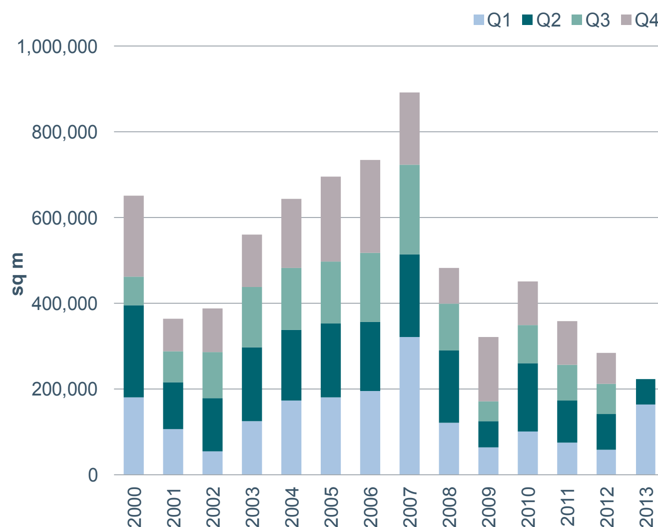
savills

Market report
Madrid offices

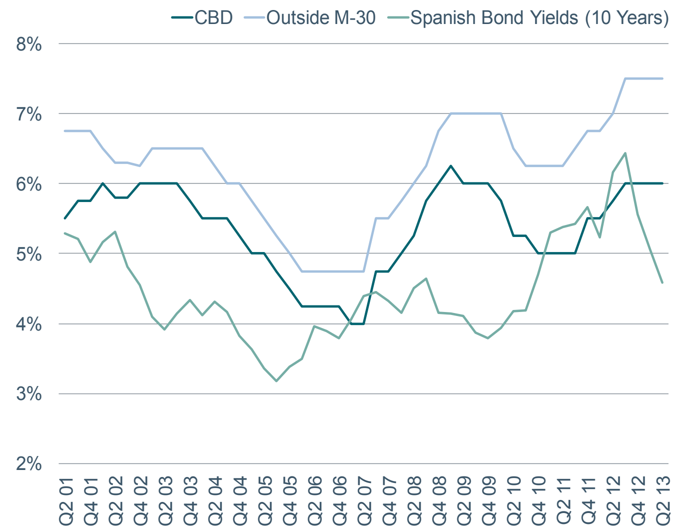
Q2 2013

GRAPH 1
Annual take-up



Source: Savills

GRAPH 2
Prime yields vs Spanish bonds yields



Source: Savills, INE

SUMMARY

The arrival of new international investors is breathing new life into the market

■ Take-up in the second quarter barely reached 60,000 sq m, which is the lowest Q2 figure on record. However, the half yearly figure far exceeded the cumulative figure for the first half of 2012. This was due to several megadeals coincidentally being signed in Q1, which significantly distorted market values, thus failing to paint a true picture of the market.

■ The vacancy rate continues to grow as second hand space continues to flood the market. Between April and June, no speculative real estate projects came onto the market.

■ The level of stock has slowed down in recent years and even decreased in 2012. The main reason for this is the slowdown in new developments coming onto the market and an increase in refurbishment projects, as well as several buildings that disappeared form the office stock as a result of a change of use.

■ The ongoing imbalance between supply and demand is causing further rental adjustments; however the strength of the CBD has meant that the headline rent has remained at €24.50 per sq m/month for the third consecutive quarter.

■ The investment market is beginning to awaken from its slumber and the Madrid office market is slowly beginning to become more active. Domestic investors continue to dominate the market, but the arrival of new players, primarily international, is breathing new life in to the sector. In addition, several of the institutional funds, which have been regular faces in the market over recent years, are scouring the market for opportunities that meet their investment criteria. The lack of comparables in the CBD makes it difficult to establish how yields are faring. We have left the achievable yield at 6%.

Economic situation

Business activity in the Spanish economy continues to shrink, although it appears that the negative values in the market are gradually improving. According to the latest data published by INE (National Statistics Institute), GDP fell by -0.5% in Q1, which is a three tenths of a percent quarter-on-quarter decline. This slowdown came as a result of a slight improvement in household expenditure, which dropped by 0.4% compared to 1.9% in the previous quarter, which on the one hand was due to individuals making purchases prior to the VAT increase in September, and on the other hand by the removal of civil servants' extra bonus payment, which affected their ability to make purchases.

