4 keys to Spain's commercial real estate market

In 2015, 9.2 billion euros were invested in Spain's commercial real estate — a record that tops even pre-crisis levels. What do professional investors think will happen next?

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Investment in commercial real estate is breaking records — surpassing pre-crisis levels in Spain. What are professional investors looking for now in the Spanish market?

"Value-added" opportunities is the short answer. With prime real estate hard to come by, investors are seeking opportunities to renovate or refurbish properties for profit.

That is one of the key takeaways from the 2nd Investors Survey in Commercial Real Estate, a project led by IESE, under the supervision of Professor **José Luis Suárez**, together with JLL, the international real estate services company.

Overall, the survey shows that foreign and domestic investors remain optimistic about Spain's commercial real estate (CRE) sector with office spaces (in Madrid and Barcelona), logistics properties, and shopping centers figuring as the most sought-after asset classes. Rising values in real estate are expected for at least the next 18 months, say 60 percent of respondents.

The survey says...

The survey targets the most active players in Spain's CRE market: 101 key investors, including a number of private equity funds, real estate private limited companies, publicly traded REITs, family offices, multistrategy funds, and insurance companies. Within this group, 65 percent are international and 35 percent are national investors, as seen in the inaugural

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survey last year.

Of those surveyed, 89 percent said that they currently have a "high" or "very high" appetite for commercial real estate in Spain, just a bit below the 94 percent who were bullish a year ago. For the 2016 outlook, polling was conducted between November 2015 and February 2016.

Four keys

The survey highlights four key takeaways:

1. **Rents are rising**. Thanks to favorable economic conditions, rents are expected to climb. Spain's GDP grew 3.2 percent in 2015, double the Eurozone average, and it is expected to grow another 2.6 percent in 2016, outpacing most economic growth forecasts in Europe. More than half a million jobs were created last year, while productivity levels increased and debt levels fell. In sum, economic recovery has taken hold.
2. **Liquidity levels are high**. From both the equity and debt sides of the equation, the market is quite liquid. Banks are lending more while private equity and other investors find themselves with cash to invest in CRE. Low interest rates, market stability and limited investment alternatives are three contributing factors.
3. **Value-added is king**. "The vast majority of investors are looking to invest in value-added properties," the report summarizes. A couple of factors are at work here. First, prime quality targets are now scarce, after a banner year for the CRE market in which a record 9.2 billion euros were invested. Investors now are casting their nets wider in search of properties in more diverse locations and fixer-uppers. Second, for many years running, the crisis prevented owners from sprucing up or maintaining their properties. But now, funding is finally available. The combination spells opportunity for investors willing to put some work into an increasingly competitive market.
4. **Political uncertainty is the top concern**. Spain's December elections left the country without a working national government, and going into March, the situation is the same. That said, the new government is unlikely to change Spain's legal stability, investors believe. At the same time, in Barcelona, for example, CRE investors are worried about getting the permits they need from new local governments. "Generally speaking, investors demand a clear regulatory framework and transparent processes in order to speed up investment decisions," the report

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notes.

Investing in which bricks?

Office spaces, logistics properties, shopping centers, and prime retail ("High Street") were the four most demanded asset classes by investors. Hotels followed in fifth position, dropping from third place in last year's survey.

Office rents are rising and are expected to continue to climb in the future. That said, they are still well below pre-crisis levels. In Madrid, for example, prime office rents now average 27.25 euros per square meter, compared to 40 euros per square meter eight years ago. Meanwhile, logistics assets continue to be attractive, aided by e-commerce-fueled demand.

Notably, there is growing interest in two "alternative" investments this year: student housing and healthcare. Opportunities for refurbishments and new developments in these sectors appeal to value-seeking investors.

The deals today and outlook for tomorrow

The 2nd annual survey reveals that the typical investment in Spanish CRE is in the range of 30 to 100 million euros, with 50 to 60 percent financed by debt. Investors tend to target an initial yield of 5 to 7 percent and an internal rate of return (IRR) of 8 to 14 percent.

As bank lending increases, survey respondents named "higher prices" and "lack of product" as top constraints to investment for the year ahead. And yet those investors seeking opportunities in "value-added" deals are driving a positive outlook for 2016 as well.

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