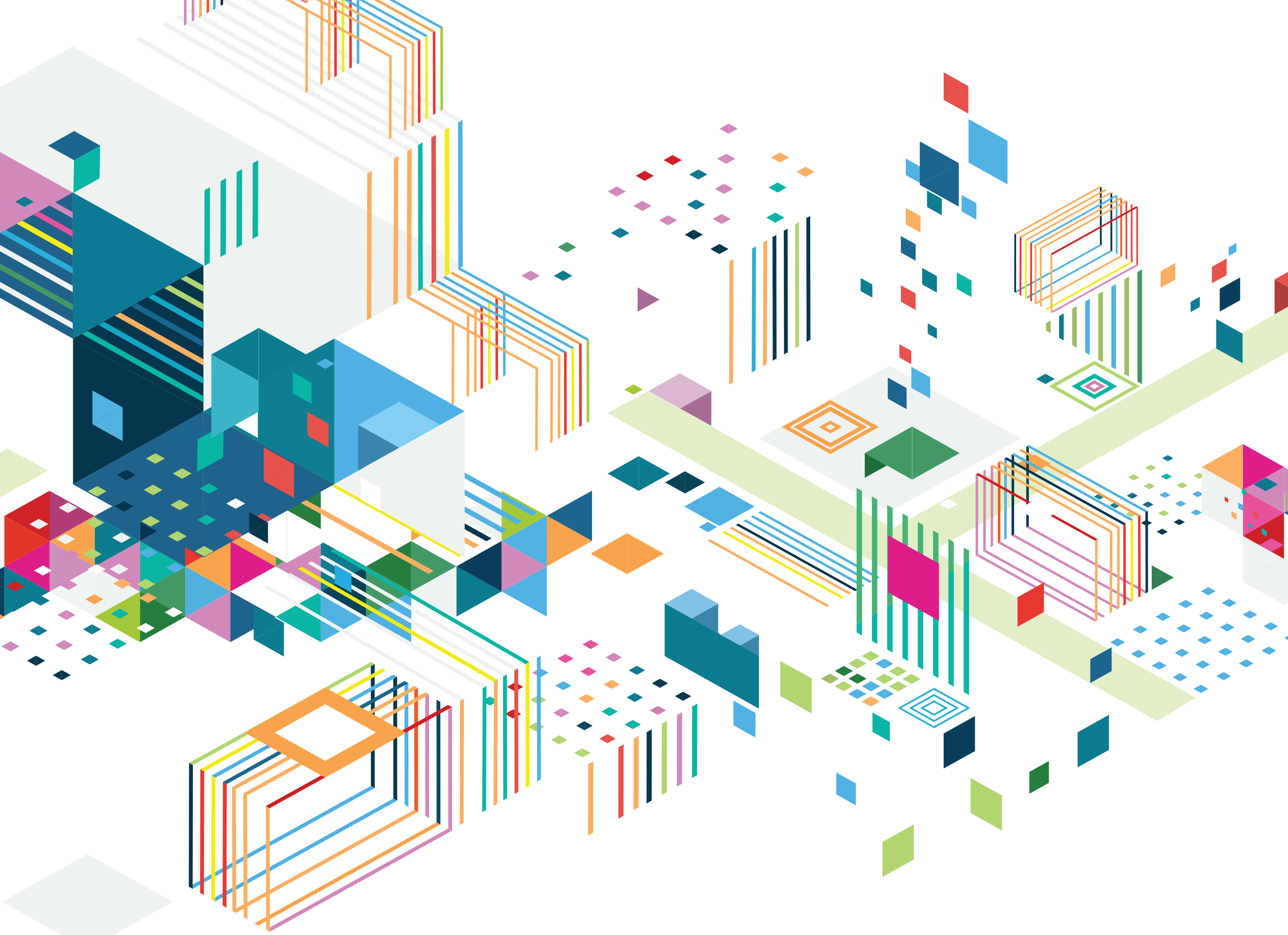
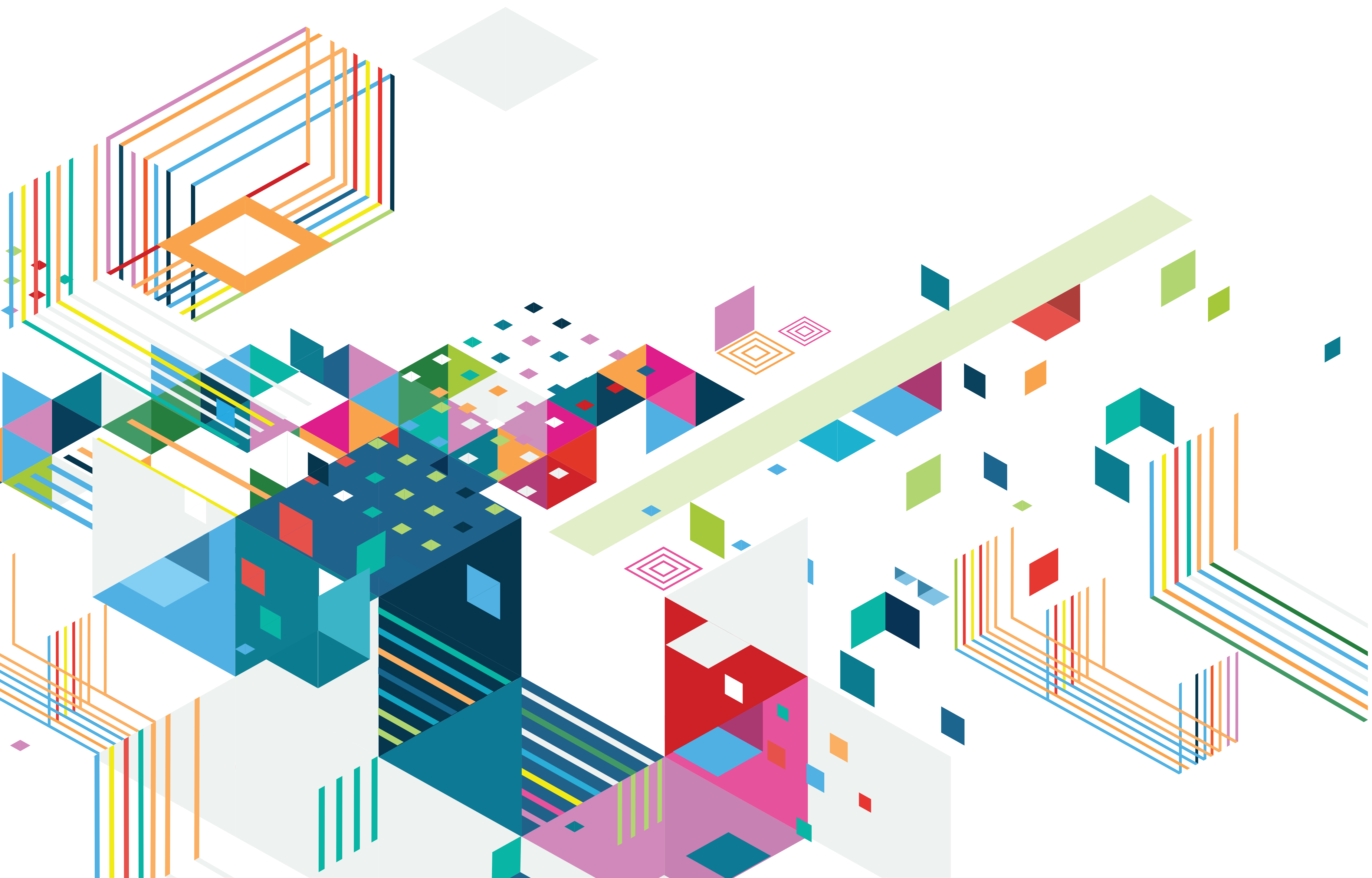
Private Rented Sector

Spain 2019



A GROUND-BREAKING OVERVIEW OF THE PRIVATE RENTED SECTOR IN SPAIN
LOCATION, STRUCTURE, DATA

POWERED BY urbanData Analytics



Welcome to our report

Private Rented Sector

Spain 2019

Knight Frank is delighted to present this report outlining the key figures for the private rented housing sector – an up and coming asset class that is quickly gaining traction in the Spanish market. We firmly believe that this real estate segment will offer attractive opportunities for investors who, with the help of professional advisory services, are able to correctly position themselves at this early stage.

This is precisely why we have created a specialist team that will be solely dedicated to this segment – the first of its kind in the Spanish rental market. We have combined the local expertise of our two main business areas – Capital Markets and Residential – and work in close collaboration with our PRS (Private Rented Sector) teams in the UK and the US, where we are market leaders in PRS, with over 150 professionals solely dedicated to this area. In terms of Big Data, we have teamed up with urban Data Analytics, the leading data analysis firm that focuses on detailed real-time understanding of the sector.

This report outlines some of the key takeaways for the rental market in Spain, looking at both the current climate and its future development. It also examines the strategic locations that could present attractive opportunities, both for renters and varying investor groups.

We are certain that this report will prove invaluable for all of our clients and will spark further debate regarding the numerous opportunities that this sector holds for the future.

In the meantime, we hope you enjoy the read.

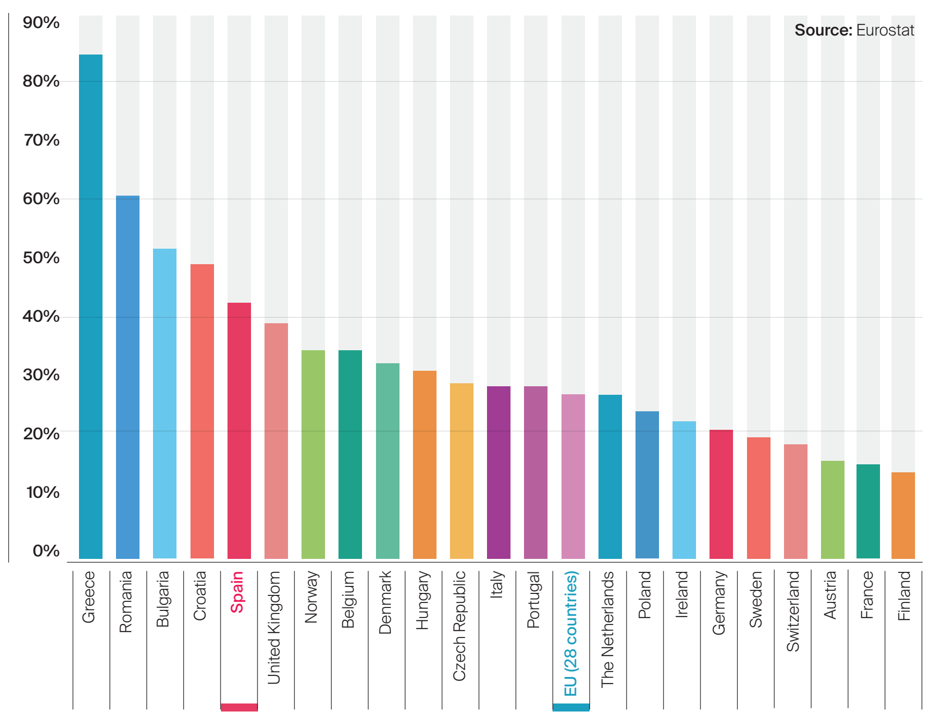
Carlos Zamora
Partner, Head of Residential

Jorge Sena
Partner, Head of Commercial

Spain vs Europe

In recent years, Spain has started to witness a shift away from homeownership towards renting, and although levels are still a far cry from the European average, there remains significant scope for this sector to expand further in Spain.

