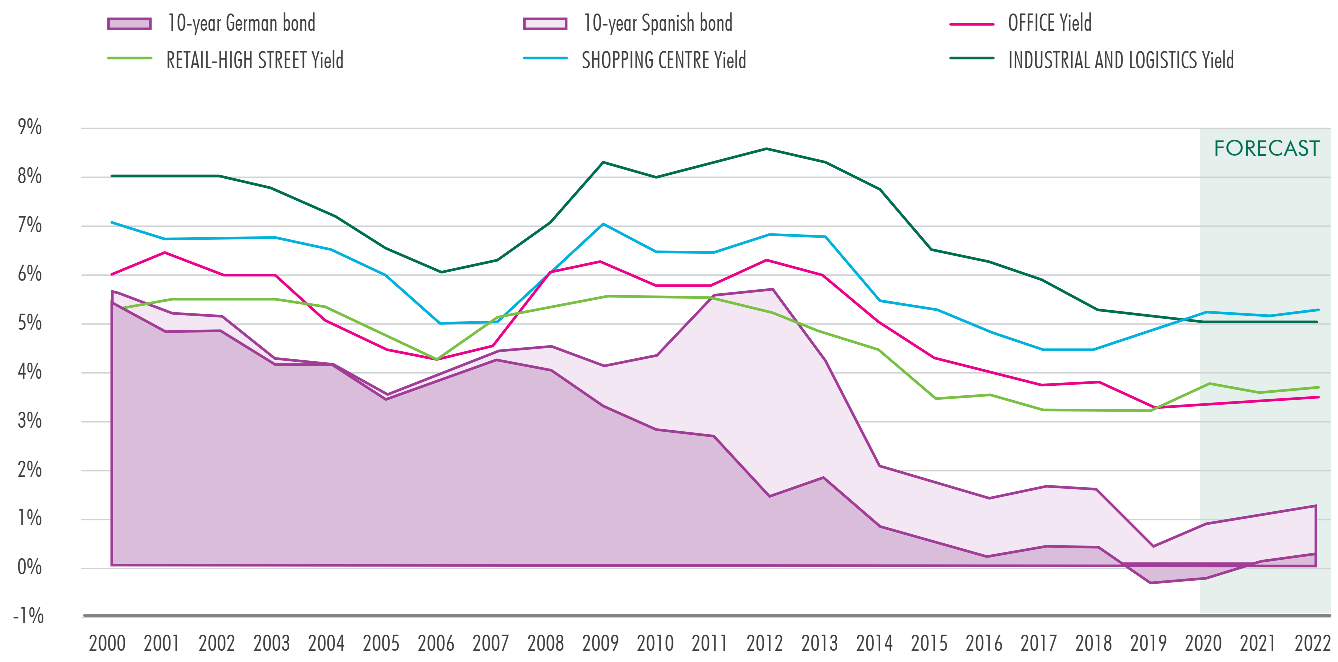
In contrast, we are seeing downward pressures on yields due to a combination of ultra-low interest rates (likely to persist for quite some time) and the vast amount of liquidity that is currently flooding the market. With all these factors considered, our forecasts suggest that prime yields in the retail sector will rise by 0.25 and 0.50 pp in the next few months before starting to tighten once again over the course of 2021, once 2020's seismic shock has been fully absorbed. In the office sector, there could be an extra spurt of around 0.25 pp over the rest of this year, while yields in the logistics sector look set to remain more stable. All of these projections hinge on the assumption that the course of the pandemic will not set back the economic recovery further, which would darken the outlook for the sector (see the Economy section of this report).

NEW CHALLENGES AND OPPORTUNITIES

The COVID-19 crisis has undoubtedly expedited certain trends that were already on our radar: the upsurge in e-commerce, last-mile logistics, remote working, increasing occupier pressure for flexibility in the face of a changing (if not unpredictable) environment, the growing number of households choosing to rent rather than buy... and that's before we account for profound ongoing shifts such as the quest for sustainability.

The pandemic has given rise to demand-side changes as occupiers alter their use patterns, and so investors are trying to get to grips with what the post-COVID-19 world might look like. Only then can they get ahead of demand to identify emerging needs – not only in specific segments (BTR, possibly in conjunction with local authorities, PRS, large-scale and last-mile logistics, and healthcare among others) but in locations that might traditionally have been overlooked.

FIGURE 5. PERFORMANCE & FORECASTS: PRIME YIELD BY SECTOR VS. GERMAN & SPANISH BONDS



Source: CBRE Research

OUTLOOK 2020-2021

- After a virtually catatonic Q2, we expect the investment market to start to pick up as of Q3, expecting y-o-y investment volume to be down 30% by the close of 2020.
- Given the acute economic uncertainty, logistics and operational real estate (rental housing, student housing, health care, etc.) and offices in prime locations will be top of investors' wish lists, whereas the successful social experiment in remote working has cast doubt on the short-term prospects of the office sector.
- There is pronounced market polarisation between prime properties and everything else. Right now, investors are focusing on income security, and so value-add and vacant properties – and those in high-vacancy locations – are furthest from their minds.
- The discounts buyers are demanding vary by segment, ranging from around 15% for value-add opportunities to 30% for opportunistic properties. For prime properties, prices remain stable at pre-pandemic levels and there is no evidence of distressed assets at present.
- We are seeing upward pressure on yields, with some variation across asset types. Worldwide, bond yields are likely to remain at a low ebb for the foreseeable future – which will help keep the spread with the real estate sector in check.

FINANCING

A SQUEEZE ON FINANCING

It is hardly surprising that the COVID-19 pandemic, with all its implications for the outlook in the real estate sector, has also made an impact on the debt market.

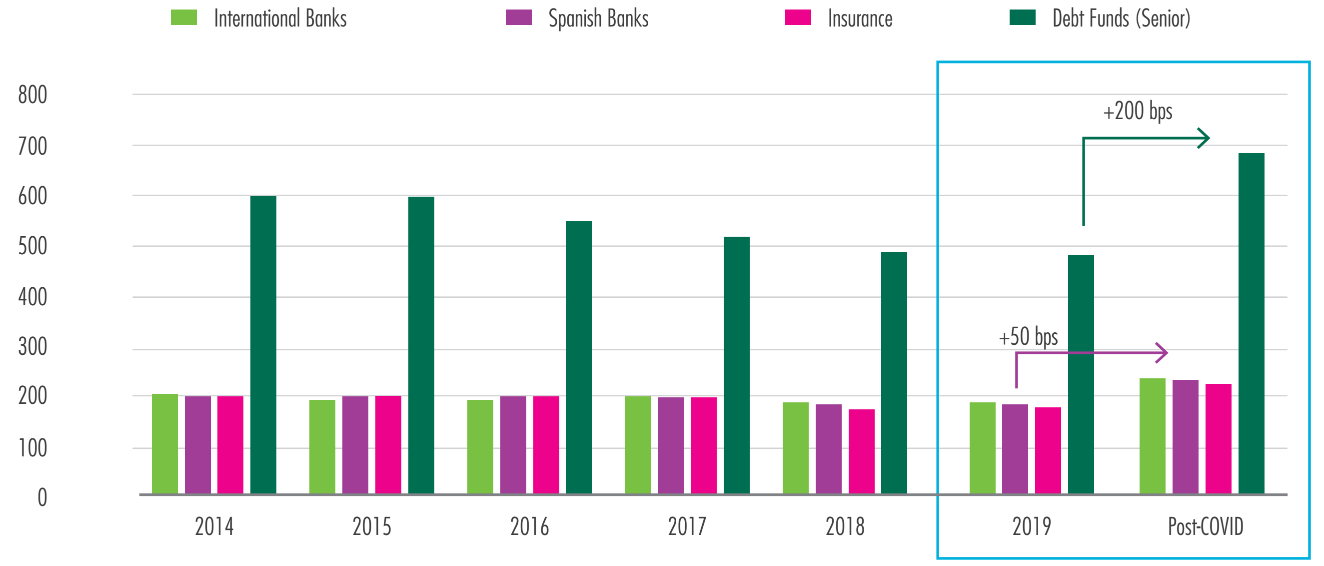
Risk committees are undergoing something of a "meltdown", and the banking sector's capabilities, responsiveness and flexibility have suffered as a result.

Most traditional lenders, i.e. national and international banks, have overcome the initial shock of the pandemic and the state of emergency and are now more focused on managing their existing credit portfolios than financing new projects. As a general rule, banks are primarily concerned with supporting their existing clients and navigating the complex fallout of the sudden loss of income that many sectors suffered in the wake of the public health crisis. These include retail, hotels and, to a lesser extent, offices.

At the same time, their appetite for new creditors has waned and they have tightened their financing terms and conditions in response to pandemic-provoked uncertainty. This sagging enthusiasm is most noticeable when it comes to development projects and to sectors such as hotels, retail and others where COVID-19 uncertainty has cast the longest shadow.

As traditional banks tighten their grip, investors and developers have been left with little choice but to turn to alternative debt financing, albeit at a higher cost.

FIGURE 6. FINANCING MARGIN PERFORMANCE (%)



Source: CASS Business School, CBRE REIB

STEEPER FINANCING COSTS, LESS LEVERAGE

Although financing is now tougher to secure, certain projects are still getting the seal of approval from banks, mainly in sectors where the outlook remains bright despite COVID-19, such as logistics and build to rent.

Nonetheless, lending conditions are markedly less favourable insofar as margins (financing costs) have risen and gearing levels have dropped.

Consequently, we are seeing a general trend towards higher financing costs for new senior loans from traditional lenders – around 50 basic points, creeping up from 1.5–2.5% pre-pandemic to 2.0–3.0% today. Meanwhile, gearing levels have fallen; the typical loan-to-value (LTV) ratio has slumped from around 60% before the crisis hit to 50–55% at present. In the alternative market, too, obtaining financing is becoming more difficult.

This translates into fewer deals being struck, since in many cases the borrower's expectations do not match up with what the market is offering in the current COVID-19 context.

TABLE 1. FINANCING TERMS & CONDITIONS

	Traditional Bank			
	Pre-COVID		Post-COVID	
	LTV	Margins	LTV	Margins
Senior Debt	60%	1.5%-2.5%	50%-55%	2.0%-3.0%
Junior Debt	n.a	n.a	n.a	n.a

	Financing Alternative			
	Pre-COVID		Post-COVID	
	LTV	Margins	LTV	Margins
Senior Debt	65%-70%	3.5%-6.0%	60%-65%	5.5%-8.0%
Junior Debt	80%-85%	6.0%-9.0%	75%-80%	9.0%-12%

Source: CBRE REIB

HEIGHTENED LIQUIDITY IN THE DEBT FUND MARKET

Over the course of the last decade, the number of debt funds has shot up exponentially as institutional investors have shifted towards a more defensive stance, preferring to fund their real estate investments by taking on debt rather than dipping into shareholder equity. While private-debt fundraising volumes shrank in 2019, we believe this was a temporary response to the circumstances at the time. In the context of COVID-19, a more defensive approach to this capital should revive fundraising activity in the coming months and years. In any event, there is a vast amount of liquidity in the market at the moment, with sufficient capital to finance new projects to the tune of over €60,000 million.

The majority of international debt funds regard Spain as a top-tier investment destination, while at the same time, a legion of national fund managers have also started to appear on the market. In many cases, these new funds have adapted their strategies to prevailing market conditions, slipping into existing gaps. Typically, the banking sector has provided financing at around 2–3% and funds at around 10%, whereas these newcomers offer borrowing costs ranging from 5% to 8%.

On the demand side, investor appetite has grown further still since the public health crisis began, and these funds are financing projects which traditional banks are reluctant to commit to at the current time. Another distinguishing feature of this kind of financing is the speed and flexibility with which transactions can be completed. This is a key advantage in the current climate, with traditional banks operating at reduced capacity and struggling to clear a customer-service backlog.

