2nd Investors Survey
Commercial Real Estate

Spain

March 2016

jll.es

Contents

1.- Introduction

Aim of the survey

It is our great pleasure to present you the 2nd edition of the 2016 Commercial Real Estate Investors Survey.

- JLL and IESE Business School, two recognized organizations within the Financial Education and Real Estate sectors, leaded this project for the second time.
- The Investors Survey reflects investor sentiment on the Commercial Real Estate market in Spain.
- Understanding the expectations of the key players in the market and having an insight into their objectives and investment policies will contribute to greater transparency in the sector.
- This is an objective that both JLL and IESE have focused on for some time and set in motion with the first Investors Survey of the Spanish market, presented in 2015.
- In addition, sharing the investment sentiment of relevant sector players; reading their comments and looking at the property statistics published in this report, will help to understand the current market status and its future outlook.

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

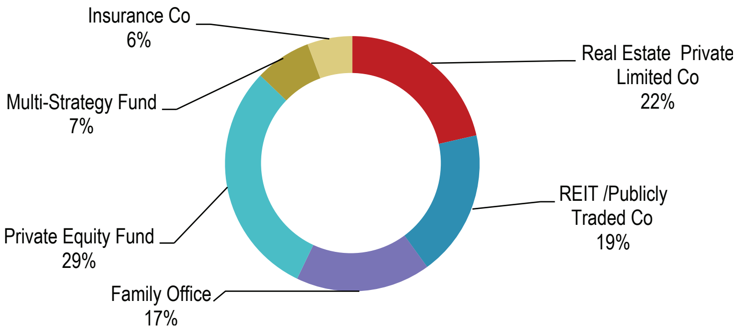
Warren Buffett

Survey metrics	
Number of participants	101
Survey period	Nov 2015 - Feb 2016
National participants	35 (35%)
International participants	66 (65%)

Answer were gathered by phone, online and direct interviews

Respondents by investor type

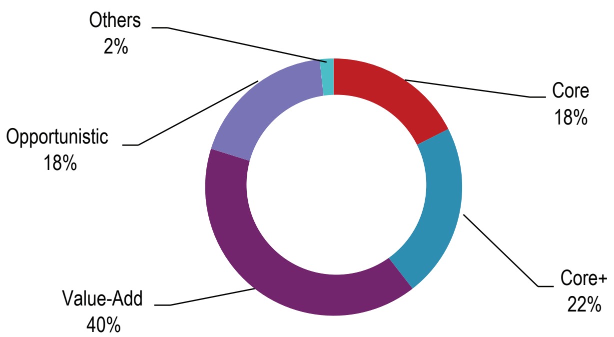
What type of investor is your company?



- The Survey was carried out via face-to-face and telephone interviews in 90% of cases and extended via an online survey.
- Respondents include a wide range of investor profiles and types.

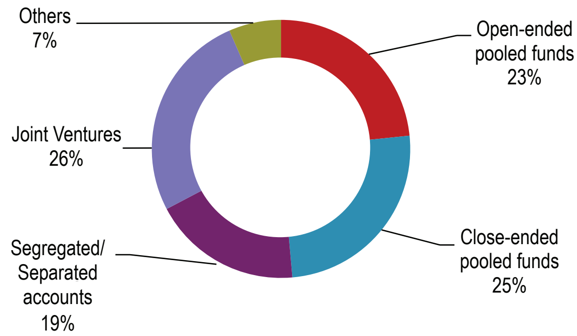
Respondents by risk profile

What is the investor profile of your company?



Respondents by investment vehicle

Which investment vehicle does your company use?



