

1st Investors Survey in Commercial Real Estate 2015 – Spain

Survey Conclusions



March 2015







Content

1. Respondent investors profile
 - Survey introduction
 - Survey participants
 - Market situation
2. Investment strategy / policy
3. Investment volume & leverage
4. Asset classes and investment profiles
5. Main investment variables
6. Value assessment
 - Pro's & Con's of investing in Spain
7. General topics
8. SOCIMIs' focus
9. Conclusions
 - Investor appetite
 - Investor main conclusions
 - But... why so much appetite for the Spanish Commercial Real Estate?
10. Closing remarks
11. Contacts

1.- Respondent investors profile

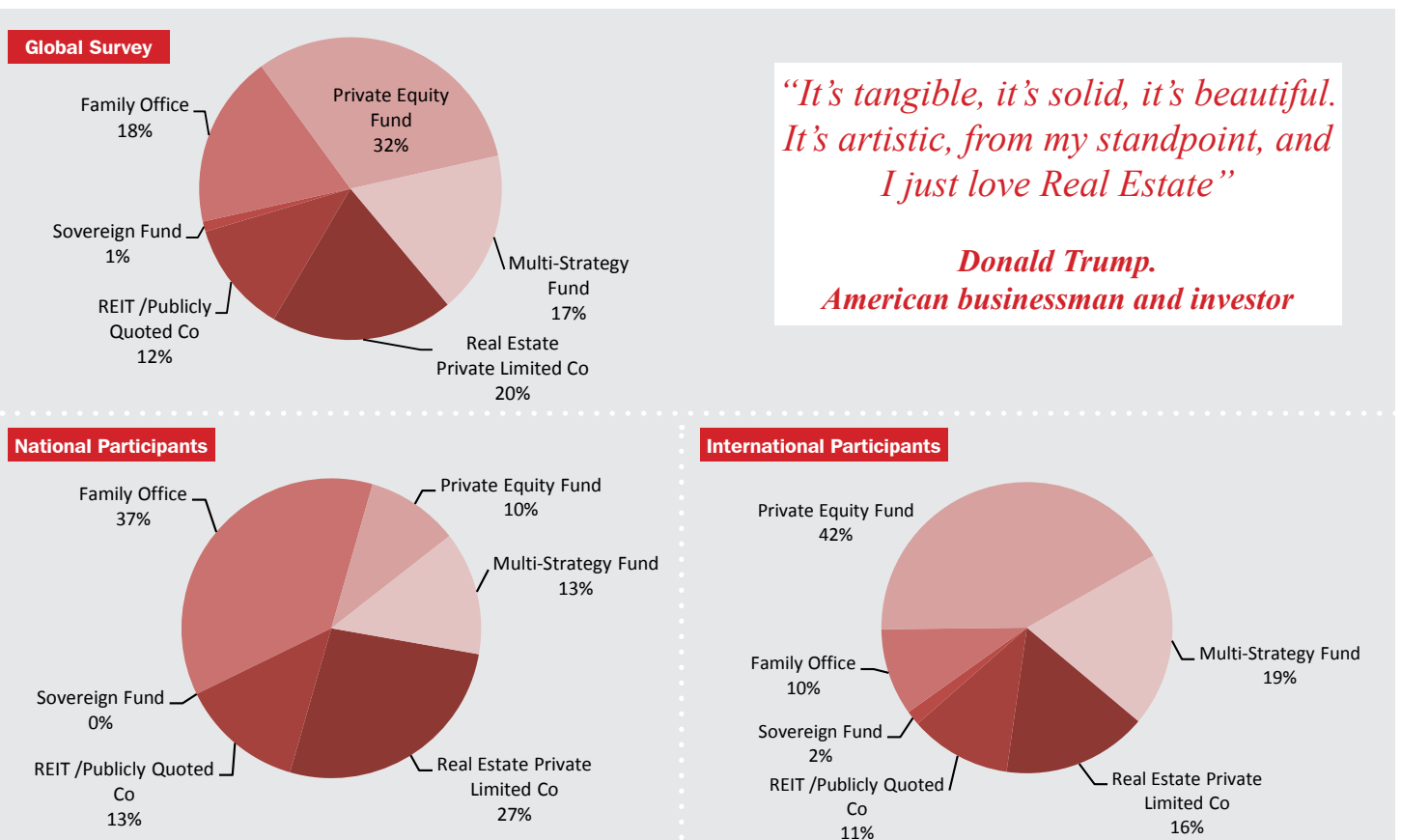
Introduction

- We are proud to present you one of our most ambitious initiatives of this year, “1st Investor Survey in Commercial Real Estate 2015 - Spain”
- **IESE and JLL**, two recognized organizations within the Financial Education and Real Estate sectors, have been leading this project
- The Investors Survey in Commercial Real Estate (CRE), is on a confidential basis and covers each Investor’s testimonial, reflecting **market sentiment** and providing **transparency** to the Spanish CRE market
- The survey covers many of the most active players in the Spanish RE, such as: 18 Real Estate Private Limited Co, 11 REIT /Publicly Quoted Co, 17 Family Office, 29 Private Equity Fund, 16 Multi-Strategy Fund, 1 Sovereign Fund and 9 Other
- We are presenting the output of this survey, including interesting comments from investors
- This study aims to become the preferred source for actual criteria of active investors in the Spanish CRE market; as well as for property market statistic information

Survey metrics	
Number of participants	101
Survey period	Jan-Feb 2015
National participants	35 (35%)
International participants	66 (65%)
Survey Publication Date	March 2015
Answer were got by phone, online and direct interviews	

Survey participants

- Covering a complete range of investor profiles, the Investor Survey IESE-JLL 2015 aims to gather first-hand feelings and opinions about the CRE investment market.