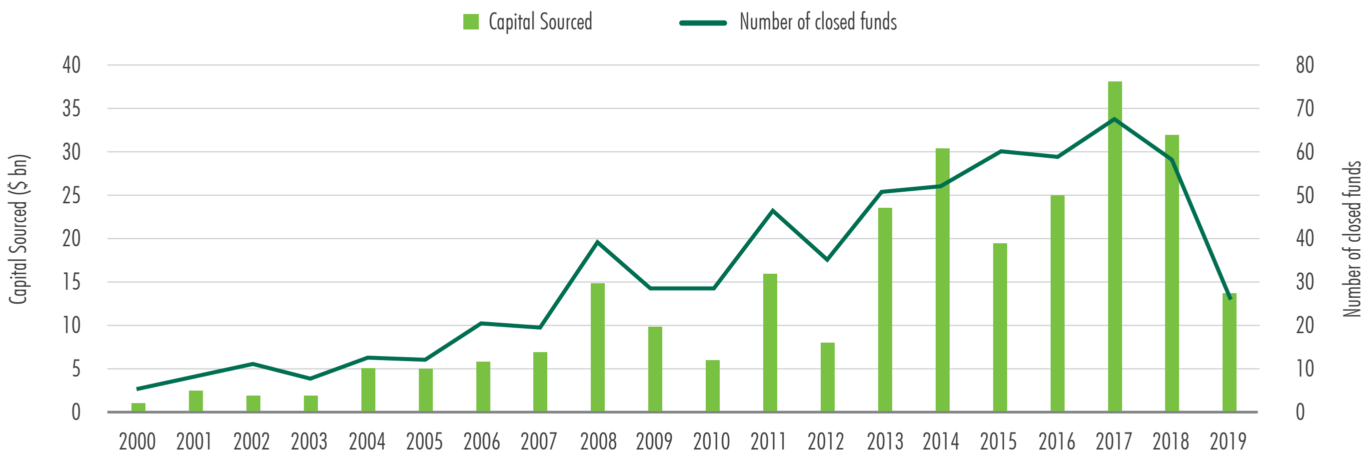
COMPANIES SET TO TURN TO REFINANCING AND RESTRUCTURING EN MASSE

The public health crisis dealt a severe blow to demand, and there is bound to be a knock-on effect for real estate firms and their finances, particularly those more vulnerable to changes in discretionary consumption patterns or whose business models depend on recurring income.

Generally speaking, real estate companies are on more solid financial ground than in the last economic crisis, predominantly solvent with reasonable debt/gearing ratios. Government support, mainly channelled through the ICO, has helped many firms keep short-term liquidity pressures at bay, at least to some degree.

However, the decimation of cash flows during the lockdown, and reduced activity even in the 'new normal', will inevitably drive companies to take on significantly more debt. This will have an impact on their solvency over the next few months. The ICO loans are no more than a temporary measure, and in most cases they need to be accompanied by short-term efforts to refinance balance sheets. Once these support measures are withdrawn and debts start reaching maturity, we expect to see a high volume of refinancing transactions in the sector and – in some cases – restructuring. In the current climate, new financing instruments offered by traditional banks will be limited, and a growing number of companies will consider alternative sources a viable option.

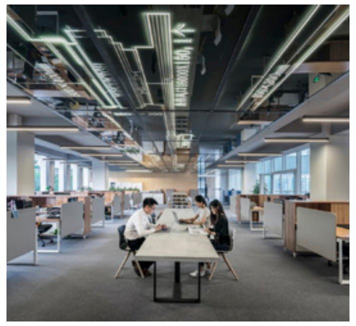
FIGURE 7. NUMBER OF DEBT FUNDS WORLDWIDE AND CAPITAL SOURCED



Source: PERE

SECTORS

20 OFFICES



Compared with 2019, office take-up is likely to be down by around 50% in 2020. While unemployment has soared, forecasts suggest that more jobs will be retained in sectors that rely on office space to do business (financial services, tech companies, law firms, etc.). Prime rents are holding steady in a context where good-quality supply is thin on the ground. It may well be that some of the changes ushered in by the mass shift to remote working are here to stay. In any case, the role of the office is set for a rethink, as social distancing forces lower densities and workplace hygiene is viewed in a new light.

26 LOGISTICS

COVID-19 has depressed activity, but things should start looking up from September onwards, both in the occupier and investment markets. Demand will continue to be driven by e-commerce, which will only gather strength as time goes by. More and more owners will be adding incentive clauses to new lease agreements and offering help with fit-outs. Last-mile platforms will remain topmost in investors' minds and demand will continue to grow.

29 RETAIL

Changing patterns of demand and consumer behaviour, digitalisation and the momentum behind e-commerce are on track to reshape the sector. In the short term, visiting a shopping centre will be more about purpose than pleasure, and we are already seeing a higher average spend per shopper than prior to COVID-19. Retailers will continue to consolidate store locations in a bid to optimise their portfolios. Still conscious of the valuable role played by brick-and-mortar stores, they will nevertheless be seeking to broaden their platforms to boost profitability and build omnichannel capacity.

33 RESIDENTIAL

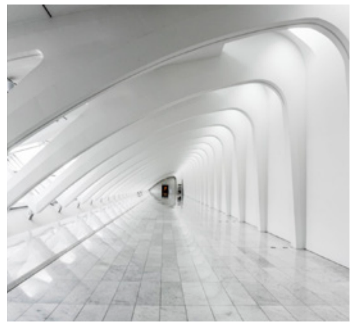
The COVID-19 pandemic erupted at a moment when Spain's residential real estate market was beginning to show signs of slackening. Resales are expected to be harder hit than new-build primary homes, as are second homes in certain locations such as the Costa del Sol and Levante. Multifamily housing is proving rather more resilient than most residential segments. When the crisis hit, residential investment was in rude health, with record volumes in BTR/PRS transactions. The market should continue in this vein, bolstered by mounting demand for rental housing.

36 HOTELS

Forecasts for this sector had to be drastically downgraded in the wake of the pandemic, and COVID-19 will continue to wreak havoc over the next few months. International leisure demand along with business travel will be the hardest hit segments. It is anticipated that the recovery will unfold in three phases: domestic demand first, then short-haul, then long-haul. Value-add investors, and those with a more opportunistic profile in general, will be looking for discounts; nevertheless, we don't expect to see widespread price-cutting this year.

38 OPERATIONAL REAL ESTATE

The alternative sector's fundamentals are looking positive, and this sector will be well positioned to weather the COVID-19 storm in the medium to long term, thanks to a defensive attitude and an inordinate mismatch between supply and demand. The healthcare and student housing sectors, still fragmented and underdeveloped, will continue to consolidate as the crisis abates, and we will see more mergers and acquisitions among operators looking to grow their market share. Despite the reputational, operational and regulatory risks posed by COVID-19, this kind of property will continue to hold a lot of appeal for investors. Portfolio deals will become increasingly more frequent, drawing in both core and core+ investors.



OFFICES

SEVERE BLOW TO OFFICE DEMAND

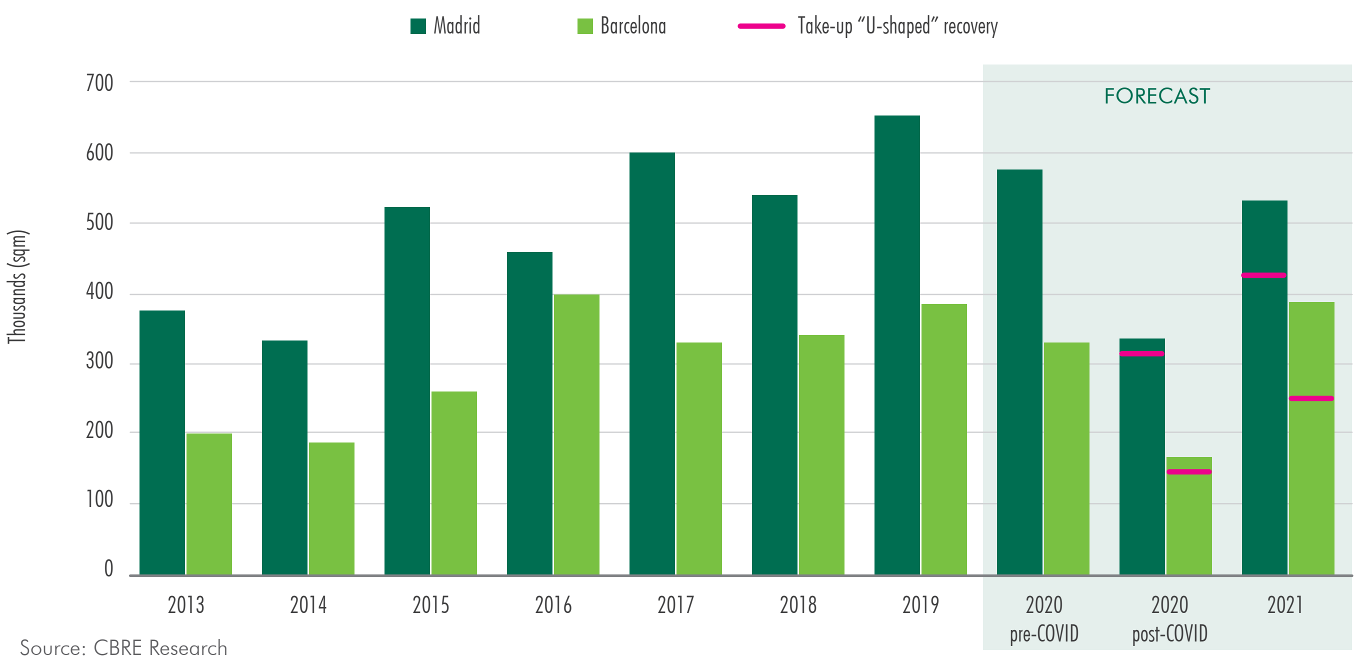
After an exceptional 2019, with the highest take-up recorded for a decade (650,000 sqm), forecasts drawn up in early 2020 predicted a year-on-year slump of around 10–15%, consistent with the onset of a gentle slowdown in the Spanish economy and more modest employment growth. Measures introduced to contain the public health crisis provoked by COVID-19 left the market at a standstill for the greater part of March and almost the entirety of Q2. As a result, take-up for the first six months of the year came in at just 164,000 sqm in Madrid and 81,000 sqm in Barcelona, marking a drop of 36% and 56% respectively compared with the last five-year average for this period.

According to CBRE's internal data, 75% of companies that were on the hunt for new office space prior to the state of emergency being declared still intended to push ahead with their plans at the time of writing this report. Of the remaining 25%, 15% have abandoned their search and 44% have postponed it indefinitely. As far as new demand is concerned, April brought a sharp y-o-y drop of around 70%, however this eased in May (-33% y-o-y), as inspections and site visits gradually started up again. Things continued to pick up over the first half of June. That said, the contraction in new demand observed since mid-March will shape overall take-up figures for 2020.

Given that office take-up is directly linked to economic and employment growth, in our base-case scenario for the post-pandemic recovery (i.e. a V-shaped recession), office take-up for 2020 is predicted to fall by around 50% y-o-y in Madrid and somewhat more in Barcelona, and is expected to be down 32% and 48% respectively compared with average annual figures since 2014.

Under this scenario, the economy will bottom out before the end of 2020, with an impact on employment in sectors that rely on office space to operate. So, after shedding jobs in 2020 (-0.8% in Madrid and -0.1% in Barcelona, according to projections from Oxford Economics), these sectors should experience renewed employment growth in 2021. The office sector would then close out 2021 on take-up of around 420,000 sqm in Madrid and 260,000 sqm in Barcelona. If this scenario bears out, then we would not expect take-up to return to something resembling normal levels until at least 2022, when the economy as a whole should start to look a lot brighter (figure 9).

