RESEARCH

Knight Frank

SPOTLIGHT ON RETAIL

SPAIN **2015**

SHOPPING CENTRES | OCCUPIER TRENDS | INVESTMENT MARKET

EXECUTIVE SUMMARY

MACROECONOMICS

A stronger, more efficient economy

The Spanish economy has experienced a dramatic turnaround since the financial crisis, notably in the last two years. While there remain various headwinds such as a slowly recovering housing market, high youth unemployment and general elections later in 2015, key economic indicators point towards a broadly based and sustained recovery over the next 12-18 months.

GDP growth amounted to 0.9% in Q1, the seventh consecutive quarter of growth and the fastest quarterly rate of expansion since 2007. Action taken by the European Central Bank at the end of last year – namely the reduction in its key interest rates to near or below zero and the launch of its quantitative easing programme in the Euro area – has arguably boosted an economy which was already in recovery mode.

While youth joblessness remains stubbornly high at over 50%, the overall rate of unemployment has peaked and has edged down over the last 18 months to reach 23.8% in Q1. OECD forecasts place unemployment just above 20% in 2016. Indeed, some 434,000 jobs were created in 2014, helped by the previous year's labour market reforms.

Growing sectors include manufacturing, notably the car industry, which has seen a sharp rise in exports on the back of strong international demand and a weaker Euro. Tourism has also given the economy a much-needed boost, while the construction, banking and financial services sectors are more stable

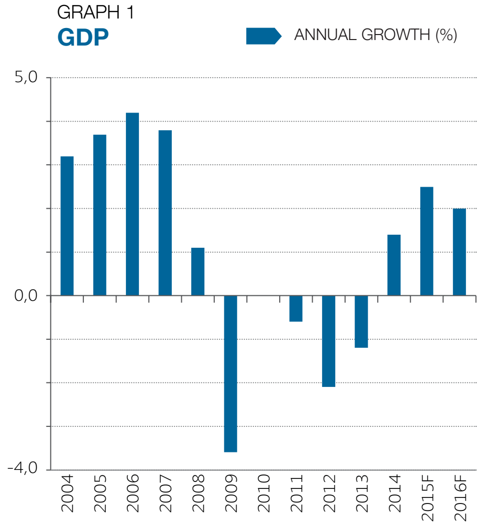
Low inflation/deflation is currently a major issue for much of Europe and negative price falls are being seen in a number of countries. In Spain the annual CPI fell below zero in early 2014 and, following a short-lived recovery, inflation has been in negative territory since last summer.

However, the negative inflation rate is mostly due to the sharp fall in oil prices and there is little evidence to suggest that shoppers are delaying purchases because goods are getting cheaper. Indeed, inflation is expected to rise again by 1.2% in 2016 once the effect of falling oil prices dissipates.

Despite the continuing domestic issues and weakness in other parts of the Euro area, the short to medium term outlook for the Spanish economy is generally positive. Forward-looking indicators such as the CPI indices point to a healthy level of growth in the manufacturing and service sectors over the coming months.

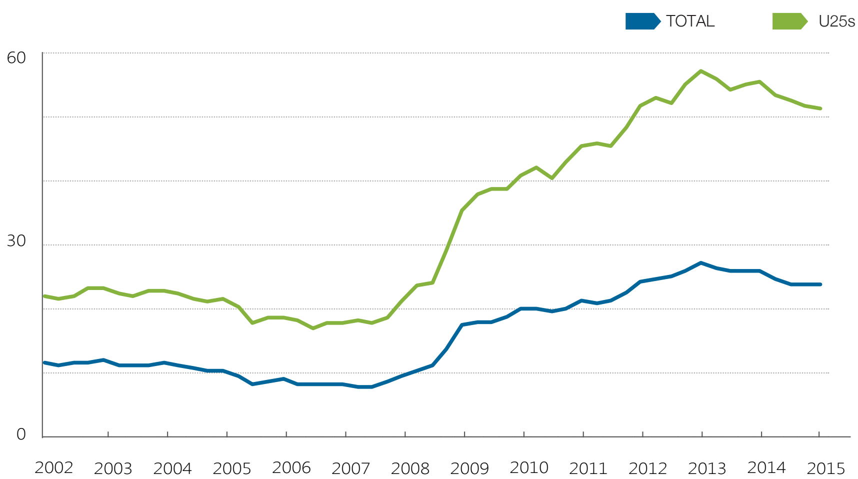
In summary, economic growth is accelerating on the back of a more robust labour market, while easier access to finance, improving confidence and lower oil prices will provide an additional boost to corporate activity. Forecasts by the OECD suggest that the economy will grow by around 2.8% this year and 2.7% in 2016.