Market situation

Macroeconomic

- Spain is the 13th largest economy by GDP in the world (€1,023bn in 2013) and the 5th in the European Union
- Spanish productivity increased during 2014 – leading the trend in Europe, as a result of government reforms
- 15 out of 16 Spanish banks passed the latest stress tests. Only Liberbank failed with a capital shortfall of €32.2m. The deficit in that bank was covered by capital raised afterwards
- The Quantitative Easing will result in an increase in lending and investing activities in the whole Euro Area. It will improve company financing, which was a problem specific to Spain
- Increase in household financing is rising significantly. Current wide range of fixed interest rates mortgages previously unknown in Spain

- Spain has more than €7.4bn in RE direct transactions in 2014
- As yields tightened, investors need to consider secondary markets to reach their investment criteria
- Investors are looking beyond CRE: developers are in the game again and housing business has initiated the recovery, although Spain has still an outstanding oversupply in main cities and coastal areas
- CRE market has been the apple of many Pan-European investor's eye over 2014, and with overseas Capital piling in, foreign Lenders have followed their client base
- Only 4 new Spanish Reits (Socimi) raised €2.5bn, more than 80% deployed in just 6 months

Spanish GDP

Spanish Unemployment

Spanish 10 year bonds vs German 10 year bonds

Spanish Commercial Real Estate Market

CRE Investment Volume in 2014

Main Office Markets: Madrid & Barcelona

Madrid & Barcelona are the main Office markets in Spain:

Virtuous Circle

- Investors are confident that growth will be in the cards in Madrid in 2015, at least for core and value-added offices.
- Prime rents in Madrid & Barcelona are around 35% lower than pre-crisis level

Madrid has shot up to nº 3 in Europe this year for investment products. Barcelona also feels the increased investor interest, mainly in the touristic sector

Office Investment Volume (€M)

Debt Side

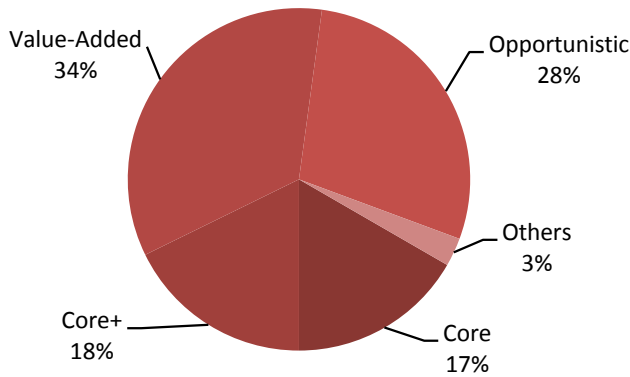
- Spanish Banking industry has been cleaning up their balance sheets and reinforcing Capital Ratios. Although SAREB has received large amount of NPL's & REOs, the Banking system still owns huge amounts of RE backed assets and bad loans
- Increasing competition and the lowest ever interest rates globally, will impact in lower cost of financing across the RE market. Lenders are not ready for developments yet, although debt Funds are getting into the games (please visit JLL 1st Lender survey October 2014)
- 2015 will be an attractive year. Let's see how tight the risk curve will get and which banks will be more active lending-wise

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2. Investment strategy / policy

Investment profile of the investors

- Value Added (34%) and Opportunistic (28%) are the most popular investment profiles in the current market

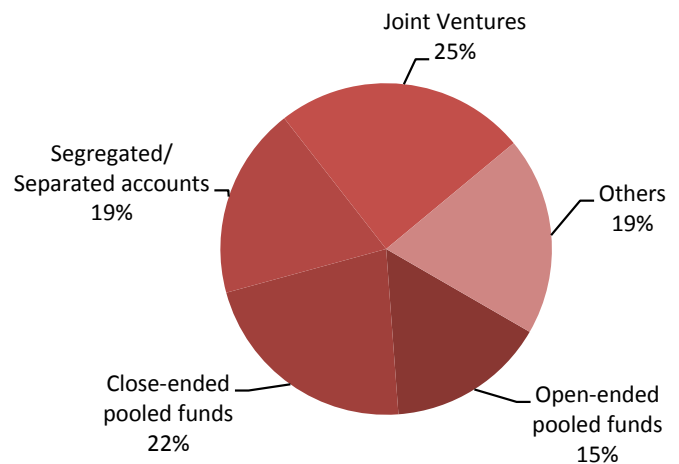


“The problem with Real Estate is that it’s local. You have to understand the local market”

Robert Kiyosaki
author of “the Rich Dad Poor Dad”

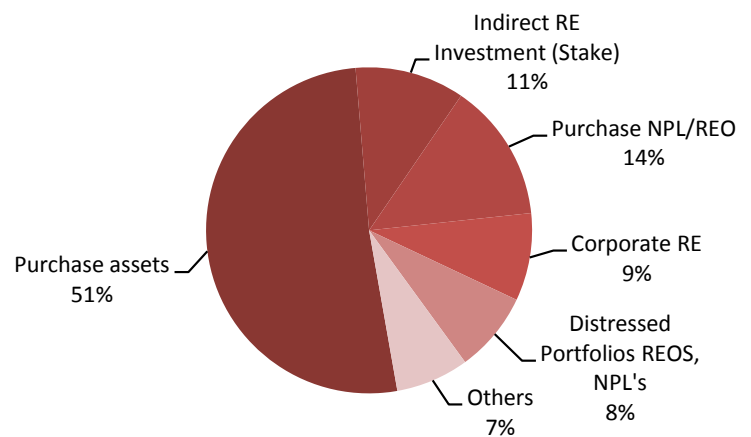
What vehicles is your company considering?

- 1 of every 4 investors are willing to establish JV, mostly with local partners
- Some investors are seriously taking into consideration the possibility to create a SOCIMI
- Direct investment is also considered by some investors
- Scarcity of product will open investors other options to get into the market



Which deals have your company closed recently by transaction type?

