

Southern Europe Investment

Bright spot found in southern Europe



Southern Europe in post-pandemic recovery

Southern Europe fared well in 2022, with investment volumes reaching a record level of €31.7bn. Multiple factors played into the success of Spain, Italy and Portugal's high-performing year, which benefitted particularly from the return of domestic consumption post-Covid and being more insulated against energy price hikes compared to the rest of Europe.

While inflation in core markets began to soar, Spain had one of the lowest rates in 2022 across Europe. Over the course of the year, the fall in Spanish inflation began earlier and more sharply than in other European countries, as a result of government intervention and a faster cooling of energy inflation.

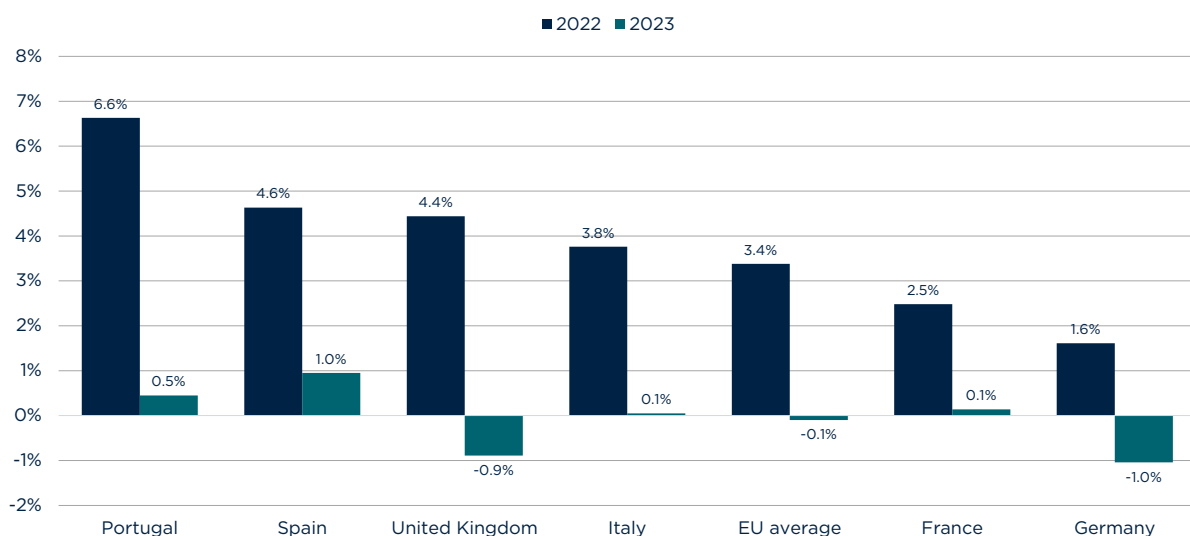
Southern Europe felt the effects of the pandemic more harshly than other European economies, with Italy and

Spain among the first countries where the pandemic arrived. The economy suffered greatly from travel bans and lockdown restrictions due to a heavy reliance on tourism, and, as a result, the rebound was expected to be greater than elsewhere in Europe. Strong tourism seasons post-Covid and the return of retail spending consequently drove investment volumes in 2022. Growth was driven by the service sector, with hotels and recreation once again a source of income.

Portugal (6.6%), Spain (4.6%) and Italy (3.8%) all had higher GDP growth in 2022 than the EU average (3.4%), and all three markets have now regained their pre-pandemic levels of GDP. In all cases, outperforming France (2.5%) and Germany (1.6%), and in some cases, the UK (4.4%). Looking ahead to 2023, despite the economic downturn present

to varying extents across Europe, southern Europe is forecast to perform well relative to the European average and core markets.

