

# Shopping Centres

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**Alex Barbany Fernández,**  
Country Retail Manager  
CB Richard Ellis España

**35 ANIVERSARIO EN ESPAÑA 1973 - 2008**

## INTRODUCTION

The fall in the rate of inflation and the reduction in interest rates, although providing a respite, have not proved sufficient to restore consumer confidence. Spaniards are aware that the economy goes through cycles and, after 14 years of intense growth, the situation has become difficult once again.

In this regard, the consequences of the financial and property crisis continue to have a negative impact on the economy. Credit restrictions are limiting the borrowing capabilities of consumers and companies. It is a very simple equation: if there is money, there are spending and consumption. In addition, rising unemployment continues to generate uncertainty among consumers and limits the capacity to consume in Spain.

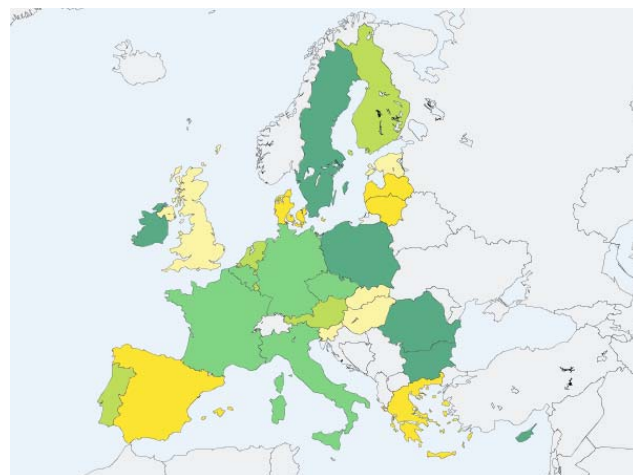
In light of this situation, we see a widespread drop in consumer spending, affecting all types sectors, particularly those related to household products and appliances.

Given this scenario, the risk of higher vacancy among shopping centres grows, as demand contracts and the number of retail operators that decide to reduce space and to restrict or cancel their expansion plans rises.

Moreover, the supply of new floor space reached a new record during 2008 with approximately 1,140,000 m<sup>2</sup> of new floor space completed. A large portion of new openings correspond to a large centre typology; over 80,000 m<sup>2</sup> (29.6%).

We are in a market where the tenant now has greater power, which is being used to good effect in negotiations. This is reflected in longer rent-free periods, rental credits and greater contributions from shopping centre for shop unit fit-outs. This situation may indeed become more marked during 2009.

## RETAILER CONFIDENCE NOVEMBER – DECEMBER 2008



44.7 - 61.6	61.6 - 69.4	69.4 - 78.7
78.7 - 83.7	83.7 - 102.2	N/A

Source: Eurostat

## DEMAND

During the third quarter of 2008, Spain registered its first negative economic growth quarter since 1993. In addition, according to figures released by the Bank of Spain, the economy contracted another 1.1% during the fourth quarter compared to the previous quarter. If and when these figures are confirmed, Spain will officially be in an economic recession (characterised by two consecutive quarters of negative growth). Furthermore, according to the Bank of Spain, GDP growth ended 2008 by falling 0.8% year-on-year in Q4.

According to official INE data, the slowdown in the construction sector and investment since the start of the year was compounded during the 3<sup>rd</sup> quarter by consumer spending. Spanish homes spent 1.0% less than in the previous quarter, representing the first drop in 15 years. In interannual terms, the figures demonstrate a pronounced consumer spending slowdown, to 0.1% during the third quarter. Everything suggests that official data for the 4<sup>th</sup> quarter will once again be negative.

In this scenario, according to the *Instituto de Credito Oficial* (ICO – Official Credit Institute), although consumer confidence increased 1.2% in January (50.1) compared to the previous month, it continues to remain close to historic lows. The progressive drop in petrol prices, CPI and interest rates is not enough to return confidence to consumers. The increase in unemployment, coupled with tougher credit restrictions, is impacting negatively on consumers capacity to consume and is leading to greater uncertainty.