Graph 1 / % population spending > 40% of income on rent in Europe / 2017



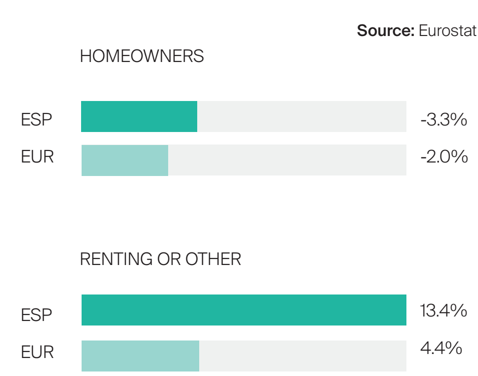
According to the latest available data, the number of homeowners over the last seven years, both in the European Union and Spain, has fallen considerably, while the number of people renting has risen – an increase that has been more prominent in Spain (up 13.4%) than the rest of the European Union (up 4.4%).

In 2010, the average percentage of people renting in the EU stood at 29.4%, a figure which has since risen to 30.7%. Although this figure is lower in Spain, it has also increased, climbing from 20.2% in 2010 to the current 22.9%. These figures include rents both at and below market price, and social rents. Focusing on specific countries within the EU, the country with the highest percentage of tenants is Germany, where close to 49% of the population rents. This is followed by Austria with 45%, Denmark with 37.8%, and France with 35.6%. In contrast, eastern European countries such as Romania, Croatia and Slovakia have the lowest percentage of renters, with 3.2%, 9.5% and 9.9% respectively.

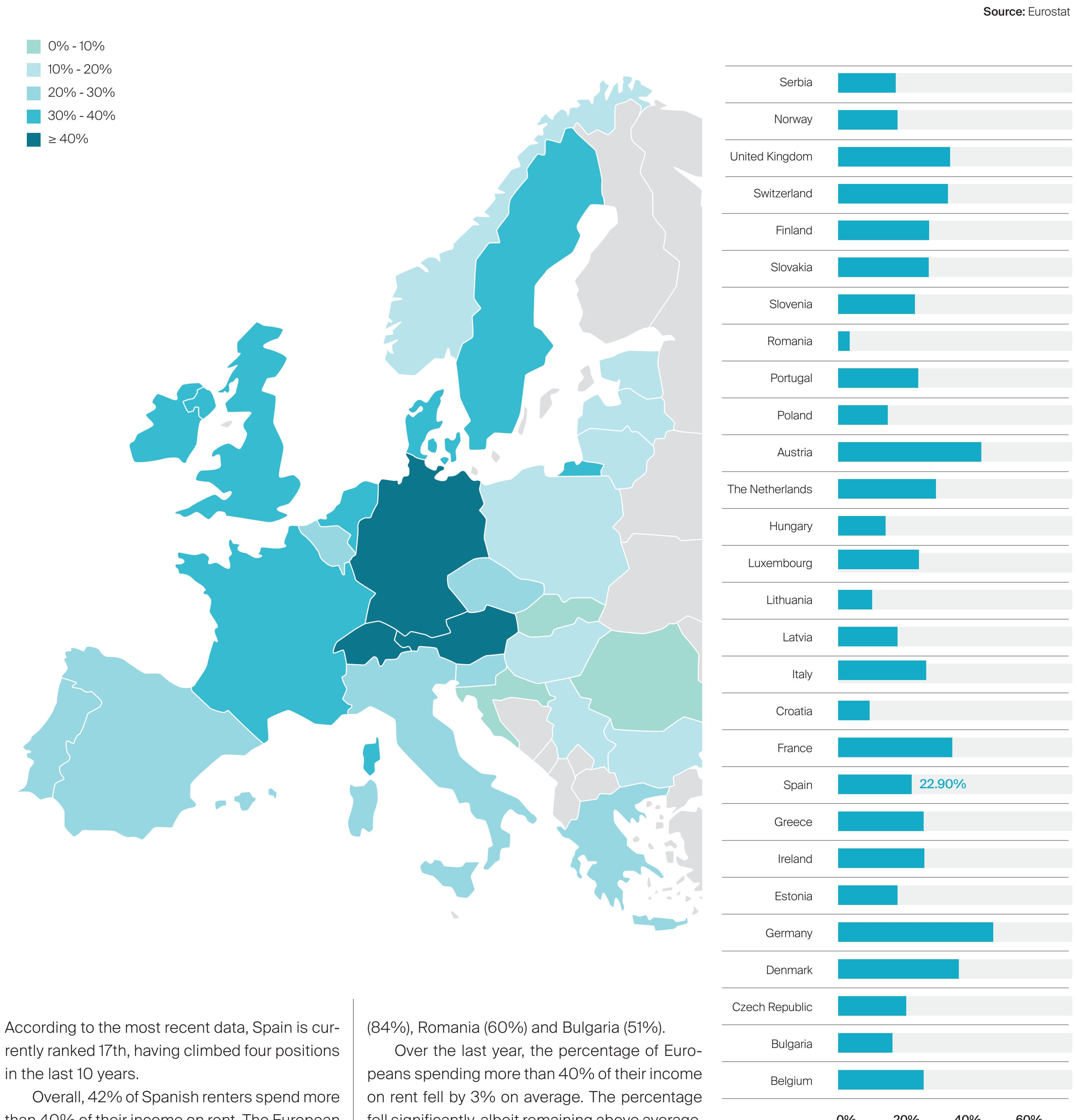
> "As PRS investment demand takes off across Europe - international mobility is on the rise and urban populations are expanding - there is an ever greater need for new supply and better quality product. Cross-border capital flows are tapping into this trend and growing, and residential investment strategies in Europe are increasingly appearing on investors' radars."

Stuart Osborn | Partner. European Residential Investment Group

Graph 2 / Variation in tenure in Spain and the EU-28 / 2010 - 2017



Graph 3 / % Population renting in Europe / 2017



According to the most recent data, Spain is currently ranked 17th, having climbed four positions in the last 10 years.

Overall, 42% of Spanish renters spend more than 40% of their income on rent. The European average stands at close to 26%, with this figure being much higher in countries such as Greece (84%), Romania (60%) and Bulgaria (51%).

Over the last year, the percentage of Europeans spending more than 40% of their income on rent fell by 3% on average. The percentage fell significantly, albeit remaining above average, in countries such as Italy and Portugal, while in Spain, the figure remained almost unchanged.

Renters and housing demand

Rental housing demand spiked following the onset of the financial crisis, however, time has proven that rental housing is a stable investment product, capable of generating recurring income and maintaining occupancy rates.

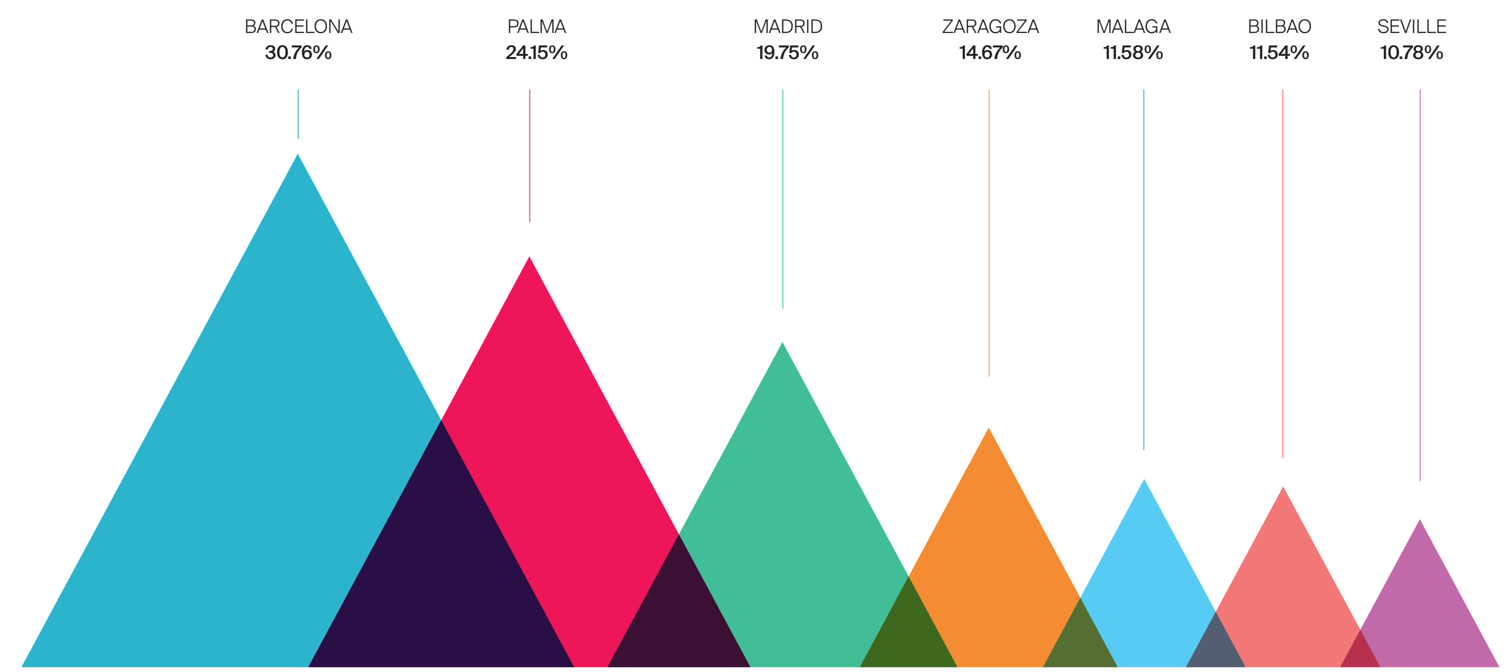
Despite the deep-rooted tradition of homeownership among Spaniards, the financial crisis sparked the start of a market shift towards renting. People suddenly began to view it as a viable option, and in fact continue to do so today. A good example of this – aside from the rising number of people opting to rent – is the rising number of households in the private rented sector. The average number of people renting per home is estimated at approximately 2.5.

