DEUTSCHE/HYPO

NORD/LB Real Estate Finance

Spain.

Real estate market defies uncertain market conditions.

Contents

Spain:
Real estate market defies uncertain market conditions

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Introduction

The coronavirus pandemic had a huge impact on the Spanish economy. Above all, the pandemic-related restrictions in the tourism sector led to a shrinking of economic output like no other country in the EU. In 2020, Spain slid into a deep recession. In 2021, however, the economy began to recover and tourism picked up noticeably. GDP grew at a rate of 5.5 %, an all-time high. Three years after the pandemic broke out, however, the Spanish economy again faced headwinds, this time from the war in Ukraine. The pace of economic recovery slowed perceptibly in 2022. A general economic slowdown combined with historically high inflation rates, rising interest rates and the energy crisis, saw market conditions change fundamentally. However, the energy crisis affected Spain to a lesser extent than other European countries, as its economic ties with Russia are much looser than those of Germany, for example. Moreover, the country can point to a well-developed infrastructure for liquefied petroleum gas. In a European comparison, Spain's economy grew at an above-average rate in 2022, albeit with weaker momentum than in the previous year. Spain is also forecast to see the highest growth rates among the biggest European economies in 2023 and 2024. As such, the country remains an important economic engine in Europe.

The Spanish real estate investment market developed extremely well in 2022, although sentiment darkened somewhat in the second half of the year due to the high level of uncertainty surrounding the war in Ukraine and a shift in the interest rate environment. The transaction volume grew by roughly 10 % compared to the previous year to around EUR 13.2 billion, simultaneously exceeding pre-crisis levels. Among the most significant asset classes in the commercial sector were retail (32 %) and office (20 %), followed by hotel (18 %) and logistics (11 %). In line with the pre-crisis years, foreign investors accounted for the majority of the investment volume, even though national investors gained in importance last year. Leading cities included the capital Madrid (EUR 3.3 billion) and Barcelona (EUR 3.0 billion). While Madrid recorded a year-on-year increase in the transaction volume (+24 %), the figure for Barcelona declined by 35 % as against 2021. The strong momentum in the investment market is mainly due to the completion of a large number of transactions in the first half of 2022. Current volatility in the financial markets coupled with rising interest rates have led to growing caution on the part of investors, reflected in the weak final quarter of 2022.[1] According to market participants, the biggest hurdle to completing real estate transactions swiftly is the discrepancy in price expectations between buyers and sellers. Moreover, higher energy and construction prices and the growing appeal of alternative asset classes are contributing to a slowdown in transaction momentum.

[1] Cushman & Wakefield: Marketbeat Spain Investment, Q4 2022

The individual asset classes saw quite a mixed recovery after the coronavirus pandemic, as the restrictions and consequences affected them to differing degrees. Although last year's recovery was overshadowed by the war in Ukraine and the related uncertainty and negative effects, the individual real estate sub-markets performed robustly overall:

// The **office property market** proved stable in 2022 despite geopolitical and economic unease. In the post-coronavirus environment, Spanish employers are focusing on flexible and hybrid workplace strategies. There was particularly strong demand for good-quality, centrally located office space with high energy efficiency standards. Demand for older and unrenovated space, on the other hand, fell noticeably. This split in the market was also reflected in the development of rental and vacancy rates.

// The **retail property market** also showed great resilience despite the uncertainty mentioned above. Consumer confidence recovered tangibly in the second half of 2022. The asset class also benefited from the sharp upturn in international tourism. This was reflected in positive trends in retail sales as well as footfall, which in 2022 reached similarly high levels as in pre-crisis times in almost all sub-segments. Consequently, demand for space in the high street shops and shopping centre segments also rose significantly compared to the previous year.

// The **hotel property market**, which was hit particularly hard by the coronavirus-related restrictions, rallied strongly in the past year. Thanks to a significant increase in international visitors, demand was only slightly below the pre-crisis level. In terms of performance, the hotel industry is now able to build on its pre-pandemic success. Leisure and city tourism saw especially dynamic activity. By contrast, the revival of business tourism is taking a lot longer and hinges on the recovery of certain key markets such as Latin America and Asia.

// The **logistics property market** is showing significant excess demand. On the one hand, the market is profiting from the dynamic growth in online shopping and the resulting expansion of space occupied by logistics service providers. On the other, demand is being driven by the protection of supply chains – an issue that has become all the more important given the current geopolitical uncertainty.

After a brief look at the macroeconomic conditions, this country analysis will examine current market development in the individual asset classes of office, retail, hotel and logistics against the backdrop of the current economic and geopolitical uncertainty and selected megatrends. It will explore the future prospects for each individual asset class, taking into account the current geopolitical and economic uncertainties and what risks or challenges, if any, need to be considered.

Macroeconomic conditions

Spain's economy defies macroeconomic pressures
The aftermath of the coronavirus pandemic left Spain dealing with the worst economic slump in the eurozone. Extensive restrictions on movement and contact were imposed in Spain to contain the pandemic. The country's heavy economic dependence on the international tourism sector meant that the pandemic-related travel restrictions had a serious impact. In 2020, GDP shrank by 11.3 %. With the progress of the vaccination campaign and the return of social life as well as international tourists, the

economy began to pick up in 2021. GDP rose by 5.5 %.[2] Spain is one of the largest recipients of funds from the Next Generation EU (NGEU) recovery fund, launched in February 2021 to alleviate the economic and social consequences of the coronavirus pandemic in the EU. The economic impact of this rebuilding programme should make itself felt in the next few years.[3]

With the war in Ukraine, the post-pandemic economic recovery phase was dampened again in 2022. Macroeconomic consequences such as the energy crisis, historically high inflation rates and deteriorating supply chain problems are weighing on the Spanish economy. As a result, despite European measures of support, Spain has not yet been able to make up for the economic coronavirus slump. While the Spanish economy will now take longer than expected to recover, the country is viewed as having more optimistic GDP growth forecasts compared to other European countries, in spite of multiple macroeconomic stress factors. According to preliminary data, economic growth in 2022 reached 5.2 % (eurozone: 3.5 %; Germany: 1.8 %). Spain is expected to post a GDP growth rate of 1.1 % in 2023, which is again higher than the eurozone and Germany (0.8 % and 0.1 % respectively).[4] The country is less affected by the energy crisis compared to the rest of Europe. It benefits from gas pipelines from Algeria as well as its relatively low dependence on Russian gas supplies. Spain also has a well-established infrastructure for importing liquefied natural gas (LNG). [5] It is one of the most important locations in Europe for the conversion of liquefied natural gas, with six LNG import terminals on the coast.[6] Given the sharp rise in energy costs, Spain currently has the advantage of a lower proportion of energy-intensive industry than other European countries. At 12.8 % (2021), the manufacturing sector's share of total gross value added is significantly below the share of a country such as Germany, at 20.8 %.[7]

After reaching a record high of 10.8 % in July last year, the inflation rate in Spain fell noticeably in the second half of the year. Over 2022 as a whole, the inflation rate rose to 8.4 % according to preliminary data (eurozone: 8.4 %; Germany: 8.7 %). In 2023, it is expected to fall to 3.7 % (eurozone: 6.1 %; Germany: 6.0 %).[8] Examples of measures to combat inflation in Spain include the introduction of a price cap on electricity and gas in the summer of 2022 and the suspension of VAT on basic foodstuffs from January 2023 (initially for a limited period of six months).[9]

In the wake of substantial price rises, private consumption weakened last year. In the third quarter of 2022, the growth rate stood at 1.4 percentage points. Substantial savings built up during the coronavirus pandemic were considerably eroded by soaring prices.[10] Companies were also put under intense financial pressure by the high cost of energy and raw materials. However, the Spanish Purchasing Managers' Index (PMI) has shown an upward trend since November 2022. In February 2023, it stood at 50.7 points (January 2023: 48.4 points) and was therefore slightly above the growth threshold of 50 points.[11]

The labour market has shown surprisingly robust growth. Restrictions on fixed-term employment have led to a steady rise in the number of permanent employment contracts. In the first half of last year, increased economic activity and labour market reforms aimed at reducing temporary work and structural unemployment helped to create secure jobs.[12] After reaching 14.8 % in 2021, the

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[2] IMF
[3] ECB: The economic impact of Next Generation EU: a euro area perspective, April 2022
[4] IMF; NORD/LB Macro Research
[5] GTAI: Spanien will aktivere Rolle für Europas Gasversorgung spielen (Spain wants to play a more active role in Europe), September 2022
[6] NORD/LB Sector Research: LNG – Leider Nicht Günstig, Aber Notwendig! (LNG – Unfortunately not cheap, but essential!) December 2022
[7] Eurostat; Deutsche Bank Research: Ausblick Deutschland, December 2022
[8] IMF; NORD/LB Macro Research
[9] https://www.dw.com/de/spain-defies-inflation-with-economic-boom-and-statesupport/a-64619676, accessed on 14 February 2023
[10] GTAI: Wirtschaftsausblick Spanien: EU-Zuschüsse beleben das Investitionsklima (EU subsidies improve the investment climate), 1 December 2022
[11] https://de.investing.com/economic-calendar/spanish-manufacturing-pmi-667, accessed on 03 March 2023
[12] Mineco: Informe de situación de la economía española (Report on the state of the Spanish economy), December 2022

unemployment rate is expected to fall to 12.8 % in 2022. This puts it at the lowest level in 15 years.[13] Despite this positive development, Spain continues to have the highest unemployment rate in the EU, alongside Greece. The unemployment rate in 2022 is expected to reach 6.7 % in the eurozone, and 5.3 % in Germany.[14]

Economic indicators (change from prev. year in %)

	2019	2020	2021	2022f	2023f	2024f
GDP	2.0	-11.3	5.5	5.2	1.1	2.4
Private consumption	1.1	-12.2	6.0	2.7	1.7	2.2
Net exports*	0.4	-2.2	0.3	3.2	-0.9	0.1
Unemployment rate**	14.1	15.5	14.8	12.8	12.8	12.5
Inflation	0.7	-0.3	3.1	8.4	3.7	2.7
Currrent account balance***	2.1	0.6	1.0	1.6	0.5	0.3
General government debt***	98.2	120.4	118.3	112.8	112.1	110.0
General government balance***	-3.1	-10.3	-6.9	-4.5	-4.6	-3.5