GRAPH 1
GDP



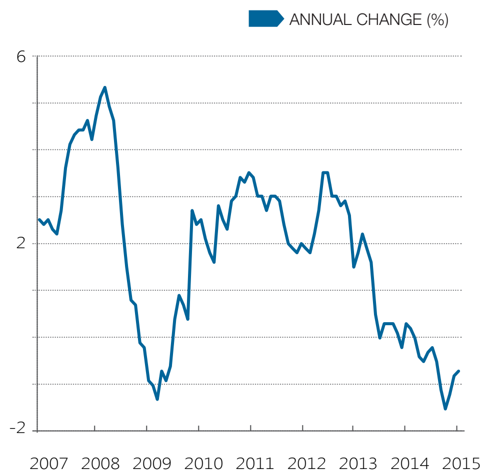
Source: INE, IMF

GRAPH 2
Unemployment (%)



Source: INE

GRAPH 3
Inflation (CPI)



Source: INE

OCCUPIER TRENDS

Retail sales growth begins to take-off

The dominance of mega fashion groups Inditex, H&M and Mango, both on the high street and in shopping centres, has increased during the crisis years. The rise of fast fashion has coincided with a reduction of independent retailers, and the recession pushed many foreign brands such as PC City, GameStop and Darty to leave the market. In their absence, we have overwhelmingly seen larger retailers, who were perhaps more comfortable with the medium to long term outlook for Spain, re-entrench themselves in the best locations, in many cases consolidating locations into large flagship stores.

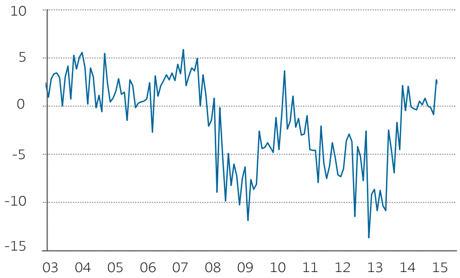
In line with strengthening position of the largest retailers in Spain, they are also developing separately branded lines to target key consumer demographics. Mango has their sub brands of H.E. by Mango, Mango Kids and Violeta. Similarly, H&M is developing a discount line to compete with Lefties and has & Other Stories and Cos to diversify their offering into higher end fashion.

The success of discount retailing has led new foreign brands to enter the market. Of note are Chinese low cost retailers such as Mulaya and Okeysi which began mainly on secondary retail streets and have now begun to expand and take shopping centre space as well; i.e opening of Okeysi.

The improving employment picture has boosted consumer confidence, which reached a post-crisis record high in March. In turn, this has translated into buoyant retail sales growth, which reached 2.8% (seasonally adjusted) in March this year. Non-food sales have picked up, with sales of household-related products doing particularly well.

GRAPH 6

Retail sales growth % (annual, volume)



Source: INE

The major fashion brands that dominate the high street have all seen year on year growth in sales in 2014. Inditex saw year on year growth of 5%, H&M posted 12% growth, Mango's growth in 2014 was 15%, while Primark reached 29% , driven predominantly by strong expansion during 2014. Inditex has reported a 28% y/y growth for their Q1 reporting period of February to April 2015.

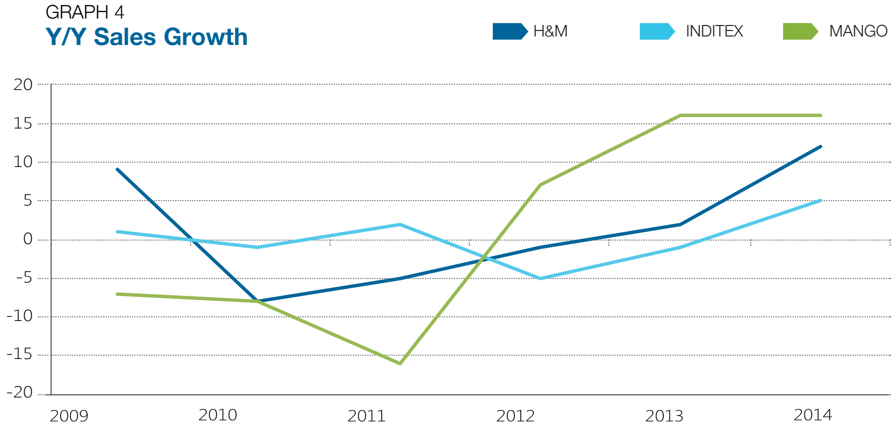
Given the positive outlook for Spanish retail and recent improvements in activity indicators such as retail sales and confidence, we expect more international brands to enter the market however the competition is stiff given the well established position of existing powerhouse brands.

As we begin to see new brands enter the market, there is already a lack of space in the best locations with prime vacancy rates in both shopping centres and high street very low.

New brands to the Spanish retail market include Violeta by Mango, Brooks Brothers, Michael Kors, Coach, Uniqlo, Supertrash, & Other Stories, Okeysi, Dealz, URBN, Missoni and Mulaya.