In 2013, the number of rented homes accounted for 21% of total housing, while today this figure stands at over 23% for the whole of Spain. In terms of autonomous regions, 36% of homes are rented in the Balearic Islands, and roughly 30% in Catalonia, Ceuta and Melilla. These are followed by the Canary Islands and the Region of Madrid, which are approximately 3 percentage points above the average figure for Spain. However, in the Basque Country, Cantabria and Castilla y León, the proportion of rented homes stands at below 18%.

People aged 16 to 44 account for the largest share of renters in Spain.

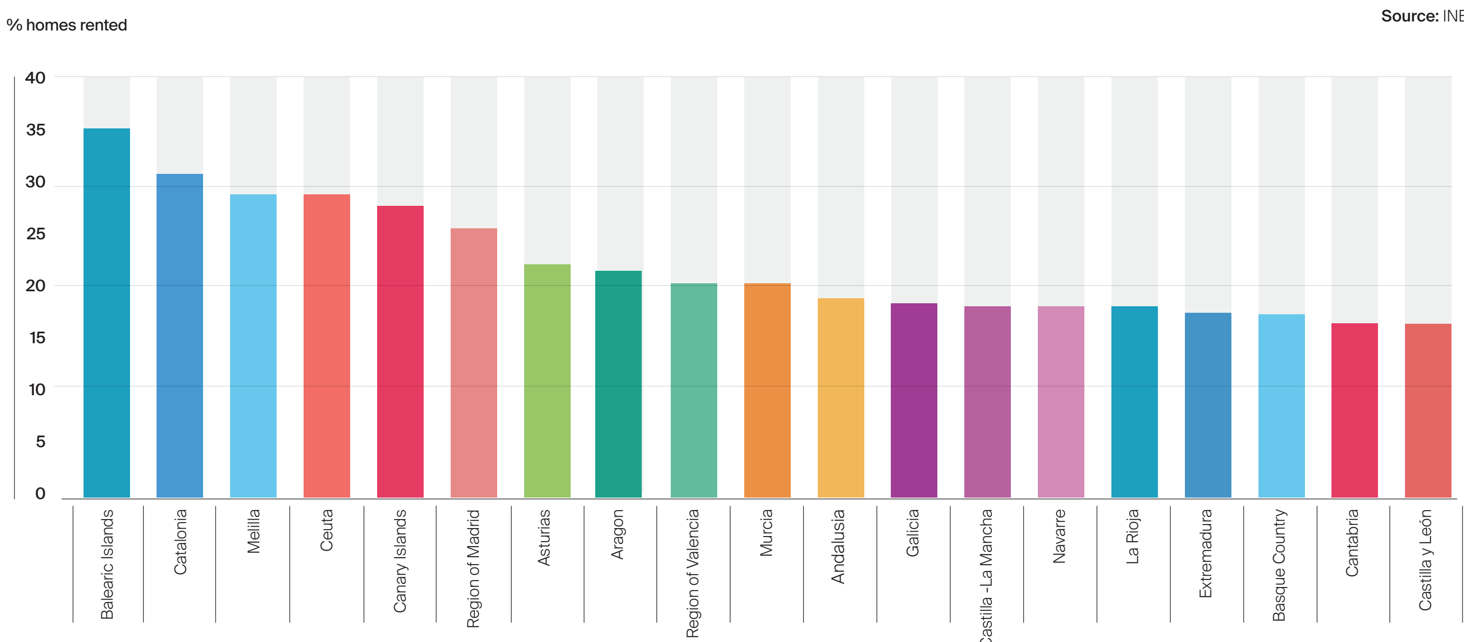
Graph 5 / **Rented housing | total housing stock in major cities** / q1 2019

Source: Knight Frank Research | urbanData Analytics



Graph 4 / **% Rented primary residences. Autonomous regions** / 2018

Source: INE



If we focus on the main cities in Spain and look at the total housing stock – whether primary or secondary residences – we can see that the biggest rental market is found in Barcelona, where almost 31% of homes are rented. This is followed by Palma, with 24%, and third-placed Madrid where close to 20% of homes are rented.

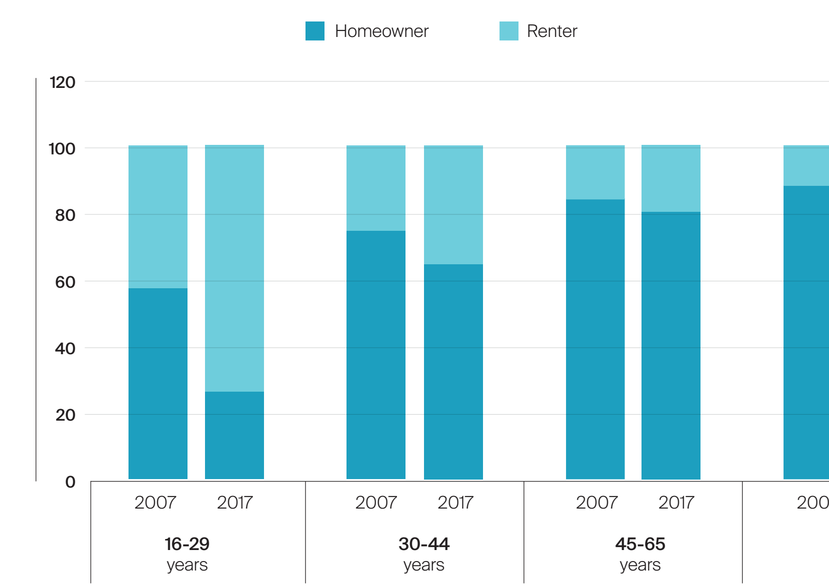
In Palma, a significant share of its rented homes are used as tourist accommodation, an especially important factor to consider in a country like Spain where tourism is the main national industry.

The 16-29 age group boasts the largest share of renters, with 74% of total households in this age bracket falling into the rented housing category in 2017 – a figure that significantly outstrips the 42% recorded in 2007.

There has also been a sharp rise in the number of people renting in the 30-44 age bracket, up from 26% to 36%.

Graph 6 / **Variation in % renters in Spain by age group** / 2007 vs 2017

Source: INE



Variation in rents

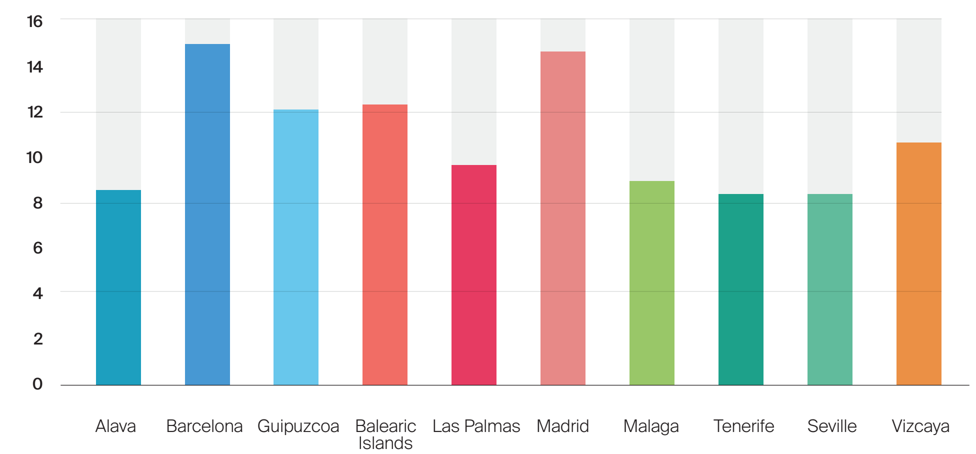
The rental market is expanding at a faster pace than the buyer market. The average cost of renting in Spain stands at €10.7 per sqm/month, up 20% on the maximum recorded in 2007. The provinces posting the highest rental prices are Barcelona and Madrid – with an average of €15 per sqm/month. These are followed by the Balearic Islands and Guipúzcoa with €12 per sqm/month, Vizcaya with circa €11 per sqm/month, and Las Palmas and Malaga with close to €9 per sqm/month.

Generally speaking, rents have ticked up across the board in recent years, albeit at varying rates depending on the location. Demand indicators such as population growth, social security contributions and effort rates are just some of the factors that explain this price growth. This is the case in cities such as Madrid and Barcelona which remain top of the leader board and recorded average rents of close to €16.50 per sqm/month at the end of Q1 2019.

> The average rental price for the whole of Spain is now 20% higher than it was in 2007. The highest rents can be found in the provinces of Madrid and Barcelona, with an average of €15 per sqm/month, followed by the Balearic Islands and Guipúzcoa.

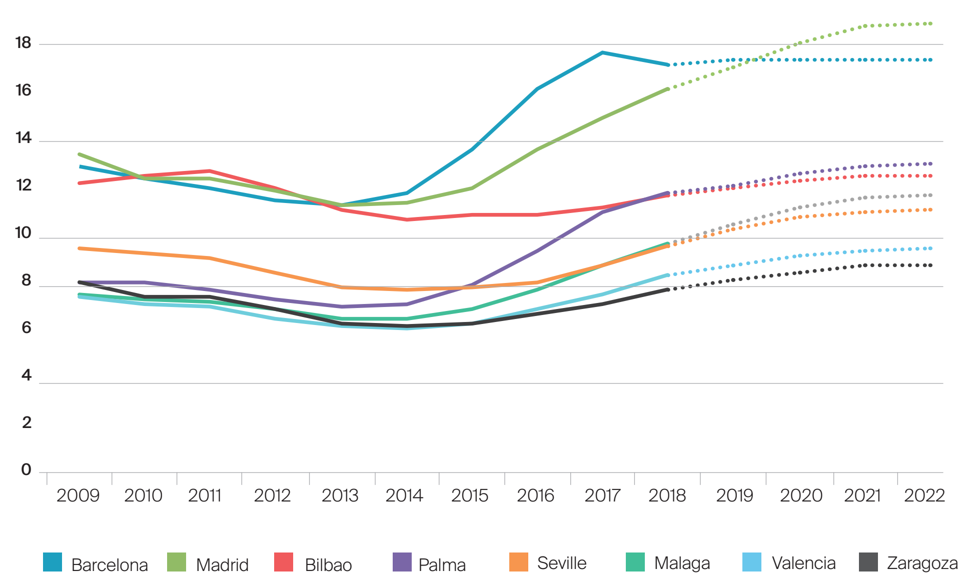
Graph 7 / Average rental price by province (Top 10) €/sqm/month / q1 2019

Source: Knight Frank Research | urbanData Analytics



Graph 8 / Average rental price growth and forecast in the main cities €/sqm/month / (2009-2022)

Source: Knight Frank Research | urbanData Analytics



Prices have not reached such heights in other cities like Palma de Mallorca and Malaga, where they currently stand at €11.45 per sqm/month and €9.70 per sqm/month respectively. However, prices in these cities have risen by over 25% in the last three years, largely due to tourist lettings.