Source: IMF, * Contribution to growth, ** in % of employed, *** in % of GDP, NORD/LB Sector Strategy

Spain's slender current account surplus was eroded by more than 70 % in 2020, and increased moderately compared to 2021. As a result of the rise in energy prices, the balance of goods was negative in the first quarter of 2022, which is likely to have a continued impact in the medium term. Offset by the positive gains in the services balance from a pick-up in international tourism, the current account surplus is expected to reach 1.6 % of GDP in 2022.[15] As in the rest of the European Union, Spain's sovereign debt mounted in the face of the coronavirus pandemic. The public deficit has been reduced since then, but still remains at a high level. Above-average economic growth and high inflation have contributed to Spain's positive trend in debt reduction.[16]

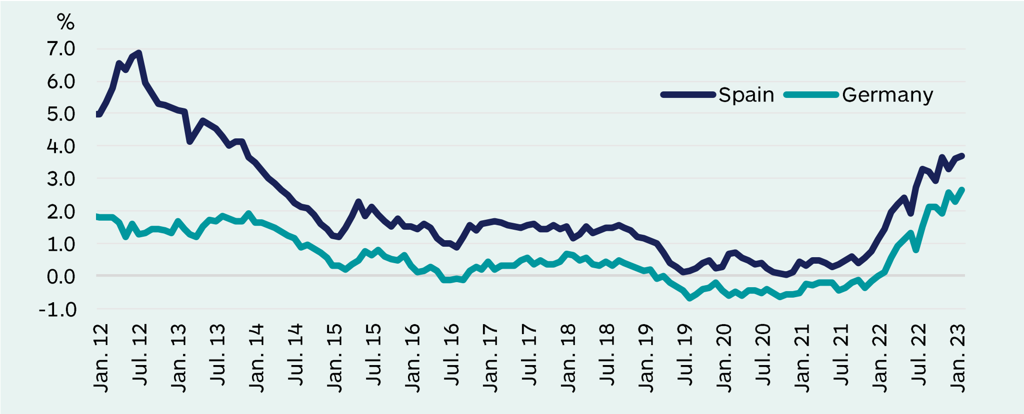
Spain has a population of around 47.6 million (preliminary figures for 2022), accounting for one tenth of the population of the European Union. The birth rate is in decline. With 1.19 children per woman, in 2020 Spain recorded the second lowest figure in the EU. The EU average stood at 1.50 children per woman. Nevertheless, the population grew in the first half of last year due to positive net migration. Based on current demographic trends, the Spanish population should climb to more than 51 million by 2037, and 52.9 million by 2072. The average age in 2022 was 44.3 years, somewhat above the European average of 44.1 years, but below the German figure of 45.9 years. By 2050, the share of the population aged 65 and over is expected to increase to 30.4 %. Currently, this proportion is only 20.1 %.[17]

2022 was the year of the interest rate around. The gradual increase in the ECB's key interest rates caused the yield on Spanish government bonds to rise accordingly. The ECB maintained its interest rate trajectory at the beginning of this year as well. With inflation still high, the ECB is set to continue its tightening course for the time being and further rate hikes are likely this year. The next rate rise of 50 basis points is expected in March.[18] At the end of February 2023, the Spanish government's long-term refinancing costs stood at 3.6 % (February 2022: 1.1 %). The risk premium on German government bonds

[13] INE
[14] NORD/LB Macro Research: Economic Adviser, March 2023 issue
[15] IMF: Spain Country Report, January 2023
[16] Handelsblatt: Teils niedriger als vor Corona - Wieso die Schuldenlast in Südeuropa sinkt (Lower in part than before coronavirus – why the debt burden in Southern Europe is sinking), 23 February 2023
[17] INE; Eurostat
[18] IMF; NORD/LB Macro Research

has risen only slightly over the past year and currently stands at just under 1.0 percentage point. In the country rankings, Spain is given a high credit rating. Standard & Poor's classifies Spain as A and Moody's as Baa1.[19]

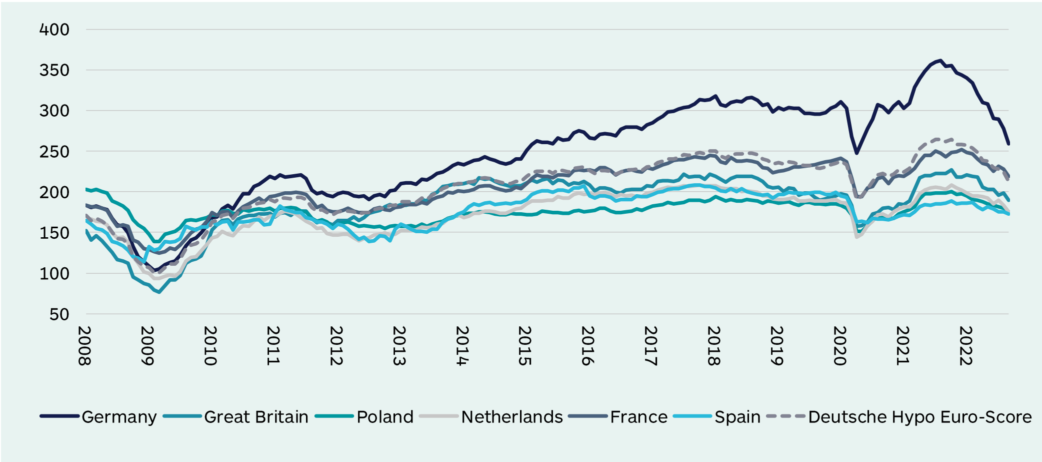
Performance of 10-year government bond yields



Source: Macrobond, NORD/LB Sector Strategy

Following the high inflation rate and resulting rise in interest rates, Spanish real estate activity weakened in 2022. The Deutsche Hypo Real Estate Economy Index (REECOX) for Spain fell to 172.9 points in the third quarter of 2022, a quarter-on-quarter decline of 2.9 %. Compared to the rest of Europe, however, this represented the second lowest rate of decline (REECOX Germany: -10.3 % Q/Q).[20] The Spanish real estate investment market was able to buck this trend and reach an all-time high last year: If the transaction volume on the residential investment market (around EUR 3.1 billion) is considered in addition to the commercial transaction volume (around EUR 13.2 billion), the previous year's result once again increased by about one third to a total of around EUR 16.4 billion. However, the slowdown in market activity seen since summer 2022 due to the above-mentioned uncertainty is likely to continue in the first half of 2023. Price corrections are expected to continue as a result of increases in prime yields.[21]

Performance of Deutsche Hypo REECOX (09/22)



Source: Deutsche Hypo Real Estate Economy Index (REECOX), NORD/LB Sector Strategy

[19] Macrobond
[20] Deutsche Hypo REECOX: Country report Spain Q3 2022
[21] CATELLA: Market Tracker: Real Estate Investment in Spain 2022. The year of change, 2 February 2023

Outlook for 2023: Economic growth is slowing

Demographic development	↗
GDP growth	↘
Unemployment rate	→
Inflation	↘
Private consumption	↘

In 2023, the Spanish economy continues to face great uncertainty and challenges. The positive rebound that emerged after the lifting of coronavirus restrictions has been overshadowed by the war in Ukraine and is delaying the economic recovery this year as well. GDP growth is likely to slow tangibly in 2023, but to what extent is extremely uncertain under current conditions. The pre-crisis level is unlikely to be reached before 2024.[22] Nevertheless, the Spanish growth forecast remains above average compared to the rest of Europe. A major pillar of Spain's economic recovery is the buoyant tourism sector, which should continue to contribute significantly to the economic recovery in 2023, although lower household purchasing power (particularly in European source markets) may dampen tourism demand. One of Spain's key strengths in times of energy crisis is its LNG import capacity. Thanks to its geographical location and climate, Spain also has high potential for renewable energies and for the development of a green hydrogen economy.[23] Grants from the Next Generation EU (NGEU) programme are also having a positive effect on economic development. It will be crucial to implement the programme quickly and transparently. The labour market is likely to remain stable in view of government measures, which in turn should support consumption. Inflation is thought to have peaked, although the ECB's inflation target of 2.0 % remains distant. High prices are likely to persist in eroding purchasing power, which, according to estimates, will not be offset by wage increases until 2024.[24]

Office property market

Office property market shows strength despite macroeconomic headwinds

The consequences of the coronavirus pandemic were clearly felt in the Spanish office property markets in 2020. Demand for office space declined significantly, and the future viability of office buildings was called into question due to the widespread practice of working from home. Three years after the outbreak of the pandemic, Spanish employers are focusing on flexible and hybrid workplace strategies. As a place of communication and innovation for companies, the central office will continue to be of great importance in the future; the demand for quality, particularly in terms of location and facilities, has increased considerably. Attractive office space plays a major role in the war for talent, and modern office space with high energy efficiency standards also helps companies achieve their ESG goals. As a result, the market situation for office real estate stabilised in 2022 despite the high degree of uncertainty. Core office real estate in particular has shown itself to be particularly resilient.

Spain's most important office markets are Madrid and Barcelona. Madrid ranks among the top 20 office markets in Europe. The stock of office space has risen steadily in recent years and stood at around 17.8 million m² at the end of 2022. A further increase is expected for this year.[25] The city ranks tenth in Europe on the list of the most important financial centres. As an international financial and trading

[22] GTAI: Wirtschaftsausblick Spanien: EU-Zuschüsse beleben das Investitionsklima (EU subsidies improve the investment climate), 1 December 2022
[23] bulwiengesa: Logistik und Immobilien (Logistics and Real Estate), September 2022
[24] European Commission
[25] Colliers: Office Report Madrid & Barcelona, 2022

centre, a large proportion of Spain's banks and insurance groups, as well as the Spanish stock exchange, have their headquarters in Madrid. Similarly, numerous foreign companies have branches in Madrid. With around 80,000 m² of office space, the Méndez Álvaro quarter in the east of the Arganzuela district is particularly attractive for companies due to its favourable location and excellent connections via urban railway, underground and bus. The development of the new Nuevo Norte financial and business centre is helping to further enhance Madrid's office market. The newly planned area in the north of Madrid will see a mix of residential space (approx. 1.1 million m²) and real estate for offices, retail and services (approx. 1.6 million m²).[26] The Madrid region is currently planning the biggest expansion of its public transport system in 15 years. This is likely to make Madrid even more attractive as a place to live and work.