2.- Economic & Real Estate context

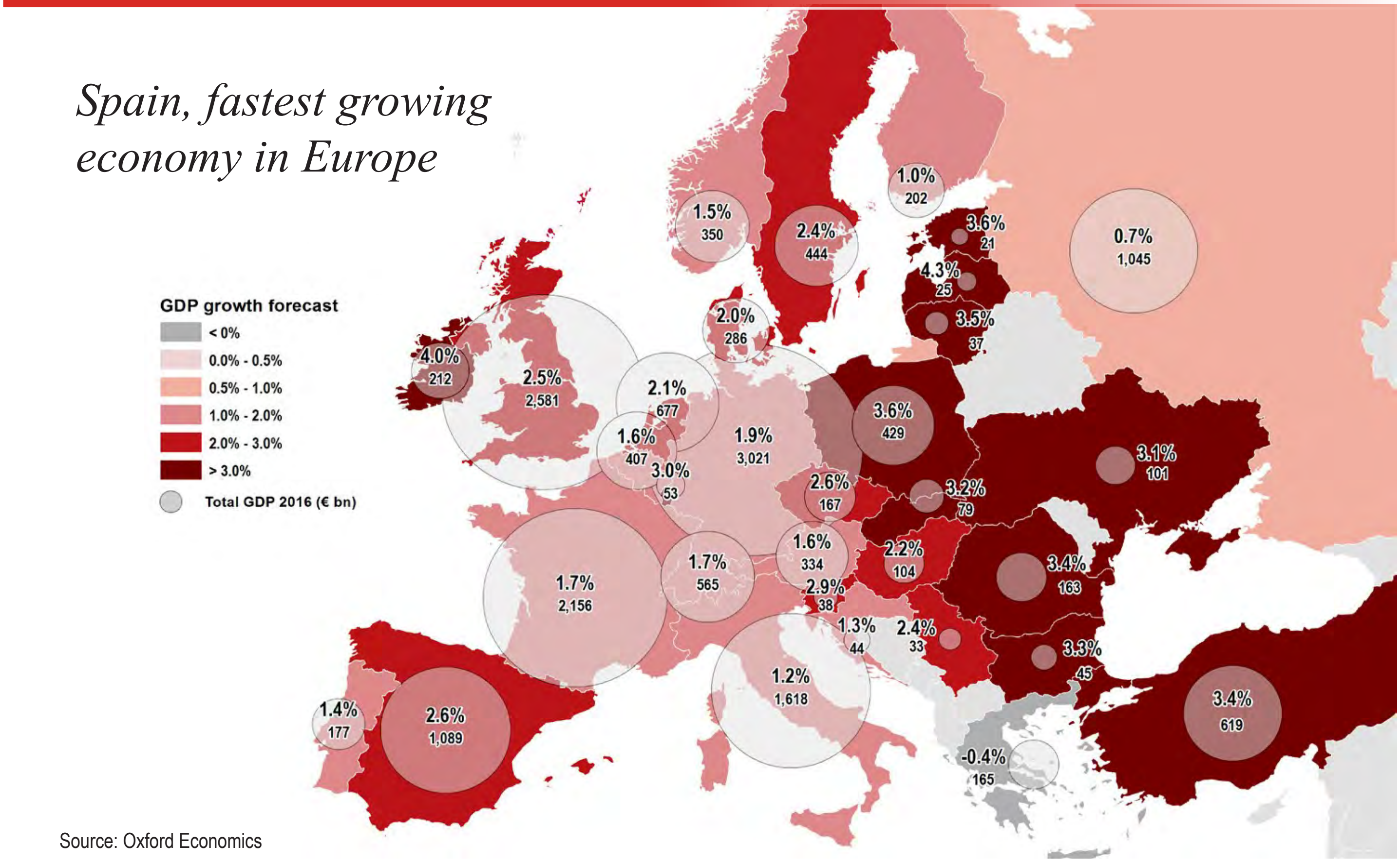
In 2015 Spain's GDP grew by 3.2%

Economic overview

- 2015 macroeconomic data has now corroborated that Spain's economic recovery has taken hold. With **GDP growth** of 3.2% in 2015 (which doubled the Eurozone average), according to the IMF, Spain grew the most out of all of the European countries.
- With the **creation of more than half a million jobs, the highest increase since 2006**, Spain enjoyed the highest rate of job creation in the Eurozone in 2015.
- Spain also headed the **increase in productivity** among the main European economies in the post-crisis years. According to Eurostat, since 2010 the productivity per hour worked increased by 7% in Spain, compared to 3% in the Eurozone.
- Despite the fact that Spain continued to run a trade balance deficit, during 2015 the upsurge in exports helped to reduce the deficit by 9.3% up until May 2015, which was the opposite to 2014. Exports now account for more than 23% of GDP.
- **Inflation** stood at -0.5% in 2015, due to the continued fall in oil prices, but the underlying rate remained stable, which is a sign of the continued recovery.
- From the European Union, Spain is the country that has reduced its **private indebtedness** the most during the crisis. In large part this deleveraging was forced on it, due to the sharp restriction in access to credit from 2010 onwards.
- At the end of 2015, **household debt** fell by 16% of GDP since 2007, which is equivalent to €165Bn, compared to pre-crisis levels.
- **Debt for non-financial businesses** fell by more than €300Bn, since the onset of the crisis. The decrease in debt during the crisis (families and businesses) amounts to 45% of GDP.
- Although **the total indebtedness of the private sector is decreasing**, families and businesses are capitalising on the return of liquidity to the market and are again taking on new financing.
- The tourist sector is still booming. **Spain is the third most visited country in the world**, with 68 million tourists in 2015 (close to 5% more than in 2014).
- Up to November 2015 international tourists spent an accumulated €4Bn, 6.4% more than in the same period the year before.