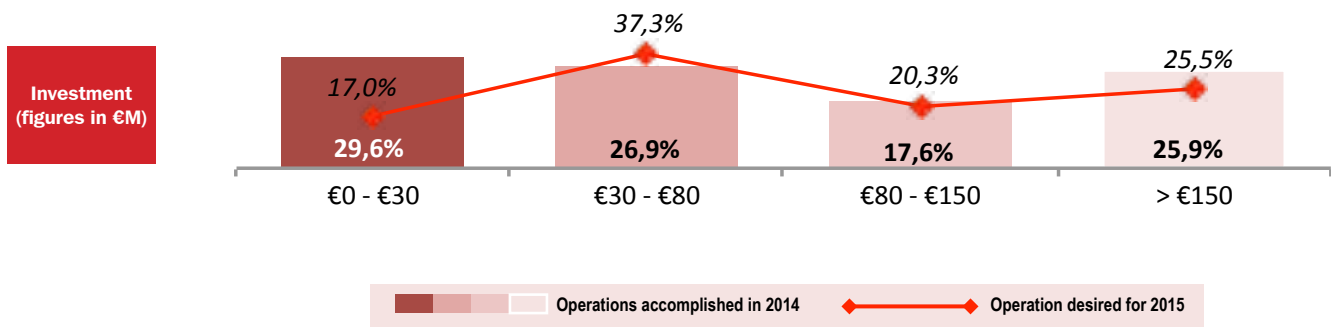
- Direct Asset deals represent more than 50% of the market
- However 50% of the investors say they would look at other transaction types / profiles
- NPLs / REOS the 2nd largest transaction class, a rising typology that we will see as a main actor in the coming years
- Prime deals harder to secure
- Many of the respondents say that it is easier to get capital than to find good deals
- Corporate deals will get more attention as the scarcity of product is getting worse information



3. Investment volume and leverage

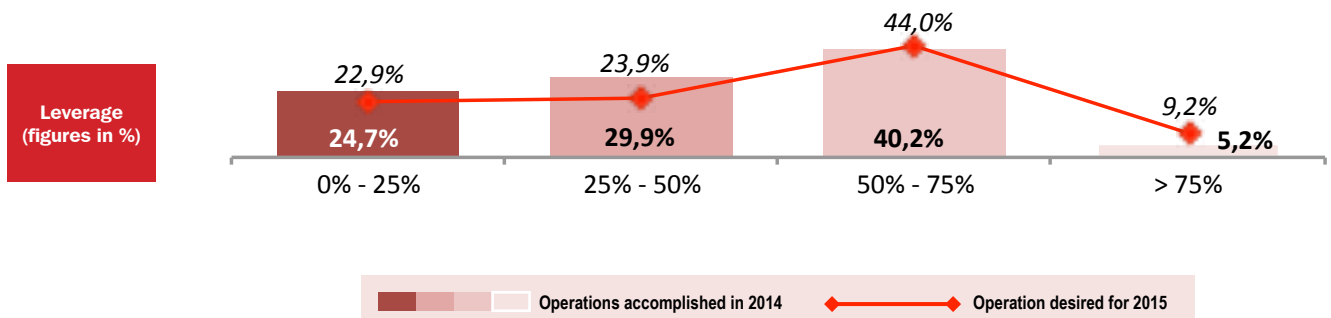
Investment volume in a typical transaction (2014 vs. 2015)

- The most demanded transactions those are opportunities between €30m & €80m
- The largest investors have a number of funds with different investment and leverage profiles
- Investors are typically divided into two different segments: <€80m & >€80m



Leverage volume in a typical transaction (2014 vs. 2015)

- Only 5% of investors are achieving leverage ratios of 75% or above
- 49% of investors at leverage level below 50% in 2014
- 40% of investors were looking in 2014 for 50% - 75% LTV



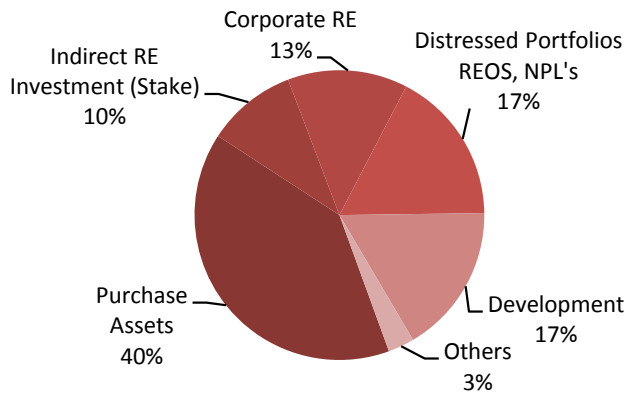
“I’ve lived through periods of illiquidity before. Asset prices come down. The economy slows or even goes into recession. Then the cycle re-starts. We buy at lower prices with less leverage.”

Stephen A. Schwarzman
Founder and CEO of Blackstone

4. Asset classes and investment profiles

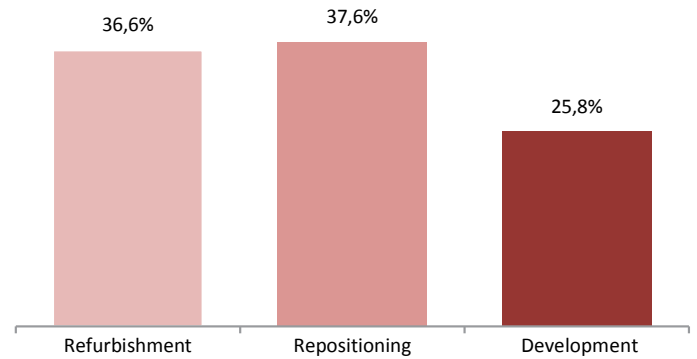
Which investment criteria your company suits?

- It is more about return requirement of every investor
- Some Investors are interested in being Debt providers



For value-added investors, which is your target acquisition?