Spain's second-largest office property market is the Catalonian capital Barcelona, which had around 6.5 million m² of office space at the end of last year.[27] Thanks to its dynamic entrepreneurial ecosystem and tech culture, Barcelona is particularly attractive and appealing to both home-grown and foreign start-ups. The analysis institute StartupBlink ranks Barcelona fifth among cities in the European Union, behind Paris, Berlin, Stockholm and Amsterdam, and just ahead of Munich.[28] In particular, leasing by companies from the service sector and the technology, media and telecommunications (TMT) industry has increased in recent years and now accounts for almost half of the demand for office space in Barcelona.[29] Moreover, last year Barcelona was voted one of the best cities in the world for working from home. Taking priorities such as internet speed, quality of life, climate, flight connectivity and rent into account, Barcelona came sixth in the global rankings. Employees appreciate the city's good work-life balance in particular.[30]

Robust demand for space in Spain's metropolitan areas

After a slump in the crisis year of 2020, take-up in the Spanish office property market recovered in 2021. A look at the metropolitan areas of Madrid and Barcelona revealed a mixed picture. Demand increased noticeably in Barcelona, but remained well below pre-crisis levels in Madrid. In 2022, take-up of office space in both Madrid and Barcelona was robust, although the consequences of the war in Ukraine became apparent in take-up towards the end of the year. In Madrid, take-up increased to about 445,000 m² in 2022. This corresponds to a rise of around 33 % compared to 2021. Despite the uncertain market conditions, take-up also grew in the second half of 2022 compared to the same period of the previous year (+ about 24 %), but with weaker momentum than in the first half of 2022 (+ about 43 %). With a share in take-up of more than 50 %, space in central locations was in particular demand.[31] ESG is also becoming increasingly significant. The share of LEED- or BREEAM-certified office space in total take-up is constantly growing.[32] In Barcelona, take-up in 2022 came to around 270,000 m², which corresponds to a year-on-year decline of around 16 %. This development is a result of weaker demand in the third and fourth quarters of 2022 compared to the same quarters of the previous year. It is also worth noting that two major transactions comprising over 40,000 m² took place in 2021, which were not repeated on this scale in 2022. In the Catalonian capital, too, demand was particularly strong last year for centrally located office space (35 % share of take-up) and District 22@Barcelona (26 % share of take-up). The trend towards hybrid working solutions, often in smaller, well-equipped offices in sub-markets close to the city centre, can be clearly seen in the way demand has developed. There is also a particular focus on meeting ESG requirements. Consequently, the demand for certified buildings is higher than average.[33]

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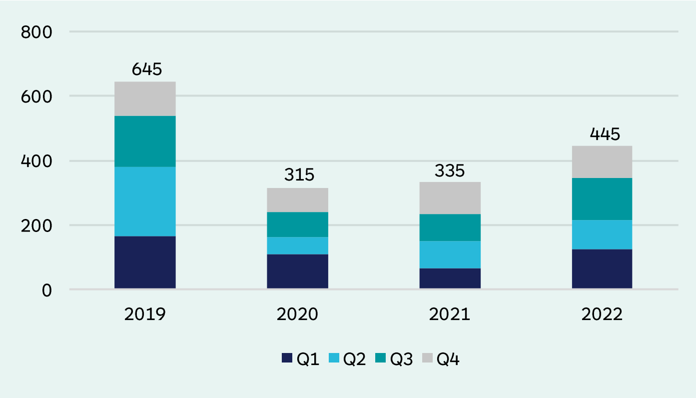
26 https://www.gtai.de/de/trade/spanien/branchen/staedtebauvorhaben-madrid-nuevo-norte-konkretisiert-sich-820808, accessed on 5 January 2023
27 Colliers: Office Report Madrid & Barcelona, 2022
28 https://catalonia.com/de/-/barcelona-ranks-5th-as-a-startup-hub-in-the-european-union-in-2022, accessed on 6 January 2023
29 Cushman & Wakefield: Marketbeat Industrial Madrid & Barcelona, Q4 2022
30 https://www.savills.de/insight-and-opinion/savills-news/328222/lissabon-ist-der-beste-wohn--und-arbeitsort-fur-executive-nomads-weltweit, accessed on 6 January 2023
31 Colliers: Office Report Madrid & Barcelona, 2022
32 Savills: Spotlight Madrid Offices, Q3 2022
33 Colliers: Office Report Madrid & Barcelona, 2022

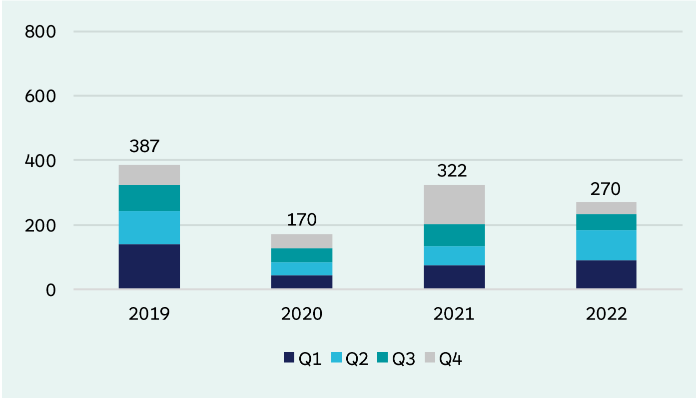
Alongside the traditional office, the share of flexible workspaces in total take-up has perceptibly increased in both Madrid and Barcelona over recent years. While development stagnated in 2020 during the coronavirus pandemic, demand for flexi-space solutions picked up again in 2021. This trend is particularly pronounced in Barcelona due to its dynamic start-up scene. At the end of the third quarter of 2022, flexible office solutions accounted for around 7 % of total take-up in Barcelona and around 3 % in Madrid. These proportions are likely to increase further in the next few years, albeit without replacing the traditional office.[34]

Madrid: Growth in take-up (in 1,000 m²)



Source: Colliers, NORD/LB Sector Strategy

Barcelona: Growth in take-up (in 1,000 m²)



Source: Colliers, NORD/LB Sector Strategy

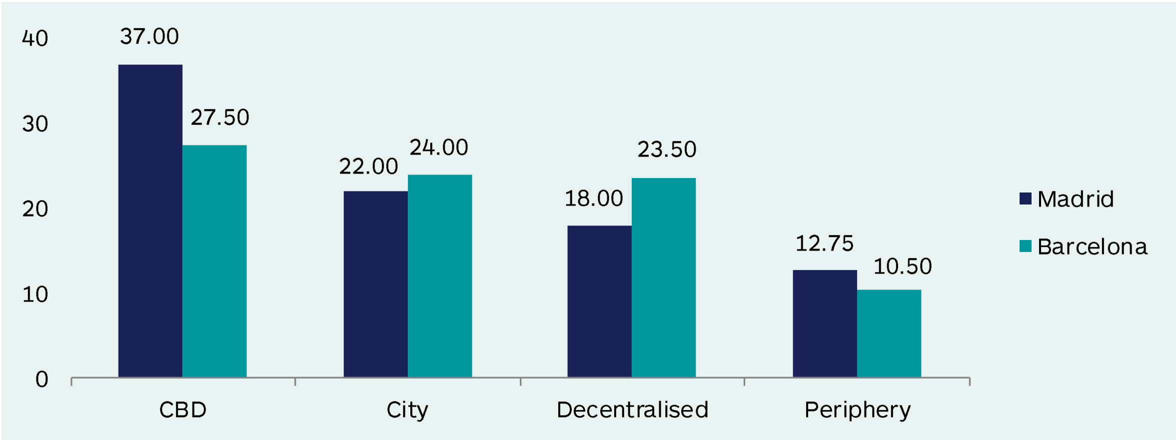
The vacancy rate in Madrid was stable in 2022. By contrast, there was a noticeable rise in vacancies in Barcelona at the end of 2022 due to a substantial increase in space in District 22@Barcelona and a large number of refurbishments in the central business district (CBD). As at the fourth quarter of 2022, the average vacancy rate stood at 10.6 % in Madrid (Q4 2021: 10.7 %) and at 10.1 % in Barcelona (Q4 2021: 8.6 %). Last year, both cities reflected the Europe-wide trend: on the one hand, short supply of central and high-quality space, and on the other, a much higher vacancy rate for older space in peripheral business districts.[35] Consequently, at around 5.0 % (Q3 2022), vacancy rates in the CBDs of Madrid and Barcelona were significantly below the overall average.[36] In total, 90,000 m² of new office space was made available in Madrid and 240,000 m² in Barcelona during 2022.[37] Construction activity in both Spanish cities remains buoyant this year. In Madrid, around 128,000 m² of new office space is currently under construction. An additional 450,000 m² of new space is being planned for the next few years. In Barcelona, the space under construction amounts to 162,000 m²; an additional 558,000 m² of office space is at the planning stage. In the Catalonian capital, the dynamic growth in refurbishments is particularly striking. In the third quarter of 2022, the share of total space growth stood at around 40 %. In 2020, this proportion was only about 6 %. Refurbishments are expected to play an important role in providing new office space in the future. This option is regarded as cheaper, faster and more sustainable.[38]

Segmentation according to location and quality of space was also reflected in rental price trends last year. During 2022, the rental price range between the CBD and the periphery has widened year on year in both Madrid and Barcelona by EUR 2.00 per m² per month and EUR 1.25 per m² per month respectively. Prime office rents in Madrid increased significantly to EUR 37.00 per m² per month (Q4 2021: EUR 34.50 per m²

[34] Cushman & Wakefield: Flexible Workspace Report, October 2022
[35] Colliers: Office Report Madrid & Barcelona, 2022
[36] Savills: Spotlight Madrid Offices, Q3 2022; Spotlight Barcelona Offices, Q3 2022
[37] Colliers: Office Report Madrid & Barcelona, 2022
[38] Savills: Spotlight Barcelona Offices, Q3 2022

per month) and in Barcelona more modestly to EUR 27.50 per m² per month (Q4 2021: EUR 27.25 m² per month).[39] This trend shows that prime and sustainable office space in central locations is proving particularly resilient. Older properties with low energy efficiency standards in fringe locations, on the other hand, are feeling downward pressure on rents.