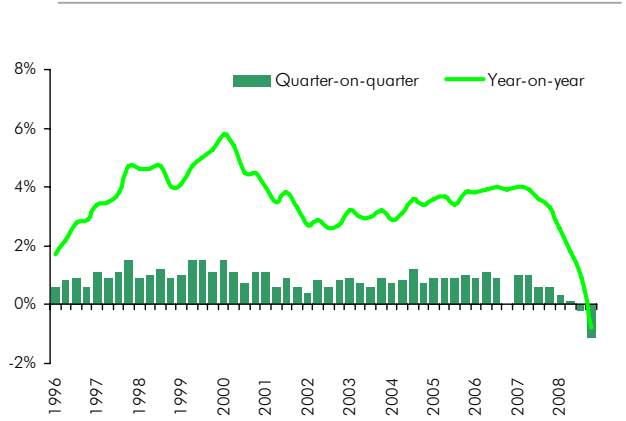
### Unemployment and lack of credit are hindering spending.

As regards unemployment, the construction sector has been the main culprit in terms of job destruction. However, industry and services have joined in since the start of the third quarter.

Furthermore, the granting of personal loans has dried up and is also affecting spending. Banks and savings banks now see greater risks in granting consumer credit.

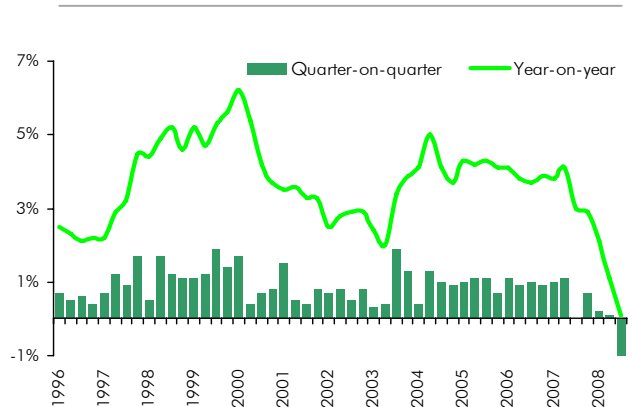
In addition, we should highlight that, according to the Bank of Spain, consumer spending of families could fall by 300 euros per year for every 10,000 euro drop in property prices. In this regard, lower property prices weakens guarantees for future loans and, due to the wealth effect, lowers propensity to spend.