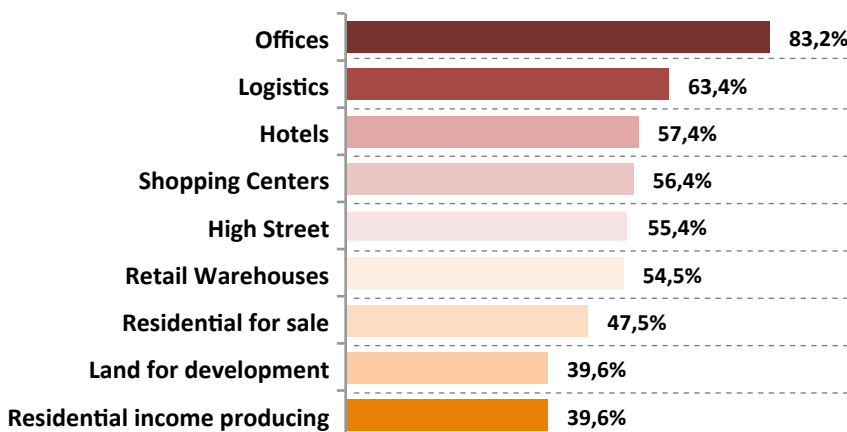
- Good market momentum for development
- Location should be very good and tenant risk acceptable
- Residential is preferred option for new development and refurbishment



Investors interest by asset type

- The most attractive market is by far the office market, demanded by circa 85% of the investors surveyed
- **Prime:** High Street, Offices and Logistics are the investors principal target, with more than 30% of their interest
- **Value-Added:** Shopping Centers, residential for sale and residential income producing are the most attractive asset classes
- **Opportunistic:** Land for development and Residential for sale are the preferred opportunistic assets

Investors interest by asset type



Investors interest by asset class

	Prime	Value-Added	Opportunistic
Offices	32,4%	42,8%	24,8%
Logistics	33,0%	38,3%	28,7%
Hotels	28,9%	42,2%	28,9%
Shopping Centers	23,9%	46,7%	29,3%
High Street	36,9%	39,3%	23,8%
Retail Warehouses	28,6%	40,3%	31,2%
Residential for sale	17,4%	44,9%	37,7%
Land for development	26,3%	35,1%	38,6%
Residential income producing	23,8%	44,4%	31,7%

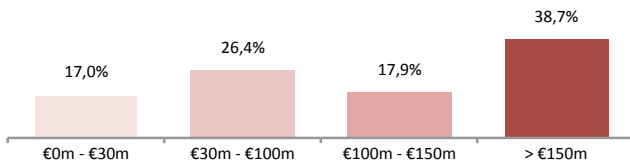
*“Real Estate is the key cost of physical retailers.
That’s why there’s the old saing: location, location, location”*

Jeff Bezos - founder and CEO of Amazon

5. Main investment variables

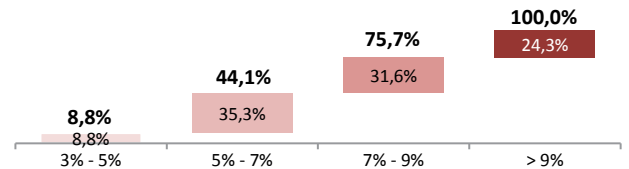
Investment volume assigned to Spain (in €m)

- There are two clear groups of investors up to €0-€100m and from €100m to > €150m



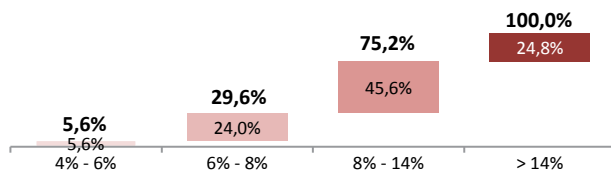
Initial yield

- Opportunities from 5% to 9% are the most demanded by investors with an up to 67% of the demand



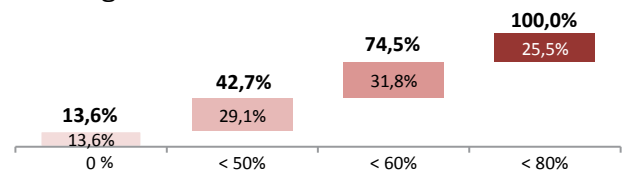
IRR unleveraged

- 70% of the investors are looking for IRR's above 8%



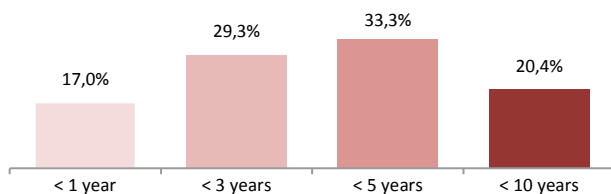
Leverage

- 25% of the investor universe would demand over 80% LTV leverage levels



WAULT* occupied buildings

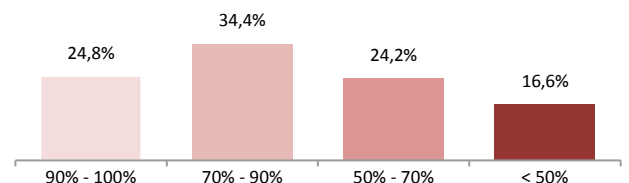
- If the building is well located, opportunistic investor prefers shorter WAULTS



*WAULT: Weighted Average Unexpired Lease Term

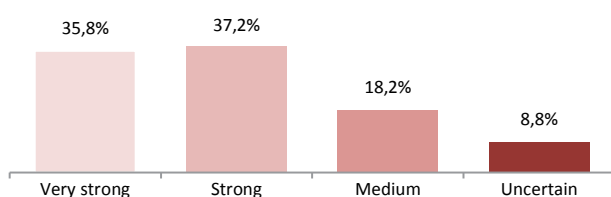
Occupancy rates (in occupied buildings)

- Different strategies from investors for core assets (high occupancies) and opportunistic assets