GDP Growth Forecast in EMEA 2016

Spain, fastest growing economy in Europe



Source: Oxford Economics

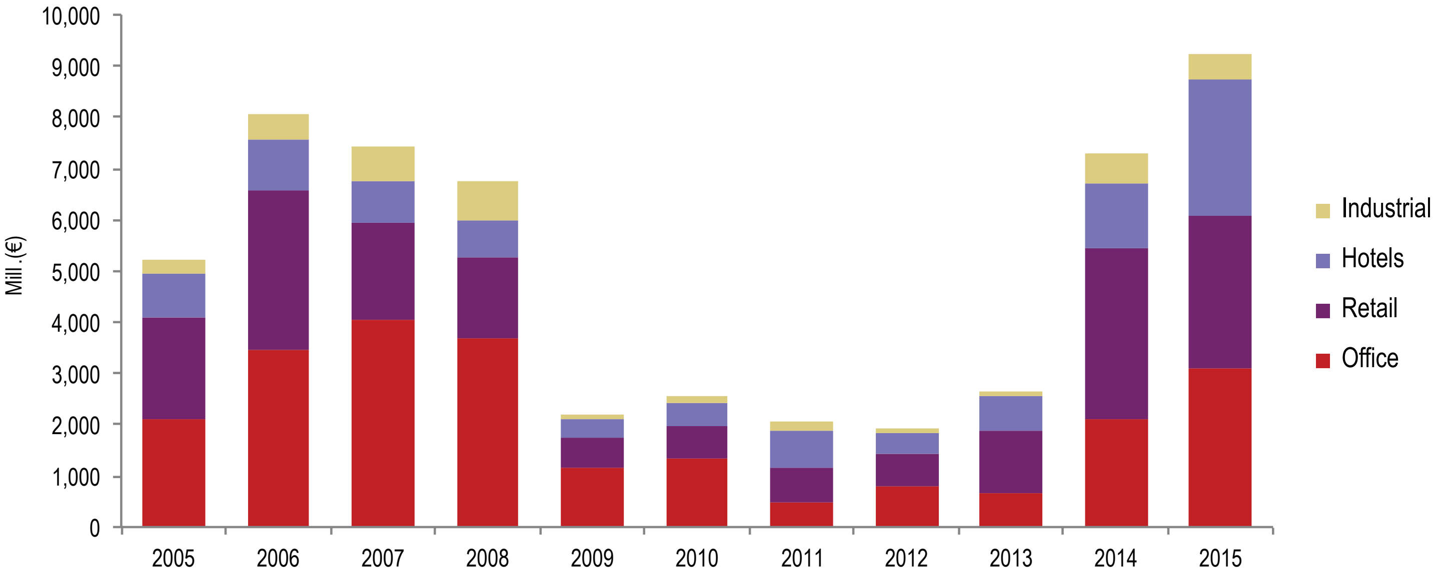
Real Estate market overview

- In 2007 the **Spanish Real Estate market** was hit by a double crisis. A global financial crisis and a residential sector crisis that hammered both the investment market and the occupier market for 7 years.
- Investment fell by 75% from maximum levels in 2006, dragging market values down to record lows. At the same time, lettings and rents fell drastically in all sectors. No sector went unaffected.
- After this major setback, Spain's Real Estate market appears to have emerged fitter and stronger.
- The sector has become more professional with new players in the market. **REITs legislation has been a resounding success and investment has returned with a bang.**
- Spain has won back the interest of investors. Investment is up by five times what it was at its lowest point in 2012 and hit a new all-time record in 2015 surpassing even the figures registered in 2006, with a total of **€9.2Bn** according to JLL data.
- **Take-up is rising, which is pushing rents up**. The occupier market appears to slowly but surely be coming back in line with the investment market.
- **The residential market is showing signs of stabilising**. Up to Q3 2015, 286,176 homes were sold, a 12.8% *y-o-y* increase. 12% of these sales were to foreigners. The number of housing starts in Q1 2015 stood at 10,000 homes, a 25.5% *y-o-y* increase.
- **Housing prices grew by 1.4% in Q3 2015** compared to the previous year, reaching a national average of €1,476 per sqm (Source: Ministerio de Fomento).
- Land and development on the rise.

"In Real Estate, you make 10% of your money because you're a genius and 90% because you catch a great wave"

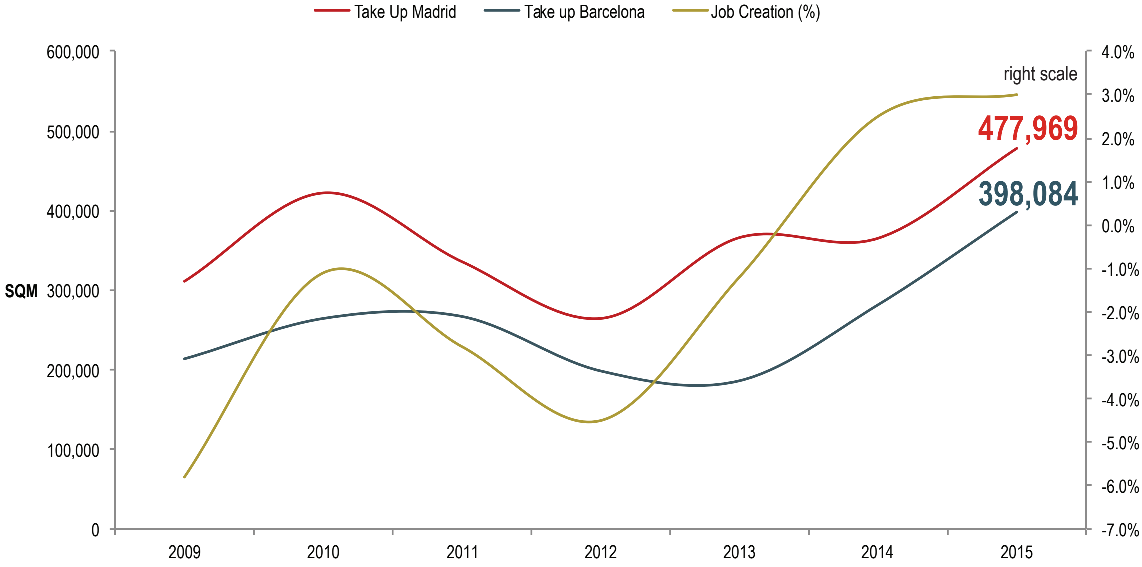
Jeff Greene

Direct investment in Commercial RE in Spain (€ Mill.)