Prime rents in EUR per m² per month for Madrid and Barcelona in Q4 2022



Source: Cushman & Wakefield, NORD/LB Sector Strategy

Investment market – demand for modern office properties in core locations

The nationwide transaction volume in 2022 totalled roughly EUR 2.66 billion, representing year-on-year growth of around 8 %. While transaction activity was still more buoyant in the first half of the year, momentum slowed markedly, particularly towards the end of the year, in response to the changing interest rate environment. In the fourth quarter of 2022, the share of total transaction volume in 2022 only came to just under 18 %. While the transaction volume in Madrid almost doubled year on year to around EUR 1.27 billion in 2022, transaction volume in Barcelona declined by 57 % to EUR 1.05 billion. The share of total take-up was 48 % in Madrid and 39 % in Barcelona. Besides location (in Madrid: focus on CBD and city; in Barcelona: focus on CBD and District 22@) and quality, investors showed a keen interest in the ESG profile of the properties. Following the rise in interest rates, yields increased, especially in the second half of last year. In the fourth quarter, the prime yield in Madrid's CBD stood at 5.10 % (Q4 2021: 4.50 %) and beyond the CBD at 3.90 % (Q4 2021: 3.40 %). In Barcelona, the prime yield in the CBD climbed to 5.50 % (Q4 2021: 5.00 %) and beyond the CBD to 4.25 % (Q4 2021: 3.60 %).[40]

Outlook for 2023: High-quality office space in central locations still the main focus

Supply	↗
Demand	↗
Vacancy rate	→
Prime rent	→
Investment volume	→
Prime yield	↗

The two largest Spanish office property markets should continue their steady development in 2023, although macroeconomic uncertainty remains high. This is likely to be underpinned by the steady recovery of the labour market combined with a growing number of office workers (forecast for 2023: +1.2 % compared to the previous year).[41] Supply of office space is expected to increase further in both Madrid and Barcelona in 2023 due to planned new construction projects as well as refurbishments, although prime

[39] Cushman & Wakefield: Marketbeat Industrial Madrid & Barcelona, Q4 2022
[40] Colliers: Office Report Madrid & Barcelona, 2022
[41] JLL: Spain Office Market Snapshot, Q4 2022

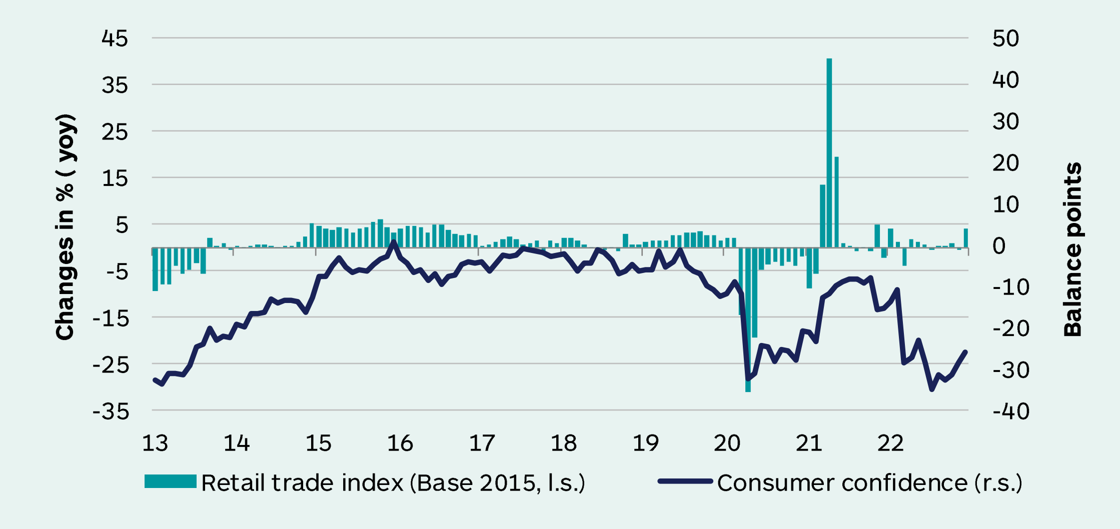
office space is likely to remain scarce owing to high demand. However, the sharp rise in construction and financing costs may cause some postponements, especially among speculative new-build projects. Interest in high-quality buildings in favoured locations is expected to remain high. Property characteristics such as the feasibility of flexible and hybrid workplace strategies, as well as the ESG profile, are becoming ever more important. Flexible offices should expand their share of total take-up. Meanwhile, demand for unrenovated and older buildings in peripheral sub-markets is likely to weaken further. This divide is also likely to persist when it comes to vacancy rates and rents. Overall, prime rents in Madrid and Barcelona should develop steadily. The top Spanish office property markets are likely to remain the focus of investors, with a clear preference for core properties. Based on current market conditions, we expect the transaction volume to remain stable for 2023 as a whole, although a decline is likely for the first half of the year. Consequently, prime yields should continue to rise slightly in the first half of the year. In the second half of the year, market momentum is likely to pick up again when buyer and seller price expectations become better aligned.

Retail property market

Strong resilience despite ongoing uncertainty

Despite the coronavirus pandemic and a difficult market environment, sales in the Spanish retail sector grew significantly in 2021. At 7.7 %, sales growth was above that of the 27 EU countries, which also recorded a robust increase of 6.8 %.[42] The strong sales development is mainly attributable to the weak level from 2020, when the pandemic had a tighter grip on European countries. The non-food segment, which suffered a sharp drop in sales in the first year of the crisis due to coronavirus restrictions and considerable consumer anxiety, has recently been a significant growth driver.

Real retail sales and consumer confidence



Source: Instituto Nacional de Estatistica, Macrobond, NORD/LB Sector Strategy

[42] GfK: Einzelhandel Europa 2021 und 2022 (Retail in Europe 2021 and 2022)

Last year, too, real estate retail sales mostly recorded slight positive growth compared to the same month of the previous year (see figure). Spanish consumer confidence, which also recovered perceptibly from the outbreak of the coronavirus pandemic in 2021, collapsed again in the course of 2022 due to the war in Ukraine and the resulting ongoing uncertainty (higher interest rates, loss of real purchasing power for private households). Since August 2022, however, a gradual recovery in consumer confidence has again been in evidence. Household consumer spending in 2022 is likely to have been around EUR 80 billion, slightly lower than in 2021 but roughly 5 % above the pre-crisis level of 2019.[43] The powerful revival of international tourism is also expected to have played a part in the Spanish retail sector's positive development. Following two weak years, the number of overnight stays by visitors from abroad in 2022 reached about 90 % of the pre-crisis level (see also the section on the hotel property market).[44]

As a result of the coronavirus pandemic, online shopping in Spain experienced strong growth in 2020 (+40 % compared to the previous year). In 2021, however, the rate of growth slowed again (+18 %).[45] Shopping centres and high streets remain the preferred shopping channels for Spanish consumers: Shopping centres account for 18 % of retail sales, high street shops for 72 % and online sales for only 10 %. The share of online trade is below average compared to the rest of Europe (13th place behind countries such as the UK (online share: 30 %), France (19 %) or Germany (18 %)).[46] This is mainly due to lifestyle and consumer habits in Mediterranean countries. However, by 2025, Spain's share of online retail sales is expected to more than double (21%).[47] This will give Spain the highest annual growth rate in e-commerce retail sales among European countries in the next few years (+19 % p.a.; Europe: +14 % p.a.).[48]

Rental market showing signs of recovery

The Spanish retail property market is well balanced between high streets and shopping centres, with retail parks gaining in importance. The high street segment is mainly concentrated in the larger provincial capitals such as Madrid, Barcelona, Valencia, Bilbao, Palma, Zaragoza, Seville and Malaga.[49] As the capital, Madrid holds the largest stock of retail space (428,000 m², vacancy rate 6.6 %), closely followed by Barcelona with 354,000 m² (vacancy rate 11.6 %).[50]

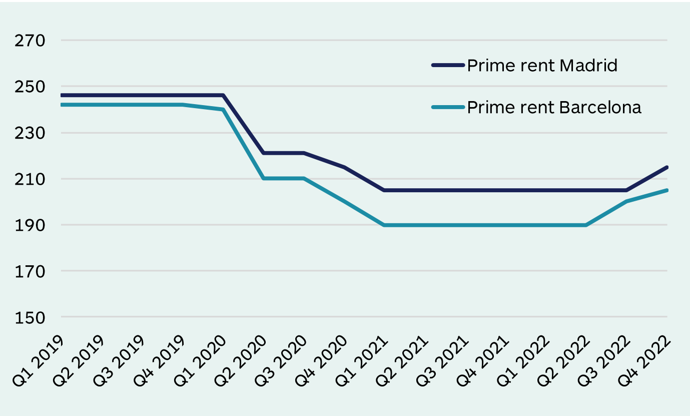
Conditions for the development of the high street segment were extremely favourable in 2022. Over the course of the year, retail sales and footfall reached levels similar to those seen in the pre-crisis period. Retail sales rose by 12 % compared to the previous year. Likewise, the retail leasing market also saw a noticeable recovery in 2022. The number of transactions was up by 16 % compared to the previous year, standing 25 % above pre-crisis levels. International brands accounted for 42 % of transactions, increasing their presence by 8 percentage points compared to 2021.[51] In terms of market activity and new openings, fashion has emerged as the most important segment. This is closely followed by specialist retailers and the accessories sector. Gastronomy is also on a course of expansion, positioning itself in the main shopping streets of the most important cities such as Barcelona, Madrid, Seville and Valencia.