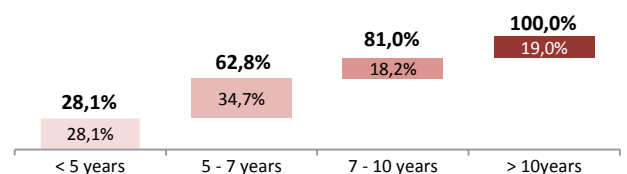
Tenant covenant quality

- More than 70% of the investors, consider crucial the tenant quality
- Most of opportunistic investor prefer short lease terms or no lease to improve with Capex the building quality and re-let it



Investment term

- Up to 5-7 years are the preferred terms for investors



6. Value assessment

Pro's & Con's of investing in Spain

<p>Advantages Opportunities</p>	<ul style="list-style-type: none"> ↑ Market Recovery: <ul style="list-style-type: none"> ✓ Meaningful market recovery: investors are forecasting economic recovery and yield compression in the medium term ✓ Potential increase in rents and capital value upside ✓ Positive economic outlook ✓ Yield compression across all asset classes ↑ Structural economic measures and market transparency: <ul style="list-style-type: none"> ✓ Spain is more transparent than other Southern European countries ✓ Positive results from recent structural reforms ↑ Good opportunities in refurbishment / repositioning / development ↑ With €50.8bn received from financial institutions, SAREB is expected to be a key vendor in Spain, as it takes advantage of the recovering Real Estate market ↑ Quality assets: <ul style="list-style-type: none"> ✓ As an opportunistic investor it is the optimal cycle momentum to invest in mismanaged assets ✓ Some investors seek opportunist assets that require good management ↑ Tourism Sector as anchor of the economy: Touristic Real Estate in Spain has global demand (3rd most visited country worldwide) ↑ Volatile market, as an advantage for opportunistic investors
<p>Disadvantages Challenges</p>	<ul style="list-style-type: none"> ↓ Market competition: <ul style="list-style-type: none"> ✓ High bidding competition has an impact on prices and lack of product ✓ Investors are anticipating price increase for the coming years, due to strong demand ✓ Aggressive asking prices ✓ Many competitive sales processes ✓ Slow and poor information quality ↓ Building quality ↓ Due Diligence efficiency: Lack of quality DD processes, compared to other countries ↓ Tax and Legal Issues: <ul style="list-style-type: none"> ✓ Fiscal instability ✓ Urban Planning Issues: Different municipality and local planning regulations by regions ✓ NPL's - Sponsor favorable legal structure ↓ Small market, not as liquid as the UK ↓ Market Transparency: Transparency in the office market only in Madrid and Barcelona

7. General topics

Investors interest by asset type

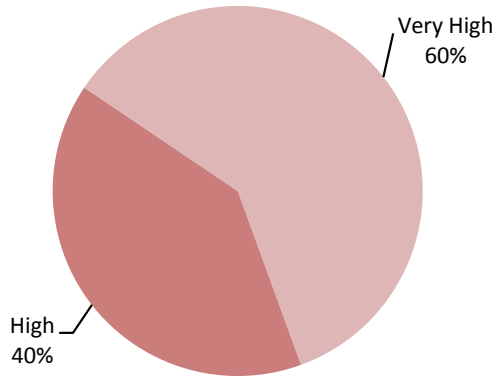
- Spain is one of the main target countries across Europe, with successful structural reforms implemented
- Size of the market, increased liquidity and improved transparency, in combination with low point in the cycle and capital values, gives attractive opportunities to investors
- Banks are more selective and cautious when lending, which is a good lesson learnt

	Survey Questions	Investors comments
1	What has been your experience in buying distressed portfolios, REOS, NPL´s? In affirmative case, how do you analyze the collaterals and ability to repay?	<ul style="list-style-type: none"> ✓ Investors look at Real Estate fundamentals. If needed they invest in Capex, to sell before 5 years ✓ In general, good experience with legal system, enforcement and bankruptcy processes ✓ Investors analyze how to take control of the asset in timing and cost; and possible defaults
2	Are you considering to establish Joint Ventures / agreement with Servicers for Investments? Any recent examples?	<ul style="list-style-type: none"> ✓ Most investors open to JV´s, some of them had positive experiences with local partners ✓ More frequent agreements with asset managers than with pure servicers
3	In your opinion what have we learnt from the Real Estate crisis?	<ul style="list-style-type: none"> ✓ Not much, unfortunately we will forget it all soon, some mistakes are being repeated. Everything is happening all over again. Spain is in better shape, but some investors are already getting crazy with the pricing ✓ Unbalanced risk return deals: Analyze deals with professionals from the Real Estate industry point of view, not only IRR. Values should be in line with sustainable income. Be cautious in capital recovery, according to real economy and rental increase ✓ To be more patient and optimistic during the crisis, this crisis is larger and more globalized. Be humble. One needs to be tenacious and never give up ✓ Look for long term deals with strong fundamentals, to take a long term view ✓ Harmfully large LTV positions, be more cautions with the leverage level and also with majorities in syndicated loans ✓ Lack of understanding of the Real Estate cycles´ nature: It is crucial not to enter the market at peak level ✓ Location, location, location, to differentiate good and bad products. You need to know where you invest
4	Spanish economic environment: how do you think it will develop in 2015?	<ul style="list-style-type: none"> ✓ Government reforms are being undertaken more efficiently than in other countries. Very favorable economic context, capitalizing the reforms and the notable effort made by Spain ✓ Political: Except for political risk, the market should go upward ✓ Economy: <ul style="list-style-type: none"> • Macro is perfect, oil low price, interest rates. But it takes time to transfer the recovery to the real economy • Positive outlook with GDP>2% and some employment creation. The economy will keep improving if there is no structural shocks • Spain will create big numbers of employment ✓ Market: <ul style="list-style-type: none"> • At market level it is a bit crazy. Many private equity companies are not now putting offers for good assets, as they know they will not be the winner • Investors would like to have a more reasonable market with less investors for a single deal • The return of construction will boost the economy • The market will continue to grow, while the ECB continue injecting liquidity into the system, with the risk of the bubble to rise again • CBD offices will slowly show an increase in rents. Occupancy levels in secondary areas will recover sooner than later ✓ Yield compressions across all sectors, not taking into account political risks

