Executive Summary

April 2019
Financial Advisory | Real Estate
1 Market Overview

“Most of the unsatisfied demand comprises the younger population with limited salaries looking for their first house. Spain and Europe are converging towards a positive household creation trend and a negative ownership rate trend. The main Spanish macroeconomic indicators are positive. However, the growth is slowing down compared to previous years. Young demand, land management and product design as main market trends in the short term. Industrialisation has a role to play.”

2 Supply & Demand

“Production housing has significantly increased in the last year, which is not an issue to the current demand. 3,200 new active developments and 159k housing units have been monitored. These new active developments are distributed across more municipalities than in previous years, therefore there is less concentration. The ASP of the sample is quite high (€2,750 bsqm) and this may affect the demand in the near future if it continues to increase, particularly on primary markets. The main Spanish macroeconomic indicators are positive. However, the growth is slowing down compared to previous years.”

3 Investment & Financing Market

“Strong appetite in a more mature and stable industry with significant activity though different types of transactions. Search for financial resources (equity and/or debt), financial partners looking for industrial players with operational capacity, property resi - build to rent - and exit strategies as main market trends in 2019. Market towards consolidation: The top 5 developers account for 16% of the housing units in terms of ongoing developments. + 4 pp vs 2018. Upcoming movements in the sector: deep analysis is key to determine the most suitable strategy for the coming months. Financing is definitely back but subject to reasonable LTVs and deep projects and sponsors understanding.”

4 Key Factors

“Mature market where existing prices are becoming price sensitive locations. Affordability is one of the main market challenges for those looking to buy a house. Rental property is an alternative. Construction cost trends may be a challenge, although until now, it has been offset by HPA (margins accretive). Oil stain effect in the market. Ability to adapt product design, ASP and different types of clients as a key factor for success. Lack of fully permitted land at attractive prices in consolidated locations. Land management and investment discipline are required.”

5 The Future of Development

“Sale prices in some of these hotspot areas are already over-priced, therefore land purchasing prices become particularly sensitive to the business plans. Large developers have to compete with local developers and niche markets. Young demand, land management and product design as main market trends in the short term. Industrialisation has a role to play.”

Housing transactions have doubled since 2013. This upward trend has slowed down in the last months due to the moderate increase in new built housings sales and foreign transactions. Most of the unsatisfied demand comprises the younger population with limited salaries looking for their first house.”
Spanish GDP has experienced the most significant growth compared to other EU countries (+2.5% in 2018).

Since 2016, there has been a positive population trend (+166k residents, mainly foreigners). 51% of the total population are potential buyers.

The current unemployment rate is c.15% (11 p.p. less than 2013). In the near future, it is expected to reach 12%.

In the near future, Spanish GDP is expected to grow at c.+1.5%.

31% of the total potential demand relates to the replacement housing market and most of it has been satisfied.

Youth unemployment is still an issue. There is a clear wages stagnation which contrasts with the HPA increases.
Since 2007, there has been a positive household creation trend in Europe, especially in Spain.

The Spanish ownership rate has followed a similar convergent trend to Europe. (-1.7 p.p. from 2014 to 2017)

Spanish housing transactions continue increasing at a faster rate than Europe (+15.7% vs +1.9% CAGR from 2013 to 2017).

Spanish housing affordability is below the European average.

The increase in the number of households is due to the decrease of their sizes. Therefore, it is important to take the type of product into account.

The Spanish ownership rate is still slightly higher than the EU average (77% vs 70%) mainly due to a strong cultural component.

The HPA of both Spain and the EU are converging to similar levels. This is a contrast with previous years when Spain was growing faster.

Housing affordability rate is significantly higher among young people, which implies the real challenge.
Spanish housing transactions continue increasing at a faster rate than Europe (+15.7% vs +1.9% CAGR from 2013 to 2017).

The HPA of both Spain and the EU are converging to similar levels. This is a contrast with previous years when Spain was growing faster.
Total housing transactions have almost doubled since 2013 to date (from 301k to 582k units) and are expected to continue increasing. The spread of transactions is similar to the previous officially approved developments, therefore no new housing stock has been generated. The average selling price of new open market housing is above pre-crisis levels. However, the global open market is still 20% lower. Young people are looking to purchase houses with affordable prices and thus, look for 2nd hand houses and refurbish them.

