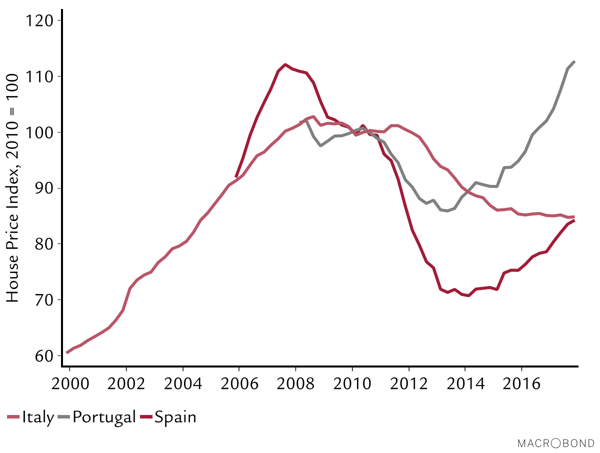
# Real Estate House View
*Italy, Spain, Portugal*

*Second half-year 2018*

## Key takeaways

- The office market in Southern Europe remains dynamic: investors are seeking to increase their exposure to these markets given the improving fundamentals. Vacancy levels have decreased and new additions remain low, reducing the risk of future oversupply.
- On the demand side, the economy is improving and tenants are paying higher rents for good-quality offices.
- Geopolitical uncertainties remain a downside risk.
- High street retail assets continue to outperform the retail sector in Southern Europe. Increased retail sales, partly fuelled by stronger tourism figures, are supporting turnover growth for retailers.
- Hotels continue to benefit from investors' growing appetite. Acquisitions of hotels in this region accounted for 23% of all European hotel transactions. Visitor numbers are expected to increase in these markets as there is a growing interest in the region from tourists visiting from Asia, and there is potential for business travellers to increase.

## Chart in focus




The three countries followed different paths after the global financial crisis. Portugal’s housing market is booming, driven by foreign capital inflows which reach new highs every year. In Spain and Italy this trend is less evident and house price growth varies between cities and is mainly linked to income growth. Overall, this divergence reflects the concentration of wealth and population within large cities or popular tourist destinations at the expense of smaller cities.

Portugal is benefiting from labour market reforms undertaken during austerity, while progress in this area has been less encouraging in Italy. According to the most recent Manpower employment barometer covering 43 countries around the world, Italy is the only country where a majority of firms plan to reduce staff over the next three months. In Spain, unemployment has crept up from a cyclical trough reached in 2017. Political uncertainties have intensified, but financial markets seem to differentiate between pro-European statements from Spain's new government and populist declarations coming from Italy's anti-establishment coalition. Higher credit costs for Italian firms pose a risk to the growth outlook for Italy, but less so in the other two countries. The entire region is a beneficiary of financial repression. Higher interest rates in the event of a monetary policy regime shift by the ECB and widening sovereign credit spreads represent a key risk for these countries.

## Improved office fundamentals

The investment market in Southern Europe performed well, with EUR 7 billion invested in 2017, although the political uncertainties in Spain constrained activity. Despite geopolitical risk, these markets have performed strongly over the past few years due to improving economic and real estate fundamentals. Vacancy levels have decreased and rents have risen, as new additions remain low. Future performance will probably be driven mainly by rental growth rather than further yield compression. By 2019, prime rents are forecast to increase by 5% in Madrid, 4.5% in Milan and 1.5% in Lisbon. This rise is being driven by improved economic conditions and the short supply of prime buildings. Also, a positive impact from Brexit and cost-reduction strategies from large European companies have been seen. Some banks are moving teams from London to Madrid and large French companies are relocating their back-office functions to Lisbon. Milan is benefiting less from this trend but remains the economic and industrial heart of Italy.