8. SOCIMIs' focus

SOCIMIs' role and appetite

- SOCIMIs are providing transparency and allowing the investment by private individuals in the CRE market

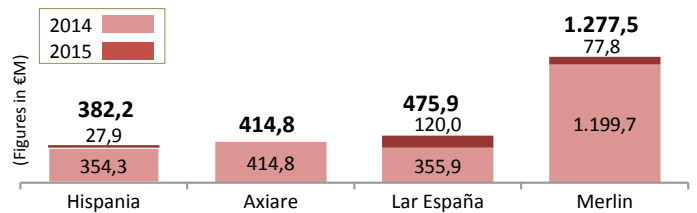


“In ten years, the most relevant SOCIMIs we know today will be part of the Ibex 35”

Ismael Clemente - Merlin Properties

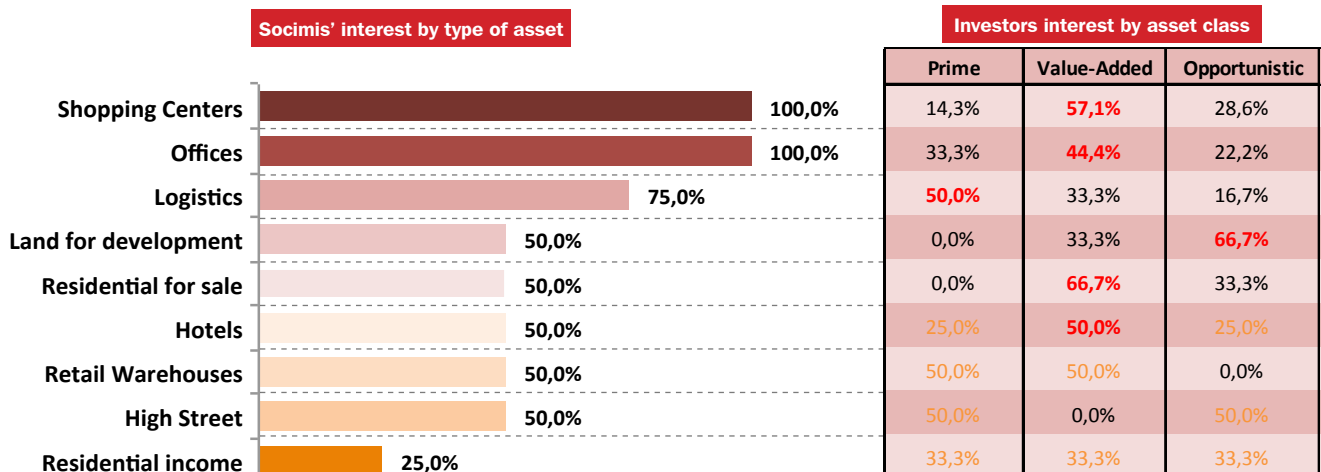
SOCIMIs' role and appetite

- Based on the public information available on the SOCIMIS, the 4 largest have invested in total €2,500m. However, with an estimated pending LTV of 40%-50%, a significant amount of capital will be ready for reinvestment
- In 2014 the four main Socimis have closed almost 25% of the total Spanish Real Estate deals
- Advantageous position in the Real Estate market due to favorable taxation



SOCIMIs' interest by asset type

- Clear preference for prime High Street retail units

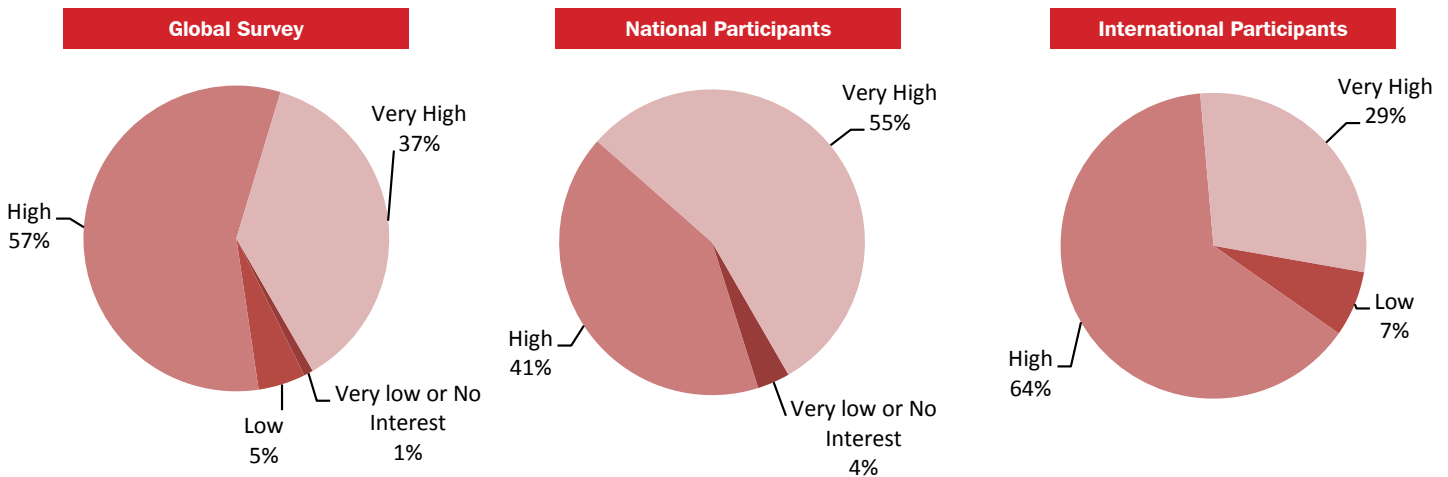


Note: For this question Investors were able to choose more than one asset, therefore the % does not sum 100%