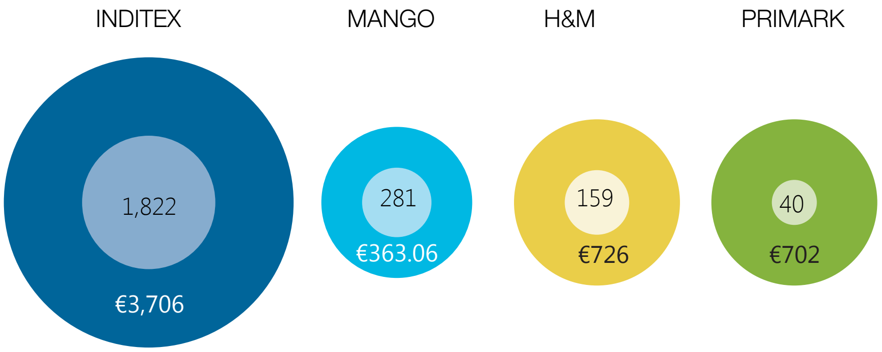
GRAPH 4

Y/Y Sales Growth



GRAPH 5

Number of Stores and Amount of Sales (€M)



2014/2013 % CHANGE IN SALES VOLUME

INDITEX + 5%

H&M + 12%

MANGO + 15%

PRIMARK + 29%

CORTEFIEL + 5%

TECHNOLOGY IN RETAIL

While the broader Spanish economy suffered greatly during the crisis, e-commerce sales have grown at an average quarterly rate of 20% since 2009.

According to the National Statistics Institute for Spain, recent online purchases (3 months) in 2014 rose to 27.5% of the adult population and approximately 43% of the adult population has made an online purchase in their life. The most commonly purchased products/services were holiday accommodation and other travel services, sporting goods and clothing and event tickets.

The success of an online platform model has its limiting factors.

Greater online sales can create logistical difficulties, particularly with consumers' current expectations regarding delivery windows, which are rapidly decreasing, necessitating significant investment in logistics infrastructure such as warehousing and transport.

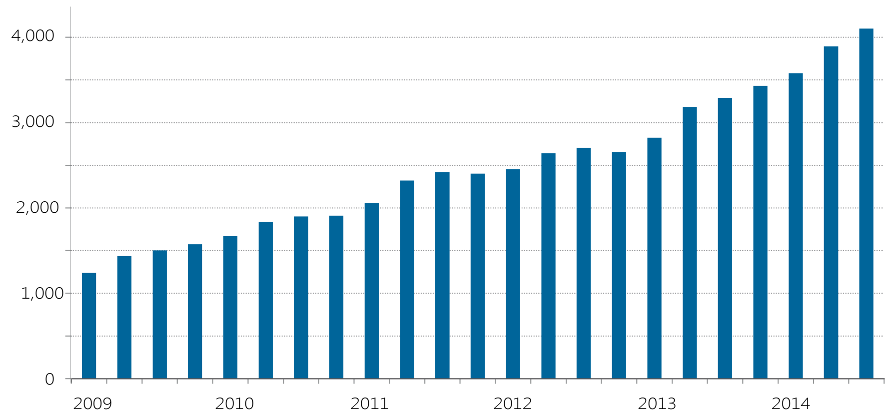
Online platforms are becomingly increasingly important to retailers active in the Spanish market. That being said, Spain does lag many other European countries and is considered a high potential market for e-commerce. According to comScore, Spain´s online penetration of retail websites sat below that of most major European countries, reaching 78.7% of internet users in 2013 which is well below the 90.9% in the UK.

The rise of online sales in retail is not however the death knell of the traditional bricks and mortar retail format. Multi-channel formats, such as Click & Collect, incorporating online sales with pick-up and returns within physical stores, are convenient for many consumers, allow for cross selling and can ease logistics complications. Many retailers are incorporating in-store access points to their online platforms, which allow consumers to order out of stock product and familiarize themselves with the platform with the support of sales personnel. Multi-channel retailing, when done effectively, increases demand capture and creates a complimentary relationship between physical stores and online platforms.

As technology changes, having a basic online platform is no longer sufficient. The rise of alternate devices other than a standard computer has created the necessity of having online retail platforms compatible for use with smartphones, tablets etc. In 2014 there were more internet users than computer users and internet users are increasingly using a variety of devices in order to access the internet. As consumers become more comfortable with online payments and the payment process becomes easier, we expect alternate device sales to increase in tandem.

GRAPH 7

Quarterly e-commerce sales Spain

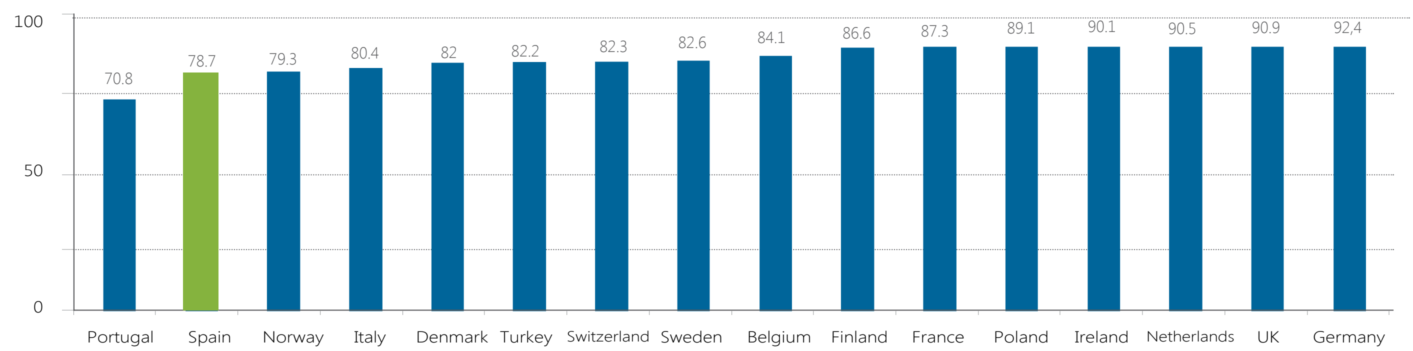


Source: CNMC

GRAPH 8

Online penetration of retail websites across European countries (Nov 2013)

Source: Comscore; Statista



HIGH STREET

Prime retail rents were one of the only occupier sectors that resisted a mass fall in values during the crisis period and the most expensive high streets in Spain saw relatively little vacancy. Those units that did become vacant on the best streets in Madrid and Barcelona were quickly re-let.