Rental prices are expected to continue growing over the next few years in the main cities, albeit at a slower pace.

In Madrid, they are expected to rise further, while in Barcelona they are set to remain more stable.

Madrid

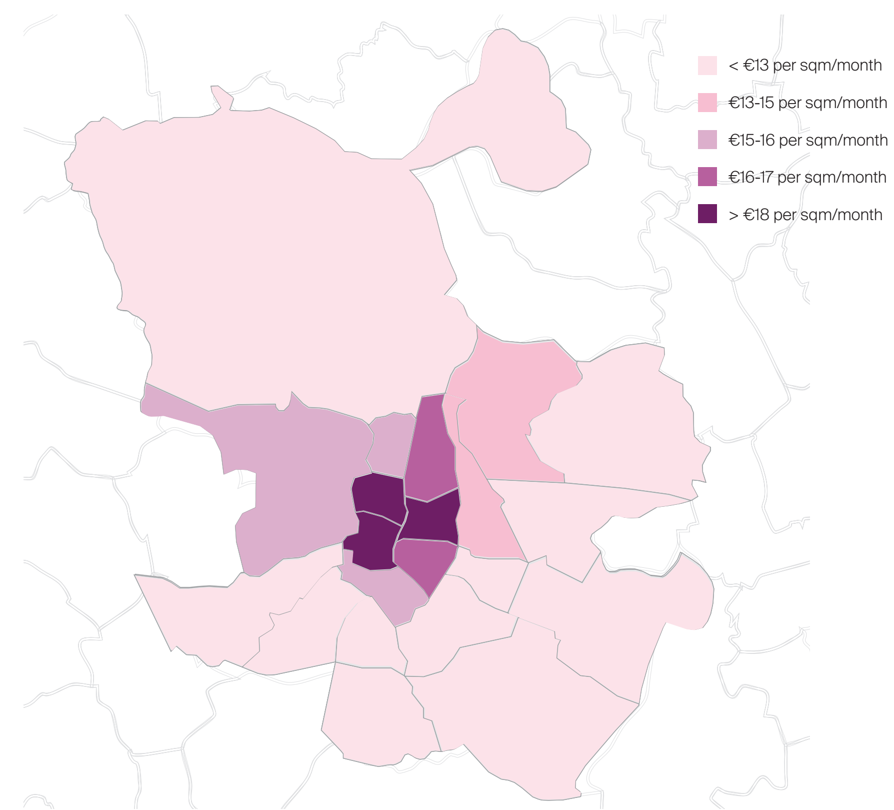
While the highest rents in Madrid are found in the centre of the city, the outskirts of the capital are where more competitive rents can be found. Rents are most expensive in the Central, Salamanca and Chamberí districts, where average prices stand at circa €18.80 per sqm/month.

Vicálvaro, Villaverde and Villa de Vallecas are at the other end of the spectrum and home to the city's most affordable rents, with prices closer to €10.50 per sqm/month.

Over the last year, rents have risen most in the Madrid districts located between the M-30 and M-40 ring roads. The sharpest upticks were recorded in the Latina district, were they rose by nearly 12%, followed by Usera, up 9.4%, Moratalaz up 8% and Carabanchel, up 7%.

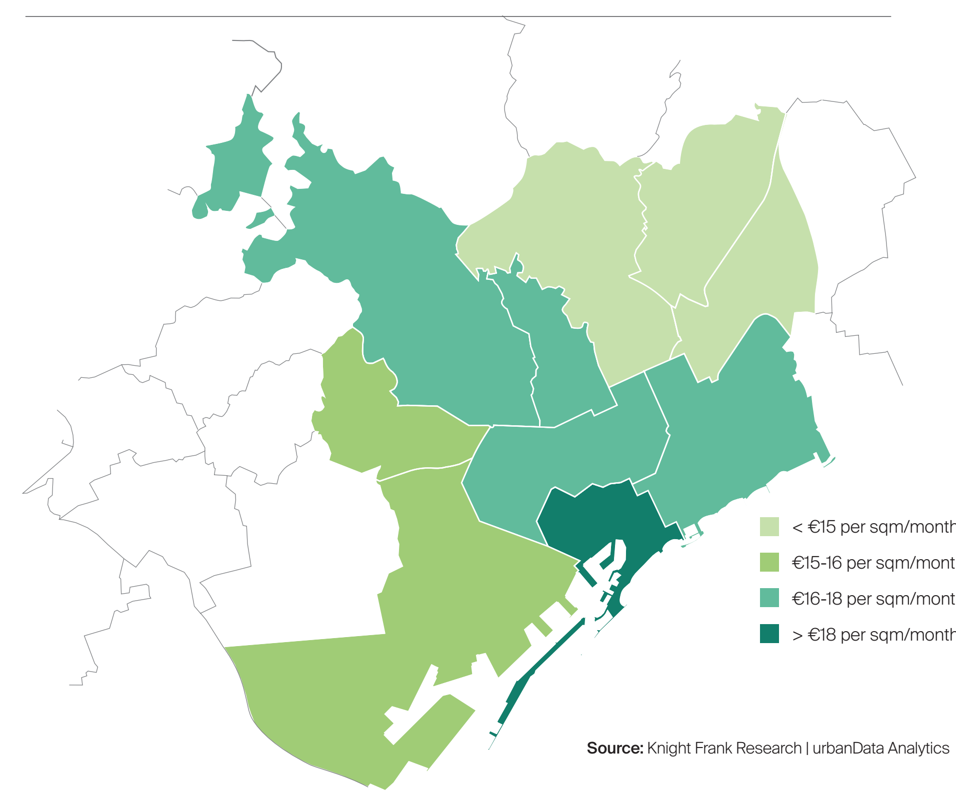
Prices in the Central and Salamanca districts remained stable last year, registering minimal variations of -0.6% and +1% respectively. Chamberí is still one of the city's most sought-after locations, with prices climbing 6% in the district over the last year.

Graph 9 / Rents by district in Madrid / q1 2019



Source: Knight Frank Research | urbanData Analytics

Graph 10 / Rents by district in Barcelona / q1 2019



Source: Knight Frank Research | urbanData Analytics

Barcelona

In Barcelona, the city's highest rents can be found in more widespread areas than in Madrid. At €19 per sqm/month, Ciutat Vella is the district that commands the highest rent, followed by others such as Eixample, Sant Martí and Sarriá-Sant Gervasi, where rents stand at around €17 per sqm/month.

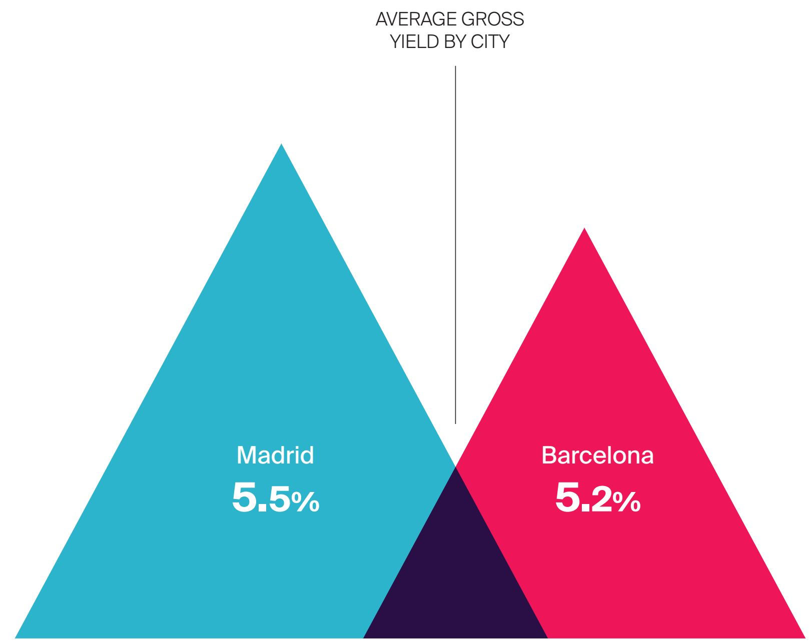
The most competitive rents are found in the districts to the north, such as Nou Barris, Sant Andreu and Horta Guinardó, where the average stands at €13.50 per sqm/month.

Over the past year, price growth has largely mirrored the trends observed in Madrid, with the sharpest increases being registered in the areas with the most competitive rents, such as Nou Barris, up by over 9%, Sant Andreu up by 6%, and Horta Guinardó, up by close to 4.5%.

In contrast, Ciudad Vella, Sarriá-San Gervasi, Sants-Montjuic, Sant Martí and Les Corts all saw rents decline by an average of 2%.

Risk-reward

With investments carrying virtually no risk, Madrid is the ideal place to invest. The cities of Seville, Malaga, Zaragoza and Valencia also boast an average yield of more than 6%, but investments here carry a medium-low risk level.



Source: Knight Frank Research | urbanData Analytics

The gross yield for rental housing in Spain reached 3.9% during Q1 2019, according to official figures from the Bank of Spain. This figure outstrips the yields offered by other investment alternatives, such as the 10-year government bond – which has fallen by up to 1.1%.

According to UDA (Urban Data Analytics), the achievable gross yield in the province of Madrid hit 6.5% in Q1 2019 and 7% in Barcelona. The highest achievable gross yields are found in the provinces of Toledo (8.4%), Soria (7.5%) and Seville and Teruel (7.4%), while Guipúzcoa, Gerona and Vizcaya were home to the lowest gross yield.

This study was carried out for every city across Spain. In terms of risk-reward, Madrid is the best place to invest, as it combines a 5.5% yield with virtually no risk. The cities of Seville, Malaga, Zaragoza and Valencia also boast an average yield of more than 6%, but investments here carry a medium-low risk level. Barcelona's risk level is on a par with these cities but offers a yield in the region of 5.2%.

Bilbao lies at the bottom of the table, combining the lowest yield (4.9%) with the greatest risk compared with the other regions. The gross yield for rented housing in Spain reached 3.9% during Q1 2019. This is because the cost of buying is high compared to the cost of renting.