## Retailing stronger in large cities

Retail markets show notable differences across locations and sectors. In Spain, Italy and Portugal, high street retail in large cities continues to outperform the shopping centre submarket as a whole. Madrid, Barcelona, Milan, Florence, Rome, Lisbon and Porto have continued to experience rental growth driven by stronger output growth compared to national figures. Footfall and spending growth from affluent locals and tourists continue to fuel turnover in the prime locations: Calle Serrano, Preciados in Madrid, Avenida da Liberdade in Lisbon and Via Torino in Milan have been targeted by international brands for the opening of flagships or new concept stores. At the other end of the spectrum, in medium-sized cities rental values in shopping centres and retail warehouses are still 10–20% below their peak on average. These assets are highly sensitive to spending from local shoppers, which is still being constrained by high unemployment. Pan-European shopping centre REITs have rationalised their portfolios in these submarkets and in core locations: proactive management, including the rotation of brands, is key for competing with high street retail.

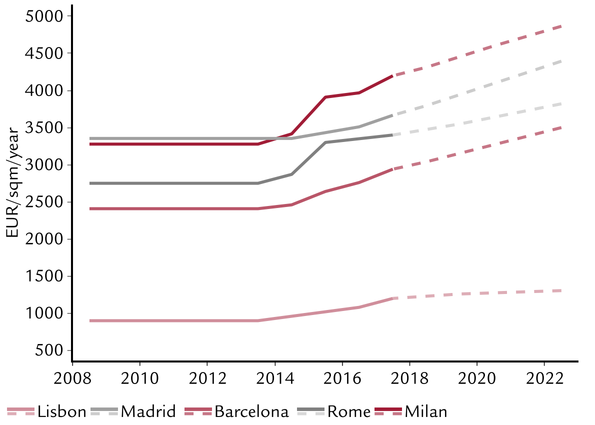
## Hotels still outperforming

Hotels also have benefited from growth in foreign tourism for a couple of years: Revenue per Available Room (RevPAR) rose by 2–6% in 2017 in all main cities. Strong interest from Asian tourists in both historic and coastal locations continued in the first half of 2018. The investment market remains hindered by the lack of properties for sale. Some investors have started to convert offices to hotels, as previously seen in Barcelona. This type of conversion may represent an interesting opportunity to access products and deliver attractive returns. Prime yields are hovering between 5% and 5.5% from Barcelona to Milan. Pricing is expected to harden further on the back of stronger income return.

## Higher foreign capital inflow

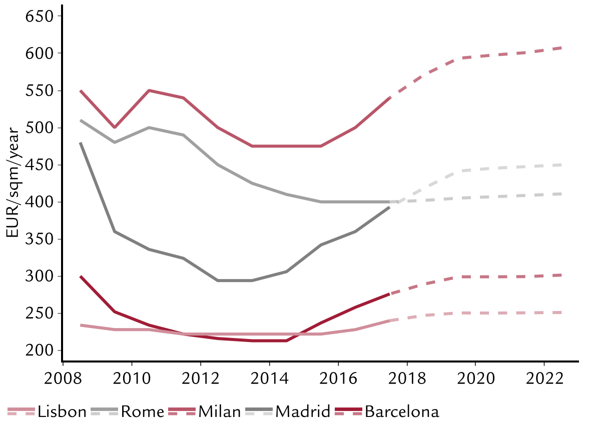
The residential market has bounced back in large cities, particularly for more upmarket products, over the past few years. Strong demand from private overseas capital has fuelled housing price growth in specific areas of Madrid and Lisbon. Residential performance across these three countries will continue to vary between cities, given the sharp differences in income growth. House prices in coastal areas will continue to recover.

Chart 1: High street retail rents in Southern Europe's main cities




Source: PMA, Swiss Life AM

Chart 2: Momentum still positive for office rents in Southern Europe




Source: PMA, Swiss Life AM

# Authors


## Swiss Life REIM France

**Béatrice Guedj**
**Head of Research and Innovation**
beatrice.guedj@swisslife-reim.fr

**Charlie Jonneaux**
**Financial Analyst**
charlie.jonneaux@swisslife-reim.fr

## Swiss Life Asset Managers

**Francesca Boucard**
**Economist Real Estate**
francesca.boucard@swisslife.ch

**Marc Brütsch**
**Chief Economist**
marc.bruetsch@swisslife.ch


**Do you have any questions or would you like to subscribe to this publication?**
Please send an email to: info@swisslife-am.com.
For more information visit our website at: www.swisslife-am.com/research