While there has been limited downward movement in prime rents during the crisis, we have seen the divide between prime and secondary locations deepen, with side streets off the best locations flattening with other secondary locations and prime areas condensing in size. As previously mentioned, prime streets have remained strong, with little vacancy throughout the crisis, however secondary streets suffered greatly.

During 2015 we expect to see more expansion from brands more likely to locate in strong secondary locations, such as Mulaya, Okeysi, Dealz, Hema, and Tiger, helping to revive streets that have seen high vacancy during the crisis such as the Calle Bravo Murillo in Madrid.

An excellent example of reviving secondary streets is the recent changes in Calle Orense in Madrid. Calle Orense has always had a strong retail component however the first half of 2015 will see the opening of a new format Pull & Bear, a newly built Mango and a separate Violeta by Mango. This is in addition to other new tenants such as Tiger and Hema.

Madrid's Calle Serrano has been the focus of high levels of investment in 2014. With the recent street refurbishment works completed, we are beginning to see upward pressure on rents and stronger demand. Luxury brands such as Louis Vuitton and Montblanc have recently opened new stores on the more prime side of the street, while mass market brands such as Inditex and Nike are making the traditionally less prime side of Serrano more attractive to occupiers.

Spotlight on Sol

With Project Canalejas under construction and the recent opening of the new Apple Store, we are seeing increased occupier demand in the area, particularly in Puerta del Sol. Both Tous and Swarovski have let units between the Puerta del Sol and Canalejas, in apparent anticipation of the projects' completion and amidst rising rents.

The Puerta del Sol sits at an axis of multiple important retail streets, including Calle Preciados, with some of the highest rents in the country. It is a major tourist attraction and has high footfall. We expect to see demand increase further and upwards pressure on rents during 2015.

GRAPH 9
Prime High Street yields

GRAPH 10
Prime rents Madrid

AREA	(€/sq m / month)
Sol / Preciados	280
Serrano	220
Fuencarral	150
Gran Vía	230

GRAPH 11
Prime rents Barcelona

AREA	(€/sq m / month)
Portal del Ángel	250
Portaferrisa	158
Paseo de Gracia	208
Avenida Diagonal	167

SHOPPING CENTRES

Stock

There are currently 544 shopping centres and retail parks in Spain, with a total GLA of over 15.4 million sq m.

Almost half of shopping centres in Spain were built before 1999. However the majority of these centres are smaller schemes, averaging about 20,000 sq m. Since 2000, larger centres have been developed, bringing average delivered scheme size up about 60% to around 32,000 sq m.

Between 2004-2014, the GLA of schemes above 40,000 sq m has nearly doubled. Over the last ten years with developers focusing on larger, destination centres, smaller convenience schemes tend to be dated and requiring CAPEX. However at the same time, many convenience schemes that are well located within their neighbourhoods perform extremely well.

Footfall

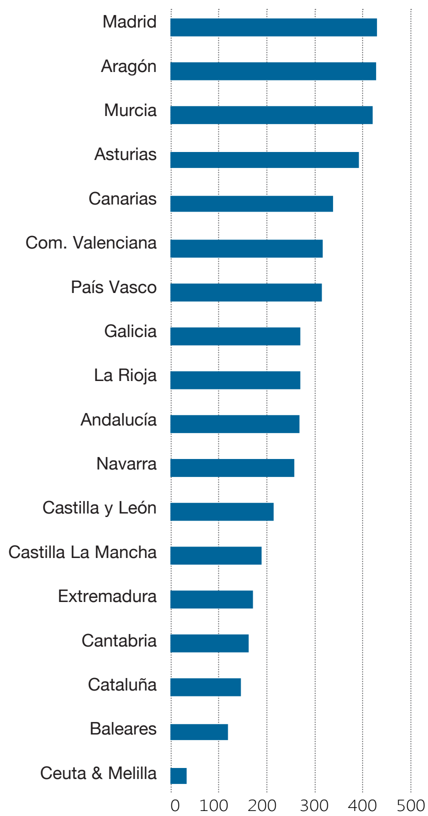
Footfall began to move up in 2014 and closed the year more than 3% above 2013. Footfall continues to trend upwards, adding to the number of positive indicators showing growing momentum in the retail sector.

Across a sample of shopping centres of varying sizes, types and locations across Spain, looking at footfall on a sq m basis, we found that the top five centres were predominantly smaller shopping centres, in central, urban locations and medium sized hypermarkets in city centres. The small centres with high footfall per sq m were also, typically, either centres that have become destinations in their own right, with large leisure components or very well positioned convenience schemes with strong complementary service tenants.