> The gross yield for rental housing in Spain reached 3.9% during Q1 2019, according to official figures from the Bank of Spain.

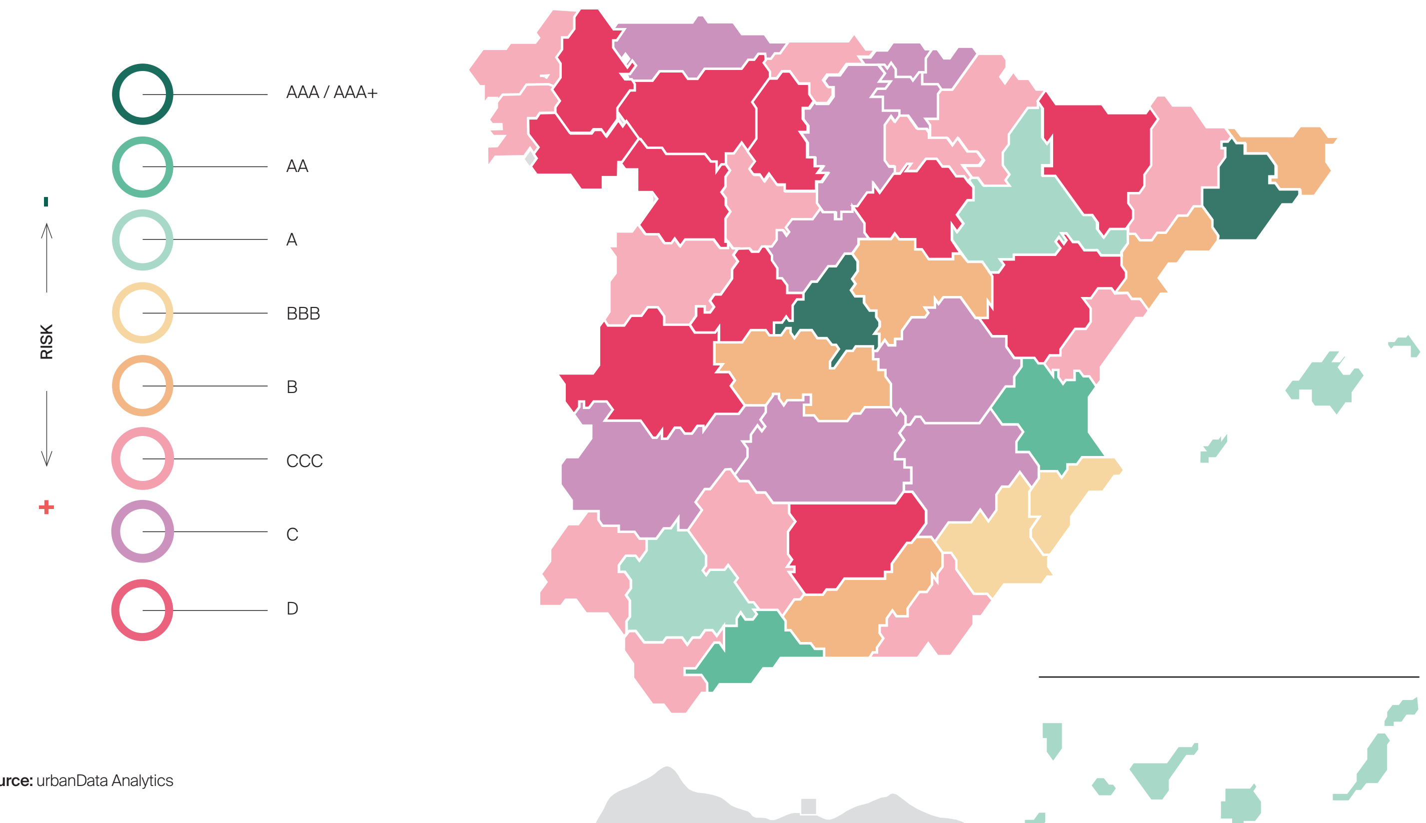
Another variable that affects Bilbao is the length of time it takes to sell or let a property compared with the other cities in the study. This is largely due to the fact that Bilbao has a below average interregional mobility rate for Spain and a very limited housing supply.

If we focus this analysis on specific districts, Puente de Vallecas, Carabanchel, Villaverde and Latina emerge as the best locations in which to invest in Madrid. Barcelona's most coveted districts for investment are Nou Barris, Horta Guinardó and Ciutat Vella.

Risk factor

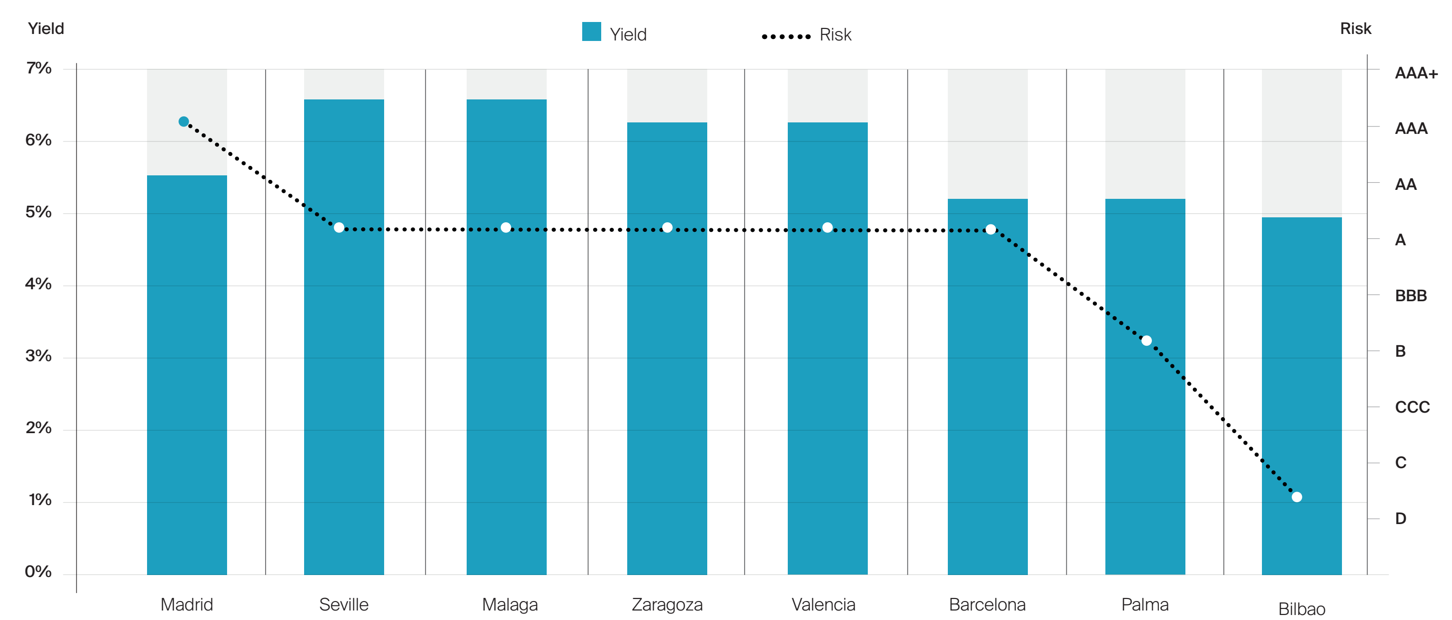
(*) UDA models produce a risk factor by using an algorithm based around 40 different variables, ranging from market fundamentals to shifts in demand for rented housing. This model factors in variables such as GDP growth, social security contributions, unemployment, household formation, liquidity, asset rotation, and the buyer and renter effort rates. This risk variable should be considered alongside yields when it comes to deciding which real estate micro-market to invest in.

Graph 11 / **Rental market risk analysis by province** / q1 2019



Source: urbanData Analytics

Graph 12 / **Risk and yield analysis in the main cities** / q1 2019



Source: Knight Frank Research | urbanData Analytics

Opportunities and the most sought-after product

The outer tiers of Madrid and Barcelona are where investors can find the opportunities that offer the best risk-reward profiles.

The most sought-after product are homes that are less than 70 sqm and well-connected with the city centre via public and private transport.

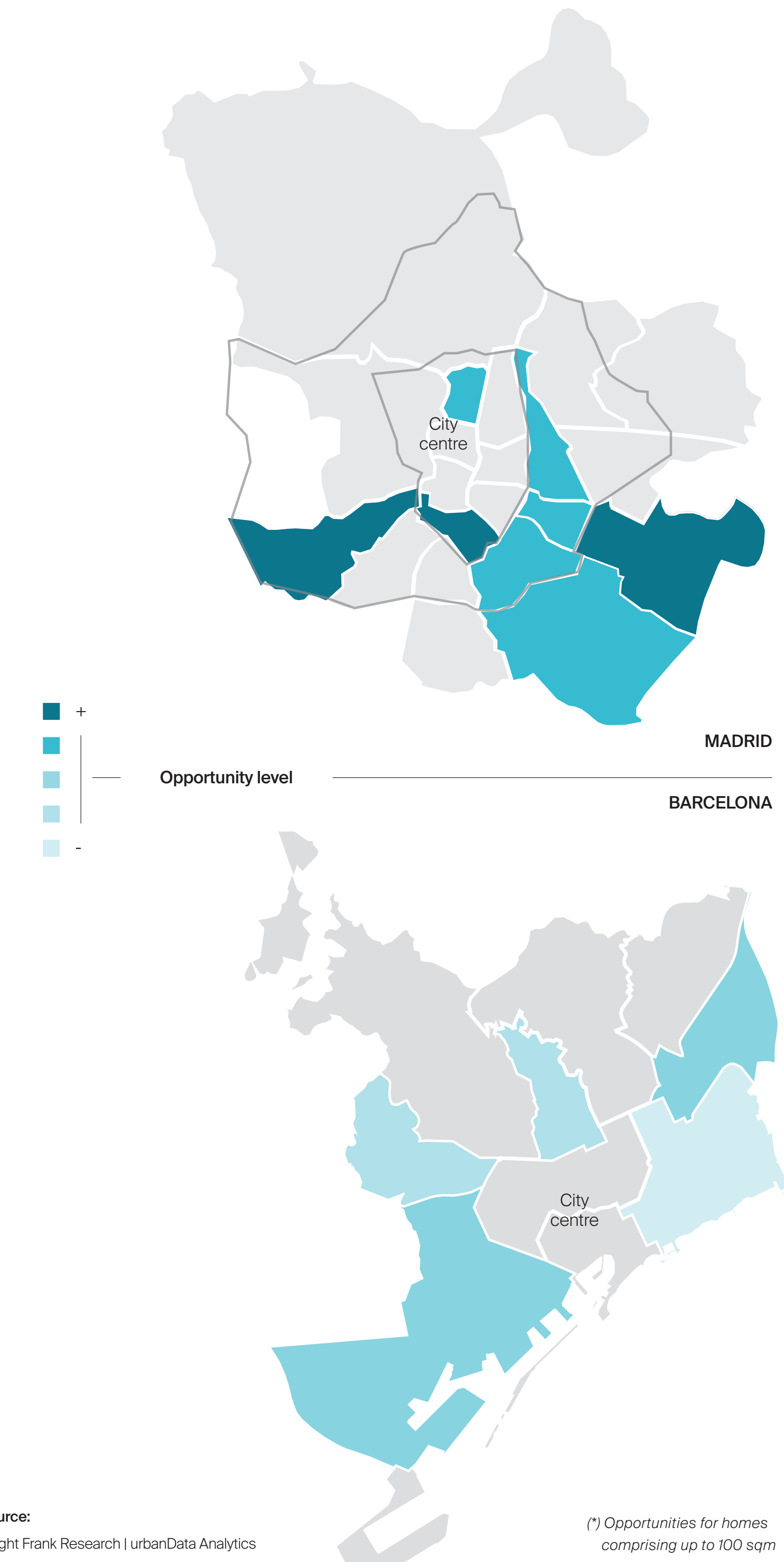
An analysis of the districts of Madrid and Barcelona shows that the most attractive areas for investing – in terms of take-up and yields – are generally located close to the city centre. In Madrid, some areas located further out, to the southeast and southwest of the city, also present good opportunities.