Chart 1: GDP growth



Source Oxford Economics

Record-breaking €32bn invested in 2022

Record levels of capital transacted in southern Europe in 2022 reached a high figure of €31.7bn, a 36% increase on the previous year, while total investment in Europe decreased by -23%. For the first time since 2011, Milan received a higher volume of investment than Madrid. Southern Europe also had the largest recorded share of total investment last year at 11%, up from 6% in 2021 and higher than the previous five-year average of 7%, representing how interest in this part of the continent peaked.

Portugal received the highest YoY growth in 2022 at 67% (€3.3bn), followed by Spain at 39% (€16.6bn) and Italy at 26% (€11.8bn).

Cross-border investors accounted for 59% of the total sum invested in southern Europe, reaching a total of €18.7bn in 2022, the highest volume ever recorded. The majority of foreign capital invested into southern Europe came from elsewhere in Europe and the American continent, accounting for 23% and 15%, respectively, of the total investment volume.

All sectors proved to be resilient in 2022, recording positive growth in southern Europe when looking against both the previous five-year average and YoY growth, which was not the case for total investment volumes across Europe, as seen in chart 3. Beds and sheds particularly stand out, with purpose-built student accommodation (PBSA) achieving the highest sector growth of 113% against the previous five-year average, followed by industrial (80%) and multifamily (47%). Overall, the rationale behind this particularly high investment volume in the region is the combination of a comparatively strong economic landscape, solid property fundamentals and attractive pricing.

Chart 2: Total investment growth

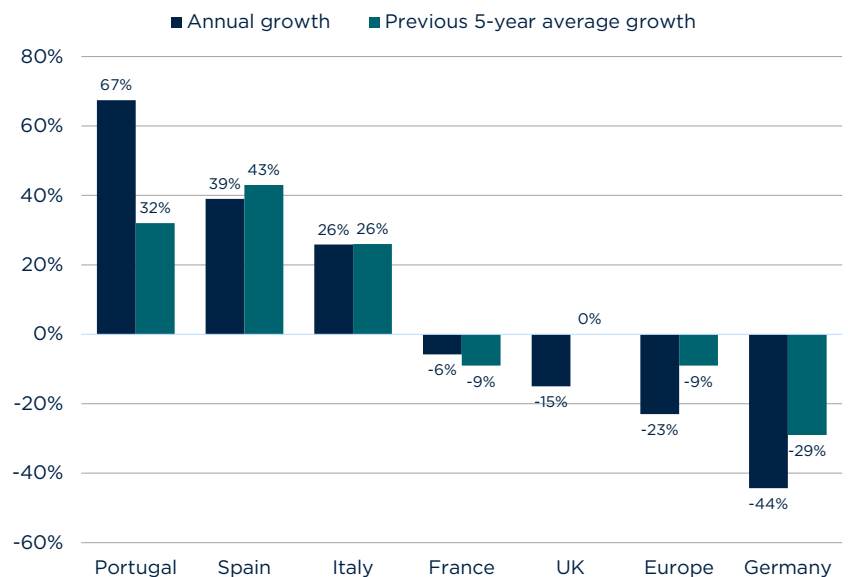
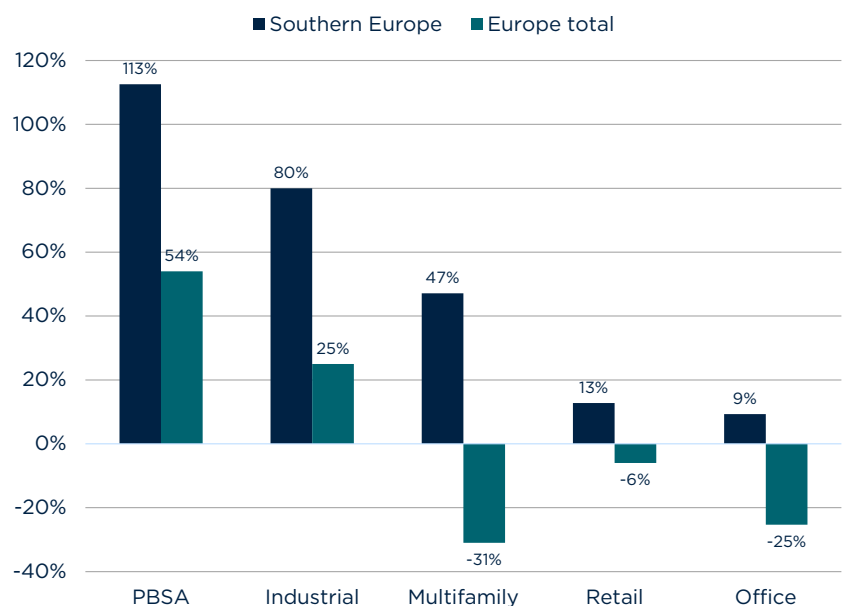