The outbreak of the coronavirus pandemic had a noticeable effect on the development of rents for high street shops in Spain's leading cities.[52] Rents in Madrid and Barcelona, for example, dropped by 10 to 20 % in the first 12 months after the pandemic began. Rents fell even more sharply in secondary locations and

43 Knight Frank: Retail Snapshot, Q3 2022
44 Börsen-Zeitung: Die Gäste sind zurück (The guests are back), 18 January 2023
45 Savills: Markets in Minutes: eCommerce Situation in Spain. July 2022
46 Savills: Retail in Spain, September 2022
47 Savills: Markets in Minutes: eCommerce Situation in Spain. July 2022
48 Savills: Spotlight: European retail fair pricing in 2023. December 2022
49 Cushman & Wakefield: Global Cities Retail Guide – Spain. 2019
50 CBRE: Figures Retail, Q4 2022
51 ibid.
52 Savills: High Street Retail in Spain 2022

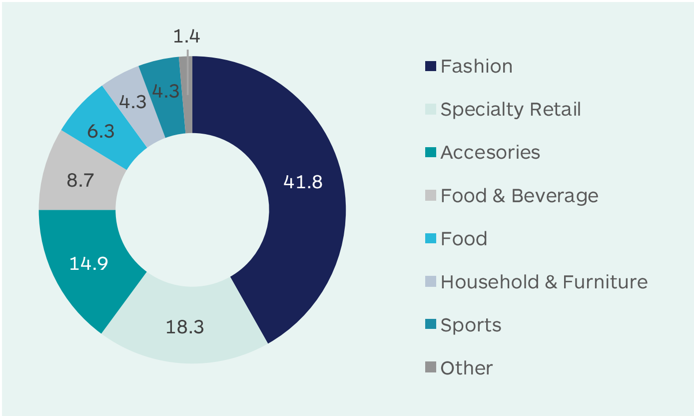
areas dominated by tourism.[53] In 2022, the strong recovery of demand – accompanied by a decline in vacancy rates, which have reached similar levels as in the pre-crisis period – led to a slight increase in rents of 3 to 5 % in the most important cities for shopping. The prime rent increased by 5 % year on year and currently stands at EUR 215 per m² per month. [54] Among the top 20 most expensive main shopping streets in Europe, Madrid's "Preciados" is in 13th place, closely followed by Barcelona's "Portal de L'Angel" street (14th place). In a ranking for the luxury segment, the "Passeig de Gracia" in Barcelona (10th place) and "Serrano" in Madrid feature among the top 20.[55]

Development of prime rent (EUR per m² per month, high street)



Source: CBRE, NORD/LB Sector Strategy

Demand for space by segment (Q4 2022, YTD, in %)



Source: CBRE, NORD/LB Sector Strategy

In the shopping centre segment, Spain has 17.6 million m² of available floor space, giving a shopping centre density of 373 m² per 1,000 inhabitants. Since 2021, more than 270,000 m² of shopping centre space has come on to the market, including 24,800 m² in the first half of 2022. In the course of 2023, about 430,000 m² of additional space should be completed in the shopping centre segment, around 150,000 m² of which will be taken up by retail parks. In the next four to five years, the stock of space could increase to over 18.7 million m², which would boost the shopping centre density to 396 m² per 1,000 inhabitants. Given the current level of uncertainty, however, some of these projects may be postponed or cancelled.[56] More than 85 % of the current stock of space is older than 10 years, resulting in great potential for modernisation. Many owners are looking at refurbishment with a new focus or considering various additional offerings to complement traditional retail.[57]

In the shopping centre segment, too, footfall and retail sales continued to pick up significantly, almost returning to pre-crisis levels. Retail sales grew by around 15.9 % in 2022 compared to the previous year, down only 2.5 % from the levels achieved in 2019. Footfall also increased further (+18.5 % compared to 2021), but still lags around 14.4 % below pre-crisis levels. This is mainly down to the pandemic-related decline in leisure activities, which play a key role in boosting footfall. However, this segment is likely to improve further over the course of 2023. Leasing activity (new shop openings) in shopping centres grew by 24.6 % in 2022 compared to the previous year. This was driven mainly by restaurants, fashion shops and sports stores. The prime rent in shopping centres was EUR 50 per m² at the end of 2022,

[53] Cushman & Wakefield: Marketbeat Spain: High Street Retail, Q1 2021
[54] CBRE: Figures Retail, Q4 2022
[55] JLL: European Retail Market Outlook 2023. November 2023
[56] Savills: Retail in Spain, September 2022
[57] ibid.

corresponding to a drop of 9 % compared to the beginning of 2022. In the coming months, however, rents in this segment are likely to remain stable.[58]

Retail real estate the most important asset class in 2022

In 2022, the Spanish investment market for retail real estate posted a transaction volume of EUR 3.973 billion. This was driven in large part by the transaction between BBVA and Merlin in the second quarter of 2022. Even without this transaction, the investment volume of EUR 1.986 billion still equates to an increase of 85.6 % compared to 2021 (+27.6 % compared to 2019).[59] In the second half of 2022, however, transaction activity cooled considerably in line with the trend across the commercial investment market as a whole. Overall, retail real estate made the largest contribution to the total transaction volume on the Spanish property market last year, with a share of about 32 %.[60] Shopping centres and high street shops accounted for most of the transaction volume in this asset class (excluding the major transaction). Supermarkets, which were particularly popular in the first two years of the crisis, followed in third place. As a consequence of higher interest rates, prime yields in the retail sector have also increased over the past year. In the fourth quarter of 2022, prime yields for shopping centres stood at 6.25 % and those for high street shops at 4.00 %. Compared to January 2022, this represents an increase of 75 basis points in each case.[61] Nevertheless, retail real estate will remain attractive for potential investors in the future due to its rent stability, crisis resilience and high yields for shopping centres compared to other asset classes.[62]

Outlook for 2023: Retail property market remains on a growth trajectory in the medium term

Supply	↗
Demand (stationary retail)	↗
Vacancy rate	→
Prime rent	→
Investment volumes	→
Prime yield	↗

The supply of space on the Spanish retail property market, particularly in the shopping centre and retail park segment, is likely to expand further in the coming years. In the short term, the ongoing material shortages, higher interest rates and soaring energy and construction costs are likely, at the very least, to contribute to some of the planned projects being delayed, postponed or cancelled due to extended construction times.[63]

Bricks-and-mortar retail is likely to benefit this year from the sustained recovery in tourism and removal of coronavirus-related restrictions. Weak consumer confidence, high inflation and steep energy costs are currently still dampening consumption. This affects low-income households in particular. Spanish retail sales will continue to show a high level of resilience and increase slightly over the course of 2023. Retail sales in Spain will return to a solid growth trajectory from 2024 at the latest, in line with the larger European markets.[64] Against this backdrop, demand for space should continue to increase and lead to stable vacancy rates in most cities. Prime rents are expected to remain stable across all retail formats in the coming months.[65] Given the sustained rise in online retailing, the shopping centre segment will continue to change. New and innovative usage concepts will be in demand in the future, with service, leisure, health and hospitality offerings set to play a major role. The focus is on advice, experiences and entertainment.

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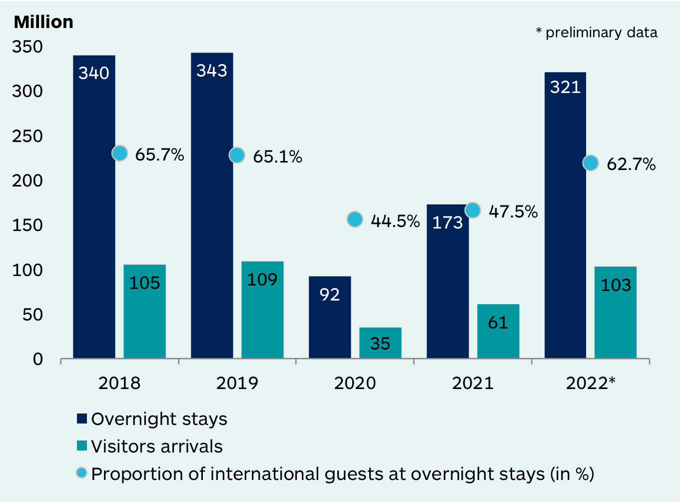
[58] CBRE: Figures Retail Q4 2022
[59] ibid.
[60] Cushman & Wakefield: Marketbeat Spain Investment, Q4 2022
[61] CBRE: Figures Retail Q4 2022
[62] Savills: Retail in Spain, September 2022
[63] ibid.
[64] JLL: European Retail Market Outlook 2023. November 2023
[65] Cushman & Wakefield: Marketbeat Spain: High Street Retail Q3 2022

Demand on the investment market should remain largely stable, even if the current level of uncertainty leads investors to act more cautiously and scrutinise investments more closely in the future. In the coming months, upward pressure on prime yields looks set to continue, with prime locations holding up better than secondary locations, as expected. Besides shopping centres, smaller, urban retail parks (including a supermarket to attract customers) or larger retail parks on city outskirts are seeing the strongest investor demand.[66]

Hotel property market

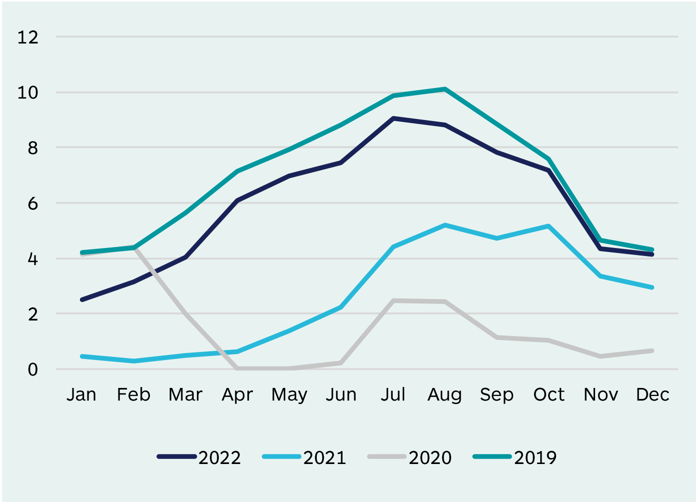
Demand in 2022 almost back to pre-crisis level
Despite unfavourable overall conditions (the spread of the Omicron variant, the war in Ukraine, ongoing inflation and harbingers of the expected recession in Europe), Spain recorded extraordinary growth in tourism over the past year. The country welcomed 102.7 million foreign and domestic guests (+69 % compared to the previous year), and the number of overnight stays also increased, rising by 85.6 % to 320.7 million. This development is primarily due to the lifting of coronavirus restrictions, the resumption of international flights and a pent-up urge to travel, all of which led to overnight stays by foreign guests shooting up by 144.7 % year on year. Nevertheless, the number of nights stayed by guests from abroad is still 10.1 % below the pre-crisis level of 2019. Domestic tourism also rose significantly (+32.1 % overnight stays) and was able to fully recover in the past year (+0.3 % above the 2019 level). This meant that, overall, overnight accommodation figures were still 6.5 % lower than before the pandemic. As in the pre-crisis years, foreign guests accounted for 62.7 % of overnight stays, while domestic tourism contributed 37.3 %. The UK, Germany and France are among the leading tourism source markets.[67] Most of the overnight stays took place in the period from May to September (59.1 %), which saw a 75.4 % increase against the previous year. Currently, tourism demand is expected to slow temporarily because of high inflation and weak or recessive economic trends in the European source markets.[68]