In terms of the most coveted size of home in both cities – a variable that can offer a greater opportunity from an investment perspective – smaller homes currently hold more sway. More specifically, renters favour homes comprising less than 70 sqm, followed by homes between 71 sqm and 99 sqm.

One of the biggest challenges facing the rental market is supplying the right type of product to be able to meet current demand and move into line with the rental levels seen in other European countries.

At present, barely 5% of rental housing is managed by professional operators, with the rest owned by private landlords or small firms – highlighting the fact that this is a far from professionalised market. Such a fragmented market presents investors, developers and managers alike with a major challenge in the short and medium term.

Graph 13 / **Most sought-after product (*)** / Madrid and Barcelona



Source:
Knight Frank Research | urbanData Analytics

(*) Opportunities for homes comprising up to 100 sqm

Rented sector regulation

In recent months, many national and regional bodies have been putting measures in place to regulate and create a more efficient rental market. Each and every one of these measures has sparked controversy among professionals, who to some extent are doubtful of the consequences that these measures will ultimately have. The following are some of the measures set out in the last legislative decree for the reform of the rental housing market.

1

Increasing term certains. The term certain has been extended from 3 to 5 years –7 years for companies– and the tacit renewal period has been extended from 1 to 3 years, unless otherwise agreed by the parties involved.

2

Rental increases are now pegged to the CPI or Housing Price Index, which is under development.

3

Deposits are capped at two months' rent.

4

The option for the owner to recover the rented property for their own use must be stated in the lease at the time of signing.

5

The Catalan Government has passed a legislative decree to cap rental prices. The cap is calculated depending on the benchmark index and the specifications of the property.

Graph 14 / **Rental vs. investment markets | main cities in Spain** / q1 2019

Source: Knight Frank Research | urbanData Analytics

NO. OF HOMES RENTED
= NO. OF HOMES SOLD
100%: the rental and sales markets are of a similar size

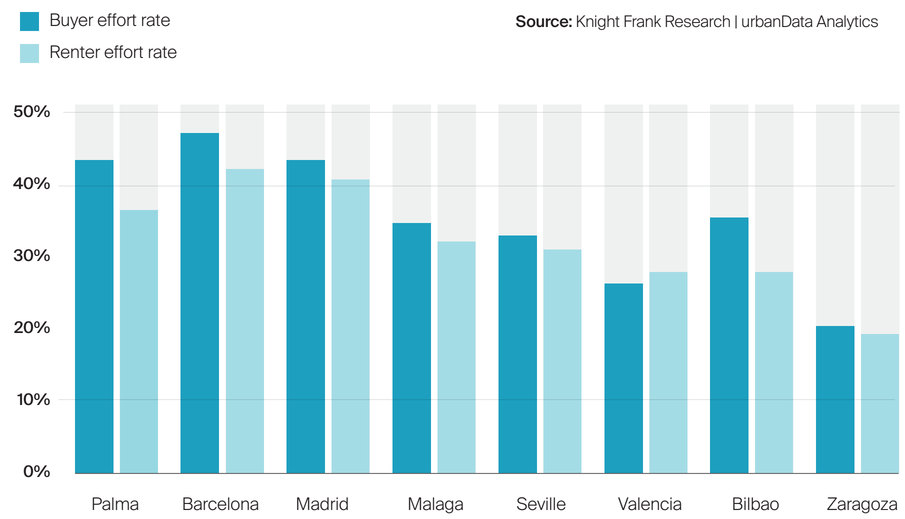
NO. OF HOMES RENTED
> NO. OF HOMES SOLD
0%: the rental market outweighs the sales market

The following scale has been created using an indicator generated by UDA, which analyses rental housing take-up compared to housing sales in each market. The scale is an effective way of measuring market trends. If we compare rental housing take-up with housing sales in the main cities, we can see that the rental market plays a more prominent role. In Zaragoza, however, renting and buying are equally popular. Barcelona lies at the other end of the scale, with a far more active rental than sales market.

Structural change or a one-off phenomenon?

The rental market is rapidly expanding and looks set to continue to gain traction over the coming years.

Graph 15 / Buyer vs. renter effort rate in main cities / q1 2019



During the financial crisis, renting presented people with a different way of being able to leave home, given that their financial and employment situation made buying a property an almost impossible option.

Professionals across various sectors initially believed that the shift towards the rental market would prove short-lived, but since the economy began to recover, rather than lose steam, renting has gone from strength to strength. According to the Bank of Spain, the number of renters is locked in a clear upward trend, while the number of homeowners is declining.

Renter effort rate

In the study of the main towns in Spain, the achievable figures indicate that the renter effort rate – the percentage produced by dividing average annual rent by household income – is still lower than the buyer effort rate, with the exception of Valencia. This is despite the fact that rental prices have continued to tick up in recent years.

The buyer effort rate is calculated by dividing the purchase price by household income, applying a theoretical 80% mortgage rate, over 30 years with a 2.4% interest rate.

In cities such as Madrid, Barcelona and Palma de Mallorca, the average purchase price and rental price are both higher than the average figure for Spain.

However, household income is also much higher than average in these locations and there is a greater presence of international investors.

This therefore highlights the need to go beyond isolated data and study the cases where these levels are not sustainable for the population of each market.

In Bilbao and Palma, the difference between both effort rates is greater than in other locations, whereas in Zaragoza, the buyer and renter effort rates are closest, with both standing at close to 20%.

Job mobility

Job mobility has become the second most decisive factor when it comes to choosing whether to rent or buy a home. The concentration of job opportunities in certain cities, such as Madrid and Barcelona, act as a magnet for an active population that finds renting the ideal way to live for an indefinite period of time. In 2018, just 19% of people worked in their home town or city, 22% worked in the province in which they were born, while 34% of workers were employed in another province or region – the remaining 25% were working abroad.

Graph 16 / Key sales and rental figures / q1 2007 - q1 2019

SALE

Q1 2007 VS	Q1 2019
Price*	- 22%
Mortgages	- 71%
Sale*	- 27%
Mortgage size	- 18%

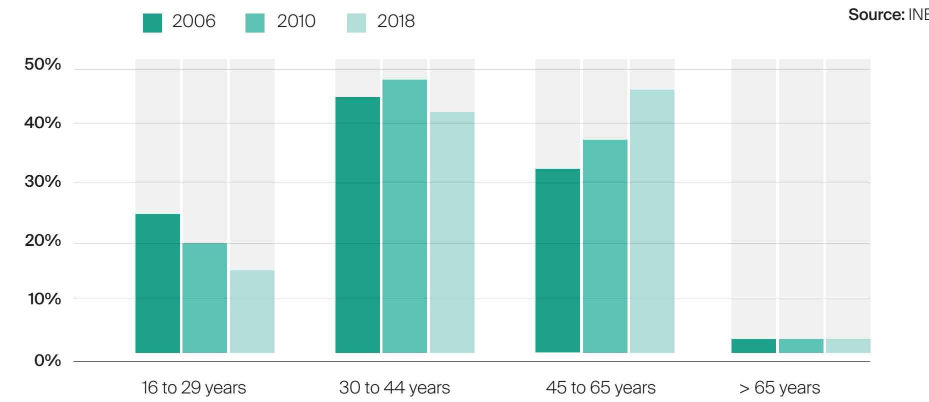
Source: Ministry of Public Works | INE
* Number of housing transactions. Annual figures 2007-2018.

LETTING

Q1 2007 VS	Q1 2019
€/sqm/month	+20%
Rental tenure*	+ 17%
GDP per capita	+ 8%
Yield	+30%

Source: Bank of Spain | INE | Idealista
* Based on latest available data

Graph 17 / Workers by age group (%) / Spain



Employment among the newest generations

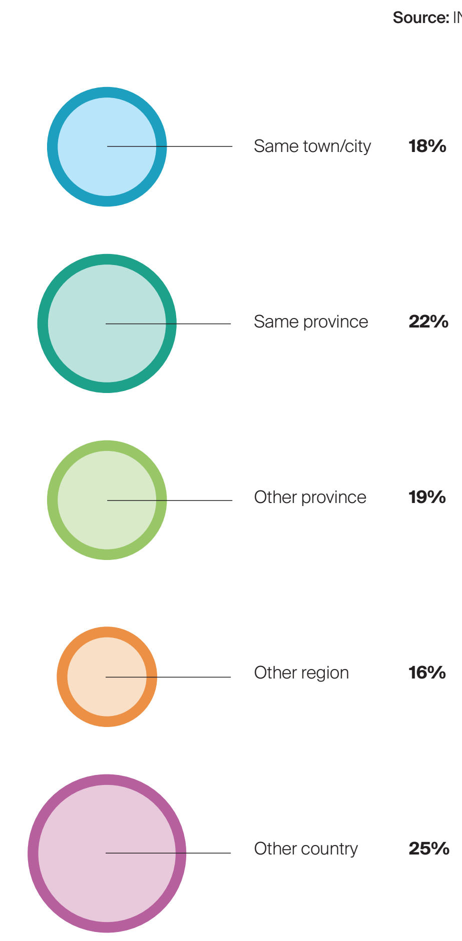
The number of workers registered with social security in Spain stands at 19.1 million, close to the record high of 2007. During Q1 2019, the largest age group in work was people aged 30-65, accounting for 86% of the total, while young people made up 13% of the workforce. These figures indicate that since the financial crisis young people have been finding it increasingly difficult to break into the jobs market. Solving this situation as quickly and effectively as possible presents manifold challenges across all levels. The Ministry of Labour, Migration and Social Security has announced its commitment to developing a new long-term production model. To this end, the 2019-2021 Action Plan for Youth Employment has been designed to target people aged 16 to 29 and lower the unemployment rate for this age bracket. Its objective is to reduce youth unemployment from current 33% to 23.5% and increase the employment rate for people aged 20-29 to 73.5%.It also aims to raise the number of permanent work contracts by 15%.

