Real Estate House View

Italy, Spain, Portugal

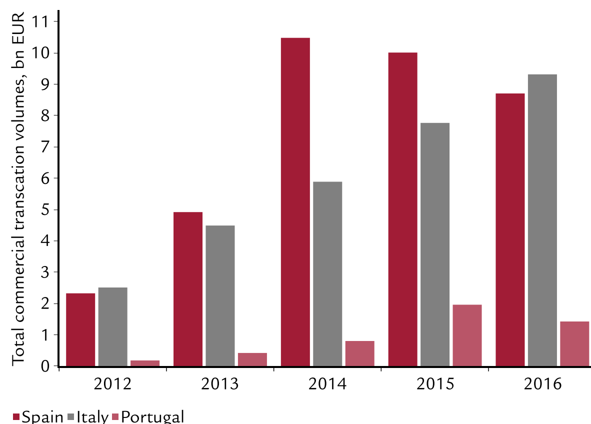
SwissLife Asset Managers

First half of 2018

Key takeaways

- The global economic upswing plus means of financial repression to cap nominal bond yields and hence ensure cheap refinancing for European peripheral sovereign debtors are supporting the regional economy, with Spain proving to be the most dynamic in the group.
- Office markets in Italy, Spain and Portugal performed well in 2017. These markets are more and more in the scope of core institutional investors looking for diversification and rental growth.
- Retail assets showed excellent performance: this asset class benefits from the increasing number of inbound visitors (e.g. +10% in Portugal). Tenants look for maximum visibility in iconic locations where footfall exceeds 8,000 pedestrians per hour.
- Hotels are also benefiting from this tourist momentum and the main cities all experienced a RevPAR (Revenue per Available Room) increase of at least +2% per year. The market is highly competitive among investors as there is a lack of properties being sold as owners tend to keep their assets to benefit from the positive trend.
- The residential sector, however, showed mixed performance in 2017. We expect the trend in prices to be positive in large cities and resort towns.

Chart in focus



Investor interest in Southern European real estate is increasing. These markets are rather specific as almost half of all investment in commercial real estate is directed towards retail assets. Most investors target high street retail assets that benefit from improved economic conditions and a buoyant tourist sector.

After years of austerity and reform efforts, Spain and Portugal are enjoying strong economic growth. Spanish unemployment rate fell from a high of 26.9% in March 2013 to just over 16% by the end of 2017. During the same time, the unemployment rate in Portugal more than halved from 17.5% to 8.5%. Italy is lagging behind, but there too, economic activity has started to accelerate: the purchasing managers' index for the manufacturing sector climbed to high levels during the final quarter of 2017. Persistent overcapacities and labour market reforms are holding inflation back in all three economies. Spain and Italy report inflation rates around 1%, suggesting that the European Central Bank (ECB) is not under pressure to abandon its accommodative monetary policy anytime soon. Politics are the elephant in the room: uncertainty about Catalonia and the upcoming elections in Italy remains high.

New target for office core investors

In Spain, Italy and Portugal, the typology of investors broadened these past few years from opportunistic investors to a larger scope ranging from core to opportunistic strategies. As a result, the region saw an investment volume of EUR 7 bn in office properties in 2016, 2.5 times higher than in 2013. This level is expected to be reached again in 2017 despite political instability in Catalonia. Aside from Barcelona, these markets remain very attractive to core investors as prime rents are rapidly growing after years of flat growth and stable prime yields. Rental growth was between +2% and +6% in the region and rents could increase by more than 1.5% in 2018. We consider the real estate markets in Madrid and Milan to be in good health: developments levels are low, vacancy rates in CBDs are around 7% and there is currently a shortage of well-located assets in good technical condition. Also, these two cities have broad economic networks in diverse activity sectors which make them resilient to economic shocks. In Barcelona, the real estate market showed good performance in the first half of 2017 but we remain cautious in light of the current political uncertainties. Rome and Lisbon are rather specific markets in our opinion: the former is in the hands of national investors and the latter is relatively small.

Targeting the right retail location is key

The retail sector in Spain, Italy and Portugal is very dynamic and represents about half of the total investment in commercial real estate. Investors are particularly keen on investing in high street retail locations where rents are on the rise (+1.5% in Milan and +5% in Madrid and Barcelona) and footfall is high. Calle de Preciados in Madrid sees more than 10,000 pedestrians per hour and Corso Vittorio Emmanuele in Milan approximately 9,000. These locations benefit from improved economic conditions and a sharp rise in tourism (inbound visitors +4% in Milan, +6% in Madrid and +10% in Portugal). This increase is benefiting high street retail as visitors tend to spend more than locals. At the other end of the spectrum, rental values in shopping centres and retail warehouses remain flat as these asset classes are more sensitive to consumption from locals.

Shortage of beds

Hotels also benefit from an increase in tourism, so Revenue per Available Room (RevPAR) grew between +2% and +6% in 2017 in all main cities. The investment market is actually hindered by the lack of properties for sale as owners tend to keep their assets to benefit from the positive trends. Prime yields decreased to 5% in Barcelona, 5.25% in Madrid and Rome and 5.75% in Milan. Yields could go even lower but value creation within the next few years is expected to be achieved through increased rental performance resulting from higher variable rents.

A mixed residential market

The residential markets showed mixed performances in 2017. We expect the main Spanish cities plus Lisbon and northern Italy to post the highest performances in the years to come. We remain more prudent in medium sized cities and in southern Italy, where the economic outlook remains modest. These markets are mainly driven by private owners, whereas multifamily type investments by institutional investors remain rare.

Chart 1: High street retail rental levels in Southern Europe - main cities on the rise

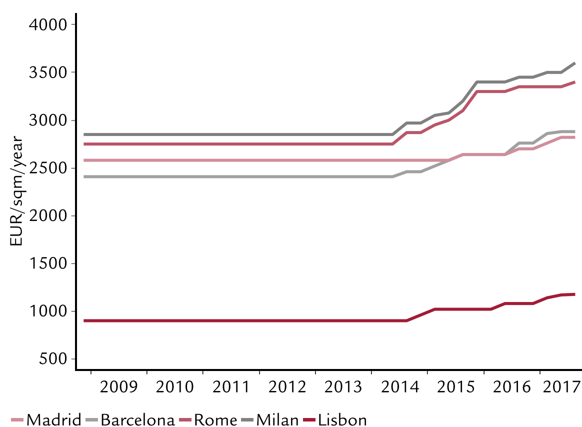
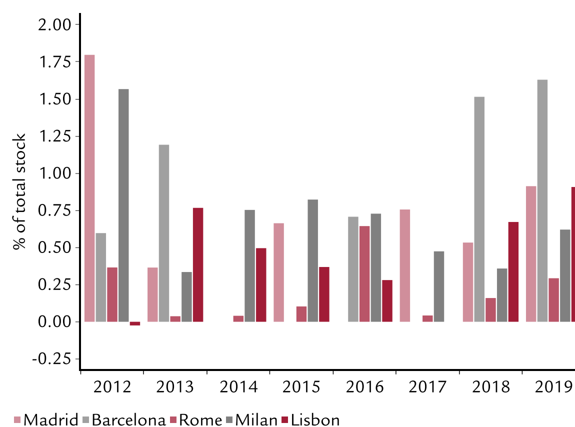


Chart 2: Net additions of office surface remain modest - below 2% of total stock in all markets



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