FIGURE 8. OFFICE TAKE-UP 2013-2019 AND 2020-2021 FORECAST ("V-SHAPED" AND "U-SHAPED" RECOVERIES)



Source: CBRE Research

TECH COMPANIES AND FLEX-SPACE OPERATORS WILL EMERGE ALL THE STRONGER

The technology sector is shaping up to one of the main drivers of demand over the coming months, as the pandemic has created a massive opportunity to extend its reach. Companies are pouring their resources into technology in an attempt to remedy the short-term difficulties imposed by the crisis, but they are also keen to quicken the pace of their transition towards 'super-digitalisation'.

Meanwhile, flexible workspaces are increasingly seen as a perfect option for companies grappling with uncertainty. With their quick and agile adaptability, they allow companies to create a space that meets their needs without spending a fortune in fit-out and furnishings, with the added hook of total contractual flexibility. For these reasons, we expect to see growing occupier demand for more flexible solutions, and once the initial impacts have been absorbed, the flex-space sector should emerge as one of the most dynamic in the market.

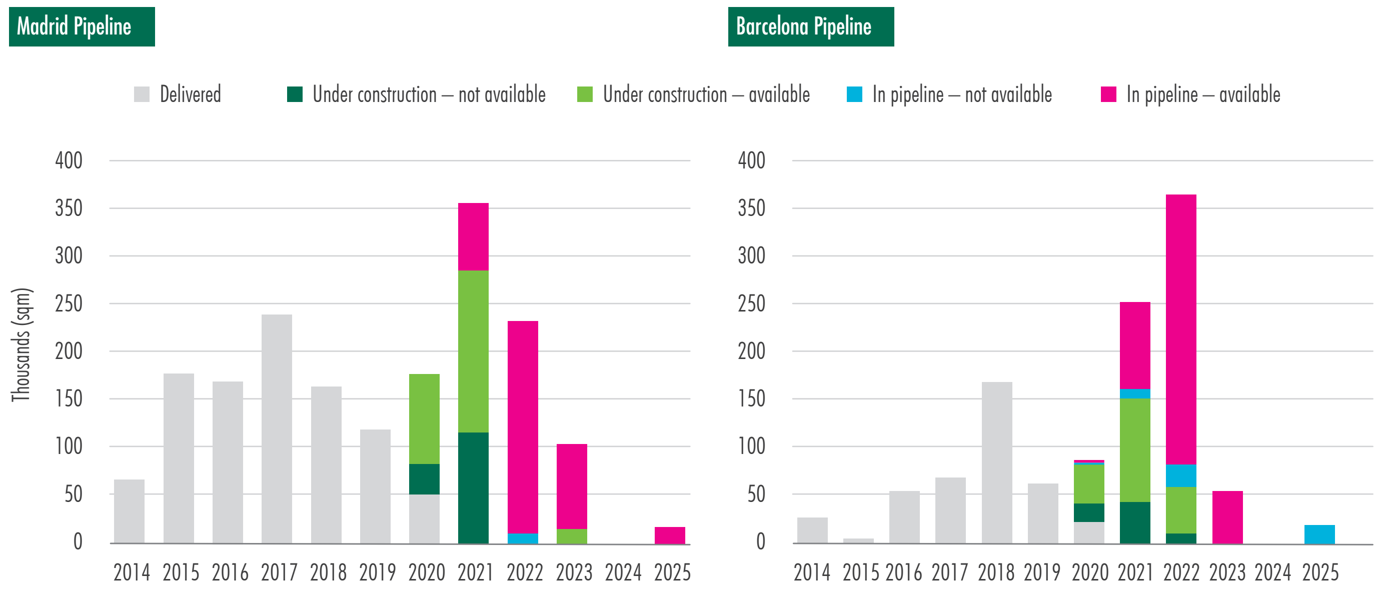
In contrast, the industrial and energy sectors will be among the hardest hit, along with consumer goods and leisure. This includes, for example, the automotive, textile and tourism industries.

FEWER NEW-BUILDS HITTING THE MARKET

The majority of ongoing developments have pushed back their completion dates. This means that the flow of new supply expected for 2020, already somewhat limited even before the pandemic, will be reduced to a trickle. In Madrid, just 106,000 sqm of new-build space will hit the market in 2020, 73,000 sqm of it currently available – a big step down from the 298,000 sqm expected before COVID-19 arrived on the scene. The most active submarket at the moment is the CBD, accounting for 30% of space under construction, followed by the A-2 hub with 25%. In Barcelona, just 60,000 sqm is scheduled for completion by the end of 2020, compared with the 75,000 sqm initially predicted. Here, the bulk of new construction activity currently underway will count towards the 2021 total. More than half of projects due for delivery between now and 2023 are being developed in 22@ – the most dynamic area in the Barcelona market at present.

Despite months of lockdown, it is interesting to note that various new speculative projects have recently broken ground in both cities: Ombú 4–16 and Miguel Ángel 23 in Madrid and La Escocesa and Mile in Barcelona.

FIGURE 9. FUTURE SUPPLY MADRID AND BARCELONA OFFICE MARKETS



Source: CBRE Research

PRIME RENTS CONTINUE TO HOLD FIRM

COVID-19 put the upward trend being seen in rental growth temporarily on hold. Still, the supply-side situation looks very different today compared with 2008. There is a severe shortage of high-quality space (with vacancy rates of 2.0% in Madrid and 0.4% in Barcelona), and this in theory should stave off declines in prime rents at least in the short term. How quickly and vigorously the economy recovers will be decisive in the medium-term; in our base-case scenario (a V-shaped recovery), rental growth will be dampened to an annual average of around 3.1% in Madrid and 2.3% in Barcelona over the next four years.

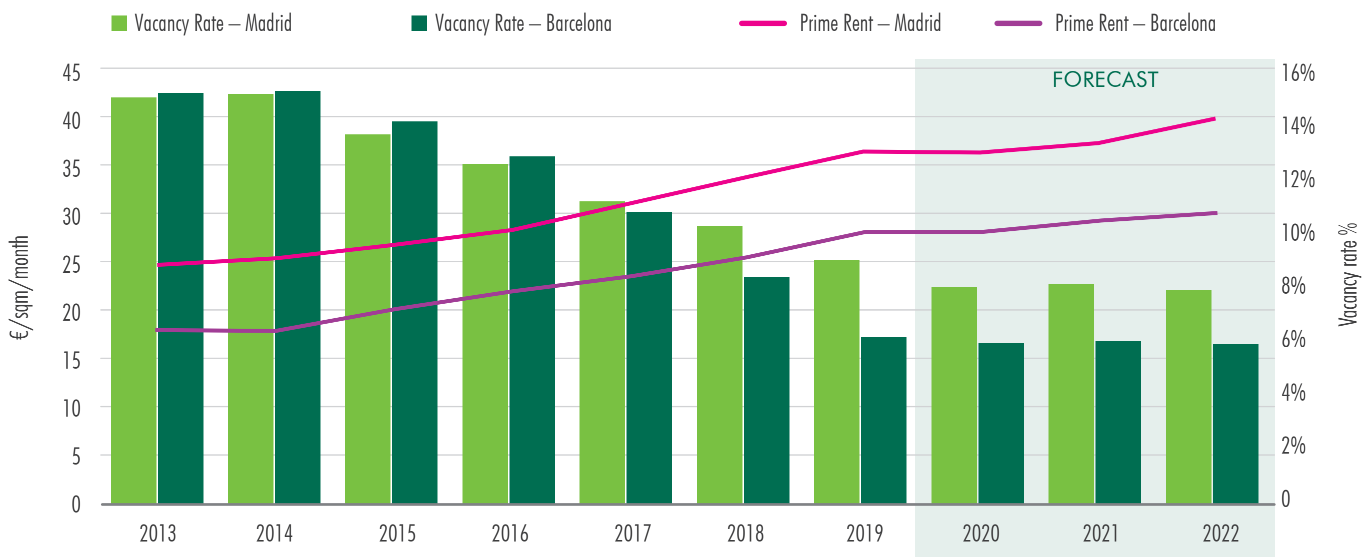
In our opinion, if the market continues to underperform past Q3, the first signs of any rental decreases – whether in terms of incentives or headline rents – are likely to appear in oversupplied areas. At the same time, the most outdated stock will be left on the shelf as occupiers become increasingly demanding, seeking out properties with the technical and technological specifications to help them create a safe and comfortable working environment that protects the health of their teams. That said, with uncertainty running high, we cannot rule out the possibility of further rental adjustments across more or less the entire market. In this context, if we disregard the risk of oversupply due to new development, the flow of second-hand office properties coming onto the market is an indicator worth keeping a very close eye on.

TOO SOON TO ASSESS THE IMPACT OF REMOTE WORKING ON DEMAND

The key factor here is the speed and vigour of the economic recovery, and what that means for employment – especially in sectors where there is a consistent demand for office space. Moreover, as companies hone in on cutting costs, conscious of the success of the remote working experience, many will be tempted to downsize their space – and fast. Nevertheless, firms should be cautious of making hasty decisions that may seem like the obvious choice now, but could do serious long-term damage to their business.

For now, the threat to public health from COVID-19 remains very real, and companies are pondering how they can keep the wheels turning while protecting the health of their employees. In doing so, they are reassessing both their staffing allocations and their need for office space; however, for the time being restrictions on numbers and compulsory social distancing will deter them from shedding excess space to some degree. In the longer term, companies will reach a point where they are in a position to revise their occupancy strategies, and flexibility will undoubtedly weigh heavily in their decisions.

FIGURE 10. RENTS VS. VACANCY RATE 2010-2019 AND FORECASTS



Source: CBRE Research

SECTORS: OFFICES

THE FUTURE OF THE OFFICE SECTOR

There is no question that technology has played a pivotal role in the mass shift towards remote working, to the extent that some observers believe it could spell the end of the traditional office. In our opinion, that's an overly simplistic view that disregards our essentially social human nature. Personal interaction fosters learning, creativity, development and collaboration and helps forge a company culture in which everyone feels invested. All of these elements are vital to a company's success.

A few years from now when the COVID-19 situation has progressed, workplaces will be more fluid. People will be able to work from anywhere, without missing out on any of the traditional conveniences of a central office. The result will be a far more mobile workforce, with benefits for companies and for employees themselves.

To ensure that workplaces adapt to employee lifestyles and not vice-versa, companies will need to pursue a hub-and-spoke strategy: holding on to their central offices in major CBDs, which will become a sort of corporate command centre, while operating out of satellite offices in residential areas offering a short commute for employees.

The central office will play a vital role in promoting face-to-face interaction, with spaces that inspire people's creativity and make them feel valued and productive during the time they spend on-site. This means expending more effort in making employees feel welcome, nurturing a sense of belonging and offering a genuine opportunity to engage with company culture.

As for their satellite offices, companies will be looking very favourably on flex-space solutions and seeking out locations with easy access to fitness facilities, shopping centres, and urban hubs close to their client base. In this new working world, flex-space operators may find they have a winning formula. These new spaces will also appeal to workers, by helping them feel part of a larger community.

AN INVESTMENT MARKET IN THE DOLDRUMS

In 2019 and early 2020 (before COVID-19 came along), the office sector stood head and shoulders above the rest in terms of the potential for rental uplift. One third of the total investment volume for 2019 (€3,700 million) and the first quarter of 2020 (a spectacular €900 million) was driven by office transactions.

For the first two or three weeks of lockdown, many investors were proactively seeking out opportunities, without any mention of potential discounts. Very soon, however, their attitude became more cautious. Concerns about the impact of the pandemic on income and cash flow, difficulties with underwriting and other problems have brought about a situation where many funds are no longer receptive to opportunities without any discounts on pre-pandemic prices.

However, once again, the picture varies significantly between the core, value-add and new-build speculative development segments – the latter looked especially promising at the start of the year, naturally generating the highest returns in a context where a seemingly bright outlook kept risk levels low. Today, these kinds of investors are opting for existing properties with scope for repositioning. At the other extreme, prime properties are still whipping up a lot of interest and yields remain low: around 3.25% for Grade-A space let at current market rents.