Financing new mortgages

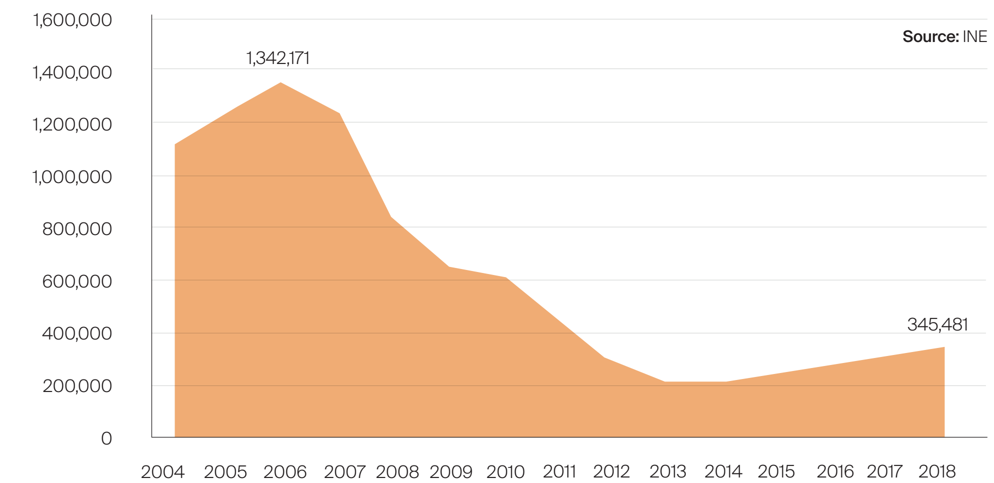
In the years following the bursting of the real estate bubble in 2008, banks stepped up the requirements for taking out a mortgage. This sent the number of mortgages granted tumbling by 84% compared to 2007. Even today, very few banks will finance more than 80% of a home purchase and they carry out a thorough assessment of every potential home buyer in order to determine their ability to pay off their future mortgage. The low Euribor rate is a plus for mortgage borrowers, as despite initial forecasts for the Euribor to pick up as the economy recovered, the majority consensus is now for it to remain flat for the foreseeable future.

Young people's consumption habits and the growing instability of the jobs market make it much harder for this age group to save money. This is one of the main reasons they find it so hard to take out a mortgage, as they are simply unable to front the 20% down payment required by banks. In addition, the tax deduction for purchasing a permanent residence was withdrawn in 2013, further reducing the incentives of homeownership.

Graph 18 / Job mobility by birthplace (%) / Spain. 2018



Graph 19 / Number of mortgages granted in Spain



Build-to-Rent

Featured below are the two primary ways of acquiring PRS properties – a model that allows investors to acquire a built property capable of generating a healthy return on the capital invested.

Forward Funding

A sales-purchase contract for a property, entered into by a seller (developer) and a buyer (investor), whereby the seller commits to selling a plot of land and carrying out construction works, on the condition that the investor finances the construction process.

Investor benefits:

- Improved return on equity (ROE).
- Acquires the right product for the rental market.
- Avoids developer risk.

Developer benefits:

- Less developer risk.
- More flexible project financing than that available from banks.
- Avoids commercial costs and risks.

Forward Purchase

The investor commissions the construction project by signing a standard construction contract with the developer. Rather than financing the development, the client makes the payment upon delivery of the homes.

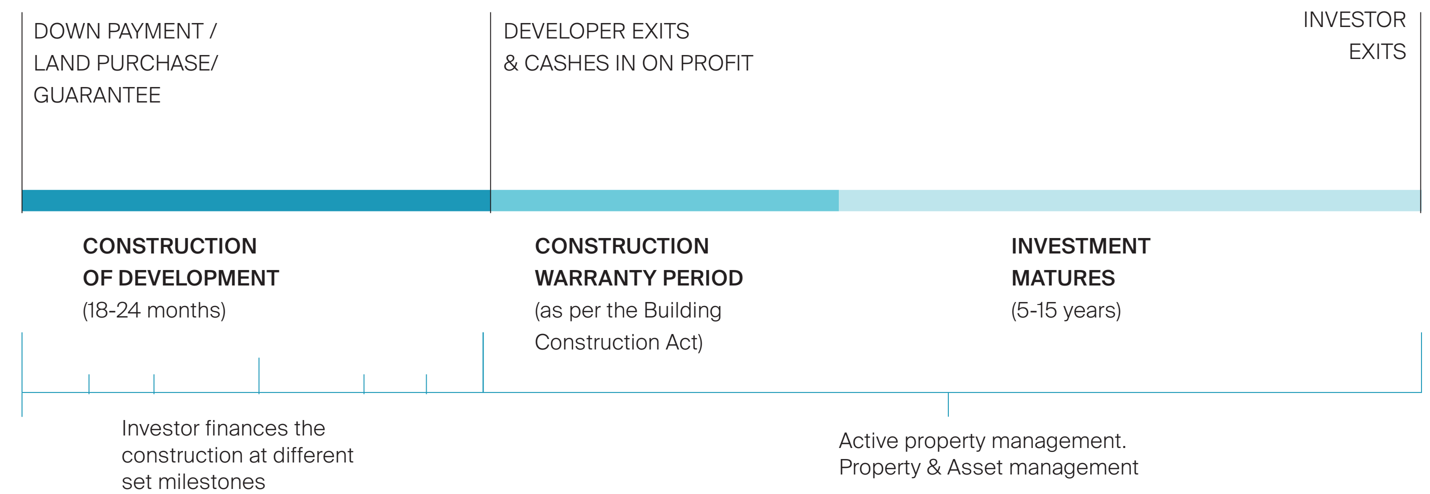
Investor benefits:

- Lower initial down payment, the bulk of the investment is made once construction is complete.
- No risks until delivery (maximising available capital).
- Developer risk avoided.

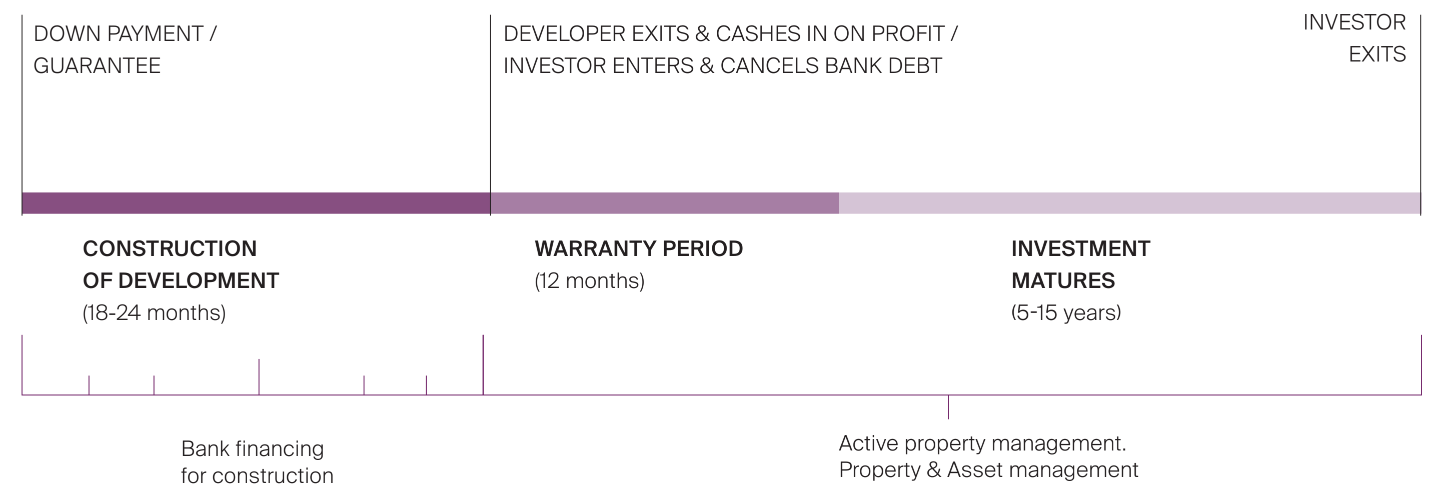
Developer benefits:

- Easier to access bank financing with a purchase agreement signed for the entire development.
- No pre-sale requirements prior to construction.
- Better margins compared to Forward Funding.

Forward Funding



Forward Purchase



SOME COMMON THEMES

PRS investors are willing to pay a premium to work with solvent developers.

Financing new properties rather than acquiring existing ones, allows investors to maximise both operational efficiency and returns per sqm/month. It also eliminates the risk of discovering inherent issues with existing properties further down the line.

The initial yield currently found in a market like Madrid and its metropolitan area stands at between 3.5% net for pure core properties, and 5.5% for the more out-of-town properties. In our view, yields in these areas will remain stable in the medium term.

The impact of design

The design of a rental product is crucial, as it not only helps optimise the product, but also creates homes with a different look and feel – a vibrant and diverse setting that attracts a wide range of tenants.

Community

If properties are to entice tenants to stay longer, their design and overall architectural concept need to create a sense of comfort and community. Communal areas play a vital role in developing a sense of community among residents, and also help to provide the control and security that tenants look for at the entrance to their properties.

Communal areas should include workspaces, communal terraces and gyms. Rather than generating additional income, the aim of these facilities should be to create a sense of community. All these aspects help tenants to get to know each other better and, as a result, make them more likely to stay in the long term. This in turn helps to reduce property vacancy rates and has a direct impact on net operating revenue.

Space design

Optimising the average surface areas of properties allows investors to both obtain more attractive returns and offer their target market feasible monthly rents.
It is also especially important that properties boast an efficient design across all areas – many of the services that used to be included in private homes can now often be found in communal areas.