Source: JLL

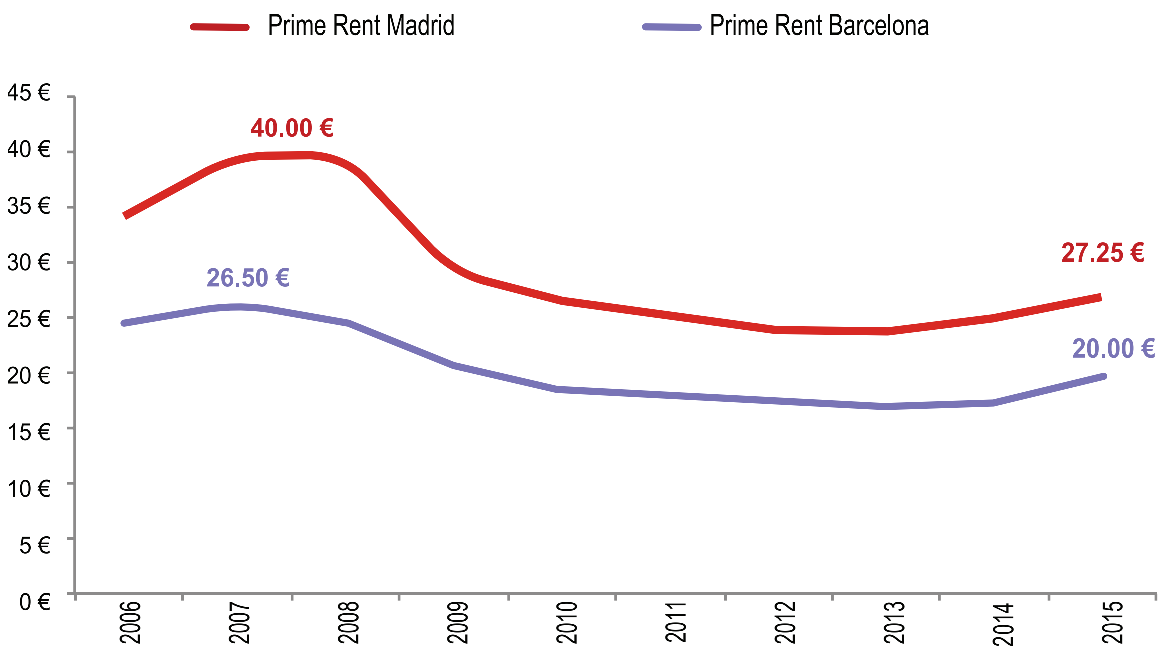
Variation in employment and office take-up



Source: JLL

- Of particular interest were **Madrid and Barcelona**, both of which **have robust growth forecasts and potential.**
- According to the "JLLGlobal 300" report (Dec.15), Madrid stands in 31st place in the economic and real estate ranking. According to the JLL "Globalisation and Competition" report (Nov 2015), Barcelona belongs to the "New World Cities", being seen as a cultural, leisure and tourism hub.
- After the upturn in investment thanks to **strong liquidity** in the markets, the rental market is now on the up. Economic growth and associated job creation are driving a recovery in the Real Estate occupier market.

Change in office rents



Source: JLL

3.- Highlights

What do investors say?

1 Rents are rising

Rents are driven by economic situation up to a certain extent, and given the Spanish GDP outlook, rents will continue to rise.

Employment grew by half a million people in 2015 pushing prime and secondary office rents up.

Logistics and High Street rents have grown given the improvement in national spending and consumer confidence (consumption and e-commerce uplift).

2 Liquidity will remain high (from both equity and debt sides)

National and international banks and capital markets are providing lending to investors in order to improve their P&L results given low interest rates.

Bank financing is generally provided for plain vanilla transactions, while for more complex deals, alternative lenders are sought.

On the equity side, funds, PE firms and family offices have cash to invest, and given the scarcity of product in the market prices are going up.

3 Value added is king

Lack of prime quality product is drifting investors to assess wider spreads of assets based on location, potential value uplift and ability to implement a Business Plan to meet required yields.

The vast majority of investors are looking to invest in value-added properties. Refurbishments and repositioning are taking place.

Little or no investment in Capex by owners over the past 6-7 years, due to the lack of access to financing during the financial crisis.

This is the case in virtually all sectors, but primarily in offices, hotels, logistics and residential. And to a lesser extent, shopping centers that have not carried out sufficient maintenance in the past.

Alternative sectors such as Student Housing and Healthcare have also become attractive for a large number of investors. There are also a number of refurbishments and new developments in these sectors.

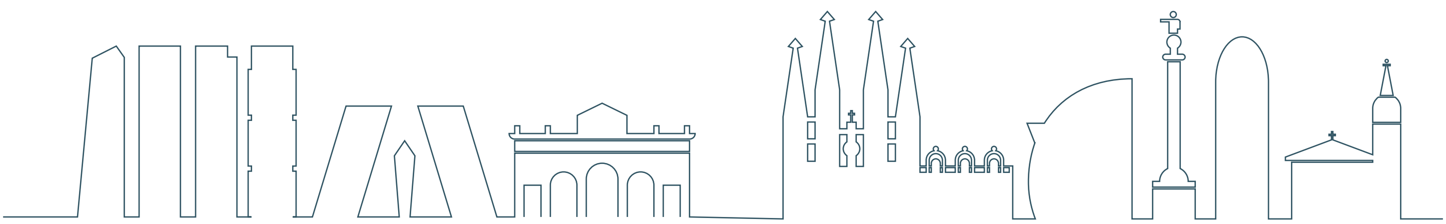
4 Investors are watching the political situation

Spain's main challenge is its political uncertainty, but the new Government is unlikely to change Spain's legal stability.

Respondents expect that politicians will continue to follow much the same economic strategy.

Various investors mentioned their concern regarding local authorities granting necessary permits, for instance in Barcelona.

Generally speaking, investors demand a clear regulatory framework and transparent processes in order to speed up investment decisions.

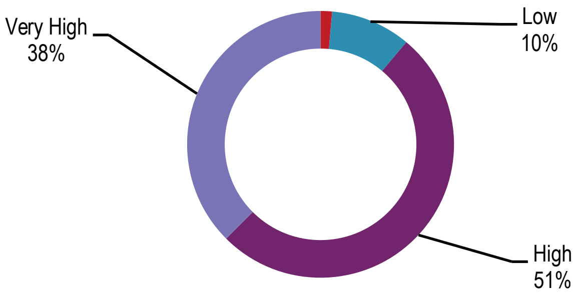


4.- Investors appetite:

89% of respondents continue to have a high or very high appetite for the Spanish market, very similar percentage than previous year

Investor appetite

What is the current investment appetite of your company for the Spanish market?