The number of transactions – the best way to gauge prices – plummeted in Q2. During this period there were only eight transactions (for a total value of €166 million) anywhere in Spain. All of these transactions were already under negotiation prior to the COVID-19 crisis, and its effect on end price was negligible. It is clear that investors have grown more risk-averse, and this will have repercussions for both investment volume and prices for properties that are vacant and/or outside the prime market. On another note, we may see a resurgence of sale-and-leaseback transactions among companies seeking to unlock the value of their head offices and generate liquidity.

SECTORS: OFFICES

OUTLOOK 2020-2021

- Take-up in the office sector will fall by around 50% in 2020 compared to 2019. Occupiers ’ minds will be focused on controlling costs control and keeping their businesses going. After a stay-or-go analysis, many organisations will choose to avoid making decisions in the short term.
- In our base-case scenario, which assumes an asymmetric V-shaped recovery, 2021 will bring a substantial upswing.
- It is still too soon to assess the impact of remote working on the office market. Our view is that, in the short term, supply may hold steady given the need for social distancing in the workplace and the time required to conduct the studies required to make space-related decisions.
- Prime yields should remain stable as rental prices hold up in the most desirable CBD properties, primarily due to the lack of quality supply. Assuming a V-shaped recovery, prime rents will continue to climb in 2021, although growth will be more moderate compared with the past four years.
- The office sector continues to be a major draw for investors, but uncertainty over demand and rents have convinced them to adopt a more cautious approach. As sales processes gradually get under way again and deals are struck, the existing gap between buyers and sellers should start to narrow.

LOGISTICS

SOARING DEMAND ON THE BACK OF THE E-COMMERCE BOOM

Forecasts from the early part of 2020 augured brisk activity in the occupier market, much like we saw in 2019. This prediction was borne out in the first few months of the year in the Central Area, Valencia and Seville and, to a more modest degree, in Catalonia. However, COVID-19 then hit and completely changed the landscape. While many transactions that were already at an advanced stage before the pandemic have followed their expected course, others have been put on hold until after the summer, as market actors wait cautiously to see how the situation develops.

Lockdown gave a hefty boost to online retail, to the point that a lot of companies involved in the e-commerce, food, pharmaceutical/healthcare, technology and sporting goods sectors found themselves hard pushed to keep up with an unprecedented deluge of orders. Many opted to lease additional space on a temporary basis while they got the situation in hand. Ultimately, those sectors will come out of the pandemic all the stronger, whereas others, such as automotive or textiles, will need to wait until 2021 before demand returns to pre-COVID-19 levels and normality is restored.

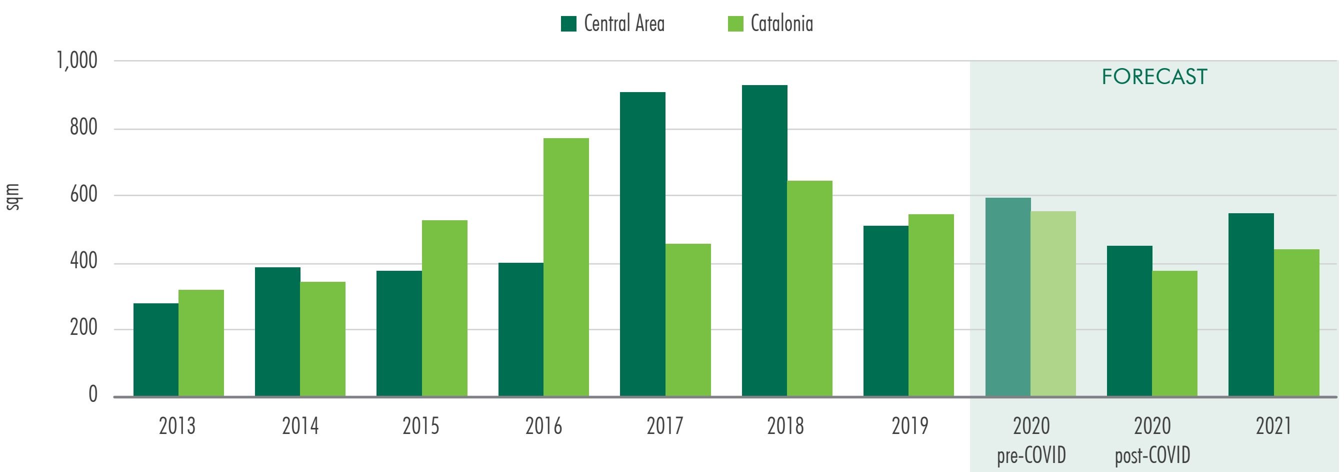
The good news is that a slight upturn in new demand was detectable at the close of Q2 2020, as some investors started to emerge from their wait-and-see positions. For the remainder of this year, the most active regions will still be the Central Area and Catalonia, with projected take-up of around 450,000 sqm and 380,000 sqm respectively. Take-up should return to pre-pandemic levels in 2021, reaching around 550,000 sqm in the Central Area and 450,000 sqm in Catalonia. In other logistics centres, continued strong demand will again be buoyed up by the lack of high-quality supply, with the exception of Valencia, where take-up may be just as robust as in previous years.

The key point to take away is that logistics has been one of the least damaged real estate sectors, and it will be one of the first to return to normal levels of activity.

DESPITE COVID-19, NEW DEVELOPMENT AND REFURBISHMENT PROJECTS ARE UP

On the supply side, while most development projects have lost a few weeks due to the havoc caused by COVID-19, the amount of space currently under construction remains substantial, both in the Central Area (with 620,000 sqm expected between 2020 and 2021) and in Catalonia (340,000 sqm). These figures should pose no major difficulties, given that the historic average for these markets is in the region of 500,000 sqm.

FIGURE 11. TAKE-UP AND FORECAST



Source: CBRE Research

However, in certain parts of Catalonia (Tier 1) and the Basque Country, land shortages are putting a damper on activity. This has led to a renewed focus on the refurbishment of outdated warehouses, which in many cases have emerged as state-of-the-art, automated platforms with sustainability certification to boot – even though the investment required for such a project is substantial. Disused factories could also have scope for conversion into automated warehouses. We can be certain that the COVID-19 pandemic will only fuel this trend further, right across the Spanish logistics market.

REBOUND IN INVESTOR ACTIVITY IN THE FINAL QUARTER OF THE YEAR.

The year started strong, with an investment volume of €390 million recorded in Q1, and there was every reason to predict an outstanding 12 months for the logistics sector. As we indicated at the time, the predicted total was around €1,600 million, in the same league as 2019. Yet, like every other sector, logistics has suffered a dip in investment due to COVID-19, with fewer transactions posted in Q2 2020. At this stage, it looks unlikely that the year's total investment volume will exceed €1,000 million.

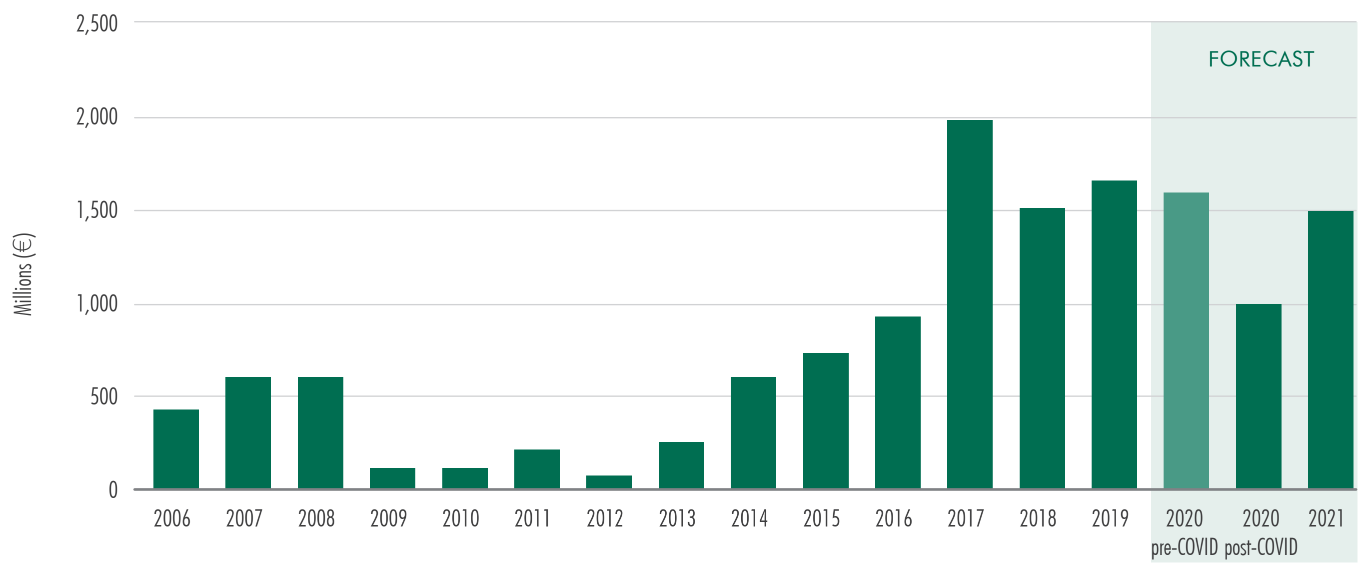
A number of transactions have been put on hold until after the summer, while others, including some very interesting portfolio deals, are progressing as normal.

Despite the extraordinary situation brought about by Covid-19, the logistics sector is in a great position to capture capital investment from major players, as the general view is that it will be the first to recover from the crisis and return to normal activity levels. It is likely that the sector will start to rally in Q4 2020, posting a healthy investment volume of around €1,500 million even in 2021.

Over the coming months, we'll see demand from core investors who do not require financing and are looking for opportunities offering long-term income security, such as sale-and-leasebacks and build-to-suit projects. Moreover, deals may be struck for platforms occupied by e-commerce and food companies, which have a chance to turn the current situation to their advantage.

Back at the start of 2020, we remarked on growing investor interest in new projects for cold-storage logistics space, and again the pandemic will likely accentuate this trend. Online sales of essential consumer goods will foreseeably rise after the crisis has abated. This shift in consumer behaviour will bring about a whole new landscape, with new projects coming forward not only under the build-to-suit model but also as speculative development – something that has been virtually unheard of until now. Investors will be watching this trend closely.

FIGURE 12. LOGISTICS INVESTMENT VOLUME IN SPAIN AND FORECASTS



Source: CBRE Research

MORE RECOURSE TO INCENTIVES IN NEW LEASE AGREEMENTS

In certain markets, including Malaga, Valencia, Bilbao and Seville, the logistics stock has been burdened with outdated properties, to the extent that prime rents have barely moved over the last few years. These areas are in very high demand, and as new platforms come on the market – XXL and last-mile alike – we would expect rents to start creeping upwards.

Meanwhile, stability still reigns in the Central Area and Catalonia, something that is unlikely to change in the next few months. Nevertheless, owners will be upping their game when it comes to incentive clauses in new lease agreements, and more will offer help with fit-out costs. As we move through 2021, the prime rent in Catalonia could climb by around 2–3%, whereas there will be little change in the Central Area.

COVID-19 GIVES NEW IMPETUS TO SUPPLY CHAIN TRANSFORMATION

Once the pandemic has subsided, online retail can be expected to go from strength to strength, becoming increasingly mainstreamed into Spanish society. This presents us with a whole new state of play, with more sales than ever going online. Companies will need to prepare themselves for this new world by reviewing and reconfiguring their supply chains.

All of this will have a string of repercussions for the logistics sector, spurring on trends that were already beginning to take hold. In the immediate term, companies will be looking to expedite their plans to integrate new technologies into their platforms to help them manage spikes in demand. We can also expect to see mounting demand for last-mile warehouses for fast-moving goods, cross-docking sites close to major cities and platforms with mezzanine levels or on multiple storeys.