In this respect, the deep and prolonged weakness in private consumption is taking its toll on retail sales, which have now been in decline for 35 months. The latest seasonally corrected annual retail trade figures for May stood at -4.6%, which is two tenths of a percent above the previous month's figure. This slight improvement in the consumption index was accompanied by an 11 -point increase in the consumer confidence index published by the CIS (Centro de Investigaciones Sociológicas) in June (61.8), which began to increase again after initially climbing up the scale in March before stalling in May. This was the highest figure registered over the past 15 months.

With regard to the job market, in June, SEPE (Servicio Público de Empleo Estatal) registered the highest drop in unemployment on record (since 1996). However, this is directly linked to the increase in employment over the tourist season, and as such we should wait until October to confirm this trend, which started in March.

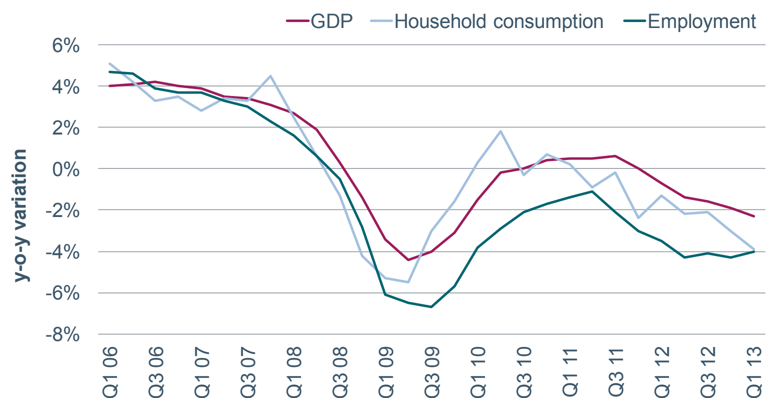
GDP growth will lag behind the upturn in employment figures; however, according to the latest forecast from Focus Economics, the outlook for future quarters suggests that the situation will gradually improve, with positive growth (the first seen since mid-2011) expected by the end of the year.

The main areas expected to support the economy are the external sector and the extra flexibility with regard to the deficit target set by the European Union, with the latter being at the expense of new reforms, where the Commission for instance has suggested an increase in indirect taxes or delaying the age of retirement.

Exports continue to grow, and appear to be the key way of exiting a crisis that is being shunted ever further back off into the future, due to a lack of investment and consumption. Foreign trade continues to grow, reaching record highs, given the increase in competitiveness (via a decline in labour costs and better end prices for goods and services). The trade growth is also linked to an increase in the number of companies that export and have diversified their sales into different foreign markets, in which emerging countries with greater growth potential are becoming increasingly more important.

GRAPH 4

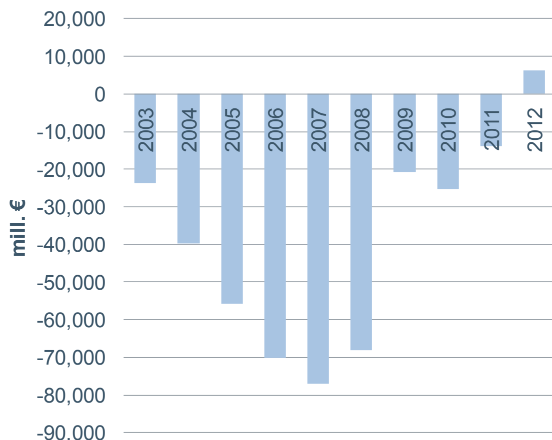
GDP, consumption and employment



Source: INE

GRAPH 3

Balance of payments: good & services



Source: INE, ICEX, Banco de España

TABLE 1

Economic indicators

Indicator	2011	2012	2013*	2014*	2015*
GDP	0.4%	-1.4%	-1.6%	0.3%	1.2%
Houshold consumption	-0.8%	-2.2%	-3.0%	-0.3%	1.0%
Unemployment	21.6%	25.0%	26.8%	26.8%	25.2%
CPI	3.1%	2.4%	1.7%	1.3%	1.4%

Source: Focus Economics (July 2013) / * forecasts

Take-up and demand

Take-up in Q2 barely reached 60,000 sq m. This is the lowest Q2 figure on record (since 2000), and represents a 31% decline year-on-year. On the other hand, one should highlight that the half yearly figure far exceeded the cumulative figure for January to September 2012, due to several ‘megadeals’ coincidentally being signed in Q1, which significantly distorted market values, thus failing to paint a true picture of the market.

