At a glance
INVESTMENT SPAIN Q1 2018
ABUNDANT LIQUIDITY SUPPORTS THE SPANISH PROPERTY MARKET

**Resilience of the Spanish Economy**

Having passed through a period of political turbulence experienced in Catalonia during the last quarter of 2017, forward data from the Bank of Spain shows a continued expansion in economic activity. The flame that kindled uncertainties in the region has yet to be extinguished, however there are signs that the situation is gradually getting back to normal. Proof of this is the fact that growth of 0.7% is estimated for Gross Domestic Product during the first quarter of 2018, in line with the last eight quarters. In addition, employment creation continues apace and inflation is showing no sign of becoming worrisome.

**Less Room for Increases in Capital Values**

Direct real estate investment during the first three months of 2018 amounted to 2.407 billion Euros. This figure is only 9% below the average for the last eight quarters (2.658 billion Euros), demonstrating that interest from investors in Spanish property assets remains firm.

The last three years in the Spanish market has seen consistent growth in capital values, 2018 began by showing symptoms that the upturn in capital values is coming to an end. Investors are now looking for returns from rents and are focusing their efforts on asset management. Rents will be driven by the occupational market fundamentals, particularly demand. Asset management will move towards making properties more efficient, increasing cost savings, carrying out refurbishments and improving the quality of tenants. The levels of yield compression seen last year have become less intense. Prime yields for offices (3.25%), logistic warehouses (5.85%) and high street retail (2.80%) at the close of the first quarter were in line with the last quarter of 2017.

BNP Paribas Real Estate forecasts for 2018 point towards prime yields being maintained at these levels.

**Fundamentals Butressing Investment**

The fundamentals which nourish the occupier markets continue to grow stronger. The Retail Trade Index, measuring the trend in sales and employment in the retail sector, has seen 41 months (out of a total of 42, January 2018 included) of positive year-on-year results. This means that sales have gone up every month in comparison with the same month the previous year.
In terms of offices, the estimate for office based job creation for 2018 amounts to 120,000 posts (Source: Oxford Economics). These new employees will contribute to a net positive increase in take-up in the occupier market and this will show up in the trends in rents and vacancy rates. Hotels continue to increase their occupancy rates and profitability indicators as a consequence of the strong momentum in tourist arrivals.

**Funds Take Over the Market**

Investment funds are reinforcing their position as the leading purchasers, supplanting the SOCMIs. The latter remain immersed in asset management processes and preparing themselves to divest part of their portfolios. These types of firms meanwhile continue to grow in number, going from 46 in June 2017 to 54 in March 2018. During the first quarter of the year, the distribution of investment was along the same lines as 2017: retail assets were the most sought-after and two out of the three most significant deals demonstrated this: the sale of 12 Inditex premises for 370 million Euro and the Parque Corredor retail park for 200 million. The second most significant deal of the quarter involved the acquisition of 1,500 residential units by Testa from Caixabank, for 228 million Euros.

**Catalonia on the Road to Recovery**

Towards the end of 2017, Catalonia became immersed in turbulence around electoral processes, which created a high degree of uncertainty in local markets and the potential for contagion to spread to others. Although the strength of the Catalan economy prevented havoc, some uncertainty carried over into the property market.

The political situation is now more settled and though the clouds have not entirely dispersed, investors are again looking at the acquisition of assets in Catalonia. A number of deals struck during the first quarter of 2018 were being incubated at the close of the previous year. It is anticipated that the investor market will gradually return to normality, in part due to the good results achieved during the first quarter in the occupancy of offices and logistics warehouses.

**Outlook**

Funds will continue to flow towards the Spanish property market as long as there is liquidity in the financial markets, particularly for funding deals, and there is a wide enough differential between bond yields and the yield on real estate assets.