## GDP GROWTH



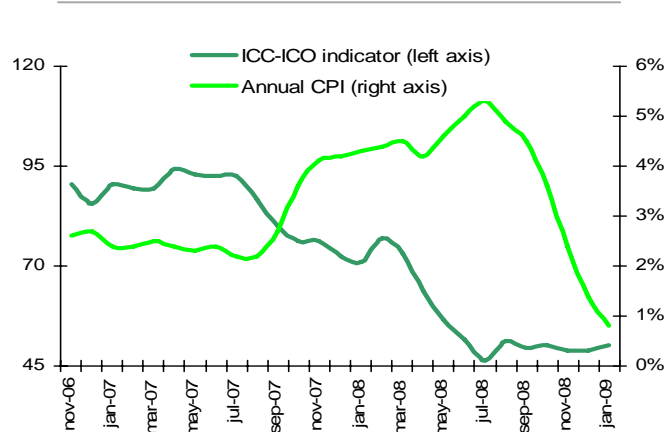
Source: INE

## CONSUMER SPENDING



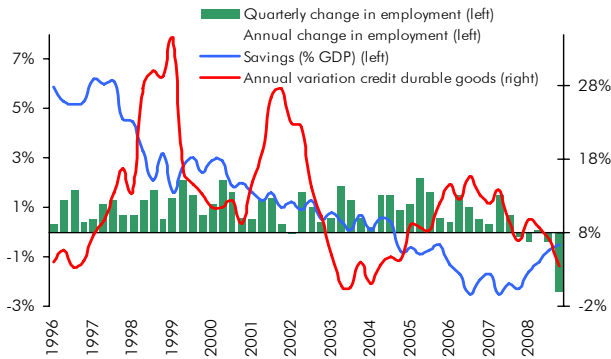
Source: INE

## CONSUMER CONFIDENCE INDEX AND CPI



Source: INE, ICC-ICO

**SAVINGS AND HOUSEHOLD FINANCING**



Source: INE

**Seventh fall in retail sales**

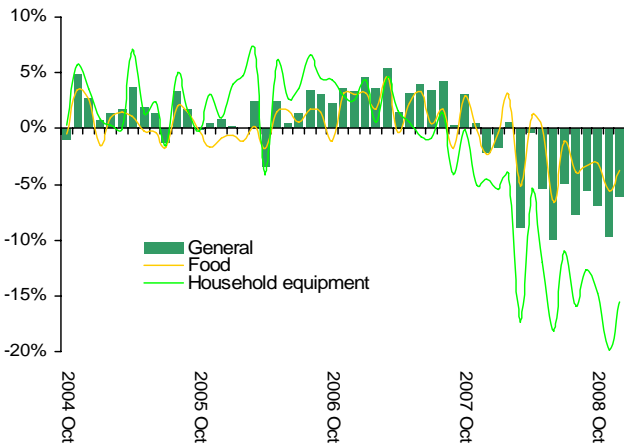
General retail sales dropped again in December in comparison to the same period of the previous year 2007 (-6.1%). The uncertainty regarding the duration and intensity of the financial crisis is changing spending patterns in Spanish households. Consumers are replacing spending on some products and services for cheaper alternatives in order to tighten budgets. A large number of consumers are adopting more responsible spending attitudes and considering what can be cut in order to save. The sale of high level luxury products has not escaped the crisis. Although their “core” public with high purchasing power has liquidity, they currently maintain a more conservative behaviour in relation to large purchases due to the economic and financial uncertainty. In addition, occasional purchasers with medium purchasing power are staying away from luxury shops.

As part of this drive towards “savings”, consumers are significantly reducing their spending on durable goods and leisure. In addition, when it comes to meeting basic clothing, shoes and food requirements, they seek alternatives that permit greater savings.

With regards to durable goods, the considerable drop in residential property sales is dragging down the sale of other goods related to their furnishing. According to the Association of Property Registrars, the purchase and sale of homes fell 30.4% during the third quarter. This entails lower sales of washing machines, refrigerators, televisions, sofas, beds, etc. In addition, Spaniards that have already furnished their home, and when considering the renewal of furnishings, decide to postpone their purchases indefinitely due to the uncertainty with regards to how the crisis may affect them. However, as soon as the economic climate improves and households decide to purchase again, it is likely that the sales of these product will recover sooner and faster than that of other products.

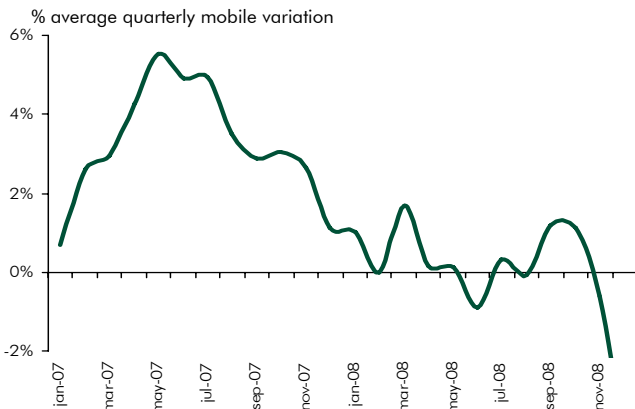
Moreover, changes in consumer spending are also noticeable with regards to medium-range products destined to meet certain basic requirements, such as food and personal hygiene. Consumers are increasingly changing their spending habits and opting for ‘white brands’ (distributor own brand products). Thus, for example, the market share of white brands in the canned food market is about 40% and around 35% in the case of frozen products, milk and milkshakes.

