Investing in Spanish residential real estate

The development of investment strategies and the allocation of real estate investments have always been subject to the general economic environment and are reflecting the sentiment of investors in general. This was also visible in the renewed focus on core investments in 2020 and 2021 as well as the high investment activity in the more crisis-resistant considered residential real estate sector of institutional investors, which followed as a reaction to the Corona pandemic and emphasised their security affinity.

However, rising construction prices and interest rates since the beginning of the year 2022 have increased the pressure on a market already characterised by high demand and corresponding yield compression. The core markets in Central and Northern Europe, which were already affected by falling yields before the Corona pandemic, were particularly hit.

The existing tension between risk tolerance and return expectations was resulting in a more visible willingness to adjust the risk profile in the end of 2021 and beginning of 2022. But also influenced by the alignment of the actual and target allocation in real estate following the high investment activity in recent years, many European investors started adopting a cautious stance from the second half of 2022 in anticipation of possible price declines as a result of falling demand in connection with the persistently high interest rate level. The lowered growth forecasts in many countries in the course of 2022 in combination with continued high, albeit declining, inflation and the increasing sustainability requirements of real estate products also tended to increase the preference of European investors for investments in core products again.

These real estate investments are in direct competition with other investment products and the financing market, which have become more attractive due to higher interest rates. The yield spread between real estate and government bonds of many European countries, which fell significantly since the second quarter of 2022 due to the increase in yields for long-term government bonds on the one hand and the strained yields for real estate investments on the other hand, leads to considerations of investment alternatives.

Nevertheless, real estate remains an important part of many investors' investment portfolios, especially against the back-drop of the sharp increase of inflation. This applies in particular under the assumption of a weakened economic development in the following financial quarters. In order to generate the desired target returns for pension funds and insurance companies, risk diversification within the real estate portfolio by adjusting the risk profile in relation to the real estate asset classes or allocation are potential strategic approaches.

Even before the Corona pandemic, the search for risk-adjusted alternatives in the real estate sector directed the focus to investment opportunities in the build-to-rent sector in Southern Europe. The residential real estate market in Spain is here particularly interesting. Still strongly characterised by a high ownership rate, a constant, albeit slowly increasing interest in the rental housing market can already be observed since the financial crisis in 2008. The underlying reasons for this are a changing sentiment, also resulting from an increasing flexibility of the labour market, as well as the more difficult access to financing, especially for younger people. The current rise in financing requirements and interest rates in some European countries could reinforce this dynamic. In this context, the activity of Spanish developers in the build-to-rent segment has increased in recent years, although initially primarily for projects planned as build-to-sell and in social housing, but subsequently also as an independent segment. In contrast to many Northern and Central European real estate markets, Spain still offers high growth potential in the residential build-to-rent segment, but at the same time, compared to other Southern European markets such as Portugal, it is characterised by an already mature market with an increasing orientation and adjustment to institutional investors. The residential market in Spain is overall already the fifth biggest European residential market in terms of transaction volume.

For investors a considerable yield pick-up is currently still obtainable on the Spanish residential property market compared to other Central and Northern European markets. Even taking into account regional and sectoral adjustments of purchase prices and purchase price factors as a result of rising construction prices and interest rates with upholding high demand for living in the core markets of Central and Northern Europe, no adjustment of this dynamic is to be expected in the short to medium term.

The economic slow down in Spain and generally in the entire European region and the associated restraint of potential buyers of residential property could also make it necessary to reschedule properties planned as condominiums into rental flats.

To be considered are the differences between the country's major cities as primary investment destinations for international investors and smaller regional centres. Given the security affinity of many institutional investors, investment activities have remained largely concentrated in Madrid and Barcelona in recent years, resulting in an increasing yield compression. Investment opportunities outside these metropolitan areas, can often be characterised by significantly higher returns. The corresponding risk premium must be evaluated in the context of the analysis of the micro-location. Spain has many regional centres with solid economic and demographic fundamentals, which make them suitable for investments from institutional investors. In the coming years, an increasing establishment of the Spanish residential built-to-rent market as part of a European real estate investment portfolio and the consolidation of the rental housing segment among the Spanish population can be expected. With this, the Spanish residential market still allows investors to invest with adequate risk yields and long-term value stability.

Primevest Capital Partners is a pan-European investment boutique that specialises in investments in innovative real assets. At Primevest Capital Partners, our vision is to help our clients to provide for their sustainable financial future by investing in the future of our cities in realising sustainable urban living, improving connectivity, and enabling mobility. Our investment philosophy and vision are energised by the current trend of urbanisation and the ability to fulfil the needs of modern metropolitan communities, while enhancing the quality and sustainability of people's lives.

From our offices in Utrecht, Eindhoven and Berlin, a team of 70 professionals manage €3.2 billion in assets including sector-focused funds, individual institutional mandates and a number of funds targeting private investors as well as family offices following acquisition of the Holland Immo Group.

Peter Renk

Head of Residential & Country Manager Germany

peter.renk@primevestcp.com

Frank Noé

Head of Capital Formation & Sustainability (ESG)

frank.noe@primevestcp.com