Pipeline

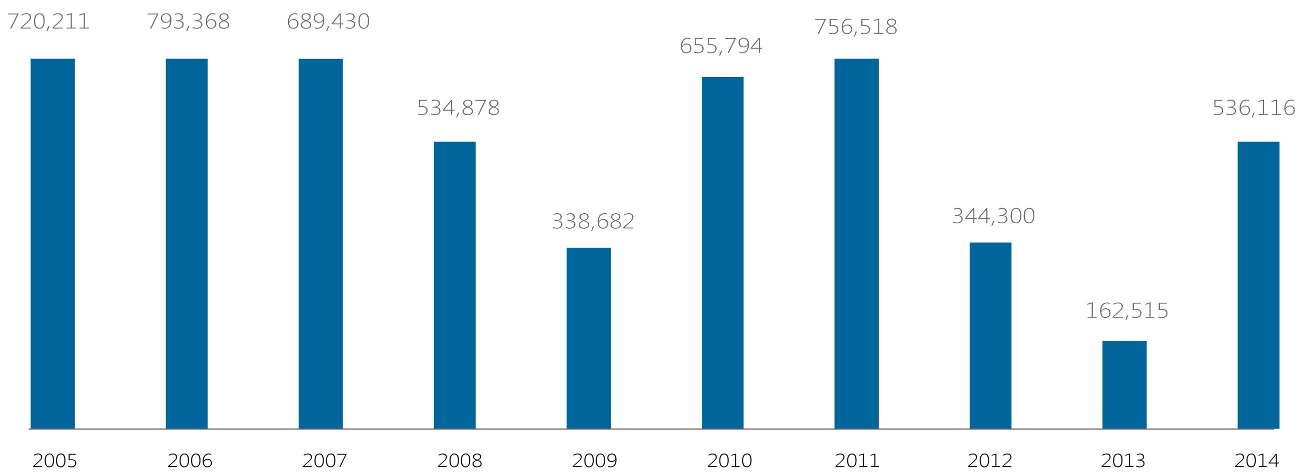
There are currently six shopping centres in the pipeline for delivery in 2015. The largest project set to be delivered in 2015 is the Sambil centre in Madrid, with a GLA of 42,830 sq m. There are currently only two small shopping centre schemes in the pipeline, accounting for only 2.6% of the new development expected over the short term.

GRAPH 12
GLA Density per 1000 inhabitants



Source: AECC

GRAPH 13
GLA by year of opening



Source: AECC

GRAPH 14
Mid-market benchmark

SALES

Fashion	>2,500	1,500-2,500	<1,500
Food & Beverage	>3,000	1,800-3,000	>1,800
Food Anchor	> 4,000	2,000-4,000	<2,000

EFFORT RATIOS

Fashion	<15%	15-17%	>17%
Food & Beverage	<17%	17-20%	>20%
Food Anchor	<3.5%	4.5-5.5%	>5.5%

RENTS (€/SQM/MES)

Fashion	<15%
Food & Beverage	<17%
Food Anchor	<3.5%

+2.7%

Footfall May 2015

Footfall continues to trend upwards, adding to the number of positive indicators showing growing momentum in the retail sector.

Historically the Balearic Islands have had a relatively low shopping centre density, due in part to more complicated legal and planning laws. The Balearic Islands are currently the only autonomous community left with a shopping centre density below 200 sq m/ 1,000 in habitants, except for Ceuta/Melilla. With the two projects currently in the pipeline for the Baleares, GLA density will bring the area from one of the lowest at 171 sq m per 1,000 inhabitants to approximately 291; an increase of almost 73%, but still below the national average of 332. However; these figures don´t take into account high tourism numbers in the area which, with 23 M air passengers annualy form an important part of the market.