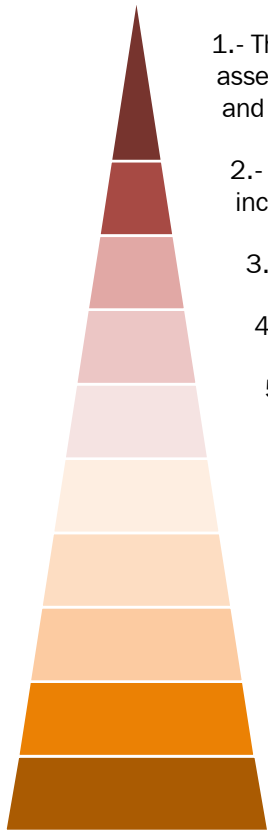
9. Conclusions (1 of 2)

Investor appetite

- 94% of the participants have either a high or very high interest in the Spanish Real Estate market
- 55% of National investors have expressed a high or very high appetite by 41%
- Compared to International investors, their appetite is very high with a 30% and high 63%



Investor main conclusions



- 1.- The gap in yield between Madrid and Barcelona and the rest of Spain is increasing. For High Street prime assets, operations shall see below 4%. The two speed market is increasing the difference between Madrid and Barcelona and the rest of the country
- 2.- The private investor looks at capital value (€ / m²) in addition to profitability, relying on a recovery of income to have an effect of improving value for assets purchased
- 3.- Leverage is under the radar for non institutional investors
- 4.- Clear preference for prime High Street
- 5.- Scarcity of first class opportunities. The challenge is to be creative...
- 6.- Pricing on secondary assets beginning to look more attractive with a backdrop of general economic improvement
- 7.- It is clear that the "first mover advantage" for Private Equity investors has gone – value needs to be found from a bottom up approach
- 8.- Debate is still open – has pricing got ahead of market fundamentals?
- 9.- Spain compares well with opportunities and returns obtained by Investors in other European countries
- 10.- **ALTHOUGH REPEATED:** Location, Location, Location

9. Conclusions (2 of 2)

But...why so much appetite for the Spanish Commercial Real Estate?

	First Wave 2010 - 2011	Second Wave 2012 - 2013	Third Wave 2013 - 2014	Fourth Wave 2014 - ¿?
WHO?	Sovereign wealth funds and large pension funds	Traditional European capital such as French insurers and German pension funds	Supersized opportunity funds (Blackstone, Lone Star, Starwood and TPG)	Pension funds funding Spanish REITs
WHERE?	Large global cities like London and Paris	Non-core assets in core markets and core assets in non-core markets	Move towards non-core assets in non-core markets, notably recovering markets such as Spain where yields are relatively high and there is potential for rental growth	Across Spain
WHAT?	Core assets	In Spain this was exemplified by the purchase by Axa of a portfolio of offices from the government of Catalunya in 2013	Opportunistic assets	Indirect real estate investment
WHY?	Abundant equity In search of large lot sizes and liquidity	Established investors make a first step up the risk curve	US pension funds, in many cases underfunded and in search of higher returns, are investing in these funds Europe looks attractively priced compared to the US, while emerging markets are deemed negatively impacted by a higher dollar and the slowdown in China	Low interest rate environment Competition is prompting investors to find new ways to gain exposure to real estate

10. Closing remarks



This survey describes the investors' sentiment in Spain for 2015, coming from both national and international players. The sample includes all type of investors, the distribution of those who received the questionnaire and those who answered mirrors the universe of investors that are active in Spain.

The investors' sentiment is extremely positive, 94% of all them have a high or very high interest in the Spanish Real Estate market. That interest, indeed, follows a strong market in 2014, with a record €7.4bn of CRE investment, the resumption of debt financing from both national and international players, and the consolidation of the Spanish REITs (SOCIMIs) as one of the most aggressive and dominant players.

The resurgence of the Spanish Real Estate industry during the last year, went hand in hand with the recovery of the economy, a healthy GDP growth and employment increases for the first time in seven years. The 2015 GDP is expected to grow around 2.3% this year, one of the strongest in the EU.

The positive change in sentiment towards Spain is evident in the evolution of investment policies. On the one hand, the opportunistic and value-added are now predominant with 64% of respondents; on the other, core and core+ appears in the investors' plans in 34% of cases. The former becomes consistent with the search for larger transaction volume beside higher leverage.

Offices, logistics, hotels and shopping centers were the most sought after asset classes, with retail warehouse and High Street coming close behind. The activity in the hotel segment is remarkable, which is compatible with the relevant Spanish tourism activity, the third preferred country for international visitors.

The typical investment is around €40m-€50m, with a 50%-60% of debt financing, pursuing an IRR of 8%-14%, targeting a 5%-7% initial yield, and with a 70%-90% of space occupied by strong tenants. That most common intended investment has a term between 5 and 7 years.

This is the first comprehensive and representative survey of investors' intentions in Spain and it is a pleasure for the authors, IESE and JLL, that it coincides with one of the strongest investment cycles in the Spanish Real Estate market.

11. Contacts



Prof. José Luis Suárez
(IESE - Business School)
IESE Professor
T: +34 91 211 30 00
JSuarez@iese.edu



Jorge Valenzuela
(JLL – Head of Debt Advisory, Capital Markets)
T: +34 91 789 11 00
jorge.valenzuela@eu.jll.com



Benoît Du Passage
(JLL- President)
T: +34 91 789 11 00
benoit.dupassage@eu.jll.com



Pedro de Churruca MRICS
(JLL- Managing Director)
T: +34 91 789 11 00
pedro.dechurruca@eu.jll.com



Maurice Kelly MRICS
(JLL – Head of Capital Markets Offices Madrid)
T: +34 91 789 11 30
maurice.kelly@eu.jll.com



Xavi Cotet
(JLL – Head of Capital Markets Offices Bcn)
T: +34 93 318 53 53
xavi.cotet@eu.jll.com



David Brown MRICS
(JLL – Head of Capital Markets Retail)
M: +34 662 350 435
david.brown@eu.jll.com