Flexible design of the individual units plays a key role when it comes to creating the end design for the product as a whole – making sure it is suited to today's various tenant profiles, from young professionals to families with children.

High-quality materials

PRS developments are designed for long-term investments, with high rotation levels of tenants. As such, the materials used during construction must be as resistant as possible. Finishes should be high-quality, easy to maintain, comfortably replaceable and durable.

Management

Effective property management helps to improve and safeguard long-term value. PRS investors look for secure, recurring income throughout all stages of the property cycle. It is therefore important that the management always ensures a property remains in a good state of repair and that its design remains attractive for tenants via active OpEx and CapEx policies.

An interview with Wolfgang Beck
CEO Testa

With over 10 years' experience in the real estate sector, in 2018 Wolfgang Beck took the helm of the leading rented housing firm, Testa, as CEO. Testa currently manages over 11,000 homes located across the length and breadth of Spain.
Wolfgang gives us his insight into the current situation and future of the rental market, from the perspective of both tenant and property manager.

In a country of homeowners like Spain, the Socimi Testa Residencial chose to take a leading role in the rented housing sector, which has expanded significantly in recent years. Do you think the current rental revolution has reached its zenith, or is there still potential for further expansion?

Our belief is that the so-called rental revolution still has a lot of life left in it. The percentage of homeowners – which stood at 85% back in 2001 – has now fallen to 77%, but this is still way above the European average of 66%.

As a result, the percentage of homeownership will continue to fall – in line with global

trends – as people place increasing value on things like mobility, flexibility and the ability to invest their savings in a more diverse way. If this trend continues as it has done for last decade, we estimate that we could end the year with between 80,000 and 90,000 new households living in rented properties. Considering that there are currently 3.3 million rented apartments, this would equate to a y-o-y growth of 2.5%. It's clear that we are dealing with a market where more and more people prefer to rent and professional investors like us are helping to meet this rising demand.

In Spain, the market share of professional rental companies stands at less than 5% and most of these institutions are Spanish. The remaining 95% of rental housing in Spain is owned by private landlords.

¿What are the advantages for a tenant renting through a major operator rather than a private landlord? And from the owner's perspective, who is the ideal tenant? And, how do you measure their solvency or credit rating?

People who rent through professional PRS companies benefit from high quality management. As they control larger portfolios, these firms can work with considerable economies of scale, directly benefitting the tenant in terms of both cost and service quality.

We are fortunate enough to have a high-quality portfolio, in excellent locations with great facilities such as swimming pools and gyms. The quality of our homes is also much higher than the average for Spain. We have a very broad range of tenants.

> I think the best thing would be a policy that helped put more homes on the market."

Spain is still a long way behind other countries in the European Union in terms of the percentage of the population that rents. Do you think Spain will ever reach the levels of other European countries, such as Germany or Austria, or even the US?

All over the world, the traditional practice of owning a home is shifting towards renting for a number of reasons, such as flexibility, as I mentioned before. Our forecasts show that the percentage of homeownership will continue to decline in favour of renting, and that eventually Spain will move in line with other European countries, so long as the rental housing supply is available.

How does the new Royal Decree approved by the Government in March affect major property owners? And more specifically, what do you think of the proposal to peg rent reviews to the CPI? Do you think it would be better to let supply and demand balance themselves out?

Firstly, the new rental law distinguishes between professional and private landlords, and establishes different conditions for each one. An example of this is the lease term. We don't actually know why the Royal Decree distinguishes between the two types of owner. Some people might think that bigger owners are the reason behind the recent rent hikes, but that's simply not true – professional owners have a market share of less than 5% in Spain. It's impossible to affect prices with such a small market share.

Secondly, the law states that annual rent reviews must be benchmarked against the CPI, reducing the flexibility of landlords and tenants to agree on the right conditions for a specific property or location.

A similar example of restrictive measures is the Mietpreisbremse law passed in Germany in 2015. Those rental restrictions had a huge impact on housing supply and ultimately led to massive rent hikes. In Berlin, for example, prices nearly doubled in the three years after these measures were adopted in 2015.

The current situation in Spain is a cause for concern, because only 50% of the required level of rental housing is being built each year. It isn't immediately obvious how we can build more rental housing if on one hand the law won't let supply and demand balance themselves out, and on the other, it limits flexibility – which in turn reduces the incentives for developers to build new rental homes.

I think the best solution would be to produce a housing policy that helps to put more homes onto the market, both in the investment and rental markets. We don't believe that capping rents is necessarily the best solution, because it could squeeze available rental housing supply at a time when people the world over are increasingly opting to rent rather than buy.

From a property owner's perspective, what measures would drive investment in income-producing properties?

We have to encourage owners to increase the amount of available housing supply. If investors aren't given the incentive to finance the 80-90,000 apartments that need to be built every year, then they simply won't get built and the biggest challenge for the rental market will remain unsolved – under-supply.

At a time when owners are increasingly demanding quality properties, how highly do they value the impact of management costs when it comes to acquiring certain properties? Are costs such as property tax and service charges always included together or are they negotiated separately? Can VAT be claimed back in any way?

You can't claim VAT back. Year on year, we are constantly working to optimise our management costs. The size of Testa's portfolio also allows us to create considerable economies of scale and operate efficiently. With a portfolio of nearly 11,000 homes, we are better placed to negotiate more favourable conditions with our suppliers than if we had a small portfolio.

How will Testa Residencial evolve over the next few years? What is your strategy focused on?

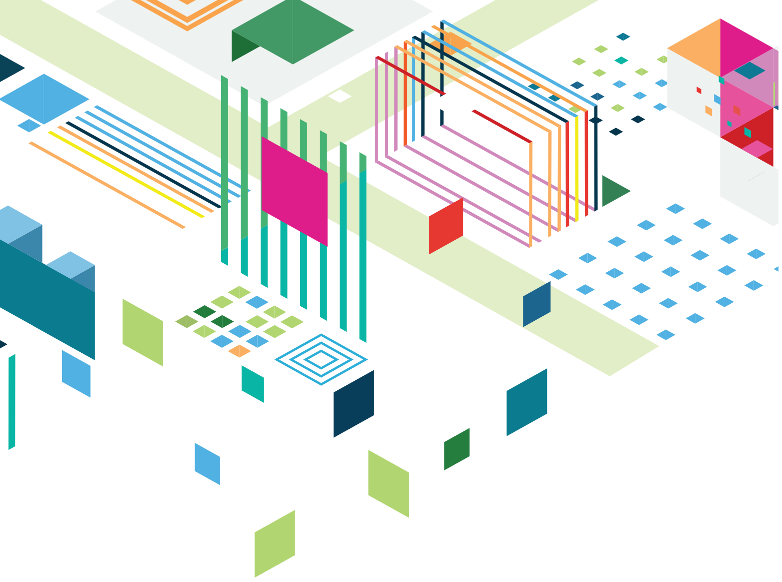
One of our core objectives is to upgrade both the apartments and the communal areas in our properties. Most of our properties boast excellent locations within the main cities and 84% of our homes were built in the last 20 years. However, our clients want to live in homes with new kitchens or more modern flooring for example. Naturally, we take these requests on board, which is why we are upgrading a large number of the properties in our portfolio.

Conclusions

- In Spain, the share of renters versus homeowners moving into line with average European levels looks set to be a trend that will continue to take hold over time, proving it to be far more than just a short-lived knee-jerk reaction to the financial crisis. The transformation of the jobs market, young people's consumption habits and the difficulty of finding a financing method that can adapt to this new reality, are all factors that will play a part in bringing the renter-buyer ratio into line with the European average.
- Specialisation will prove vital to finding the right opportunities and generating a return on investment. This segment is set to take on a commanding role in the market and therefore requires extensive analysis and professional understanding. Studies are often based on parameters and analysis from the investment market, a practice that can lead to errors in the valuation process.
- The asset management for these properties must be carried out by professional teams that are equipped to deal with the demands and challenges presented by this market. An active and efficient management has a direct impact on a property's ability to be able to generate attractive capital market returns.
- Time has also proven that rental housing is an anti-cyclical investment product, capable of generating recurring income and maintaining occupancy rates even at the depths of a crisis.
- There is mounting pressure from international investors for the diverse asset models offered by the rental market. Spain presents a very attractive investment proposition for these investors who are finding opportunities in the medium and long term – trying to replicate the success that they have enjoyed in other European countries.
- Although many developers see the PRS market as the ideal segment for buying up large lots of residential properties, in reality it is proving very difficult to reach large-scale agreements. The problem is that often products that have been designed for the buyer market are being placed on the rental market. However, the rental market is a market where purpose-built products are the undisputed key to success.
- The outer tiers of the major cities are the best places to develop the PRS market – offering the perfect combination of demand and risk-reward for investors. Competition is set to heighten for plots of land in these areas.
- There is a pressing need to assess the new measures and proposals that are being put forward and implemented by governing bodies to regulate this market. On many occasions, we have seen how these measures have proven to be counterproductive and have had the exact opposite effect to that intended.
- Madrid is steadily growing and attracting more investment. Rising private consumption, combined with a booming tourism sector and a recovering jobs market, have all helped to drive growth in the capital. In 2018, GDP climbed 3.7%, one percentage point above the Spanish average of 2.6%.

"At uDA, we provide the ability to drill down into micro locations and analyse a wide range of key indicators for the rented market.
This Big Data methodology allows us to pinpoint where, when and which type of asset to invest in on the rented market, which as we know, is a cyclical market that varies dramatically from the buyer market.
This analysis undoubtedly unlocks a range of opportunities when it comes to choosing the best risk-reward strategy for our investment."

Carlos Olmos. Founder and Managing Director urbanData Analytics.



IMPORTANT NOTICE

Definition of the Private Rented Sector

The Private Rented Sector is the general term used for private rented homes that can take a variety of forms. More specifically, and on a larger scale, it refers to professionally managed institutional rented housing, covering the direct management of tenants. New models are appearing in this sector, such as Build to Rent, Micro Living and Co Living, to name but a few. These models vary by property size, shared facilities and communal areas.

Data Source

Knight Frank Research powered by urbanData Analytics

About urbanData Analytics

Methodology

urbanData Analytics (uDA) is a digital firm that specialises in data analytics, with a detailed real-time understanding of the real estate market. It compiles and produces data from a wide range of public and private sources. It structures, classifies, visualises and analyses all of these data sets, eliminating any anomalies and converting all of the information into indicators (financial, demand-based and urban), which help to give a full picture of the real estate sector, broken down into comparable elements. Each week, uDA takes 4 million data sets from real estate websites and incorporates it into its platform, with over 40 different sources of data, both at the property and aggregate level.

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