If we only consider the number of deals signed, there is a clear lack of demand, with the numbers dropping by 27% year-on-year and 12% quarter-on-quarter.

The number of deals signed in terms of size of space taken over the last two quarters is very similar (33%, 11% and 56% for small, medium, and large-scale office space respectively). The difference is clear when we take a more in-depth look at transactions for space over 1,000 sq m. Whilst 13% of large-scale transactions that took place between January and March were for space over 3,000 sq m, in Q2 they amounted to a mere 4%, with no deals signed for space over 10,000 sqm. The largest transaction was carried out by the communications group Aegis Media, that combined all of its offices into one single 5,000 sq m headquarters. The property they chose to relocate to is one of the few commercial properties owned by Sareb. It is situated on the outskirts of Campo de las Naciones, and came free a few months ago, when Repsol vacated the premises in order to move to its new campus.

The high volume of take-up over the first half of the year and the decline in the number of deals signed has resulted in a significant upswing in the average volume of space taken (just over 1,300 sq m), which is almost double the figure registered at the end of 2012. Excluding the ’megadeals’ of the last quarter, which amounted to around half of the quarterly take-up figure (Vodafone, Iberia and Agencia EFE), the figure would stand at around 800 sq m.

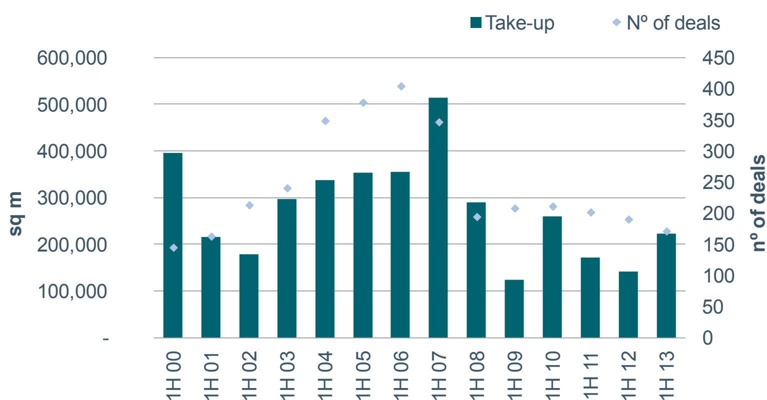
In addition, the average take-up volume for large-scale transactions (≥ 1,000 sq m) in recent quarters has increased sharply from 4,000 sq m in Q4 2012 to over 7,000 sq m in Q1 2013, before declining dramatically to 2,000 sq m between April and June.

Sector performance

If one analyses take-up by business sector, this has been affected by the uniqueness of Q1, as the new technologies and telecommunications sectors, followed by professional services took the most space (35% and 38% respectively) with Vodafone taking 50,000 sq m of space at Parque Avenida de América 115. However despite this, the number of deals signed has remained stable. Technology firms have accounted for an average of 16% of take-up since 2007.

GRAPH 5

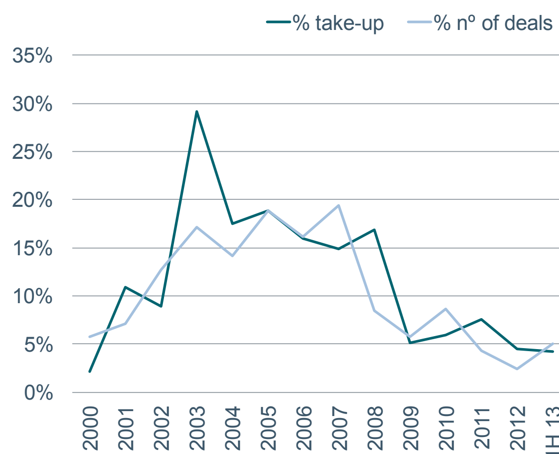
Historic demand trends



Source: Savills

GRAPH 6

Owner occupier purchases



Source: Savills

Government bodies are continuing to implement their space optimisation plans and continue to take space from time to time. In Q2, Enresa (Empresa Nacional de Residuos Radioactivos) took 1,000 sq m in a property on the first stretch of the A-2.