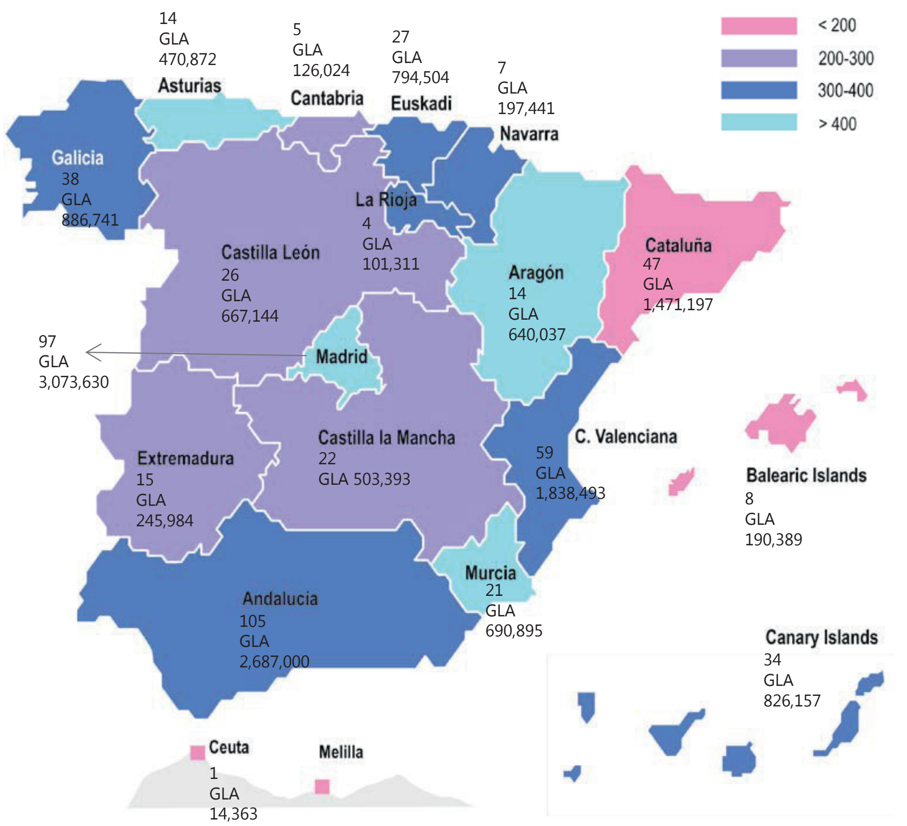
Vacancy

Prime and well-established retail schemes have continued to perform well and are already benefitting from the broader recovery. Secondary assets and cities have been hit harder by the crisis and are just beginning to feel the effects of the recovery, with occupiers starting to take on more space in secondary schemes.

Midmarket schemes tend to have vacancy rates of between 10% and 16%. Vacancy is much lower in prime / dominant schemes in main cities, particularly in Madrid and Barcelona, where occupational levels in prime centres are extremely high, often with waiting lists. In Barcelona particularly, vacancy in prime urban centres is practically zero.

In terms of store size, the highest vacancy levels are found in small-medium sized units (<200 sqm) whilst demand remains strong for larger premises (>1500 sqm) particularly in prime and dominant schemes.

GRAPH 15
Shopping center density
(number of centers and GLA)



Case study

Plenilunio

Knight Frank has managed the Plenilunio shopping centre since opening, mandated by its original developer, Riofisa, and later by its two subsequent owners Banif (2006-2009) and Orion Capital Managers (2009-2015). During this period, the value of the asset increased more than €100 million, consolidating Plenilunio as one of the best centres in Spain.

The Challenge:

In March 2006, two months before opening, Knight Frank won the full mandate for the property and asset management, including the lettings and ECOP, with the objective to position the 70,000 sq m centre as a reference for the entire sector.

The Result:

Today Plenilunio is one of the 10 best shopping centres in Spain and its sale, by Orion to Klepierre, is one of the most important real estate transactions.

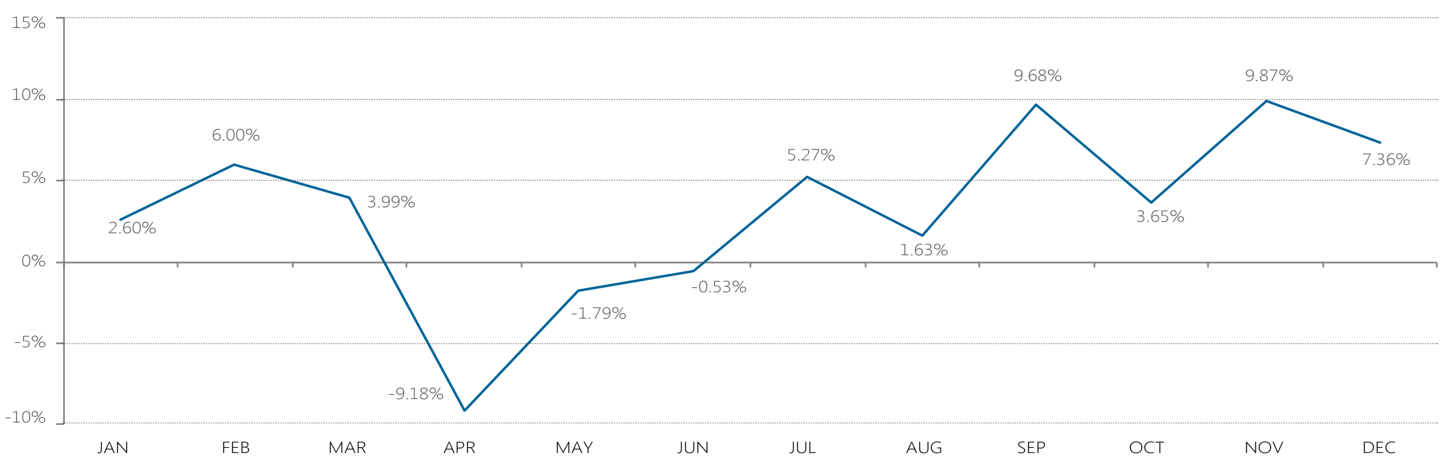
Highlights:

Knight Frank's management of the centre firmly consolidated it as a prime asset, notably improving its commercial mix and achieving excellent results such as the 2014 opening of the largest Primark in Spain, the continual increase in rents and footfall and the 100% occupation level achieved for the last three years in the restaurant area.