Gustavo Rodríguez MRICS
(JLL – Head of Capital Markets Logistics)
T: +34 91 789 12 51
gustavo.rodriguez@eu.jll.com



Borja Ortega
(JLL – Head of Family Offices)
T: +34 91 789 11 00
borja.ortegadepablo@eu.jll.com



Luis Guardia
(JLL – Head of Industrial Barcelona)
T: +34 93 318 53 53
luis.guardia@eu.jll.com



Luis Arsuaga MRICS
(JLL – Head of Hotels & Hospitality)
T: +34 91 789 11 00
luis.arsuaga@eu.jll.com



Rafael Powley MRICS
(JLL – Head of Strategy Consulting)
T: +34 91 789 11 00
rafael.powley@eu.jll.com



Evan Lester MRICS
(JLL – Head of Valuations)
T: +34 91 577 18 01
evan.lester@eu.jll.com



Lali de Juan
(IESE - Business School)
Research Assistant
T: +34 91 211 30 00
ldejua@iese.edu

The report



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Investor Survey IESE-JLL Chairs

- Prof. José Luis Suárez, IESE Business School
- Benoit Du Passage, President JLL

Authors

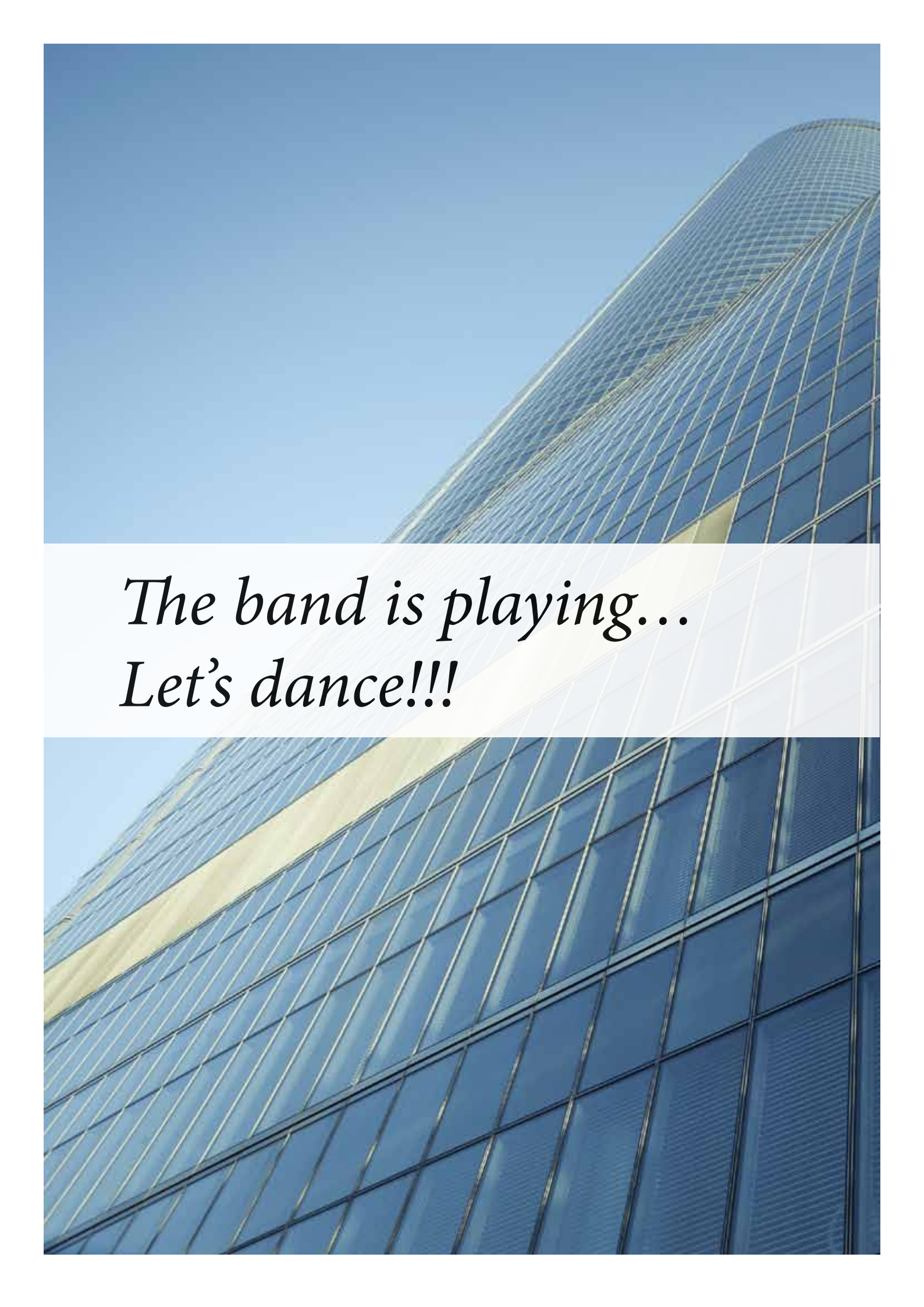
- Jorge Valenzuela, JLL
- Lali de Juan, IESE Business School
- Rafael Máiz, JLL
- Irene Verdes-Montenegro, JLL
- Francisco Torró, JLL

ULI Editorial and Production Staff

- Ignacio Herrero, JLL
- Nina Priakhina, JLL
- Patricia Harriero, JLL
- Luis Antonio Fernández, JLL

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*The band is playing...
Let's dance!!!*



Madrid

Pº de la Castellana, 79, 4ª.
Pº de la Castellana 130, 1ª
28046
T: +34 91 789 11 00

Barcelona

Pº de Gracia, 11- 4ª, esc A
08007
T: +34 93 318 53 53

Sevilla

S. Fco. Javier, 20- 3ª. 314
41018
T: +34 95 493 46 00

jll.es

Madrid

Camino del Cerro del Águila, 3
28023
T: +34 91 211 30 00

Barcelona

Av. Pearson, 21
08034
T: +34 93 253 42 00

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