Hotel industry: Arrivals and overnight stays in Spain



Source: Instituto Nacional de Estadistica, NORD/LB Sector Strategy

Number of international tourists (in millions)



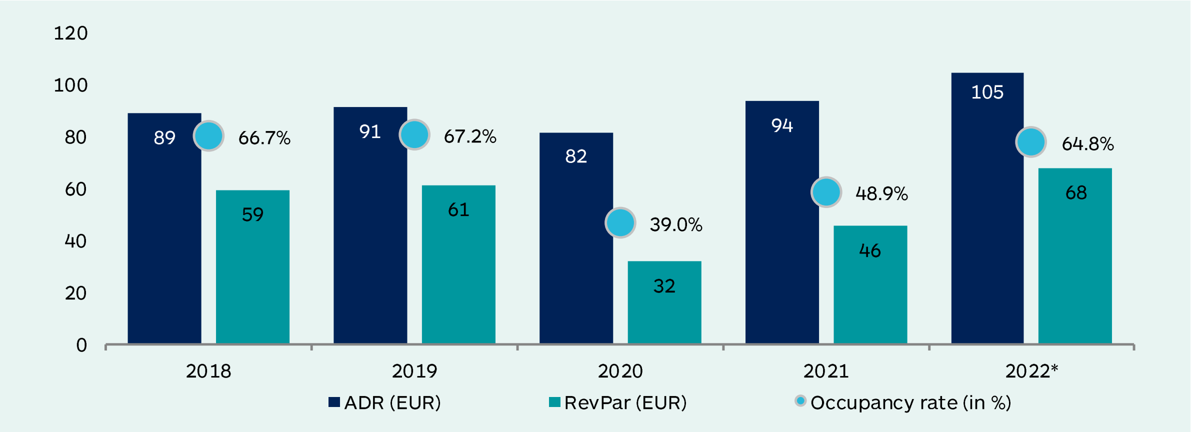
Source: Instituto Nacional de Estadistica, NORD/LB Sector Strategy

66 Cushman & Wakefield: Marketbeat Spain: High Street Retail Q3 2022
67 Instituto Nacional de Estadistica: Hotel Tourism Short-Term Trends. 24 January 2023
68 CBRE: Figures Hotels, Q3 2022

Hotels post best performance in the past four years

On the supply side, Spain had 1.48 million beds in 14,020 hotels in 2022.[69] More than 280 hotels (with around 30,000 rooms) are currently in the pipeline and scheduled to open by 2024.[70] Growing tourism demand enabled the hotel occupancy rate to jump sharply in the past year to 64.8 %, or only 2.4 percentage points below the pre-crisis level. 2022 marked the best performance by the country's hotels in the past four years. This was due in particular to an excellent showing during the summer months, when tourism demand surged. The average room price (average daily rate/ADR) was EUR 105 in 2022. This corresponds to an 11.9 % increase over the previous year (+14.8 % compared to 2019). High inflation probably played a major role in rising room prices as well. Many hotel operators passed on additional costs, such as the higher minimum wage, increased energy and food prices, and higher transportation costs.[71] Revenue per available room (RevPAR) also climbed noticeably on the back of high occupancy rates. At EUR 68, it was 49.0 % higher than the previous year and 10.8 % above the pre-crisis level.

Performance of Spanish hotel market



Source: Instituto Nacional de Estadistica, NORD/LB Sector Strategy, *preliminary data

Regionally, hotel occupancy in the past year was highest in the Balearic Islands (78.3 %) and Canary Islands (77.0 %), closely followed by the Catalonia region (66.2 %) with the capital of Barcelona (70.8 %), Valencia (65.4 %), Madrid (65.1 %) and Andalusia (61.8 %) with the city of Malaga (70.7 %). Room prices (ADR) were highest in the Balearic Islands (EUR 126.30) and the Canary Islands (EUR 114.30), followed by the Catalonia region (with Barcelona) (EUR 112.90) and the Madrid region (EUR 107.10). The regions of Madrid (+32.9 %) and Catalonia (+25.7 %) had by far the highest growth rates compared to the previous year. Accordingly, RevPAR was highest in the Balearic Islands (EUR 98.50) and Canary Islands (EUR 88.50), followed by Catalonia (EUR 75.20) and Madrid (EUR 69.80). The two latter regions also had the highest year-on-year growth rates (80.8 % and 86.0 % respectively). This reflects the strong recovery in leisure and city tourism.

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[69] Instituto Nacional de Estadistica
[70] CBRE: Figures Hotels, Q3 2022
[71] GTAI: Reisebranche knüpft an die Erfolge vor der Pandemie an (Travel industry builds on pre-pandemic success). 7 February 2023

Development of hotel markets in leading tourism regions of Spain (2022)

	Overnight stays		Occupancy rate	ADR		RevPar	
	in million	20022/2021 in %	in %	in EUR	2022/2021 in %	in EUR	2022/2021 in %
Andalusia	50.1	66.5	61.8	105.0	5.1	64.5	30.0
Balearic Islands	56.1	117.1	78.3	126.3	0.1	98.5	31.9
Canary Islands	64.5	114.0	77.0	114.3	5.0	88.5	39.3
Catalonia	53.1	107.6	66.2	112.9	25.7	75.2	80.8
Valencian Community	27.3	75.1	65.4	88.4	2.4	57.5	32.3
Community of Madrid	22.1	75.2	65.1	107.1	32.9	69.8	86.0
Spain (total)	**320.7**	**85.6**	**64.8**	**104.7**	**11.9**	**67.8**	**49.0**

Source: Instituto Nacional de Estadistica, NORD/LB Sector Strategy (preliminary data)

Barcelona was the leader among Spain's metropolitan areas in 2022 regarding guest arrivals (11.3 million) and overnight stays (30.3 million), pushing the capital of Madrid to second place compared to the previous year (guest arrivals: 11.0 million, overnight stays: 22.1 million). The Madrid region recovered much faster in 2020 and 2021 thanks to its major significance for domestic tourism since the start of the pandemic. By contrast, Barcelona only managed to regain its leading role in the past year because it is highly dependent on international tourism.[72] The recovery of both metropolitan areas continued at a rapid pace last year. In the Catalonia region, RevPAR exceeded the pre-crisis level in the past year, amounting to EUR 75.20 (2019: EUR 69.70). The Madrid region nearly returned to the pre-crisis level as well, with RevPAR at EUR 69.80 (2019: EUR 70.20).[73]

Both cities benefited from their mix of leisure and business tourism. Business tourism in Barcelona has gradually picked up since Easter 2022 in the form of trade fairs, conferences and meetings. This is tremendously important for the performance of many hotels in the city. The trend in Madrid was similar,[74] with the capital further cementing its leading position in business tourism. Madrid was recognised by the World MICE Awards as Europe's leading destination in the MICE segment[75] for the third time in 2022. [76] In addition, the IFEMA Madrid consortium earned the title of Best Convention Centre in Europe.[77] While leisure tourism has clearly recovered in Madrid, the revival of business tourism is taking a lot longer and hinges on the recovery of certain key markets such as Latin America and Asia.

Investment market achieves third-best result in 2022

After slumping by some 62 % in 2020 due to the coronavirus pandemic, the transaction volume on the Spanish hotel property market rallied strongly in the second year of the pandemic, growing by 233 % to EUR 3.2 billion. There was another slight increase in this figure in 2022, when investments in the Spanish hotel property market totalled EUR 3.3 billion. That corresponds to 3.1 % growth compared to the previous year. In historical terms, this is the third-highest result after 2017 and 2018. Leisure tourism regained its leading position after an unusual year in 2021, contributing 58 % to the total investment volume. Foreign investments accounted for some 72 % of the overall figure, and around one third of the investment volume was in the 5-star segment. This reflects keen investor interest in prime real estate, especially in the luxury segment, due to ongoing uncertainty on the market. The average price per room for the traded hotels increased by 7 % as against the previous year to a new record of EUR 168,800. The leading locations attracting investment were the Balearic Islands and Madrid – a trend that demonstrates

[72] Instituto Nacional de Estadistica
[73] ibid.
[74] Cushman & Wakefield: Hotels & Business. No. 10 December 2022
[75] MICE: Meetings, Incentives, Conventions, Exhibitions
[76] Colliers: 5 Keys: Madrid versus Barcelona. June 2022
[77] https://worldmiceawards.com/nominees/2022/europe, accessed on 7 February 2023

major investor interest in the city and leisure tourism segments. The Balearic Islands accounted for EUR 913 million. A new record was set by the capital at EUR 803 million, equivalent to around 24 % of the national transaction volume. Barcelona only contributed EUR 225 million after a record year in 2021. Malaga (EUR 562 million) and the Canary Islands (EUR 175 million) took fourth and fifth place.[78]

Outlook for 2023: Hotel market holds its own in a challenging environment

Demand	↗
Supply	↗
RevPAR	↗
ADR	↗
Occupancy rate	↗
Investment volume	→

In view of the expected economic slowdown, ongoing geopolitical uncertainty, residual risks associated with COVID-19, rising interest rates and high inflation, 2023 remains filled with challenges for the Spanish hotel property market. However, international travel is expected to continue returning to normal levels this year, after starting this process in 2022. The upward trend in guest arrivals from abroad should therefore be maintained.[79] This is in line with UNWTO projections that international guest arrivals in Europe will keep rising in 2023 and could reach or even exceed the pre-crisis level. Apart from the aforementioned lifting of coronavirus restrictions in some key Asian source markets (especially China), this is also due to robust tourism demand from the USA – supported by the strong US dollar.[80] This development should have a positive effect on the ongoing recovery of business tourism as well. Even though Chinese tourists will not be the largest group, they are particularly attractive as a result of their high per capita spending on holidays.[81] On the other hand, lower household purchasing power is expected to dampen tourism demand, despite a pent-up urge to travel. Consumers are increasingly willing to make compromises to meet tighter travel budgets by staying in lower-priced hotels, travelling during the off-season and opting for shorter stays, for example.[82] Business tourism, too, are likely to feel the impact of weak or recessive economic trends in the European source markets and higher travel costs, at least temporarily.[83] The supply of hotel rooms will keep growing in 2023/24, since more than 280 hotels (with around 30,000 rooms) are currently in the pipeline.[84]