**RETAIL SALES**



Source: INE

**AFFLUENCE TO RETAIL CENTERS - FOOTFALL INDEX**



Source: Footfall

The catering and leisure industries have also been considerably affected. There is a slowdown in middle range hotel and catering demand, with consumers favouring spending in the domestic segment and fast food establishments. Citizens are adopting different food spending habits in more delicate economic situations.

**The change of scenario also offers opportunities**

In order to benefit from consumers propensity to save, certain fast food chains are benefiting from the current situation as they supply what the market needs at cheap prices.

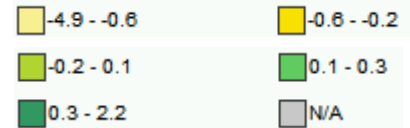
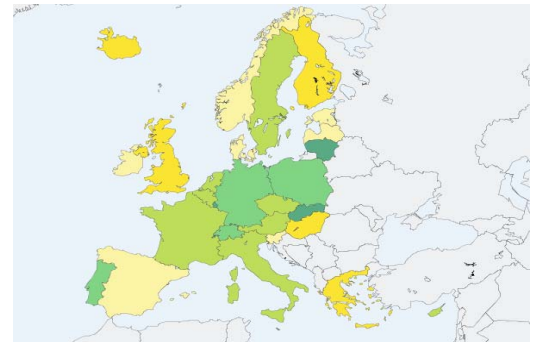
This is also noticeable in the fashion sector (clothes and shoes). Certain chains are seeing how their low cost brand lines are becoming more attractive to consumers. For example, t-shirts for 10 euros, raincoats or jackets for under 50 euros, etc. are becoming success products.

We should also highlight that during the economic crisis there is a tendency towards replacing services with products. For example, it is normal for families to dedicate more resources to repair their own homes. In order to save, it is possible that they decide to perform repairs themselves rather than hiring external assistance. In addition, many homes make these repairs or refurbish their existing house after deciding to delay the purchase of their new home. Therefore, this can represent (as was the case during the crisis in the 90s in the UK) a stimulus for product demand related to DIY and an opportunity for players specialized in this market niche.

**SUPPLY**

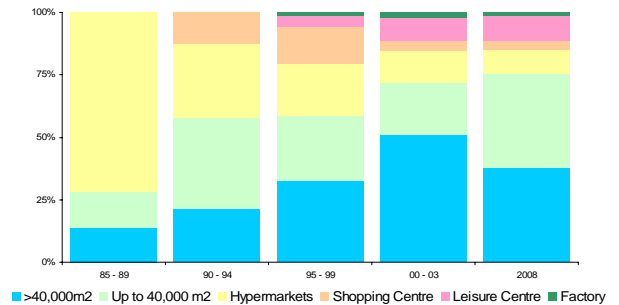
Supply continued to grow throughout 2008. From 2003 approximately, spending remained robust while the economy experienced high growth rates. In addition, low interest rates and high liquidity attracted the attention of investors. Hence, many developments were started in recent years, many of which were completed last year. As such, 2008 represented a historic record in terms of new built floor space (1,140,123 m<sup>2</sup> of GLA) and number of centres (30 plus 2 expansions).