- The minimum investment required **has also decreased** due to the lack of prime product, and there is potential to reduce further.
- The majority of investors are looking to **invest in value-added properties.**
- In terms of **bank portfolios and Sareb**, both of non- performing loans (NPL´s) as well as foreclosed properties (REOs), some investors point out the improvement in transparency of the processes and approvals. However, they also criticise the stance of some insolvency administrators, and point out that more clarity is required, with processes and rules that are easier to follow in order for them not to become protracted.
- These sectors require investment **in order to achieve value uplift in the portfolios**, although the investor that initially acquired the portfolio does not always carry out the Capex.
- Despite yield compression, there is a trend to move to real asset worldwide, being considered to be a good investment alternative as part of a diversified portfolio, compared to investment in debt that offers low returns or investing in the stock market which is more volatile – as demonstrated in the final months of 2015 and the start of 2016.
- The **greater access to financing** is helping investors that leverage their properties to achieve their targeted IRRs, as the yield compression is partially compensated with the drop in bank margins spread and 0% interest rates.
- Various investors suggest **that rents are rising slower than prices,** although rents have already risen in prime areas, and since Q4 2015, slight rental increases were also registered in secondary areas.
- Those surveyed agree that regulation of **REITs** has successfully reactivated the market.
- **88% of respondents agree that financing**, which was one of the key problems just a few years ago, is improving. Although some respondents mentioned that Spanish banks continue to be conservative for non plain vanilla deals.

Investment constraints in 2015

By % of survey respondents

	Worse	Better
Market uncertainty		80
Lack of product	68	
Political uncertainty	73	
Competition	79	

Investment constraints expected for 2016

By % of survey respondents

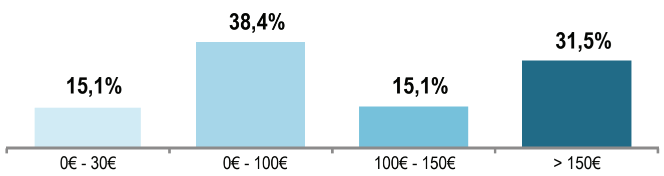
	Worse	Better
Bank lending		88
Political uncertainty	70	
Lack of product	71	
Higher prices	74	

5.- What are investors looking for?

Investment strategy:

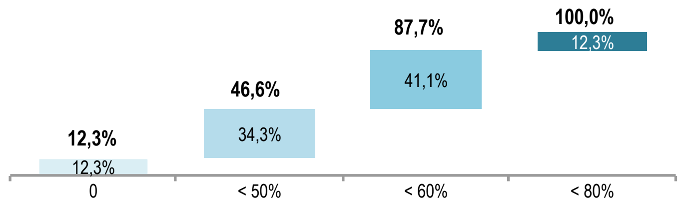
Investment volume allocated to Spain

In line with the results of the first Investors Survey in 2015, two groups of investors stood out in terms of lot sizes, those with target investments of up to €100M and those with an investment target of over €100M.



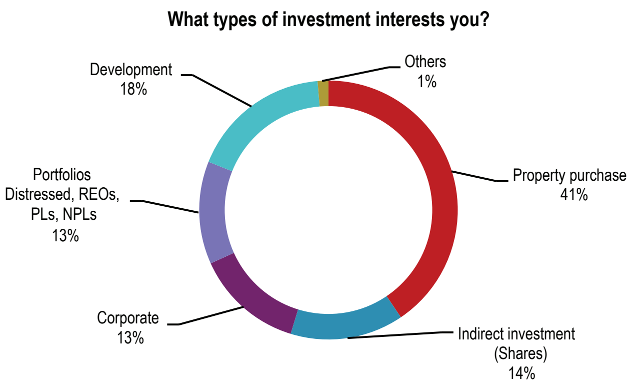
Leveraging

The majority of those surveyed (88%) look for LTVs of less than 60%. Only 12% of those surveyed are looking for LTVs higher than this.



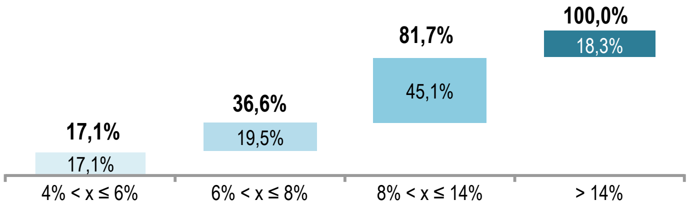
Investment type

The vast majority of investors opted for the direct purchase of properties, which were either income-producing or for development, compared to indirect investment.

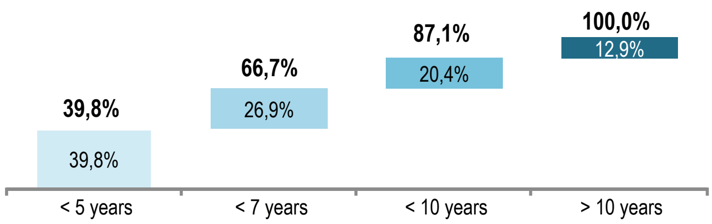


Required IRR

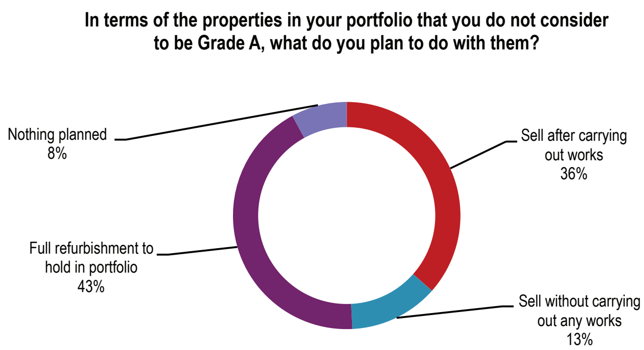
Investors have reduced their return expectations, 63% of investors (vs 70% in 2015) are looking for an IRR of more than 8%.