Despite the noticeable market recovery in the past year, hotel operators are confronted by numerous factors that are weighing on margins, including higher inflation, the increase in energy costs and rising personnel expenses. The worsening staff shortage poses an additional challenge. Companies that managed to invest in technologies and energy efficiency during the pandemic now have a competitive advantage.[85] Consistently high tourism demand should offer further leeway for another moderate increase in room prices in order to protect margins. This applies to the high-end segment in particular, which is experiencing rising demand from US tourists. A comparison with competing neighbouring countries such as Italy also shows that the Spanish hotel market still has scope to raise room prices without jeopardising demand.[86]

Record values were already reached in the hotel investment market last year, and economic and geopolitical uncertainty is expected to continue. Nevertheless, the outlook for the current year is optimistic. Projects worth around EUR 2 billion are currently in the pipeline for 2023. The pricing phase between buyers and sellers is continuing in light of rising interest rates. In the short term, some investors

[78] Colliers: Hotel investment in Spain reaches the third best historical record. Press release, 17 January 2023
[79] GTAI: Reisebranche knüpft an die Erfolge vor der Pandemie an (Travel industry builds on pre-pandemic success). 7 February 2023
[80] UNWTO: World Tourism Barometer. Volume 21, Issue 1 January 2023
[81] GTAI: Reisebranche knüpft an die Erfolge vor der Pandemie an (Travel industry builds on pre-pandemic success). 7 February 2023
[82] Deloitte: The European Hospitality Industry Outlook. January 2023
[83] https://www.businesstravelnewseurope.com/Management/The-2023-Outlook, accessed on 7 February 2023
[84] CBRE: Figures Hotels, Q3 2022
[85] Cushman & Wakefield: Hotels & Business. No. 10 December 2022
[86] ibid.

will wait until macroeconomic conditions have stabilised further.[87] Prices for the traded hotels are nevertheless expected to decline due to the interest rate increase.[88] Meanwhile, highly liquid investors that are under pressure to invest will focus on prime real estate or, depending on their investment strategy, on older properties in need of renovation.[89] Going forward, larger hotel brands and leading investment funds will continue to be very interested in establishing themselves in Spain's major leisure destinations, such as the Balearic Islands and Canary Islands, which have become global tourism icons, as well as Barcelona and Madrid as leading destinations for city tourism.[90]

Logistics property market

Logistics property market benefits from dynamic online trade
Despite difficult market conditions, the Spanish logistics property market has turned in an extremely robust performance in recent years. Spain is a logistics hub thanks to its numerous ports in strategic locations, busy airports and good connections to Central Europe and the African continent. Ocean freight is the primary means of transport for the country's non-European imports. With a coastline of more than 8,000 km, Spain is one of Europe's leading nations for ocean freight. Road and rail are the predominant transport routes within Europe.[91] The proportion of Spanish road haulage out of the overall European road haulage market is expected to grow from 9.6 % (2020) to 10.0 % (2025) in the coming years. This means that the projected growth rate for Spain is the highest in Europe.[92]

Madrid and Barcelona are among Spain's most important logistics markets. Both cities continuously expanded their volume of floor space in recent years (Q4 2022: Madrid: around 13.0 million m²; Barcelona: around 8.1 million m²).[93] The A-2 motorway beginning in Spain's capital and ending in Barcelona deserves special mention as the "golden mile" of the Spanish logistics sector. Numerous companies are clustered along this logistics route. Other important markets include Valencia (Mediterranean port, airport, close to Madrid and Barcelona), Zaragoza (conveniently located between Madrid and Barcelona) and Bilbao (close to the Atlantic).[94]

Online shopping is a key factor driving demand in the logistics sector. E-commerce has accelerated sharply in Spain due to the change in consumer spending habits during the coronavirus pandemic, and has not lost any of its dominance since then. According to the latest publications (June 2022), online sales in Spain grew by around 33 % in the second quarter of 2022 compared to the same period in the previous year.[95] Consequently, Spanish retailers are increasingly expanding their online activities. Given that Spain has a certain amount of ground to make up compared to other European countries (in particular the UK as the frontrunner, as well as France and Germany), the country is expected to see the highest e-commerce growth in Europe over the coming years. As a result, the share of online shopping in total retail sales is anticipated to rise to about 21 % by 2025, more than twice the figure from 2021 (10 %) (see

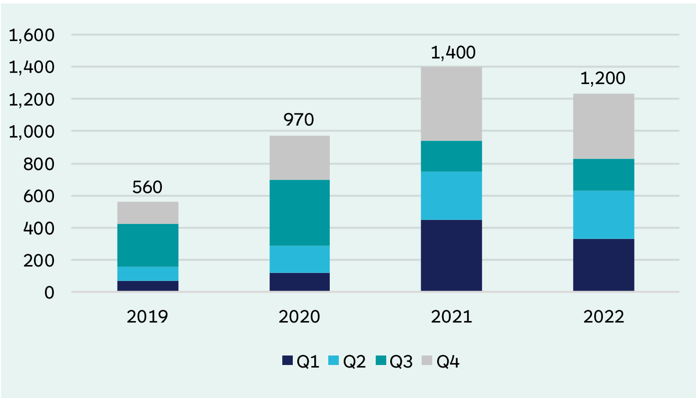
[87] Colliers: Hotel investment in Spain reaches the third best historical record. Press release, 17 January 2023
[88] Cushman & Wakefield: Hotels & Business. No. 10 December 2022
[89] Colliers: Hotel investment in Spain reaches the third best historical record. Press release, 17 January 2023
[90] Cushman & Wakefield: Hotels & Business. No. 10 December 2022
[91] https://forto.com/de/blog/how-to-guide-logistik-von-und-nach-spanien-alles-was-sie-wissen-muessen/, accessed on 20 January 2023
[92] Transport Intelligence: Germany remains the leader by far in terms of volume in the European road haulage market, with a share of 20.1% (2020) that is expected to drop to 19.6% (2025).
[93] Colliers: Logistics Report Spain, 2022
[94] Also see: Deutsche Hypo: Länderanalyse Spanien: Immobilienmarkt auf Wachstumskurs, August 2018 (Country Analysis – Spain: Growing Real Estate Market, August 2018)
[95] Cushman & Wakefield: Marketbeat Industrial Madrid & Barcelona, Q4 2022

also the section on the retail property market).[96] Demand for last-mile space is therefore climbing significantly. According to a Knight Frank analysis, the estimated demand for additional last-mile space in Spain will be 378,000 m² by 2026.[97] This puts Spain in fourth place in Europe, after Germany, France and Poland. Looking at the country's local markets, the strongest growth is expected in Madrid. Spain's capital took eighth place in a ranking of 800 European cities in seven countries.[98]

The structural shift from streamlined just-in-time inventory to secure just-in-case inventory is another important growth driver in the logistics sector. Shortening and shifting delivery routes (reshoring) became even more important after the coronavirus pandemic because of the Ukraine war. As a consequence, companies are able to gain greater control of supply chains and limit the effects of possible supply chain disruptions. This results in a further diversification of inventories, which increases demand for new logistics properties.

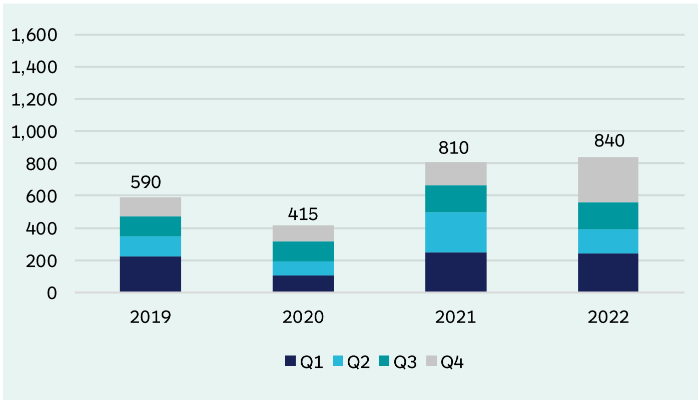
Demand for space remains buoyant
Record take-up in Madrid for 2021 was followed by a lower year-on-year figure in 2022. Nevertheless, the total volume of around 1.2 million m² was extremely healthy and exceeded the five-year average by 15 %. Logistics activities were concentrated in particular on the Henares corridor (A2) and along the A4 south axis.[99] In Barcelona, take-up increased from 810 million m² in 2021 to around 840 million m² in 2022 (total of 65 transactions). The fourth quarter of 2022 in particular was much more dynamic than the corresponding prior-year quarter. Overall the high space demand in both cities was driven by the growth of online shopping and food retailing.[100]

Madrid: Development of take-up (in thousands of m²)



Source: Knight Frank, NORD/LB Sector Strategy

Barcelona: Development of take-up (in thousands of m²)



Source: Knight Frank, NORD/LB Sector Strategy

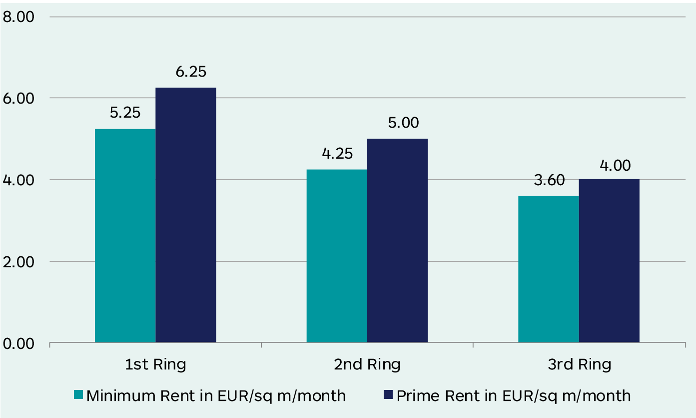
Despite dynamic construction activity, the vacancy rate in Spain's capital fell to 6.9 % at the end of 2022 (Q4 2021: 9.2 %). Around 1,113,000 m² of new space is expected for 2023, of which 22 % has already been allocated. Available logistics space remains in very short supply in Barcelona as well. The city has the worst supply shortage in Europe after Dublin. The vacancy rate in the fourth quarter of 2022 was 2.8 % (Q4 2021: 2.4 %). Around 640,000 m² of new logistics space is scheduled to be completed this year. Occupiers have already been found for nearly half of that volume.[101]

[96] Savills: E-commerce Situation in Spain, July 2022
[97] Knight Frank: Europe's last mile, 2022: Aside from Spain, the analysis examines France, Germany, Italy, Poland, the Netherlands and Sweden.
[98] https://www.knightfrank.com/research/article/2022-11-03-madrid-emerges-as-top-logistics-location, accessed on 23 January 2023
[99] ibid.
[100] Knight Frank: Spain Logistics Snapshot, Q4 2022; Cushman & Wakefield: Marketbeat Industrial Madrid & Barcelona, Q4 2022
[101] Cushman & Wakefield: Marketbeat Madrid & Barcelona Industrial, Q4 2022

There was upward pressure on prime rents in the logistics sub-markets of Madrid and Barcelona in 2022. Rents increased in particular due to strong demand for high-quality space combined with a limited supply. Increased financing and construction costs also contributed to this development in the second half of the year.