After being faced with rapidly depleted inventories during the COVID-19 pandemic, operators are conscious of the need to hold more stock closer to the end customer. This has pushed up demand for storage warehouses, especially for essential products, in a bid to improve customer service.

Lastly, although it may not be fully apparent yet, Spain could be a beneficiary of a move to relocate factories from China. We are certainly beginning to see an emerging preference for basing production in Spain, but given that labour costs are higher than in Asia, if this becomes a widespread trend it will be accompanied by greater system automation to keep costs down.

OUTLOOK 2020-2021

- On the demand side, a wait-and-see mindset still dominates, but the signs of a post-COVID-19 recovery are starting to appear. Online retail will be an even more forceful activity driver than before.
- Rents, for the most part, will remain stable. We could potentially see increased incentives and more help with fit-out costs across all logistics markets in the coming months.
- There is a lot of new supply under construction and a renewed interest in converting older properties and disused factories into automated logistics platforms.
- Investment should pick up in the final quarter of the year. Investors will show a growing interest in opportunities that provide secure long-term revenue, such as sale-and-leasebacks and build-to-suit projects.
- The transformation already under way in the logistics sector will intensify. E-commerce operators in particular will be looking to expand their network of last-mile warehouses, while automation, technology and sustainability will be key drivers of change in the sector.

RETAIL

GRADUALLY IMPROVING SALES

In early 2020, before the COVID-19 outbreak and after a very encouraging 2019 – with retail sales in shopping centres under CBRE's management up 1.6% – key indicators were all headed in the right direction, even exceeding initial expectations.

Spain's stringent lockdown measures forced all stores and shopping centres to close, unless they were providing an essential service (i.e. pharmacies, tobacconists, hypermarkets and supermarkets), between March and May. As a result, all shopping centres in CBRE's portfolio barring supermarkets reported a cumulative decline in sales of 25% (January–May) compared to the same period of 2019.

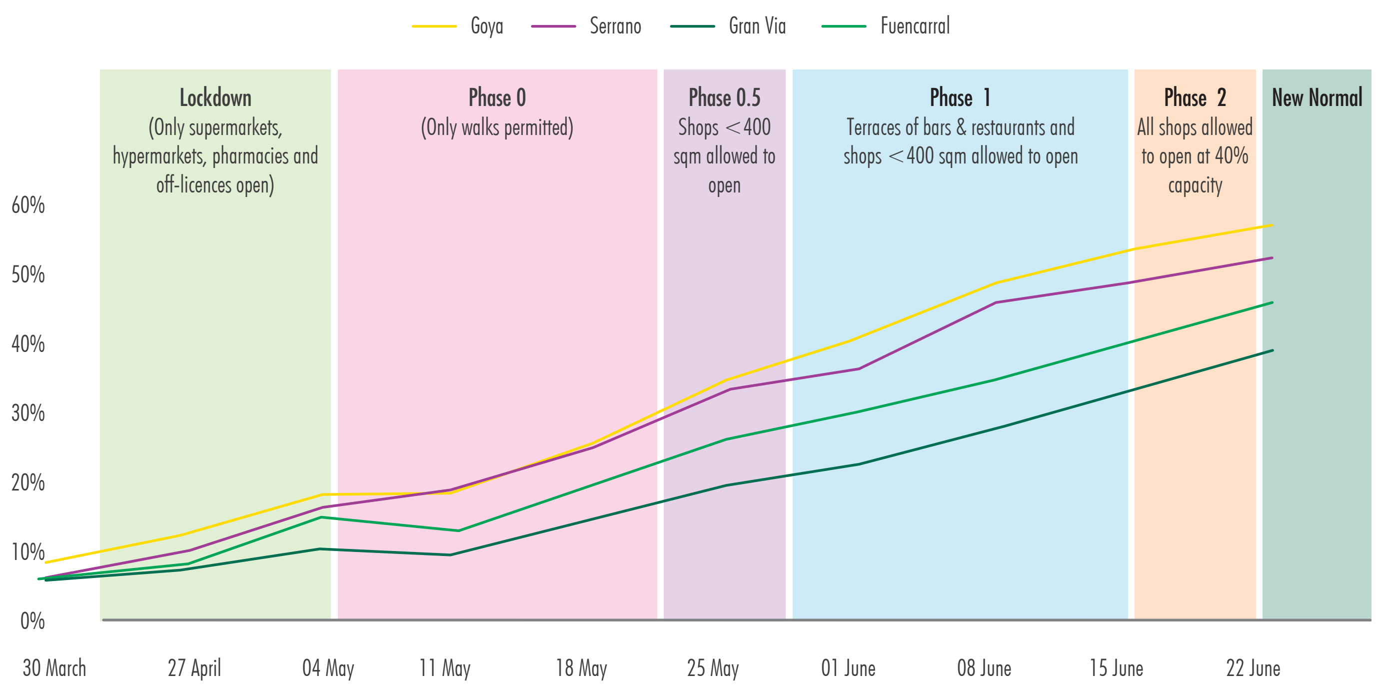
As stores have gradually reopened, shopping centres are noticing certain changes in consumer behaviour. While visitors would usually shop as a family, now it is more common for a single household member to come alone. This 'new' consumer has a more purposeful mindset and tends to plan his or her visit in advance. This has reduced the average length of stay but increased per-capita spending.

It seems probable that the safety measures being introduced in an effort to 'COVID-proof' shopping centres will soon be common practice right across Spain. This will help consumers regain confidence and push up growth to the sort of levels recorded at the start of the year.

FOOTFALL IS LOOKING UP FOR THE FIRST TIME SINCE LOCKDOWN BEGAN

Footfall took a nose-dive during the lockdown, both on the high street and in shopping centres. Thanks to CBRE's access to Big Data tools, we have been able to monitor the easing of the lockdown in various prime retail hubs in Madrid and Barcelona. One finding from this exercise is that the streets that attract the most local shoppers are recovering more quickly. On the other hand, since shopping centres reopened on 11 June (Phase 2), shoppers have returned in droves, taking footfall back to early-2020 levels. There was a real surge in the third week of June, as footfall soared by 70% in shopping centres and 40% on the high street.

FIGURE 13. PRIME HIGH STREET FOOTFALL INDEX (30 MARCH – 15 JUNE)



Source: Calibrate

TERM CERTAINS LENGTHEN AS LEASE CONDITIONS ARE RENEGOTIATED

The three-month compulsory closure has forced landlords and tenants to renegotiate terms. It is worth pointing out that different property types (e.g. prime, secondary, retail parks, leisure hubs, big box and food stores) have been affected to varying degrees; location is also a contributing factor. Retailers in secondary locations or those more reliant on tourists have borne the brunt of lost sales, whereas units in more prime locations or in areas benefitting from a substantial local market have fared better.

Most tenants spent the state of emergency negotiating rent-free periods in exchange for agreeing to longer lease terms or delaying break options; these should help keep occupancy rates high and properties solvent in the long term.

Consequently, the average occupancy rate across all shopping centres under CBRE's management remained virtually unchanged up to May: 95.3% for 2020 compared with 95.6% at the close of 2019. To a large extent, this is to the credit of major landlords, who offered support in the form of discounts or rent reductions to help offset the loss of sales during the lockdown.

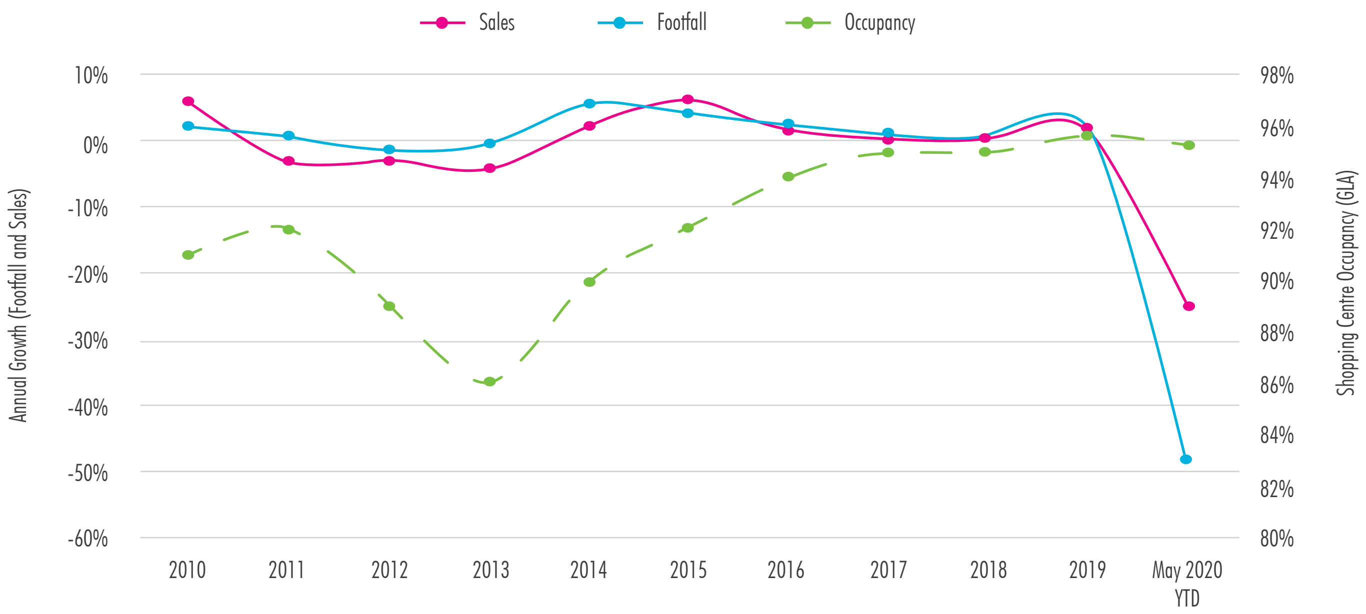
Prime high street zones, on the other hand, have suffered more acutely. The average vacancy rate has grown from 5.1% to 5.5% in Madrid and from 5.6% to 6.3% in Barcelona. This is mainly down to landlords and tenants being unable to come to an agreement during renegotiations, and to retailers bringing forward closures of non-strategic stores.

DIGITALISATION AND OMNICHANNEL RETAILING

As they look forward to the next few years, retailers are basing their strategies around optimising their store networks and renegotiating rents, with a view to ensuring long-term sustainability. Accordingly, many have expedited plans to close stores in non-strategic locations, holding on to more profitable units in key locations. These will help promote and complement their online channels through a smoother integration between modalities. Ultimately, this should make for a better customer experience.

With restaurants in full shutdown mode, the F&B sector has massively ramped up its transition to an omnichannel model, integrating delivery and take-away options in order to open up a new income stream.

FIGURE 14. MAIN KPIS FOR SHOPPING CENTRES MANAGED BY CBRE. 2010 – 2020 (MAY)



Source: CBRE Portfolio

INVESTMENT VOLUMES RISE THANKS TO TRANSACTIONS INSTIGATED PRE-COVID-19

Over the first half of 2020, there was a noticeable upswing in investment volume compared to the previous year, with over €1,600 million invested.

This was undoubtedly buoyed by the fact that certain properties were offered at discounted prices and thus narrowing the gap between buyer and seller. Prime properties are up against a high bar in terms of location, lease length, covenant and, crucially, layout. Accordingly, investors will be willing to make an offer for properties with yields commensurate with the current prime yield, i.e. in the region of 3.5%.