67% of those surveyed are considering an investment term of less than 7 years.



Property Quality



40% of respondents believe that less than 20% of their portfolio is Grade A, and 79% expect to increase Capex/carry out some form of works to gain value uplift in their properties, either to hold them in their portfolio or to then sell them.

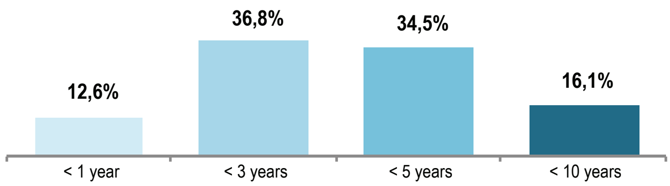
This is in line with the impression that there are many properties (especially offices) that have not been refurbished and therefore have lower rents, and are not as well located as higher quality properties.

Occupiers are no longer just looking at the basic cost when searching for spaces, but also the quality of the property.

Investment criteria for leased properties:

WAULT

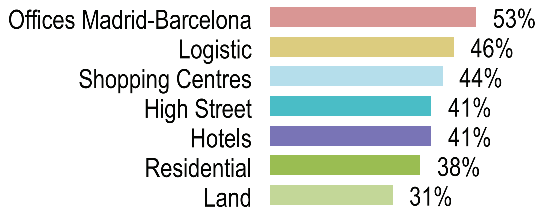
As most of the investors surveyed are Value Added, 50% (compared to 46% in 2015) of investors prefer short lease agreements of less than three years, in order to capitalise on expected rental uplift.



*WAULT (Weighted Average Unexpired Lease Term)

Sectors

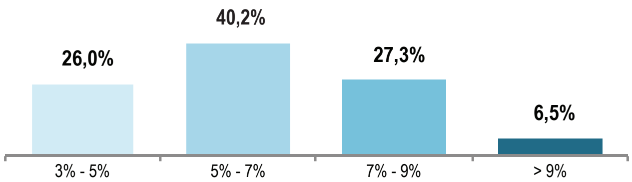
Offices continue to be the most sought after product by investors, followed by logistics properties.



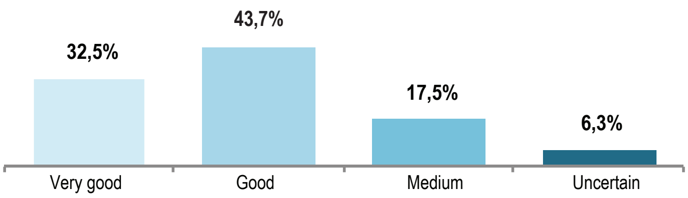
Shopping centres are in 3rd place, but they are not suitable for all investor profiles, due to the high levels of management required.

Initial Yield

The most sought after properties are those with yields of between 5% and 7%. Although 26% (compared to 9% in 2015) would accept lower yields of between 3% and 5%.

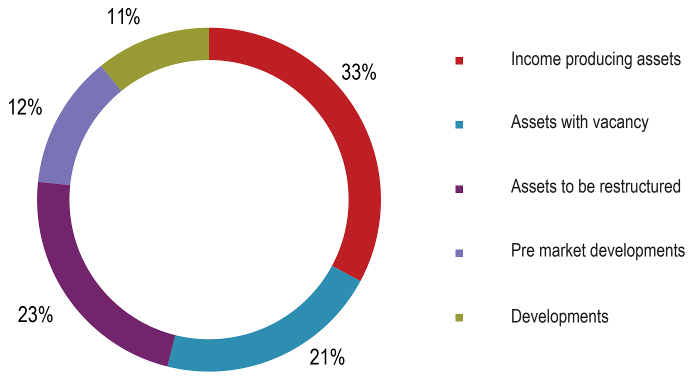


76% consider tenant covenant strength to be important.



Level of risk

Investors are primarily looking for value-add properties. 54% of investors are looking for vacant properties or properties to renovate in order to achieve higher returns.

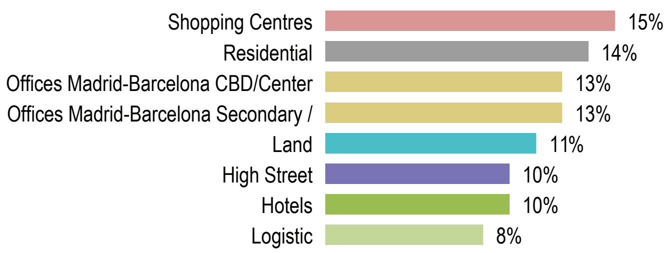


- Interest is driven by rental growth forecasts.
- However, 33% of core investors are looking for product without construction or rental risk.
- Accordingly, investor appetite is reemerging for land, residential, commercial property and logistics developments.
- The logistics investment sector perceives growing occupier demand, fueled by the strong e-commerce sector.

6.- Disposal Criteria

In the short term, investors do not appear to be looking to divest. The majority of investors are looking to capitalise on an anticipated rise in rents prior to selling, which is not expected to happen for at least 18 months. Those who are looking to divest would preferably do so with shopping centres and residential.

% in Sectors in which the investors are willing to divest in 1-2 years



- Disposal policies and time frames depend on “property type and timing required to achieve the repositioning or the expected value uplift”.
- In contrast, as mentioned by some investors, “the Government has a great deal to sell”.
- A residential investor commented: “Landowners are the ones that set the prices, who are the funds that purchased from the original owners”.
- Sellers are well aware of the minimum price they need to achieve in order to obtain their return and as they acquired in the last 2 years their IRR will be 15-17%.
- They are not in any rush to sell. If they do not get what they want, they will have to adjust their prices.