**CHANGES IN CONSUMER SPENDING**



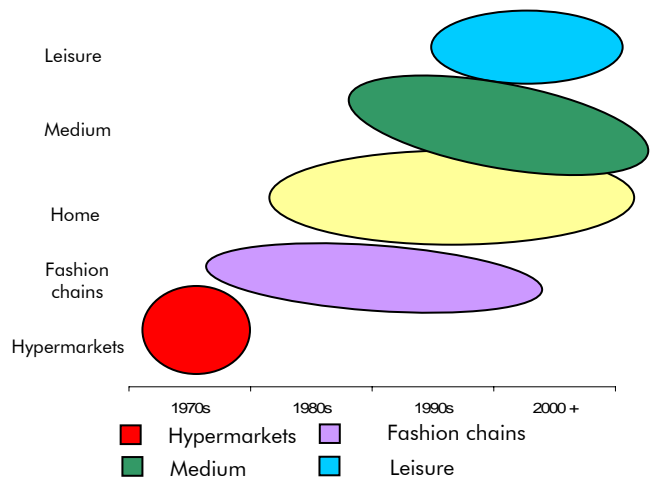
Source: Eurostat

**TYPES OF SHOPPING CENTRES IN SPAIN**



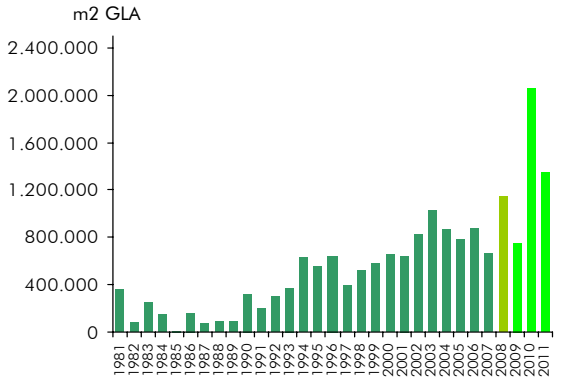
Source: AECC, CBRE

**TIMING OF OPENINGS IN SPAIN**



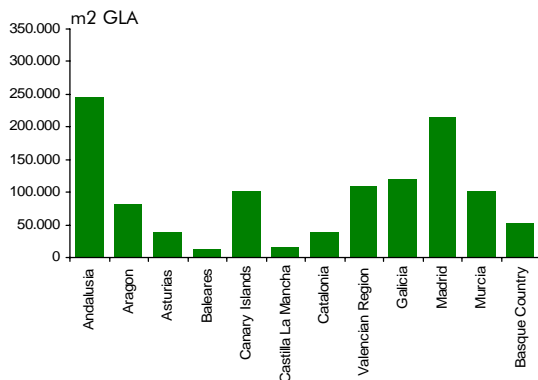
Source: CBRE

**OPENINGS OF SHOPPING CENTERS IN SPAIN**



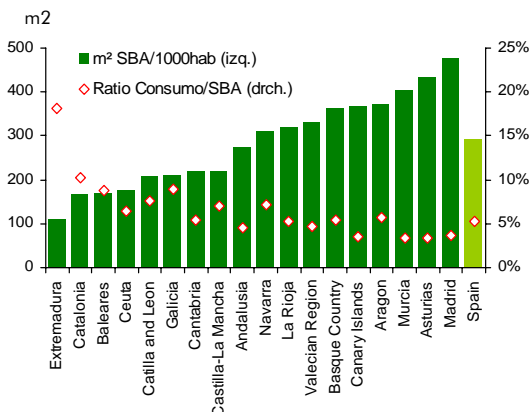
Source: AECC, CBRE (estimates)

**NEW OPENINGS BY AUTONOMOUS COMMUNITY 2008**



Source: AECC, CBRE (estimates)

**DENSITY BY AUTONOMOUS COMMUNITY 2008**



Source: AECC, CBRE (estimates)

With regards to the type of centre, the so called "traditional formats" (Very large, Large, Medium, Small and Hypermarket) represented 70.9% of new floor space. Factory outlets, retail parks and leisure centres, represented 3.48%, 21.81% and 3.76% respectively. By region, new supply was primarily located in Andalusia (21.6%), Madrid (18.7%) and Galicia (10.5%).

In certain Autonomous Communities it will be necessary to closely monitor density levels, as an excess of floor space may endanger the profitability of some projects, considering the drop in consumer spending. Furthermore, over the next three years Spain is set to become one of the European countries with the most shopping centre floor space, with almost 3.5 million m<sup>2</sup> forecast to potentially reach completion, although all developments are unlikely to be realised.

However, regions with lower retail density (Extremadura, Catalonia, etc.) may provide development opportunities. In addition, those with a spending-inventory ratio above the national average, may prove interesting due to a greater spend per sqm.