Chart 3: Investment per sector vs previous five-year average



Student housing the rising star over the last five years

Purpose-built student

accommodation (PBSA) received €1.6bn in 2022, recording a 65% increase YoY across southern Europe last year. In Portugal, a €200m Smart Studios deal made up of nine properties across Portugal increased investment volume in this sector by 431% YoY. Similarly, in Spain, the €900m student housing portfolio deal where Dutch pension fund PGGM acquired the RESA portfolio boosted investment by 179% and is the largest student housing operation in Spain.

The main reason behind the growing investors' appetite for PBSA in southern Europe is the growing young population (15-19) and the very low provision rate (total number of beds divided by the total number of students). Southern European tier 1 cities make up the six

lowest student housing provision rates in Europe, where the demand from students is not met. Rome has the lowest provision rate at 2%, followed by Lisbon at 4%, Valencia at 5% and Milan at 6%. With increasing numbers of international students, this is expected to become squeezed further given the young population is also forecast to increase by 5% in the next five years. Therefore high levels of occupancy and student numbers will further imbalance supply and demand, which will continue to put upward pressure on prime PBSA rents, positioning PBSA as an attractive and resilient asset.

Comparing to western markets, PBSA investment declined by -46% in France and -32% in Germany in 2022. As southern Europe is shielded from the same level of energy price hikes

compared to those markets, and as rental growth in line with inflation is harder to impose for students who have limited budgets, investors will particularly be attracted to southern Europe, where such hikes are less likely to affect profit margins.

Making southern Europe even more desirable is the yield gap. The average yield in southern Europe is 4.83%, comparatively more attractive than the core market yield of 3.70% and the European average of 4.46%.



Industrial assets a prime target for investors

Investment in **industrial** assets grew by 7% YoY in 2022 across southern Europe with a volume of €5.7bn. In particular, Italy received record levels of investment in the industrial sector in 2022, reaching a total volume of €2.9bn, an increase of 4% YoY thanks to a number of large deals in excess of €100m. A record low vacancy rate will also have aided this. Portugal's YoY growth was an unmissable 1273%. After several years of stagnant growth, in 2022, this sector accounted for a record-breaking €567m. Of the 15 deals that closed throughout the year, 5 of them were portfolios.

Major themes impacting the industrial sector are geopolitical relationships and onshoring. Geopolitics means that onshoring is going to pick up pace as not only has Brexit has caused onshoring in the EU for British businesses, but Europe, more generally, is going to onshore due to relations with China and post-pandemic supply side shocks. We can therefore

