

# Real Estate House View

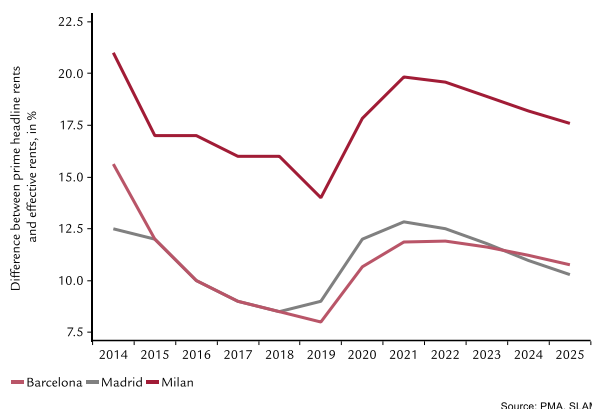
## Italy, Spain, Portugal

First half of 2021

### Key takeaways

- **Office letting activity has dried up:** due to the general uncertainty and wait-and-see approach of corporates. While economic indicators are down, headline rents decreased moderately in 2020, largely due to a lack of transactions and an increase in incentives.
- **Retail in Southern Europe continues to be hard hit:** by the lockdowns and the lack of tourism. Rent renegotiations are on the rise to keep tenants afloat.
- **E-commerce penetration:** has spiked noticeably during the lockdown periods but lasting effects on consumption habits are expected to remain relatively modest in Southern Europe, reinforcing the relevance of the omnichannel model.
- **Hospitality endures the pain:** occupancy and RevPAR are hitting rock bottom. The pace of recovery will depend on the ability of operators to attract domestic demand until the vaccines are available.

### Chart in focus



The impact of the slowdown on office occupier markets was not yet reflected in prime headline rents as of the end of 2020, with minor decreases of around -5% recorded in Southern Europe. Nevertheless, the level of incentives granted to tenants should be closely monitored in the current context in order to estimate properly the economic rents and accurately reflect the ongoing uncertainty. Following a steady decrease in recent years, incentives are on the rise, generating a reduction of economic rents of 7% to 9% in 2020 and 2021.

The manufacturing sectors in Italy and Spain recovered sharply in the final quarter 2020, benefitting from strong external demand and the fact that a coordinated European fiscal and monetary policy response avoided a local banking crisis following the severe recession of early 2020. The short-term pace of the economic recovery will depend strongly on the possibilities for travelling across Europe in the summer holiday season. Pent-up demand is elevated and would result in a strong tourism season if the pandemic situation were to allow relatively unrestrained travel. Holiday providers report strong demand and full order books. The medium and long-term economic growth potential in this region may be affected negatively by the legacy of the pandemic in the form of rising unemployment and corporate bankruptcies. To offset this negative impact, infrastructure investments and economic reforms remain as important as ever for all three countries.

## Sluggish office markets

So far, the impact on office jobs has been less severe than on other sectors such as accommodation, leisure and food services. However, there are still repercussions for the Spanish office markets, with office employment contracting and demand weakening. On the occupier side, office space demand remained subdued in Q3 and Q4 2020, suggesting that year-end absorption figures will remain low. However, as vacant space across Southern European cities has not spiked, tenants expect a short-lived crisis not deserving of a new lease structure. In this context, rental values have not plummeted, although the distance between headline rents and effective rents has increased due to higher lease incentives such as staggered rents and rent-free periods.

## A shifting model for retail

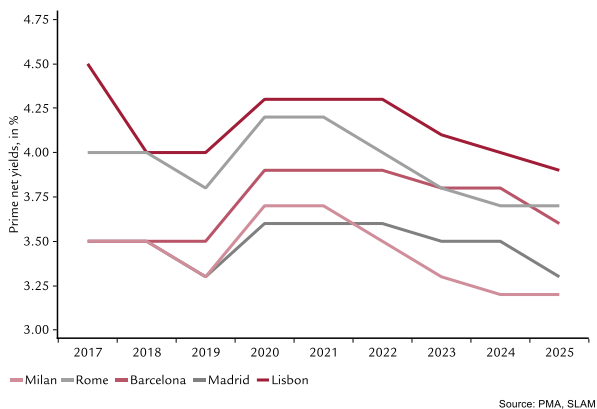
The second wave of restrictions imposed across Southern Europe in Q4 2020 is likely to be less damaging than the first, as retail, restaurants and leisure facilities are largely permitted to continue trading outside a night curfew. Nevertheless, the consumer spending outlook for Spain, Italy and Portugal is gloomy, particularly in the short term. The recovery of the high street segment is proving slow due to the partial depopula-

tion of offices in urban centres in favour of home offices and the reduction of tourist flows to cultural enclaves. As in other parts of Europe, online sales have been growing strongly in the region, particularly during lockdown, with food and pure play retailers enjoying the strongest growth. However, online sales penetration remains modest, reflecting a lower propensity towards e-commerce among Southern Europeans than their neighbours. Retailers are concentrating their efforts on omnichannel strategies, with on-site click-and-collect services. It is also likely that operators will make a number of adjustments in order to optimise their locations, freeing up space to swell the available offerings on the market, particularly in secondary areas. While some key brands in the non-food industry are closing stores, some evidence of retailer expansion and initial store openings was observed over the last six months. For example, Primark opened its 50th store in Spain in December and two further store openings are already planned for 2021. Rents are a pressing issue across the board and attempts to re-negotiate reportedly commonplace. Since the onset of COVID-19, the leading mall management company in Italy, Svicom, has been involved in the re-negotiation of rents on 650 lease contracts in malls under its management. This equates to more than a third of the 1800 units it manages and 40% of the GLA.

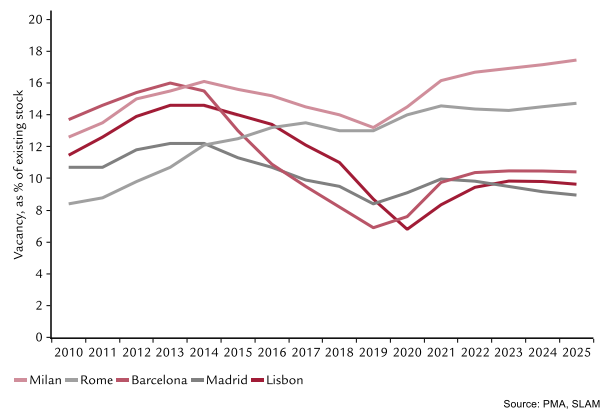
## Hotels wait for better days

Hotel occupancy and RevPAR were down 70-80% year-to-date in August 2020 in Milan, Rome, Madrid and Barcelona, representing some of the hardest hit European markets. While multiple European countries have since entered a second lockdown, there have been far fewer hotel closures during this period. As of 5 November, around 30-40% of hotels in Spain were still closed while around 10-20% remained closed in Italy. The latest news regarding the vaccine release suggests that an end to the pandemic is on the horizon, and according to a recent International Air Transport Association consumer survey demand for travel could return once the threat of COVID-19 has eased. Until then, the recovery will be slow in Southern Europe due to the dependency of these destinations on European and international demand, compared with the strength of domestic demand at Northern European destinations.

**Chart 1: Limited yield movement across Southern European markets**



**Chart 2: Office vacancy rates will increase until 2022 in most Southern European markets**



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