**Owners and investors adapt to the current situation**

In light of the change in expectations and readjustment of family habits, the retail situation is changing. Retailer demand for premises has weakened, while supply of centres increases. According to the *Confederacion Española de Comercio* (CEC – Spanish Chamber of Commerce), if consumer spending continues to decrease in 2009, up to 10% of the retail sector could disappear, which would represent the closing of 60,000 businesses. Therefore, retailers are increasingly more selective, trying to avoid risk, analyze everything with even greater detail and only selecting the best projects. In light of this situation, owners increasingly seek to adapt to the needs of their customers or potential tenants. In this regard, longer rent-free periods and rental credits are slowly being granted. In addition, while rents have generally been maintained in already existing contracts, some new contracts are now being negotiated at lower rates.

On the other hand, some developers are reconsidering, when possible, the timing of some shopping centres under development, hoping for an improvement in the economic climate and better perspectives for consumer spending.

**Survival of the fittest**

Given the market density of shopping centres and the current economic climate, opportunities are becoming increasingly difficult to identify and require more detailed analyses. However, there are still opportunities even in regions with high retail density. For example, large dominant centres characterized primarily by a good commercial mix, suitable synergies with the immediate surroundings and the generation of economies of scale, may achieve a high market share; albeit to the detriment to other existing centres which have not adapted to the market. Moreover, there are interesting possibilities for the development of more specialized centres focusing on more specific markets. Their success relies on appropriately targeted retail supply, not trying to reach all consumers but rather a highly specific sector that has been carefully analyzed beforehand.

However, the type of centre that works best in today's economic context are the ones that offers the best commercial mix, adequate to the current climate. In this regard, factory outlets and retail parks are being favoured thanks to their affordable prices, which attracts consumers. For retailers, the lower start-up and occupational costs of these formats can be very attractive.

In addition, in a more mature market, the refurbishment and expansion of existing centres will also become more important, modernizing and strengthening the position of shopping centres against the competition.

**The shopping centre as the "third place"**

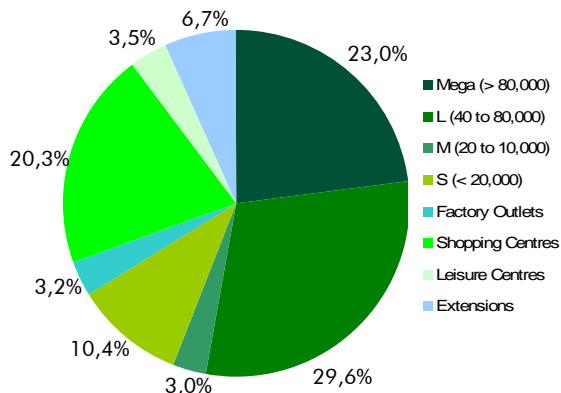
Despite the slowdown in sales, visits to shopping centres are less affected. Many consumers go to shopping centres simply for leisure. This may become an opportunity for shopping centres: the goal is to ensure the loyalty of consumers so that in the future, when circumstances improve, they realise in these centres those purchases which are presently being deferred.

**VARIOUS NEW OPENINGS SPAIN 2008 (GLA)**

Centre	Location	Floor Space (GLA)
La Noria	La Ñora	13.806 m <sup>2</sup>
Viapark Bahía	Vícar	28.320 m <sup>2</sup>
Plaza Imperial	Zaragoza	88.000 m <sup>2</sup>
Las terrazas de Jinamar	Telde	81.000 m <sup>2</sup>
Outlet Tui	Tui-Vigo	23.232 m <sup>2</sup>
Parque Oleiros	A Coruña	22.000 m <sup>2</sup>
Plaza Mayor (ampl.)	Málaga	19.000 m <sup>2</sup>
Magic Badalona	Badalona	42.329 m <sup>2</sup>
Dolce Vita	A Coruña	62.000 m <sup>2</sup>
Parque Almenara	Lorca	45.547 m <sup>2</sup>
La Gavia	Madrid	113.000 m <sup>2</sup>
Bahía Azul	Málaga	14.000 m <sup>2</sup>
Marismas del Polvorín	Huelva	15.487 m <sup>2</sup>
EL Campanario	Las Palmas	13.858 m <sup>2</sup>