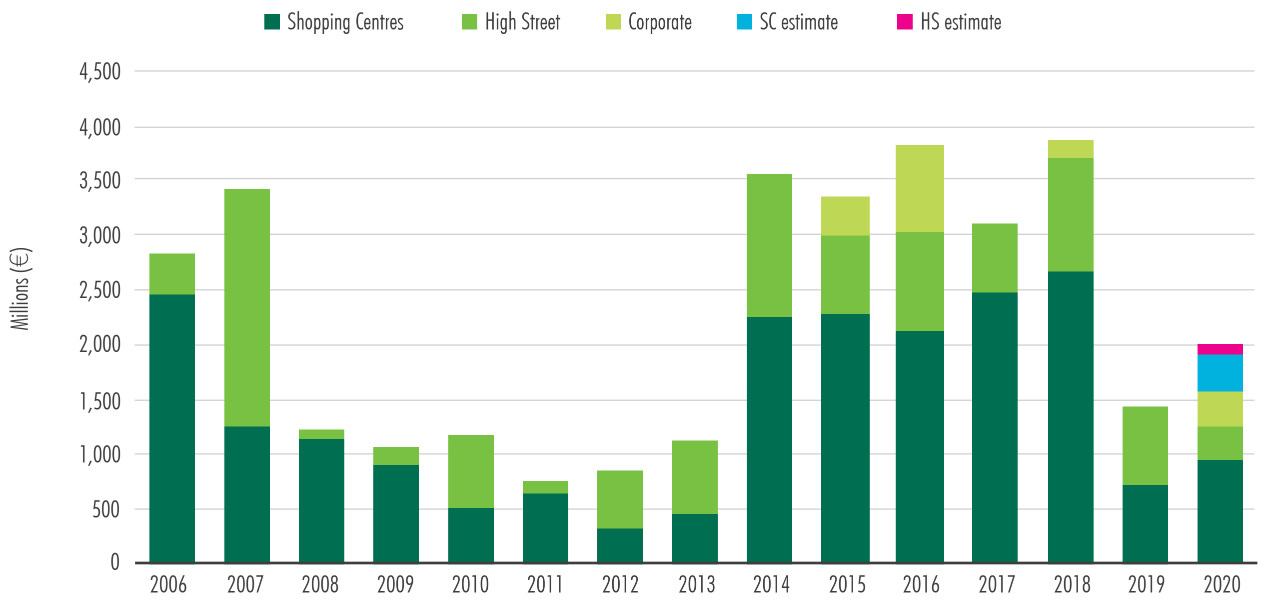
In Q2, a number of deals were struck with minimal discounts on pre-pandemic prices for properties meeting all the right criteria, although these were set in motion prior to the state of emergency being declared in mid-March.

THE FOOD SECTOR: A WHOLE NEW PROPOSITION AFTER COVID-19

There are a few transactions under way that are expected to complete by the second half of the year. Prime high-street properties are still regarded as a safe haven, thanks to their strategic value to operators. For this reason, there should be plenty of liquidity in the core market for the foreseeable future.

In light of the uncertainty generated by COVID-19, the investor community is predominantly focused on sale-and-leaseback deals, more specifically in the food sector. Supermarkets and hypermarkets have proved their indispensability to the retail sector and are emerging as another safe harbour for defensive investors, as they promise a guaranteed income stream in times when other retail segments are mired in doubt.

FIGURE 15. INVESTMENT VOLUME 2006 – 2020



Source: CBRE

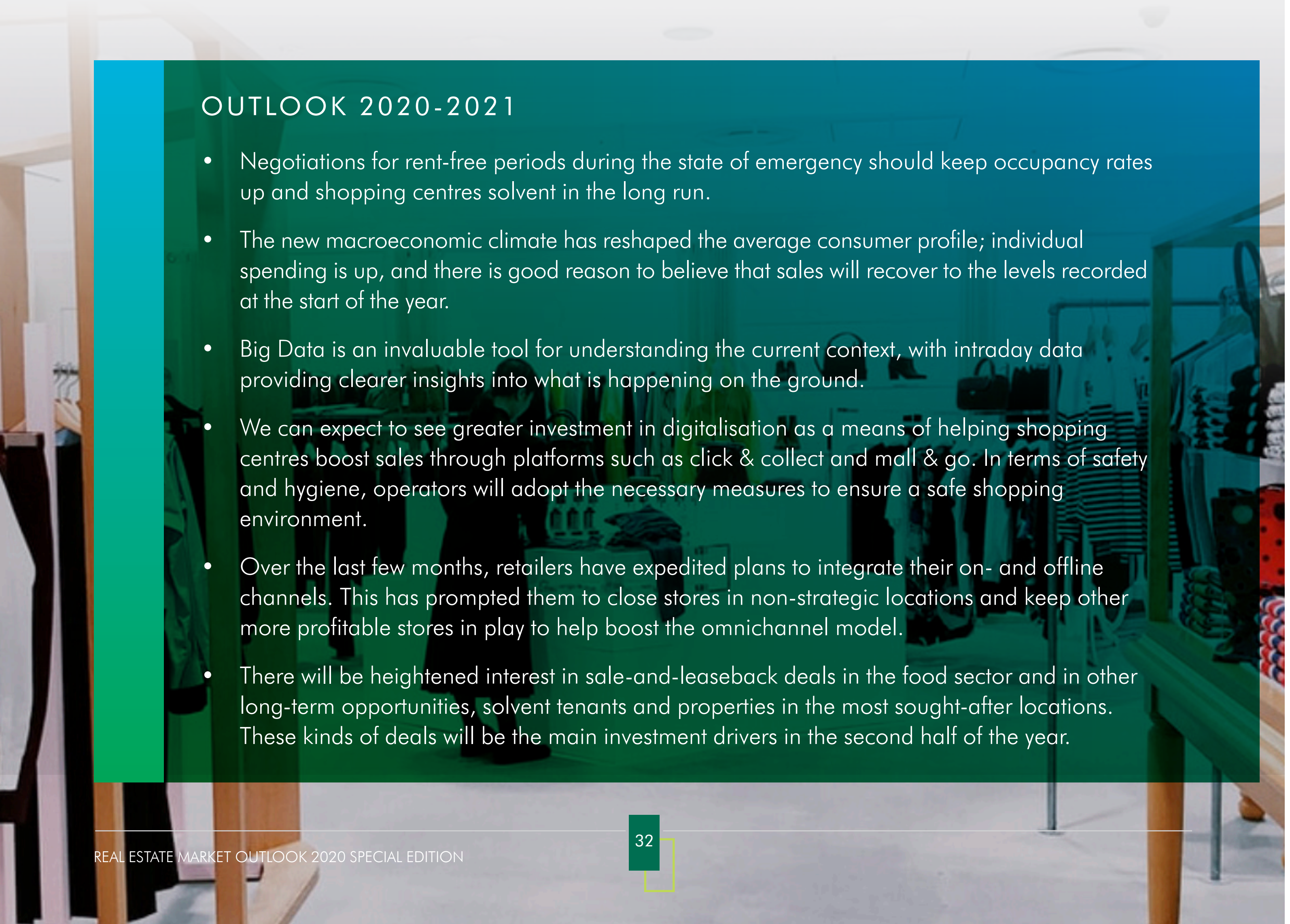
ADAPTING TO THE 'NEW NORMAL'

The last few months have served to accelerate a paradigm shift as consumers' priorities and interests changed rapidly – a process that might otherwise have taken several years. Technology is proving even more central than previously thought, helping shopping centres connect with visitors and offer them experiences tailored to the new reality, with the emphasis on what they do best: fun and exclusive entertainment.

Shopping centres are hastily plotting out new strategies to help customers plan their visits, for example through QR access codes and offering shoppers the option to pick up their purchases from a click & collect point in the car park, designated points inside the shopping centre or in-store. Online retail has been given an extra boost with the introduction of mall & go, a new concept that makes it easy for customers to order from any store in the shopping centre offering home delivery. For those who do venture a visit, many centres are controlling numbers by means of smart counting systems, signage at entrances, exits and in walkways to control the direction of travel, etc. All of these measures should make shopping that bit easier in these complex times.

Retailers, meanwhile, are introducing measures to ensure social distancing, good hygiene and courtesy to fellow shoppers. Out in the communal areas, shopping centres have temporarily blocked off chill-out zones, shared equipment (such as pushchairs), children's activities and touch-screen panels.

In short, the 'new normal' will be characterised by more rapid digitalisation and roll-out of the omnichannel model, as operators seek to give shoppers a safe and enjoyable visit. Both shopping centres and retailers have been prodded into creating much more personalised and efficient visitor experiences that would otherwise have taken years to develop – and probably met with more resistance (e.g. click & collect at shopping centres run by Carrefour Properties).



OUTLOOK 2020-2021

- Negotiations for rent-free periods during the state of emergency should keep occupancy rates up and shopping centres solvent in the long run.
- The new macroeconomic climate has reshaped the average consumer profile; individual spending is up, and there is good reason to believe that sales will recover to the levels recorded at the start of the year.
- Big Data is an invaluable tool for understanding the current context, with intraday data providing clearer insights into what is happening on the ground.
- We can expect to see greater investment in digitalisation as a means of helping shopping centres boost sales through platforms such as click & collect and mall & go. In terms of safety and hygiene, operators will adopt the necessary measures to ensure a safe shopping environment.
- Over the last few months, retailers have expedited plans to integrate their on- and offline channels. This has prompted them to close stores in non-strategic locations and keep other more profitable stores in play to help boost the omnichannel model.
- There will be heightened interest in sale-and-leaseback deals in the food sector and in other long-term opportunities, solvent tenants and properties in the most sought-after locations. These kinds of deals will be the main investment drivers in the second half of the year.

RESIDENTIAL

PRICES TO SLIDE THROUGHOUT SPAIN IN 2020 IN THE WAKE OF COVID-19

Residential demand was beginning to slacken before the pandemic hit, with housing sales down 2.5% y-o-y in 2019 and 568,000 units sold. This slowdown is the sign of a market that has reached maturity. The first quarter of 2020 brought a slump of 16%, with 116,000 units sold. However, the Q1 figures do not reflect the full impact of the COVID-19 pandemic, which began in earnest in mid-March, since it was only a factor in the last fortnight or so of this period. CBRE estimates that overall housing sales could fall by 20–25% y-o-y in 2020, with total sales dropping to 425-450,000 (compared to a pre-pandemic estimate of 600,000).

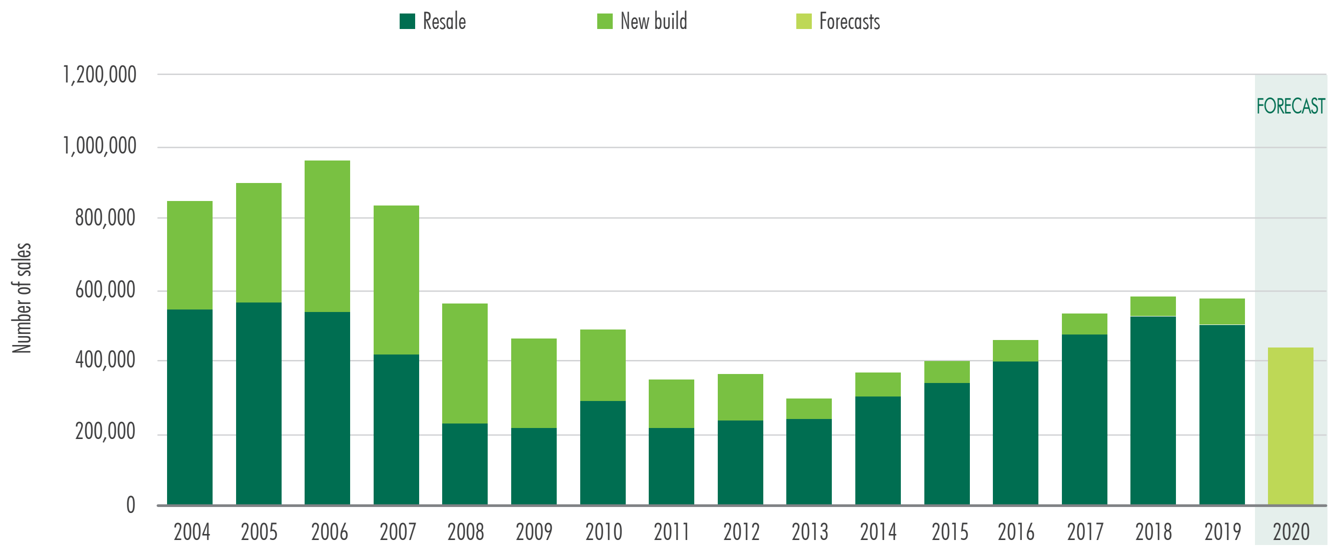
Resales are expected to be harder hit than new-build primary homes, as are second homes in certain locations such as the Costa del Sol and Levante. Madrid and Barcelona will be more resilient in terms of the impact on demand, and here we would expect to see a slump in sales of between 10% and 15% province-wide.