GRAPH 16

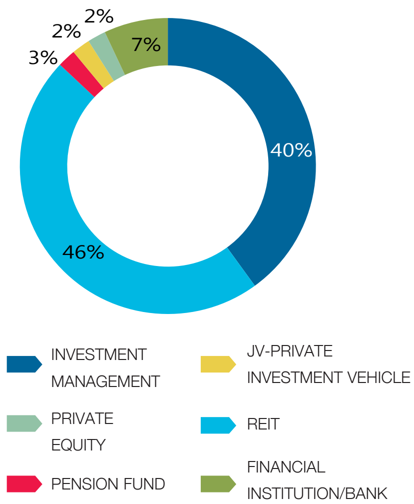
2013/2014 Footfall growth

Source: Experian



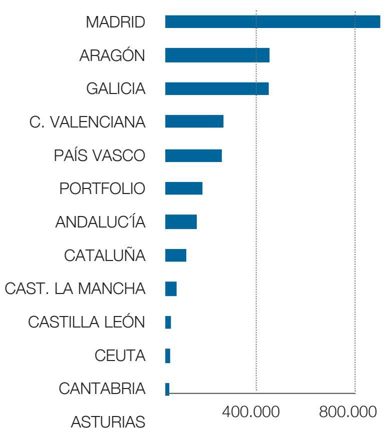
INVESTMENT MARKET

GRAPH 17
Investment volume by investor type



Source: Knight Frank

GRAPH 18
Investment volume by autonumous community



Source: Knight Frank

SOCIMIs continue to be a key player accounting 46% of the investment volume

Record levels of over €6 billion were invested in commercial property in Spain in 2014, the main sectors being offices and retail with more than €2.9 billion invested in shopping centres, including the Klepierre/Carrefour operation.

While 2015 has started strong with approximately €519M in assets closing in the first quarter, there are still many transactions pending closure and we expect the year to close with a total investment volume above the historical average however below that of 2014. In 2015 we expect fewer large operations than in 2014 but a larger number of opportunities.

While many large, prime shopping centres have come to market in the past five quarters, we expect 2015 and 2016 to be dominated by the sale of smaller or more secondary assets.

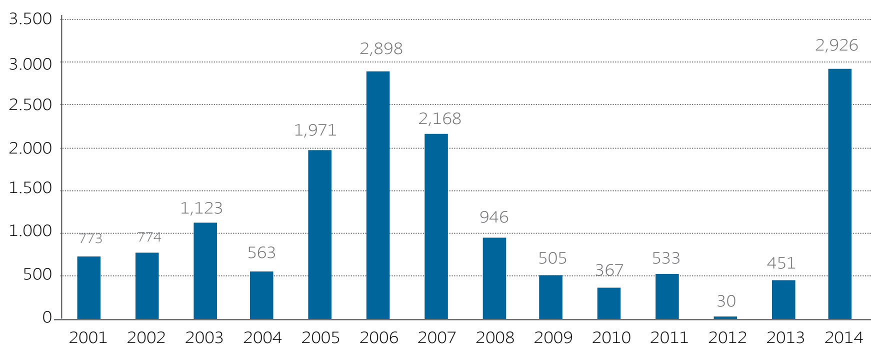
Strong interest from international investors is putting pressure on yields which have now moved in by almost 200 bps since the beginning of 2014. Both prime and secondary assets have seen yield compression and we expect to see further compression over the coming three quarters, particularly in secondary cities.

Intense competition particularly for large lot size disposals has in many cases, forced investors to be increasingly aggressive, not only on pricing but also with the speed and efficiency with which they can execute a deal.

Listed vehicles such as Socimis continue to be a key player and account for 46% of the investment volume in 2014/2015. They are followed closely by investment managers, which have invested 40% of the volume over the same time period.

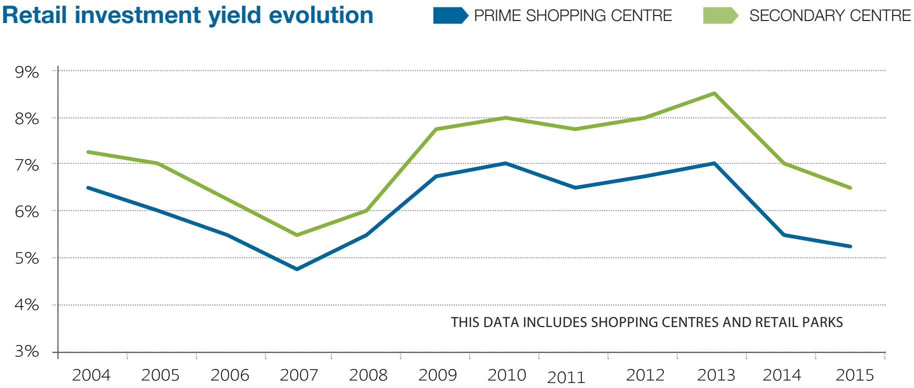
GRAPH 19
Investment volume (€M)