“Buy land, they’re not making it anymore.”

Mark Twain

7.- Investors sentiment towards Spain

How long will market values continue to increase?

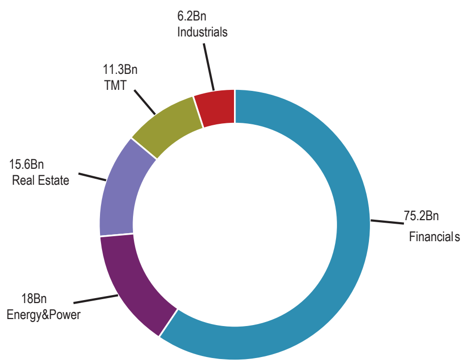
- 60% of respondents estimate that values will continue to rise for at least another 18 months.
- This is fuelled by low interest rates, improved access to financing and the recovery of economic fundamentals.
- National political uncertainty, as well as international factors (growth in China, US and EU economic policies), could put a halt to this upward cycle.
- Some experts predict that this cycle will be less pronounced and shorter than the previous one.
- There are market sectors and locations that are running at different speeds. Many investors see an upturn in the logistics sector, as well as residential, due to the strong price corrections registered during the crisis years.
- In terms of housing, “prices are still 30-40% below 2008 levels”. This correction is consistent with the six years of income required to purchase a home in Spain, compared to the average of 4 years in Europe.
- Prices have now corrected and it is expected that nominal prices will grow faster than real prices in the future.
- The upsurge in national demand fuelled by an increase in employment, along with international demand attracted by low values, should sustain growth in market values.
- The amount of unsold housing stock fell below 400,000 units and many talk about “unsellable homes”.
- The increase in value of offices located in secondary areas will be greater than in prime areas, although values will continue to increase in the latter.
- Generally speaking, investors still see room for improvement in relation to yields, but believe that they will hit their limit in 1 or 2 years time, at which point they will stabilise due to the anticipated increase in interest rates.
- The rental cycle is expected to be favourable for at least the next 4 years, although if the economy continues to remain stable and improve, this timeframe could be extended.
- In the short term, the rise in market values will come off the back of both yield compression, as well as rents, although some respondents did comment that rents are not currently increasing rapidly.

Which countries compete with Spain?

- The investors studying Spain are generally analysing the whole of Southern Europe, comparing the yields and risks of each country.
- Investors point to Italy and Portugal as being Spain’s main competitors, with initial yields at rd. 100-150 bps above Spain. Some American funds pointed out that they are studying transactions in Portugal, especially hotel and residential projects.
- However, the small size of the Portuguese market, its economy and less dynamic real estate markets make it less appealing than Spain, despite that fact that yields are currently hardening.
- In contrast, Italy is on many investors’ radar. “Spain is always compared with Italy” “Italy competes with us with yields that are 100 bps above ours.”
- Some of those surveyed also mentioned the main European markets, such as Paris and London, but their high prices make them less appealing than Spain. “In France product is scarce and very expensive”.
- Investors point out that Spain (primarily Madrid and Barcelona) could continue to be competitive at current yields (or even at lower yields) compared to other leading European markets.
- Spain offers greater legal and economic stability than other target countries, but investors continue to point out that Spain’s political situation needs to be clarified.

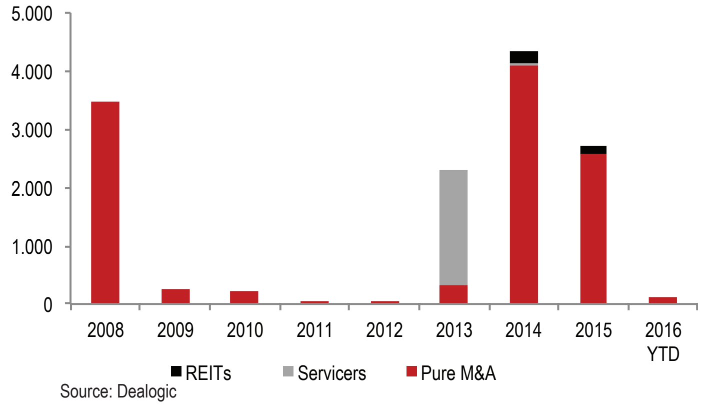
8.- Mergers & Acquisitions / RECAP

Top five sectors by value of deals across Spain 2009-2014



Source: Dealogic

Evolution of Real Estate M&A market by volume and type

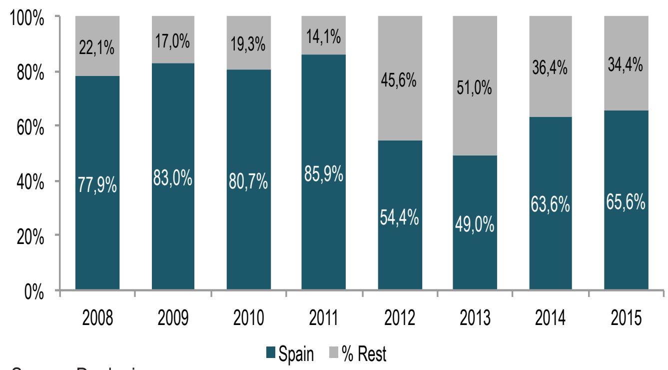


Source: Dealogic

% of M&A Real Estate deals compared to the Real Estate market (excluding transactions carried out by banks), by volume

- In **2013** international investment sentiment **shifted towards** Spain and it came back on to investors' radars.
- In **2014** international investment in Spanish Real Estate **gathered pace** and REITs burst on to the scene, accounting for a large part of the investment volume in the sector.
- As is only logical, to begin with, **investors focused on acquiring properties**. The product on offer, aside from a few specific cases, satisfied the needs of a wide array of different investors. Consequently, investment involved anything from the acquisition of NPL portfolios to Trophy Assets, to value-add properties.
- These **major asset deals** did not mean that we did not see some major M&A deals, examples were the acquisition of Neinor in 2014 by Lone Star (€1.0Bn), Tree Inversiones by Merlin (€1.9Bn) or the acquisition of Testa in 2015, also by Merlin Properties (€1.7Bn).