The impact of COVID-19 on housing prices will depend on location and the type of product on offer. At CBRE, we estimate a drop of between 2% and 4% in new-build housing prices (based on figures from the Spanish Development Ministry[1]). However, we project a sharper decline of around 6-7% in resales due to the downturn in the jobs market, the need among owners to get their properties off their hands and the increased supply on the market.

The province of Madrid is expected to see resale prices fall by 4-5% and a more moderate decline of 1-2% in new-build prices. While in the province of Barcelona, resale prices are forecast to fall by 5-6% and new-build prices to dip by 2-3%.

In terms of supply, guarantees that works on developments under construction will continue through to completion and that delivery commitments will be honoured are just some of the signs that suggest the number of completed homes will not be impacted by COVID-19. However, the number of new development projects approved over 2020 is likely to fall, due to the local government hiatus during the state of emergency and to changing demand profiles in the wake of COVID-19.

FIGURE 16. HOUSING SALES 2004-2019 AND 2020 FORECAST



Source: CBRE

[1] Estimates of the change in the price of new and used housing have been made on the basis of data from the Ministry of Development. The Ministry of Development considers as new construction all those houses with less than 5 years of age.

ASYMMETRIC EFFECTS OF COVID-19 IN THE LAND MARKET

In the post-COVID-19 world, the land market will be driven by one crucial factor: geographic location.

- Investors will remain active in the biggest cities (Madrid and Barcelona), the Basque Country, Navarre and Valencia.
- Regions and provinces where activity was ticking up prior to COVID-19 (La Coruña, Asturias, Cantabria and Zaragoza) could pick up where they left off once the crisis subsides.
- Activity in coastal and island areas will fall in developments aimed at overseas buyers and the secondary housing market. The impact of COVID-19 will be compounded by the Brexit effect. Greater supply of completed product and land will curb investor appetite.

As a result of the COVID-19 pandemic, we will see shifts in how land transactions are structured as well as changes in prices and the supply–demand equation. A scarcity of serviced development land in the principal markets will displace a lot of investor demand towards new development projects and land with planning permissions pending. On this note, the medium-term supply of land in the market – and hence prices for plots and completed developments – will hinge on how active and persistent the various public bodies involved in the planning process are prepared to be.

The availability of land zoned for the sale of owner-occupied housing should remain stable in the main provincial capitals, where a shortage of serviced development land will continue to fuel interest in plots still moving through the planning process. Investment in land zoned for rental housing will remain high, primarily in Madrid and Barcelona, where strong demand combined with weak supply and high prices will make renting the most accessible housing option for many.

MULTIFAMILY HOUSING IS GOING FROM STRENGTH TO STRENGTH WITH CONTINUED INTEREST IN BUILD TO RENT (BTR)

Residential investment stood at over €2,110 million in 2019, equating to 17% of all investment in Spanish real estate. Transactions in the private rented sector (PRS) and under the build-to-rent model came to €1,650 million – a sign of the intense investor interest that these kinds of properties elicit.

The rental housing sector is shaping up to be one of the most resilient in the face of COVID-19. The pandemic hit at a moment when residential investment was in rude health; the investment volume in the PRS and BTR segments surpassed €810 million in the first half of 2020, a y-o-y leap of 23%.

The multifamily segment is attracting investor interest thanks to heightening demand in recent years; the percentage of households living in rented accommodation has risen by more than 5 pp since 2015, reaching 23.9% in 2018. Before the COVID-19 situation arose, we estimated that the number of households opting to rent would exceed five million in 2024, accounting for over 26.3% of all households. With home ownership seeming increasingly unaffordable, the trend towards renting will only accelerate. Furthermore, new BRT developments hold a competitive advantage over an existing rental housing stock that is sorely in need of updating: 52% of it was built before 1980. Finally, many investors are noting that multifamily housing offers an attractive return at a relatively low risk. The gross yield for rental housing stands at 3.8%, compared to 0.46% for the Spanish 10-year bond.

The fact that transactions are continuing to progress now the lockdown has been lifted indicates that investor interest has held up well. A case in point is the sale of the Arco del Triunfo plot of land (Barcelona) to Conren Tramway. This was the first transaction in this market for a future BTR property that was both initiated and completed within the lockdown period. CBRE advised the seller (Hotusa) of this plot, where 108 homes are planned – all destined for the rental market.

One of the trends observed as a consequence of COVID-19 is a shift in strategy for certain development projects, initially intended for sale, that have switched to build to rent in anticipation of growing demand for rental housing.

In terms of rents, we may see a direct impact from rising unemployment and a drop in GDP and per-capita income.

A CBRE survey of Spain's largest professional landlords in April highlighted some interesting points: i) only 8% of tenants failed to pay their rent in April; ii) just 5% of tenants applied for government support; and iii) lower-income areas were disproportionately affected by the crisis.

SECTORS: RESIDENTIAL

CHALLENGES AND OPPORTUNITIES FOR THE MULTIFAMILY SEGMENT

One of the greatest challenges in multifamily housing is the expanding stock of existing rental properties as developers tap into high levels of demand. Public–private agreements and local authority collaboration will be needed to provide legal assurances and speed up the process of obtaining permits and licences for land management and residential development.

In this respect, signing a statement of compliance will help remove obstacles and expedite applications for building permits and first occupancy licences. The Region of Madrid, for instance, announced mid lockdown that a new process would apply from the start of the summer.

TECHNOLOGY, SUSTAINABILITY AND THE INDUSTRIALISATION OF CONSTRUCTION

The use of cutting-edge technology and digitalisation in the home will continue to rise in 2020. Digital management tools allow operators to optimise their income and expenditure streams – particularly for rental housing, where they can produce profitability gains for landlords.

Energy efficiency and sustainability in residential construction is one megatrend that won't be disappearing in 2020. Green mortgages are still gaining popularity thanks to more favourable mortgage conditions for properties that optimise consumption and hold energy performance certifications. The Spanish National Commission on Markets and Competition (CNMC) announced in early June that the body responsible for awarding energy certifications would be reformed within the next 12 months.

Last but not least, we cannot omit to mention the growing trend towards industrialised construction. Initially more common in the construction of single-family homes, this trend will spread to high-rise properties in 2020. This construction method helps deliver units more quickly while keeping construction costs in check, and it is sure to become more prominent over the coming months.

OUTLOOK 2020-2021

- The COVID-19 pandemic erupted at a moment when the Spanish residential market was beginning to show signs of easing. CBRE estimates that overall housing sales could fall by 20–25% y-o-y in 2020, with total sales dropping to 425-450,000 units.
- Our analysis estimates a drop in new-build housing prices of between 2% and 4% due to a downturn in the labour market and a larger supply pool. The impact will be greater in resales, with prices for existing housing slumping by around 6–7% on average.
- Shifts in the post-COVID-19 land market will have an uneven effect depending on location: the islands and coastal zones will bear the brunt of the impact.
- The multifamily segment looks to be one of the most resilient in the face of COVID-19. When the crisis hit, residential investment was in good shape, with record volumes recorded in BTR/PRS transactions.
- Technology, sustainable building methods and a drive towards industrialised construction will play ever more prominent roles.

HOTELS

HOTEL SECTOR: COVID-19'S MAIN VICTIM

After several years of robust growth, the outlook for the hotel sector at the start of 2020 was already auguring the start of a new cycle. These forecasts have had to be drastically downgraded in light of the impacts of COVID-19. The tourism and hospitality sectors have taken a battering, with virtually all of the country's hotels forced into hibernation. There is no question that things will remain tough for the next few months, especially since these sectors play such a vital role in the Spanish economy, representing 12.5% of GDP (and up to 19.1% in certain regions).

International visitors account for more than 65% of overnight stays in Spain, which attracts a diverse tourist base that ought to translate into lower risk. However, in the current crisis the number of international travellers has fallen drastically, and although the future remains uncertain, some resorts have already written off the entire summer season.

A STAGGERED RECOVERY EXPECTED

All signs are pointing to a gradual 2021 recovery for the hotel sector; we should not expect activity to reach pre-crisis levels until at least 2022. Changes in domestic demand and a move to reposition Spain's international brand will be fundamental in shaping the contours of this new landscape. Destinations more heavily reliant on international demand will need to make formidable efforts to capture a share of the domestic market, which will take on a new salience over the next few months. Depending on the extent of the rise in unemployment and fall in consumer confidence, spending on travel (for both business and pleasure) will take a distinct hit. For this reason, although we expect to see a short-term rebound in holiday travel, predominantly benefitting basic and mid-range hotels, a full recovery will be a long time coming.

Destinations with greater international exposure will be watching how the situation progresses in their biggest feeder markets (Italy, France, Germany and the UK), as this will determine how quickly they bounce back. Confidence in Spain's public health status will also be crucial – a lot of damage has been done by the perception that it has been one of the hardest-hit countries by the pandemic. Another problem to bear in mind is that air travel has been severely restricted, with some routes, particularly those that are less profitable, scrapped altogether.

FIGURE 17. OVERNIGHT STAYS – CITY DESTINATIONS | HOLIDAY DESTINATIONS

Source: INE

HOLIDAY BOOKINGS SHOW GREATER RESILIENCE THAN BUSINESS TRAVEL

Considering that the vast majority of Spain's hotel demand, both domestic and international, is owed to holidaymakers (85%), the country could bounce back more quickly than others, particularly in coastal areas and major holiday resorts, where domestic demand is more robust.

Business travel, in contrast, will be severely affected by the impact on corporate finances: most companies will be cutting back on non-essential trips. Cities like Barcelona and Madrid may sustain the greatest losses given their vulnerability to a drop in international business travel. Structural changes, such as the swift and massive-scale switch to remote working, may exacerbate the situation.

POTENTIAL IMPACT ON AIRBNB

Hotels have an opportunity to tap into changing consumer preferences, now that tourists are prioritising safety and cleanliness and may opt for hotels over Airbnb or a similar holiday rental services. The selection of properties on Airbnb's platform may also become more limited if hosts are reluctant to rent out their homes over health and safety fears. Meanwhile, some have chosen to let their properties on a long-term basis, given the uncertainty hanging over the tourist market. That said, Airbnb hosts are in a position to respond more quickly to a spike in demand; all they have to do is relist their properties online, whereas hotels need to recruit staff, etc.

DRAMATIC SLOWDOWN IN THE INVESTMENT MARKET AS ACTORS WAIT FOR GREATER VISIBILITY

Turning to the investment market, while the year began on a bright note – with activity up y-o-y in Q1 – it is safe to say that the pandemic dragged down investment to historic lows in Q2. What little activity was recorded in April, May and June was mainly attributable to deals that were already at a very advanced stage when the crisis began. Everything else seems to have been mothballed, and in many cases investors are waiting for greater clarity on the market outlook for the next few months before they make a move.

Nonetheless, Spain is still a very attractive investment destination thanks to its solid tourism infrastructure, although value-add and more opportunistic investors are currently the most active as they hunt for discounted deals. Despite current circumstances, there is little chance that these kinds of transactions will hold too much sway over the market, at least for the rest of 2020. Mechanisms such as refinancing, ICO loans, ERTEs, etc. have given a vital shot in the arm to the sector, in many cases allowing operators to get through the coming months without being forced to sell. It is worth reiterating that Spanish destinations will recover at different speeds, and this heterogeneity could mean that certain transactions in particular locations come off worse from the pandemic. This may apply to more secondary destinations or those with a very niche clientele that cannot travel at this time.