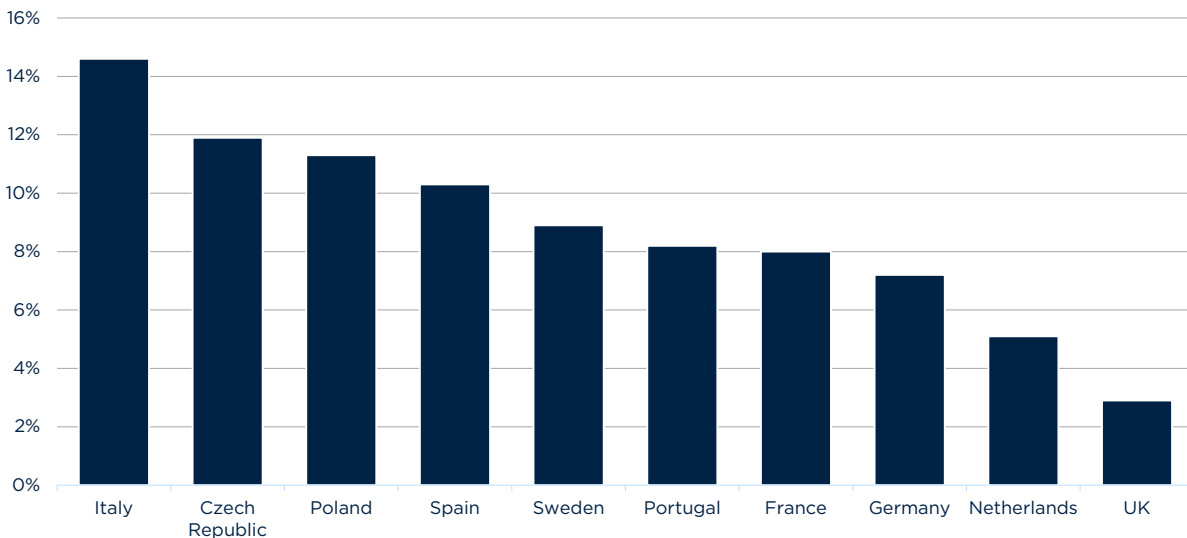
expect higher inventory supplies stocked in mainland Europe and, therefore, a peaked interest in locations outside of the traditional industrial locations such as the Netherlands and the UK.

Additionally, an increasing online penetration rate in southern Europe will heighten the need for expansion in this sector over the coming years as online retail gathers pace, and we can expect deals to increase as traditional logistics operators acquire e-commerce companies. Retailers will continue to drive the demand for space in this sector, particularly in Italy, which is forecast to see the highest growth rate in retail revenue in chart 4.

Finally, in spite of strong yield decompression during the second half of the year, the prime logistics yield remains more attractive in southern Europe (4.94% on average) compared to the European average of 4.71%. Prime

net yields in Madrid and Milan moved out by 75 bps in the second half of 2022 after having reached historically low levels, which now sit at 4.75% as of Q4 2022. Lisbon yields are unchanged YoY at 5.50%.

Chart 4: 2021 - 2026 CAGR of online retail revenue



Source: GlobalData

Multifamily will increasingly be an attractive asset for investors

Some €3.6bn transacted in 2022 were transactions in the **multifamily** sector. This sector has been, and will increasingly be, an attractive asset to investors in southern Europe due to a mix of rising numbers of remote workers relocating to southern Europe, increased demand for apartments with high-quality amenities, and rising mortgage costs for large parts of the population. Despite Portugal not recording any investment in the multifamily sector in 2022, the total volume of multifamily investment increased by 10% YoY in southern Europe while declining by -61% YoY across Europe; Spain recorded investment growth of 23% in 2022, while Italy recorded 15% growth. There are multiple reasons behind the surge in investment here.

Traditionally in southern Europe, there has been a strong cultural emphasis on homeownership. But the global financial crisis (GFC) led to a significant drop in property prices. This made it easier and more affordable for many people

to rent rather than buy. Additionally, the unemployment rates in southern European countries were amongst the highest, which has made it difficult to purchase a property. The current macroeconomic environment favours renting due to rising interest rates and inflation, and so we can expect an increased interest in the multifamily sector this year, incentivised by high demand and positive rental growth prospects. Moreover, the unemployment rate across southern Europe is forecast to rise in 2023, further inhibiting purchasing power as finance costs rise.

Additionally, over the past year, there was also a cultural shift towards viewing renting as a viable and attractive long-term housing option. Renting is no longer seen as a temporary solution for young people or low-income households but as a lifestyle choice that offers many benefits, notably flexibility.