Source: Knight Frank



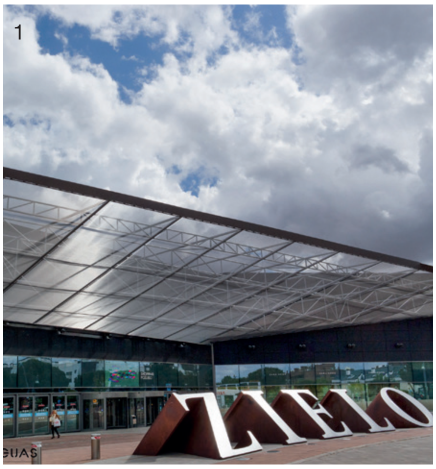
Source: Knight Frank

GRAPH 20
Retail investment yield evolution



GRAPH 21
Retail investment transactions 2015

DESCRIPTION	LOCATION	GLA TRANSACTION SQM	PRICE (€)	VENDOR	PURCHASER
Plenilunio	Madrid	70,000	375,000,000	Orion Capital	Klepierre
AireSur	Seville	20,000	76,500,000	Grupo Lar	CBRE GI
As Termas	Lugo	46,500	67,500,000	ADIA	Lar Socimi
Puerto Venencia (50%)	Zaragoza	103,500	255,400,000	Intu	CPP
Zielo Shopping	Pozuelo, Madrid	15,555	71,500,000	Hines	UBS
Portal de Marina	Ondarra, Alicante	11,500	7,000,000	Eroski	Lar Socimi



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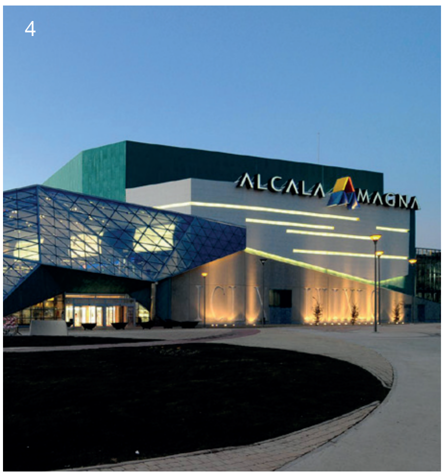
2

3



4

Top deals

1. Zielo Shopping Pozuelo
- 15.550 sqm GLA
- advisory for UBS on the purchase

2. Habaneras
- 24.000 sqm GLA
- advisory for Harbert Management on the purchase

3. Parque Ceuta
- 14,500 sqm GLA
- advisory for Morgan Stanley and Grupo Lar on the sale

4. Alcala Magna
- 34,165 sqm GLA
- advisory for Incus Capital on the purchase

FORECAST 2015-2018

The current retail sales pipeline foresees at least €3Bn of assets coming to market in the coming two years. While the majority of GLA in the pipeline until 2018 is shopping centres, we expect to see an increase in alternate format retail schemes such as retail parks and factory outlets come to market.

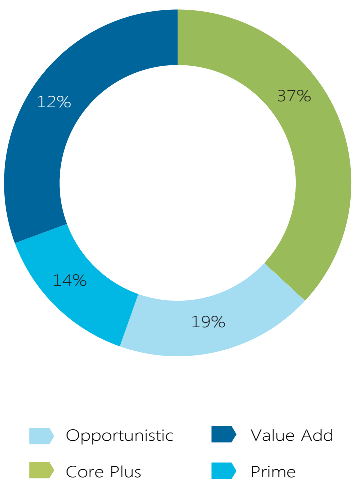
While 2014/2015 saw numerous prime centres come to market, we currently expect the future pipeline to be dominated by core plus and value add opportunities. Competition for prime assets will continue to push investors towards slightly higher risk assets, and regional schemes will see improving fundamentals as the recovery spreads from Spain's largest cities, and in turn incentivizing the sale of core plus and value add opportunities.

In addition, the centres coming to market will, on average, be of a smaller size and be more geographically diverse.

Competition will continue to be high and pressure on yields will continue over the short to medium term. Not only will investors have to be able to move very quickly to secure the best assets, they will also have to spend more time studying regional / provincial markets in Spain in order to be able to appropriately analyze the opportunities in the upcoming value-add and core-plus assets.

GRAPH 22

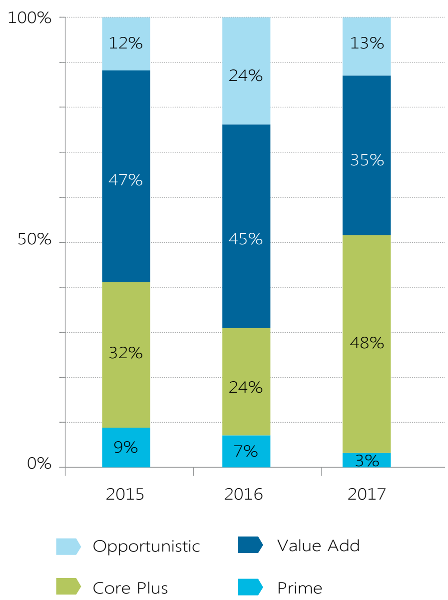
%GLA sales pipeline by profile 2015-2018



Source: Knight Frank

GRAPH 23

%Total sales pipeline by profile



Source: Knight Frank

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