OUTLOOK 2020-2021

- Phased recovery, beginning with domestic demand, then short-haul, then long-haul. Destinations with greater exposure to international demand will need to work hard to try and capture a share of the domestic market.
- Demand for business travel will fall drastically due to the pandemic's toll on company finances, with non-essential trips avoided. This will have an impact on cities such as Madrid and Barcelona.
- Although value-add and more generally opportunistic investors will seek out discount deals, we would not expect these kinds of transactions to have a significant influence on the market this year, thanks to mechanisms such as refinancing, ICO loans, ERTEs, etc.

OPERATIONAL REAL ESTATE

THE ALTERNATIVE "OPERATIONAL" SECTOR: A SAFE HARBOUR AMID THE COVID-19 STORM

In the short term, the outlook for the alternative market still looks bright, despite the effects of COVID-19. This sector has seen investment volumes surge over the last year on the back of socio-demographic trends, the changing needs of today's society and attractive returns compared with traditional investment products. This is a popular sector among defensive investors, since it meets a need rather than serving a demand, and there is currently a grave under-provision problem.

STUDENT HOUSING: NO END TO THE SUPPLY–DEMAND IMBALANCE

COVID-19 left the country completely immobilised, and both undergraduate and graduate courses were suspended, with a knock-on effect on the demand for student housing in Spain. Presumably, the new academic year that starts in September will bring a return to form as students get back to their courses and start looking for accommodation. It is to be expected that international student numbers will slump for a certain period of time, but the overall impact should not be too devastating given that more than 80% of students living in student housing in Spain are Spanish.

Within the education sector, student housing has proved the biggest draw in recent years, thanks to sustained demand and a first-rate education system. For investors, it's seen as something of a safe haven.

In fact, Spain remains profoundly undersupplied with student housing (with just 93,000 beds for 1.6 million students), with a coverage ratio of just 6%. If we calculate this ratio based on the number of students moving away from home to study, it rises – but only to 19%. According to CBRE data and considering the pipeline for the next two years, the coverage ratio is unlikely to break above 22% between now and 2022. There is therefore still a patent shortfall of student beds in Spain.

In 2019, total investment in student housing in Spain amounted to around €500 million, marking a pronounced y-o-y gain. This trend continued through the first half of 2020, which saw new transactions to the tune of almost €760 million. Standout deals included the joint venture between Brookfield and Temprano in late 2019/early 2020. This transaction saw Brookfield enter and gain a firm foothold in the Iberian market, with lease agreements with terms of over 25-years signed for 19 student residences in Spain and Portugal. Transaction volume rose to €795 million, representing more than 7,700 beds between the two countries. Spain's share equated to more than 5,400 beds and approximately €614 million.

Despite the havoc wreaked by COVID-19, it is apparent that this strategy – joint ventures between investors and international operators and/or local developers – is here to stay. This market is highly fragmented, the five leading operators holding only 17% between them.

The lack of operational platforms on the market has prompted developers active in this segment to create their own portfolios by acquiring and developing properties one by one.

As we move through the second half of 2020 and into 2021, we expect to see further market consolidation, with an increasing number of transactions for entire portfolios or operational properties. This is due to the entry of more core/core plus investors, drawn by the prospect of stable returns and the reduced planning risk that complete and already operating properties present.

Investor activity will mainly focus on areas near university campuses and Tier I and Tier II city centres – Madrid and Barcelona in the former and Valencia, Seville, Granada, Malaga, Bilbao, Pamplona, Salamanca and San Sebastián in the latter – due to their high concentration of students and greater purchasing power. We would highlight the interest in Tier III cities, which offer a welcome solution to the tough competition and rising prices being seen in more sought-after cities.

In terms of reputational risk, in the wake of the COVID-19 pandemic operators' approaches to rent payments will determine their market position.

Some operators decided to waive rents for March to July as a means of instilling loyalty in their tenants, whereas others have required payments to continue (albeit with certain discounts), on the grounds that residences have remained open throughout the crisis and a defensive position is needed to prepare for the possibility of fresh outbreaks and another national lockdown.

SECTORS: OPERATIONAL REAL ESTATE

What we can say for certain, and with the evidence to back it up, is that the take-up rate of places for the coming academic year is looking positive, especially compared to figures for 2019.

HEALTHCARE – SENIOR HOUSING: ON THE FRONTLINES OF THE PANDEMIC

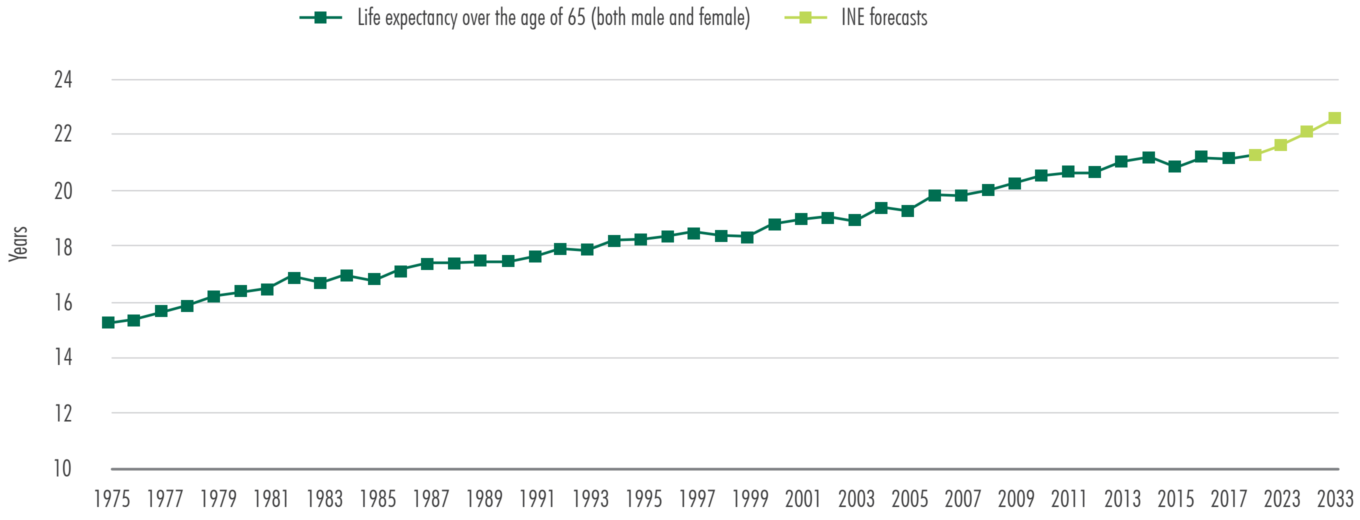
Senior housing has been among the most dramatically affected property types throughout the COVID-19 crisis. That said, the mismatch between supply and demand makes it fairly resilient and, in contrast to most European countries, Spain has a long way to go to achieve the WHO's recommended ratio to meet demand. This demand will keep building long after the COVID-19 crisis has subsided, due to rising life expectancy and the affordability of senior housing to this segment of the population.

Investors and operators will continue to explore opportunities, but final decisions may be postponed. Most operators have been focusing exclusively on managing the health crisis and have given little thought to their expansion plans. However, after spending several months on stand-by, the recovery should come very quickly as delayed investments come through and generate new opportunities. The vast majority of investors interested in this sector see the crisis as something of a bellwether.

The Spanish population is ageing and the impact of this will continue to be felt over the coming years, with the population pyramid being turned on its head as life expectancy rises. According to figures from the INE, the percentage of the Spanish population that is over the age of 65 – currently 19.2% – will reach 22.6% in 2033. This, combined with the dearth of beds in Spain (there is currently a deficit of 70,000 beds/year), the coverage rate advised by WHO (5%, compared to Spain's 4.3%) and the lack of supply on the market, will drive sales of both existing senior housing and plots of land for the development of new projects in 2020 and 2021. Before the COVID-19 situation developed, CBRE forecasts estimated that Spain would need 200,000 additional beds by 2030 and somewhere around 400,000 by 2050. This forecast will remain valid in a post-pandemic world.

Operational risks, such as a short-term squeeze on income, should not be overlooked. Firstly, excess deaths will gradually reduce the rate at which places in senior housing are occupied. Secondly, operating costs are set to rise due to the need to recruit additional healthcare staff, intensify disinfection and cleaning protocols and purchase additional materials (healthcare products, respirators for a certain quota of beds, etc.). Operators will also be conscious of a range of reputational risks as a result of the severe impact of the pandemic, which may eventually have repercussions for income flows and recruitment. Care homes have emerged from the COVID-19

FIGURE 18. LIFE EXPECTANCY IN SPAIN - AGED 65 AND OVER



Source: CBRE via INE

pandemic with a much-tarnished image, although these facilities are not hospitals and could not be expected to be equipped to halt the spread of the virus. Ultimately, there are a number of regulatory risks to bear in mind, such as the possibility of further legally enforced social distancing measures and requirements for more individual rooms or extra medical equipment.

As far as value is concerned, care homes that meet the requirements stipulated by major operators will remain attractive and hold their value well. At the moment, the problem lies with demand, not oversupply. With plenty of liquidity in the market, the value of these kinds of properties should not be greatly affected. Portfolio deals will go from strength to strength and draw in both core and core+ investors.

Post-COVID-19, the trend towards market consolidation observed in recent years will only accelerate. There are presently 185 companies active in this sector, while the ten leading operators are responsible for just 25% of all beds. The biggest firms will be looking to further the institutionalisation of the market by swallowing up the smaller fry. Moreover, care homes will need to seek out new sources of investment if they are to keep up with new regulatory requirements. Operating margins will tighten and new funds will be much in demand (in order to fit out infirmaries or purchase respirators, for example), and so owners in the small-to-middling part of the scale will have fewer resources and may be tempted to sell to larger operators.

HEALTHCARE – HOSPITALS: IN THE LINE OF FIRE

Hospitals have been overwhelmed by the onslaught of the virus, and the public health crisis has proved that they lacked sufficient PPE and practice guidelines to deal with the disease. Nevertheless, this is an extraordinary and unforeseen event, and the Spanish healthcare system has prevailed. Once the pandemic subsides, hospitals will be in a much stronger position to respond to further outbreaks or new pandemics.

Today, hospitals are the new infrastructure. We knew this even before the COVID-19 crisis began, with 2019 yields slipping below 5% and core real estate funds, or even infrastructure funds, studying this segment with interest. COVID-19 has shown that these properties are as about essential as they come, and it is likely that sale-and-leaseback transactions will ultimately become more common in Spain as hospital operators seek to focus on their core business and raise capital for expansion.

OTHER SECTORS

The co-living sector is proving particularly resilient. Indeed, some owners of tourist apartments are now marketing them as co-living spaces in the wake of the COVID-19 crisis. However, uncertainty surrounding possible regulatory limitations and changing guidelines will weigh heavily on investors' minds.

The education sector is another one to watch, having grown in prominence over the last year as major private equity firms entered the market. Finally, we must not overlook certain other highly promising sectors implicated in current megatrends, such as gyms and storage facilities.

SECTORS: OPERATIONAL REAL ESTATE

OUTLOOK 2020-2021

- The fundamentals of the alternative "operational" sector will not change significantly as a result of COVID-19 in the medium-to-long term. This is a sector that attracts defensive investors and responds to need rather than demand, and which is currently facing a critical shortage of supply.
- These fragmented and underdeveloped sectors will continue to consolidate in the post-COVID era, and we will see more mergers and acquisitions among operators looking to grow their market shares.
- Regardless of the reputational, operational and regulatory risks, student housing, senior housing and hospitals will continue to spark investor interest. Portfolio deals will go from strength to strength and draw in both core and core+ investors.
- Due to a lack of product on the market, we will see more sales of land earmarked for new developments, as well as more refurbishments in these sectors.

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