Finally, following Covid, many people adopted remote working, with some

opting to relocate to warmer climates. The growing number of foreigners requiring some apartment to rent has contributed to reducing the number of available supply on the market and pushed the rents up. Spain very recently introduced a digital nomad visa allowing non-EU nationals the chance to live and work in Spain, while Portugal launched its digital nomad scheme in 2022. Currently, Italy does not have one in place but is in the process of implementing it.

Hence we have seen a surge in demand for multifamily apartments to rent, which is limited compared to the fast-rising demand. This explains the growing investors' appetite for multifamily in Spain, Portugal and Italy, as the lack of supply will support rental growth.

As of Q4 2022, prime yields are 3.75% in Madrid and 3.50% in Milan. Average European yields are 3.70%. Milan yields remained unmoved throughout 2022, while Madrid moved out 75 bps YoY. Average European yields moved out 40

Retail investment rises in Spain and Portugal

Retail observed a 120% increase YoY in 2022, with total investment reaching €5.7bn, a figure not seen since 2018 in southern Europe which suggests a strong recovery post-Covid, even despite Italy recording negative growth (-37%). Both Spain (337%) and Portugal (108%) observed a large increase in retail investment last year, while total retail investment in Europe grew by only 14% YoY.

The record growth in Spain is mainly due to two major bank branch deals: one large portfolio deal valued at €2bn in October and a €300m deal in August. Spain is also seeing a return in confidence to the shopping centre sector, with a deal closing in Barcelona valued at close to €130m. Physical retail will remain boosted as tourism returns to pre-pandemic levels and the importance of the 'retail experience' grows. The highest YoY growth by retail sector was

supermarkets (+32% YoY) and high street units (+36%).

In Portugal, roughly half of the volume recorded was due to the sale of the Atrium Saldanha, a shopping centre in the prime CBD area worth €200m. The remainder was split between high street retail, supermarkets and secondary shopping centres. Additionally, since Covid-19, investors have shown a strong appetite for food retail units.

In Italy, the retail investment volume continues to be subdued, despite high street, grocery and retail warehousing standing out in 2022.

Shopping centre yields are higher in southern Europe (5.90%) than the European average (5.70%) as of Q4 2022. YoY, Madrid yields moved out by 50 bps, followed by Milan at 35 bps and Lisbon at 25 bps. Average European yields moved

out by 30 bps. Average high street yields in southern Europe are in line with the European average at 3.90%. The former moved out by 28 bps between Q4 21 and Q4 22, while the European average moved out by 35 bps. Retail warehouse yields are currently 100 bps higher in southern Europe at 6.60% than the European average of 5.60%.

According to Oxford Economics, online retail spending indicator, Spain, Italy and Portugal are all expected to perform well in both 2023 and 2024 compared to core countries and the EU average.