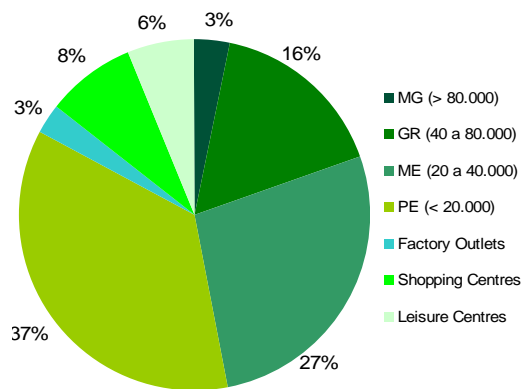
Source: CBRE

**NEW OPENINGS BY SIZE 2008 (GLA)**



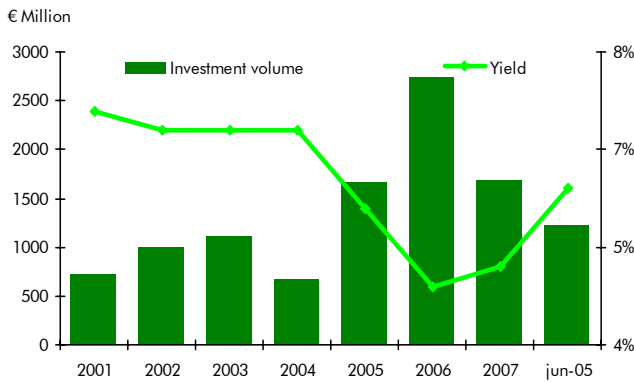
Source: CBRE

**RETAIL CENTER INVENTORY BY SIZE (GLA)**



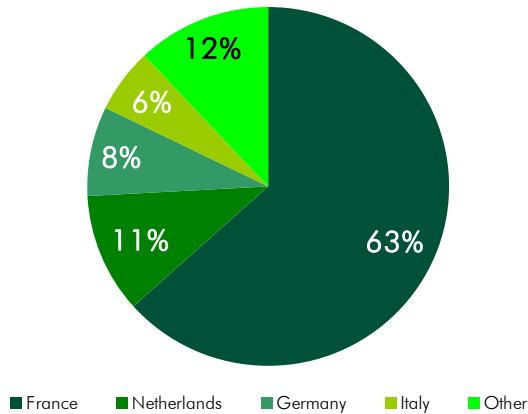
Source: AECC, CBRE (estimates)

TREND IN RETAIL INVESTMENT VOLUMES



Source: CBRE

DISTRIBUTION OF RETAIL INVESTMENT VOLUMES  
- By investor origin



Source: CBRE

MAIN DEALS

Assets	Location	Buyer	Price (€ million)
Portfolio "La Maquinista & Habaneras"	Barcelona & Alicante	Unibail – Rodamco	434
Portfolio 12 Hypermarkets	Basque Country	Topland	360
Parque Rivas	Madrid	AXA Reim	70
Parque Oleiros	La Coruña	Generali	45
Parque Puerto Real	Cádiz	Rockspring	20
"Les Mates" Leisure centre	Tarragona	TCN	20

RETAIL INVESTMENTS

The cooling down of retail activities has been more intense than in other sectors. The employment outlook, consumer spending trends and, especially, difficulties in obtaining finance have provoked a significant contraction in investment levels since 2007. In 2008, the estimated investment volume for this sector (1.2 billion euros) represented 71% of the volume registered in the previous year and 44% of retail investment in 2006.

Throughout the year, the market was characterized by (i) deals involving small size investment assets, and (ii) larger size deals in specific divestment processes and/or the search for liquidity. Some examples of the former are the sales of Tres Caminos, Puerto Real and Les Mates in Tarragona. Deals such as Metrovacesa's sale of two of its centres (La Maquinista and Habaneras; Q3 08) or the Joint Venture involving Eroski and Topland (12 centres; Q4 08) are, on the other hand, good examples of the latter.