This upward trend has slowed down in the last months due to the moderate increase in new sales and foreign transactions. In the past year, the main cities have shown signs of stabilization and sustained growth, therefore exploring new markets is necessary. Most recent developers have focused on replacement housing demand, therefore there is a risk of depletion. Most of the unsatisfied demand comprises the younger population with limited salaries looking for their first house.
Spanish Residential Market Overview

i) Housing transactions

a. Spanish housing transactions trend

Housing transactions trend
New housing vs Second hand housing transactions
Source: Ministerio de Fomento

Total housing transactions have almost doubled since 2013 to date (from 301k to 582k units) and are expected to continue increasing.

This upward trend has slowed down in the last months due to the moderate increase in new built housing sales and foreign transactions.
In 2018, housing transactions increased in most of the Spanish provinces by c. +9.31% average.

In the past year, the main cities have shown signs of stabilization and sustained growth, therefore exploring new markets is necessary.
ii) Housing selling prices

Spanish housing selling prices trend

Open market housing selling price trend - Spain

Average transaction price (€ per housing unit)

Source: Ministerio de Fomento

The new open market housing selling price is 8.9% higher than the last peak period in 2007.

The GAP between new and second hand housing prices has significantly increased, since most of the recent developments have focused on replacement housing demand.

Most of the unsatisfied demand comprises the younger population with limited salaries.
Supply and Demand

Summary

1. From a supply perspective view, the main real estate indicators show that there has been a **new upward cycle since 2013**.

2. **Housing production** has significantly **increased** in the last year, with a 3,200 new active developments and 159k housing units.

3. From a demand perspective, there is still **room for growth** in housing transactions, particularly related to **new development sales**.

4. **370 hotspot areas** distributed across 190 municipalities have been detected this year (+36% increase since 2017 | x10 since 2013)

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**Strengths**

- Final work certificates and officially approved developments are still similar to historical low levels.

- The average **selling price** of the sample is quite high (€2,750 bsqm) and may affect demand in the near future if it continues to increase.

- In 2018, the **market dynamism** was 1.25%, which is almost 1 p.p lower than 2006 levels (peak period), mainly due to the low level of new housing sales.

- The selling prices in some of these hotspot areas are already reaching peak levels, therefore **land prices** have become particularly sensitive.

**Challenges**
Deloitte’s Observatory
Current active housing units

Number of current active housing units per province
Source: Deloitte’s Observatory

Deloitte has analysed a national sample of over 159k active housing units

Top 10
80% of total

Top 3
51% of total

Note: Active developments refer to residential projects in both land or WIP status, and recently finished developments which are being sold by developers.
The average selling prices of the sample is quite high (€2,750 b/qm) and may affect demand in the near future if it continues to increase.
Deloitte’s Hotspots

Hotspots understanding

# Hotspots by chances of success

Source: Deloitte Big Data Analytics

This study is based on an algorithm which includes Deloitte Big Data Analytics and which defines Hotspots as locations with high chances of success for the real estate residential development business.

After an in-depth analysis, 370 Hotspots were identified across 190 municipalities in Spain.

Hotspots sample VS Spain

- 51% Population
- -5 p.p. Unemployment
- 57% Total housing transactions
- 60% New housing transactions
- +0.2 p.p. Market dynamism
- 30% Selling prices

A #138
Extremely high
37%

B #179
Very high
49%

C #53
High 14%
Since the beginning of the Real Estate recovery in 2013, Hotspot areas have increased more than tenfold.

Although Hotspot areas continue to increase, growth has slowed down in the past year.

Identifying these locations should be one of the key factors to ensure the developers’ success in the near future.
## Competitive Considerations

### i) Our prospects

<table>
<thead>
<tr>
<th>2018 Activity</th>
<th>2019 Expected</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A</strong> Land Acquisitions</td>
<td>Selective</td>
</tr>
<tr>
<td><strong>B</strong> Portfolio Sales</td>
<td>High</td>
</tr>
<tr>
<td><strong>C</strong> Market Concentration</td>
<td>Low</td>
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<tr>
<td><strong>D</strong> JVs/Strategic Alliances</td>
<td>Selective</td>
</tr>
<tr>
<td><strong>E</strong> Rental Market</td>
<td>High</td>
</tr>
<tr>
<td><strong>F</strong> Capital Markets</td>
<td>Limited to MVC</td>
</tr>
</tbody>
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- Our prospects include various factors affecting investment and financing decisions. The table above outlines the expected activity levels for different market aspects for the years 2018 and 2019.