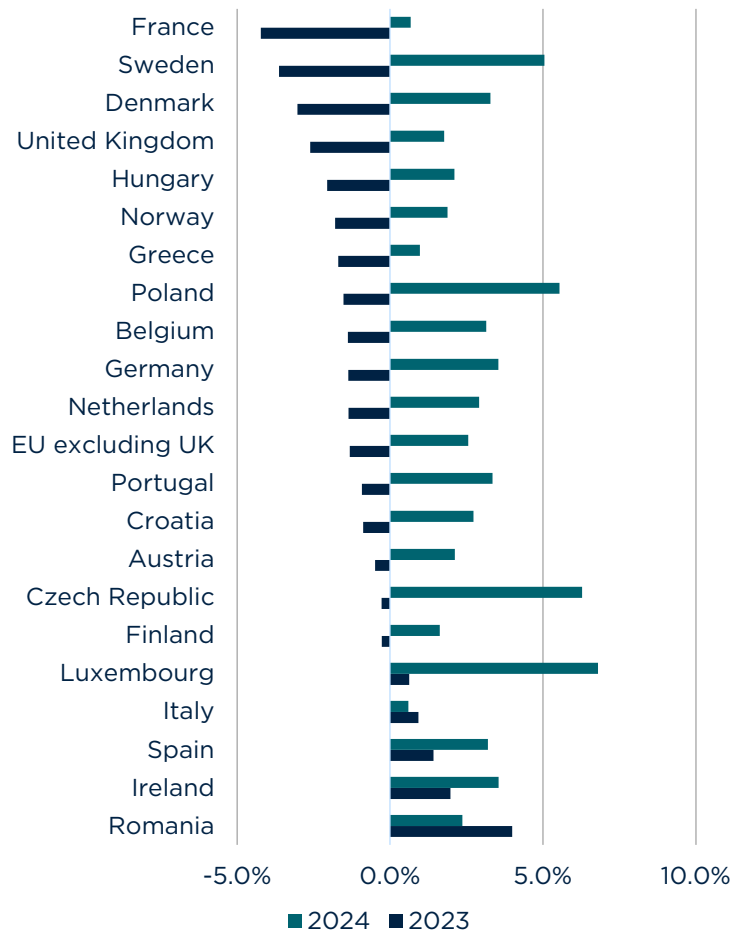
Office investment outperformed core markets

Office investment in southern Europe increased by 48% YoY in 2022 to reach €8.1bn. This contrasts with total European investment declining by -19% YoY in this sector. Italy recorded a 124% increase in volume, with H1 2022 recording the largest ever volume of investment for Italian offices. Spain records 0% growth YoY, while Portugal records -9% growth YoY. Core western markets also record negative office investment growth at -22%. Germany records the biggest decline, -26%, closely followed by the UK with -23%.

Thirteen deals upwards of €100m were recorded in Italy in 2022, the largest being a €350m office building in Milan that has an LEED Gold rating and is an NZEB (nearly zero emission building). 79% of investment was in Milan, which will continue to be the main focus for investors as in prime areas, the Grade A vacancy rate is close to 0%. Here, pharmaceutical and digital financial companies are very active. Indeed, increased occupier focus on buildings with good environmental credentials is accelerating the obsolescence of older ones and strong occupier appetite will support rental growth. In Milan, 8% rental growth YoY was recorded in Q4 2022, while this was 4% in Lisbon and 3% in Madrid.

Here, the yield gap is narrowest between southern Europe and the European average. The average prime yield in southern Europe is now 4.00%, while the European average is 4.20%. During H1 2022, the yield was the lowest on record at 2.90% in Milan, a level comparable to major German cities and Paris in the first half of the year and lower than the London-WE yield of 3.25%.

Chart 5: Online retail spending (annual growth)



Source: Oxford Economics

AFTER AN EXCEPTIONAL YEAR FOR SOUTHERN EUROPE, MARKET EXPECTED TO ADJUST

2022 was a record year for investment volumes in southern Europe, where investors showed a desire for all types of assets. Strong fundamentals, a stable economy and attractive prices have encouraged investment in Spain, Italy and Portugal.

Looking ahead, as prices have begun adjusting to reflect the current macroeconomic environment across Europe (hence narrowing the yield gap with core markets), we believe southern Europe will lose some of its attractiveness in 2023. Additionally, with the spread between government bonds and property yields closing, we expect investment volumes to decline next year, especially as the cost of borrowing rises and is higher in southern Europe than in the rest of Europe.

That said, some market fundamentals will remain solid and will continue to attract investors' interest. This is notably the case with beds and sheds. The structural supply and demand imbalance for multifamily and logistics properties favours rental growth (or at least stabilisation) across southern Europe, where occupier demand will continue to support the market.

All in all, although we expect the investment volume in southern Europe to decline by approximately 28% YoY in 2023, this figure is off the back of a record-breaking year and will still only be 3% lower than the previous five-year average, a better performance than what we expect for the European average.



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