Foreign investment continues to dominate the retail segment. Together with the evolution of the economy, the perception of country-risk among foreign capital is one of the factors with greatest impact on moderate investment levels. Highly leveraged demand has disappeared. Today, the most active investors in the market are those with a lot of equity, with an opportunistic profile and high ROI expectations.

Prices in the market are defined by a clear differentiation between assets. As at December 2008, gross prime yield was around 6%; whilst for secondary product, yields generally ranged from 7.5% to 8.0%. Greater supply and weaker expectations on rents are becoming determining factors of the upward trend in yields; more than 100 basis points in the last 12 months. While yields may indeed continue to rise over the coming months rental movements are likely to have the greatest impact on capital values.

The difficulties experienced by developers in obtaining loans and the cooling down of retailer expansion plans will become more tangible during the first half of the year. As the market adjusts, some opportunities may arise both in the refurbishment and expansion of existing centres. Opportunities will also be found in the creation and development of new co-investment structures or Joint Ventures to overcome the existing limitations on liquidity. Finally, an increase in *Sale and Leaseback* products (something being considered by various retailers) could encourage the return of more conservative capital to the market.

## Words from the professionals at CBRE

✓ “The crisis will accelerate changes and we shall see interesting opportunities in the retail sector during 2009, both for retailers as well as owners and investors. The winners will be those who closely monitor market adjustments and adapt their strategy accordingly. Undoubtedly, those of us working in the market will be witnesses to the sector’s regeneration.” –**Alex Barbany, Country Retail Manager**

✓ “The economic climate will act in the market as a natural selection of retailers. Only the best will remain; the strongest, those who best adapt to consumer requirements and those who count on advice from the best property consultant. We are about to live through a period of important opportunities.” –**Ginés Palencia, Retail Agency Manager**

✓ “The continuous monitoring of tenants and rapid decision making, adapted to the realities of 2009, will be highly relevant aspects for the management of shopping centres this year.” –**Ana Colom, Head of Retail Management**

✓ “The Spanish property market has become an opportunity for investors with liquidity, where they can buy commercial assets at very interesting yields. Opportunistic funds will be of great relevance in the near future and will probably be the ones closing the greatest number of transactions” – **Jesús Segado, Retail Investment Manager**

### CB RICHARD ELLIS OFFICES IN SPAIN AND MOROCCO

#### Madrid

Pl. Pablo Ruiz Picasso, 1  
Planta 27,  
28020 Madrid.  
Telephone: 91 598 19 00

#### Barcelona

Edificio Testa Diagonal,  
Av. Diagonal 605, 8º 1º  
08028 Barcelona.  
Telephone: 93 444 77 00

#### Valencia

Paseo de la Alameda, 35 bis,  
3º dcha,  
46023 Valencia.  
Telephone: 96 316 28 90

#### Zaragoza

Pº de la Independencia 21,  
1º centro  
50001 Zaragoza  
Telephone: 976 48 46 35

#### Málaga

Edificio Málaga Plaza  
Calle Don Christian, 2 – 4  
Planta 1º oficina 2  
29007 Málaga  
Telephone: 952 071 701

#### Marbella

Edificio Golden,  
Av. Ricardo Soriano 72,  
1º planta,  
29600 Marbella.  
Telephone: 95 276 51 30

#### Palma de Mallorca

Avda. Comte de Sallent, 2,  
Esquina 31 de Diciembre,  
07003 Palma de Mallorca.  
Telephone: 971 45 67 68

#### Casablanca

97 Boulevard Al Massira Al Khadra  
Étage 1,  
20000 Casablanca,  
Telephone: +212 229 532 50

#### EMEA Offices

Abu Dhabi (971) 2 681 4399	Kolding CB Richard Ellis Cederholm A/S (45) 70 22 9603
Aarhus CB Richard Ellis Cederholm A/S (45) 70 22 9602	Lisbon (351) 21 311 4400
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