- **Land Acquisitions**: Expected to remain selective in 2019.
- **Portfolio Sales**: Expected to remain high, with a shift to a more granular portfolio.
- **Market Concentration**: Expected to remain low, with plans to come.
- **JVs/Strategic Alliances**: Expected to remain selective.
- **Rental Market**: Expected to remain high.

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Competitive Considerations

ii) Investment Market Trends

Rental Market

What are investors looking for?

**Key Aspects of a Build-to-Rent Project**

**RENTAL INVESTORS**

- Multi-family product. Full ownership (or at least control)
- Tailor-made product with specific technical specifications
- New product: low CapEx requirements and lower maintenance costs
- Attractive location
- Maximise the number of housing units (€/sqm efficiency)

**DEVELOPERS**

- Reduce commercial risk. EBITDA and Cash Flow visibility
- Achieve run-rates
- Diversified Business Plan: Additional client segment
- Maximise ROCE
- Reduce operating costs (marketing and commercial fees)

Build to Rent as the most suitable alternative
**MARKET CHALLENGES FROM AN OPERATIONAL PERSPECTIVE**

### WHAT IS THE HPA TREND?

**HPA Broker Estimates**

**CCI Broker Estimates**

- **Key Points**
  - Mature market in which demand is becoming sensitive to prices.
  - Prices reaching peak levels in consolidated location. Unexplored markets adjusting prices “oil stain effect”

### HOW ARE CONSTRUCTION PRICES INCREASING?

- **Key Points**
  - Capacity constraints in the construction industry in recent years has resulted in inflationary pressure on costs.
  - A trend reversal is not expected, however, a smoothing of the trend is expected
  - Operational efficiency as main challenge and directly related to solid management and industrialisation

### TO WHAT EXTENT COULD MARGINS BE AFFECTED?

- **Key Points**
  - Hard Costs account for c.40% of GDV, and as a result construction costs could increase up to 2.5x higher than HPA until reaching the break even level.
  - Hard Costs should increase 2.5X times quicker than HPA to be cash flow dilutive

### WHAT IS THE AVERAGE TIME TO OBTAIN BUILDING PERMITS, TO BUILD AND SELL?

- Pre-Sales
- Building Permits
- Construction
- Delivery & LPO
- HPA absorption period
- HC inflation absorption period

- **Key Points**
  - HPA to be absorbed along the sales period which is usually significantly longer than the construction tender period.

### CLIENT FOCUS: PRODUCT DESIGN AND ADAPTABILITY

- **Strategies**
  - Need to find new areas to expand and gain size & volume.
  - Geographical expansion.
  - Cover different types of clients.

- **Key Points**
  - Land selection becomes essential.
  - Focus on clients demands to meet their specific needs.
  - Need to adjust ASP to offer an affordable and tailor-made product for different types of clients
The Future of Development

Trends & Opportunities

- Young Demand
- Land Management
- Product Design
- Rental Platforms
- New Concept: Co-living

Levers

- Industrialization
- Digitalisation
- Big Data
- Platform Size and Scalability
- Operational Efficiency
The Residential Development Handbook  April 2019

Alberto Valls  Managing Partner  avalis@deloitte.es
Rafael Arcas  Partner  rarcas@deloitte.es
Joaquín Linares  Partner  jliinares@deloitte.es
Juan Ramón Rubio  Director  jrubiozalabardo@deloitte.es
Francisco Boiso  Director  fboiso@deloitte.es
Tomás González  Director  togonzalez@deloitte.es
Pablo Rodríguez  Director  prodriguezfominaya@deloitte.es
Miguel Ochoa  Senior Manager  mochoa@deloitte.es
Reyes Población  Senior Manager  rpopoblacion@deloitte.es
Mónica Cayuela  Manager  mcayuelaferrero@deloitte.es
Javier Cuartero  Assistant Manager  fcuartero@deloitte.es
Ángela Larrabeiti  Analyst  alarrabeiti@deloitte.es
Letícia Cortés  Analyst  lcorteslachica@deloitte.es
Lázaro López  Analyst  llopezortiz@deloitte.es

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