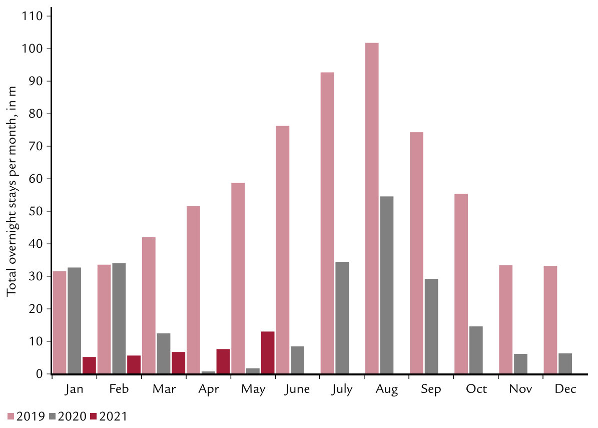
# Real Estate House View
*Italy, Spain, Portugal*

*Second half of 2021*

## Key messages

- **Offices:** Activity remains very limited due to economic uncertainty combined with the delayed rollout of the vaccine programme.
- **Retail:** Loss of disposable household income and lack of tourists is weighing on all retail segments, from high streets to shopping centres.
- **Investment:** Volumes transacted in Q1 2021 fell compared to the first quarter of 2020, with logistics the only sector to hold its own.
- **Hotel industry:** The early lifting of lockdown to speed up the return of foreign tourists was marred by the rapid spread of the Delta variant, which is expected to weigh on hoteliers' performance in the summer of 2021.

## Chart summary



Source: National data

The contribution of the tourism sector to the GDP of Spain, Italy and Portugal averages more than 12%. The annual average number of overnight stays outside the crisis period was almost 700 million, of which 50% were in Spain, 41% in Italy and 9% in Portugal. Successive lockdowns continued to impact the activity of hoteliers in the south over the first five months of 2021, with occupancy rates well below their pre-crisis level. As a result, the vaccine passport is proving necessary for relaunching activity, although the fears associated with the Delta variant have strongly impacted the potential for a rebound during the summer.

This region is the main beneficiary of the EU stimulus fund. While the announcement of the plan one year ago protected Italy, Spain and Portugal from a widening of their sovereign risk premiums, the fund's rollout will now provide an additional boost to economic growth for the quarters and years ahead. This procyclical support comes on top of an upturn in domestic activity as services gradually reopen. With the end of the pandemic approaching, we expect that the recovery will continue in areas particularly affected by coronavirus. Unlike in the aftermath of the great financial crisis, when austerity impacted heavily on these economies, labour markets are expected to start recovering from the 2020 recession from the second half of 2021.

## Office market stagnating

Letting activity in the southern European office markets in the first half of the year remained in line with 2020. The *wait-and-see* attitude persists, especially among big users, and confidence has not yet been regained. Milan's prime rent levels remain stable on the back of refurbishments in the historic centre, while Madrid and Barcelona have seen decreases of 4% on average, in addition to an increase in accompanying measures. Total returns remained stable over the period, in line with investors' interest in the highest-quality and most secure products, but this cannot mask a sharp drop in transaction volumes compared to pre-coronavirus levels.

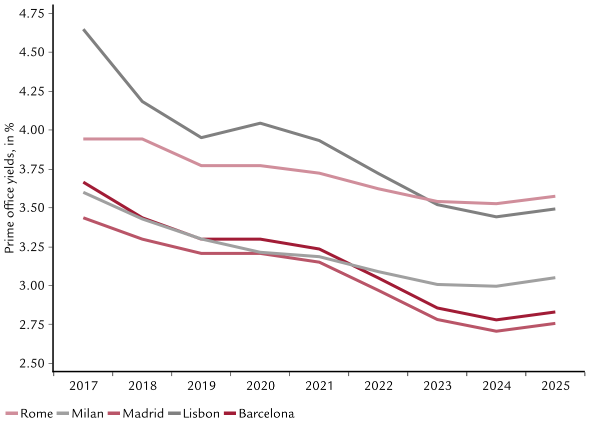
## Retail recovery

Despite the return of retail confidence indices to positive territory and improved consumer optimism since last spring, a lasting rebound in consumer spending is not expected. In all three countries, declining disposable household income is weighing on all retail segments, from high streets to shopping centres. On average, vacancy rates have reached double digits, sitting between 10% and 20%, as retail chains seek to rationalise their portfolios (Inditex is selling off 300 units by 2021) and luxury brands depart in the absence of a return of wealthy tourists. The vacancies have directly impacted rental levels, which have fallen by an average of 20%, with sharper declines in the prime market, particularly the luxury segment. The impact of the absence of Asian tourists, especially from China, is more pronounced in the Italian cities of Milan, Rome and Florence. Not surprisingly, local shopping centres are holding up, while the jumbo-sized ones in tourist areas of Spain and Portugal are continuing to suffer from the absence of their UK, Nordic and German clientele. The Delta variant, which has led to the closure of borders, has delayed the return of tourists, although the vaccine passport will have positive effects on the retail sector from 2022. In the shorter term, retailers are continuing to innovate with an omnichannel strategy, as shown by the upward trend in the penetration rate of e-commerce across all three countries; the crisis has also been conducive to the appearance of new discount brands, mainly in the food sector. The investment market in all three markets is active once again, driven by a fall in prices that outweighs the fall in rents, both in *mixed-used* with shops at ground floor level, as well as in shopping centres and retail parks. Some portfolio sales in Spain and Portugal testify to the opportunities being seized by long-term investors.

## Hospitality in suspense

The early lifting of lockdown to accelerate the return of foreign tourists was marred by the rapid spread of the Delta variant. Furthermore, the activity of the summer period has been below potential in all southern European countries which have not, like Greece, enforced the vaccine passport. Occupancy rates and RevPAR are on average 40% and 60% lower than their pre-crisis levels, respectively. Occupancy rates are lowest in the major cities of Milan, Rome, Florence, Madrid, Porto and Barcelona due to a lack of business tourism and international clientele. However, the upward trend in footfall and RevPAR should materialise as the vaccine passport becomes more widespread. On a positive note, the investment market recorded several deals in the first half of the year, with investors including the vaccination factor and betting on herd immunity in 2022, all leading to a potential recovery in 2023.

### Chart 1: Limited movement in returns for the southern European markets




Source: PMA

### Chart 2: Change in household consumption expenditure


Source: PMA

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