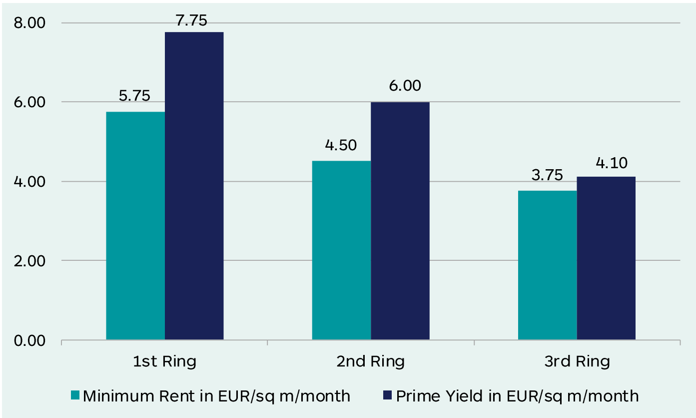
Prime rents in Madrid rose in all three of the city's logistics rings at the end of last year compared to the prior-year quarter: In the first ring (CBD) from EUR 6.00 per m² per month to EUR 6.25 per m² per month, in the second ring (up to 30 km from the centre) from EUR 4.75 per m² per month to EUR 5.00 per m² per month and in the third ring (30 to 70 km from the centre) from EUR 3.75 per m² per month to EUR 4.00 per m² per month. By comparison, the growth in prime rents in Barcelona was somewhat lower in the fourth quarter of 2022 in the individual sub-markets as against the prior-year quarter. The prime rent in the first ring (CBD) rose from EUR 7.50 per m² per month to EUR 7.75 per m² per month. It remained unchanged in the second ring (up to 40 km from the centre) at EUR 6.00 per m² per month. In the third ring (40 to 100 km from the centre), the prime rent increased slightly from EUR 4.00 per m² per month to EUR 4.10 per m² per month.[102]

Madrid: Range of rents for the sub-markets in Q4 2022



Source: Knight Frank, NORD/LB Sector Strategy

Barcelona: Range of rents for the sub-markets in Q4 2022



Source: Knight Frank, NORD/LB Sector Strategy

In the European city ranking for the projected growth of prime rents from 2023 to 2026, Madrid took sixth place with an annual growth rate of 2.9 %, and Barcelona finished eleventh at 2.4 %. With an annual growth rate of 5.3 %, Warsaw took first place by a clear margin.[103]

Investment market down, but still at a high level
Although the nationwide investment volume declined in the past year compared to the unusually positive figure in 2021, it remained considerably above the five-year average at around EUR 2.2 billion (2021: EUR 2.6 billion). Madrid received around EUR 855 million of this amount; the city's share of the total Spanish investment volume decreased from around 55 % in 2021 to about 40 % in 2022. By contrast, Barcelona was able to grow its share of the nationwide investment volume from about 25 % in 2021 to 30 %, with transactions totalling EUR 730 million. Current challenges such as the worsening supply shortage, geopolitical risks and higher interest rates had an overall negative impact on investor demand. Following a decline due to high demand in previous years, prime yields of logistics properties picked up again from the second quarter of 2022 onwards because of rising interest rates and inflationary pressure.

[102] Knight Frank: Spain Logistics Snapshot, Q4 2022 and Q4 2021
[103] JLL: Spain Logistics Snapshot, Q4 2022

The prime yield in the fourth quarter of 2022 was 4.85 % in Madrid (Q4 2021: 3.75 %) and 4.75 % in Barcelona (Q4 2021: 3.75 %).[104]

Outlook for 2023: Robust market development likely to continue

Supply	↗
Demand	↗
Vacancy rate	→
Prime rent	↗
Investment volume	→
Prime yield	↗

The Spanish logistics property market is proving resilient, even in the current market situation. Its stable development is expected to continue in 2023. Online shopping remains a key demand driver in Spain due to its projected pace of growth. A strong focus is on the expansion of the last mile – an area in which Madrid in particular is seen as having high potential. Demand for space is expected to remain elevated as logistics activities are optimised in order to safeguard supply chains. However, the supply available to meet demand for logistics space is limited, especially when it comes to centrally located and modern properties. Higher construction and material costs along with the supply shortage mean that prime rents should keep rising in 2023, albeit at a slower pace. Downward pressure on rents is also expected to continue due to a decline in speculative development projects. A higher growth rate in prime rents is forecast for Madrid than for Barcelona.[105] The interest rate turnaround will continue to make itself felt in the investment market in 2023. However, transaction activity is likely to remain robust. Prime yields are forecast to keep rising slightly in the first half of the year, before stabilising at a higher level. Better investment opportunities for equity-rich investors are expected again.

Outlook and conclusion

Demographic development	↗
GDP growth	↘
Inflation	↘
Unemployment rate	→
Purchasing power	↘
Demand for office real estate	↗
Demand of stationary retail	↗
Tourism demand	↗
Demand for logistics real estate	↗

The outlook for Spain's economy and property markets is highly uncertain. Macroeconomic headwinds remain due to inflationary pressure and the shift in the interest rate environment as a result of the Ukraine war. However, economic growth in Spain is expected to exceed the European average in 2023. Positive signs include the stabilisation of interest rates and a flattening of the inflation rate. The upward trend in the tourism sector is likely to continue in 2023, although a decline in the real income of European travellers could reduce spending. Spain's energy sector should further expand its key role. Sources of potential for the country include in particular its LNG receiving capabilities, its good prospects for the expansion of the photovoltaic market and its pioneering role in the production of green hydrogen.[106] Spain's economic development ultimately depends on the economic development of important European sales markets such as Germany, France and Italy, and on trade relations with China.[107]

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[104] Knight Frank: Spain Logistics Snapshot, Q4 2022 and Q4 2021
[105] JLL: Spain Logistics Snapshot, Q4 2022
[106] bulwiengesa: Logistics and Real Estate 2022
[107] GTAI: EU-Zuschüsse beleben das Investitionsklima (EU subsidies improve the investment climate), 1 December 2022

The Spanish real estate market is currently braving the economic and geopolitical challenges. Its investment and development prospects for 2023 are considered positive overall in comparison with other European countries. In a ranking of the most attractive European locations for real estate investors for 2023 (as part of the annual report by PwC and ULI), Madrid takes fourth place after London, Paris and Berlin. This puts Madrid among the cities set to experience the biggest growth this year (previous year: sixth place). Barcelona remains in ninth place. With regard to Spain as a whole, the potential of the country's renewable energies was highlighted as particularly advantageous.[108]

Overall, the prospects for all the asset classes analysed remain challenging under the current conditions. Transaction activity in the individual sub-markets is expected to slow in the first six months of 2023 and be lower than the first half of the previous year. The upward pressure on prime yields is likely to continue. In the second half of the year, the investment market should be more lively again.

The following asset-specific developments deserve special mention:

- In the **office property market**, the polarisation of demand between modern space in central locations and older real estate in less central locations is set to continue. This divide is also likely to persist when it comes to vacancy rates and rents. Aside from flexible and hybrid workplace strategies, the ESG requirements of tenants, owners and investors will also have a greater impact on the demand trend. Flexible offices should further expand their share of total take-up.

- The **retail property market** is still on a growth trajectory in the medium term. A further increase in the supply of space is anticipated, especially in the shopping centre and retail park segments. Retail sales in Spain should continue their upward trend in 2023 and record above-average growth compared to the eurozone.[109] Stable vacancy rates are expected in most cities as the demand for space continues to grow. Prime rents are also likely to remain stable in all sub-segments over the coming months. In addition to shopping centres, smaller urban retail parks or larger retail parks on the outskirts of cities will be in demand from investors going forward.

- In the **hotel property market**, international guest figures will continue to return to normal levels in 2023. While the leading leisure and city tourism destinations have already recovered well from the crisis, business tourism is still dependent on the gradual return of foreign guests. Despite the current uncertainty, a further upturn in tourism demand is anticipated, which is likely to boost hotel performance figures and enable a continued increase in room occupancy rates, prices and revenues.

- Demand in the **logistics property market** is expected to remain high thanks to buoyant online shopping and reshoring and nearshoring activities designed to reduce the risk of supply shortages. Expansion of the last mile is of paramount importance in view of the comparatively high e-commerce growth rates. However, the supply of space available to meet the demand from logistics occupiers is limited, especially in the high-end segment. The upward pressure on prime rents is therefore set to continue, albeit to a lesser extent.

Overall, the market environment remains uncertain in 2023. The conditions, which comprise multiple negative factors, will be challenging for both occupiers and investors. We expect the real estate market to turn in a robust performance overall, buoyed by Spain's economic strength. Both cyclical and structural

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[108] PwC and Urban Land Institute: Emerging Trends in Real Estate®: Europe 2023 – In the eye of the storm, February 2023
[109] CBRE: Real Estate Market Outlook Spain. 31 January 2023

changes will determine the development of the Spanish real estate market. The megatrends of sustainability and digitalisation will remain front and centre for all asset classes and influence rental and investment decisions.

Appendix

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