Real Estate Investment (total) by investor origin



Source: Dealogic

- In terms of **2016**, the takeover bid for **69% of Realia** (€120Mn) is still currently pending completion and we expect to see more M&A deals.
- **Demand** will come from REITs looking for greater consolidation, specialisation and re-IPO processes, from international funds looking for more complex deals, where they do not have so much competition, or national companies looking for international partners, in order to form strategic co-investment and development alliances.

RECAP

- **Continued low interest rates and the shift in investment strategies** towards less opportunistic positions, has led many investors to search for more permanent and efficient capital structures.
- Given that national banks and capital markets are also providing lending, as well as overseas banks, many investors are **readjusting their capital structures**, substituting equity for debt and fixing their terms in the medium to long term.
- This has been the **strategy of REITs**, other listed companies, servicers, as well as some developers. This has been translated into the refinancing of liabilities, in some cases via bond issues, and the fixing of interest rates via medium term swaps, in order to match the terms and conditions of the debt with the life cycle of the investment portfolio.
- Refinancing has allowed some **private equity funds** to recover part or all of their equity investment (for example, some funds that invested in purchasing a servicer).

9.- Conclusions

Interest in Spain, Investment Types & Typical Investment

There continues to be strong interest in investing in Spain from all investors type, mainly in the long term.

New investors, with different strategies, continue to enter the Spanish market, attracted by higher yields than those obtained in most of the major European economies.

In the short term, the biggest challenge Spain faces is political uncertainty.

Investment in all types of properties seems equally attractive. We are beginning to see institutional investors taking positions in the residential market, via development and renovation projects.

There is strong appetite for value-add properties, fuelled by the lack of prime properties and high occupier demand for quality assets.

Value-add Investors are not concerned about WAULT (Weighted Average Unexpired Lease Term) due to the anticipated increase in rents and because they are looking for properties to be repositioned and refurbished, which tends to imply new lease agreements and rental renegotiations.

There is growing interest in investing in alternative properties, such as Student Housing and Healthcare.

The sharp consolidation of the investment market and the logical shift in financial entity strategies will be **highly conductive to M&A deals** being carried out in the upcoming months.

The typical investment is of €30m-€100m, with a 50%-60% of debt financing, pursuing a 8%-14% IRR, and targeting an initial yield of 5%-7%. The rent uplift expectations limits the desirable weighted average unexpired lease term to less than 3 years. The most common investment term is less than 5 years.

Prime and secondary offices in Madrid and Barcelona are the preferred asset classes, followed by logistics, shopping centers and High Street. The logistics assets continue to be attractive due to the e-commerce boost.

Hotels lost two ranking positions compared to last year's survey when it was the third most preferred asset.

In terms of the large REO and NPL portfolios, although **investors** admit that there has been a marked improvement, **they request that local authorities play a more active role in preparing a regulatory framework** that is transparent and helps to speed up the sale processes.

Evolution of Capital Values and Rents

Capital Values are expected to continue to increase at least for another 18 months, due to yields holding stable or even falling slightly (there is little room for further yield compression) and subsequently via rental increases.

The recovery in take-up is now a reality.

Although there is a general expectation that rents will rise (now at record low levels) some **investors believe that there are Business Plans with very aggressive rental uplift estimations.** Property price rises will very much depend on how much the rent increases will really be.

Debt

There is an increased appetite to lend in Spain and willingness to move lending up the risk curve.

Debt will play a greater role in Real Estate investments, which **will result in more complex and leveraged deals**. Simultaneous financing to purchase is becoming more popular among investors.

Record low interest rates and lower bank margins spread, are slightly compensating for yield compression and are allowing investors to use **debt to achieve their expected returns.**

Sector Situation and Competition

The sector is more professional and is moving towards niche specialisation.

The main **determining constraints for investment** are higher prices, the lack of product and political uncertainty.

The market is becoming slightly **more transparent**.

Investors are not looking to divest in the short term, thanks to overall confidence that property prices will hold or increase in value in the short to medium term.

Portugal and Italy are Spain's most direct competitors, where yields are 100 - 150 bps higher. Given that Portugal is a smaller market, Italy presents the most direct competition. Spain's strong point is that it is perceived to have a greater legal and economic stability.

"Buying Real Estate is not only the best way, the quickest way, the safest way, but the only way to become wealthy"

Marshall Field

Participants in the Survey that authorized to provide their names

- Acciona RE
- Allegra
- Allianz
- Arcano
- Ares
- Autonomy
- Avignon
- AXA
- Axiare
- Bankinter
- Baraka
- BBVA
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- Colonial
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- Copernicus
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- IDI Gazeley
- Internos Global Investors
- Invesco
- Lar España
- LIM
- MDSR
- Meridia
- Merlin
- Metrovacesa
- Monthisa
- Mutualidad de la Abogacia
- Oaktree
- Orion
- Phoenix
- Pradera
- Proprium Capital Partners
- Realia
- Redevco
- Rujoma
- Springwater
- Stam Europe
- Torre Rioja
- Triuva (antiguo IVG)
- Ventas Reit
- Vitruvio
- Zaphir

The report

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The band is playing…
Let's dance!!!

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