Owner-occupier purchases

Following several years with barely any owner-occupier activity, the owner-occupier sales market seems to have picked up slightly. The number of deals registered since January has fallen by just 11% compared to the total figure for 2012, in which take-up declined by 26%. Companies with liquidity are making the most of the low prices in the market given the strong adjustment in prices compared to values achieved over the 2007-2008 period.

In any event, we should not consider this to be a clear sign of the market recovering, nor should it be viewed as a trend; however it is significant that, after remaining on the sidelines for a long time, vendors and buyers are now more on the same page. In other cases, the vendor has urgently needed to obtain liquidity, which has caused them to drop the price of the property significantly.

Current availability

At the end of June, there was around 1.8 million sq m of vacant space in the Madrid office market, which is a 2% increase quarter-on-quarter. No speculative real estate projects came onto the market between the months of April and June, and despite the slump in the amount of new or refurbished vacant space coming onto the market, the vacancy rate continues to rise, reaching 14% and hitting a new record high. Second hand space coming onto the market and ailing demand combined with excess supply, means that it will be difficult to see the vacancy rate fall in the short-term.

Supply in the CBD remains healthy (between 5% and 7%, depending on the location); however at the beginning of the year, the level of supply increased when Paseo de la Castellana 7 was put back onto the market. Despite this and the lack of deals signed in the prime area of the city centre, the strength of the Castellana area will cause the amount of available space to fall gradually.

Stock growth

The increase in the level of stock has slowed in recent years and even achieved negative growth in 2012.

One of the main reasons for this is the slowdown in the number of new developments coming onto the market, as some of these have incurred delays of well over two years (in 2013, 50% of new or refurbished space coming onto the market related to delayed developments from 2012 and 2011). Another important factor that would explain the sluggish rate of growth is the fact that several office buildings have changed use, mainly to hotel use.

Future supply

Delivery dates are constantly changing. This is affecting the new or refurbished space which is expected to come on to the market in 2013 and has been further complicated by the delay in construction works for the MBC building, which is located on the first stretch of the A-2. The comprehensive refurbishment project has now become even more ambitious and exacting, given that the property is now seeking LEED Platinum certification.

Consequently, the total volume of new or refurbished space in the pipeline for 2013 will barely hit 90,000 sq m, which is the lowest figure seen over the past 10 years. We should also highlight that fewer risky new build projects are being developed and that most speculative projects are primarily refurbishment projects.

Refurbishment projects

Refurbishment projects are the ideal solution when it comes to tackling the high degree of obsolescence, which is affecting the majority of the capital's office stock. This issue particularly affects the city centre and to a greater extent multi-owned properties, where it may be more difficult to reach a common ground in terms of criteria and objectives in order to improve space.

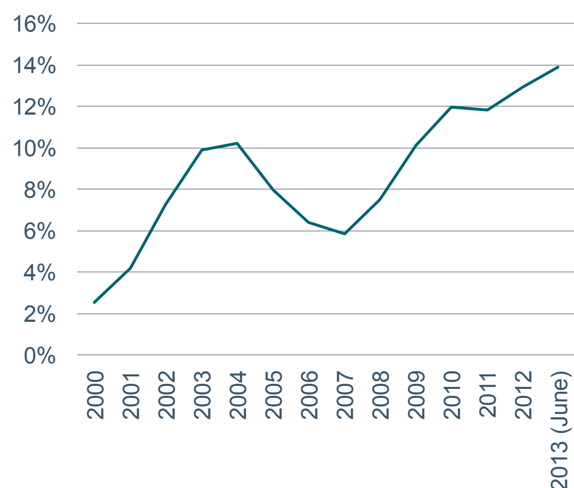
Generally speaking, single-owner properties have realised the need to renovate the properties in their portfolio, in order to improve the competitiveness of their properties, when up against new developments in the area, or other refurbishment projects.

On the other hand, the fact that several buildings that have undergone refurbishment works have been prelet is a clear indication that tenants prefer these refurbished properties.

Consequently, refurbishment projects continue to be carried out; however always by solvent groups with enough liquidity to take on the project if it has not been pre-let, but who hope to let it before the work is completed.

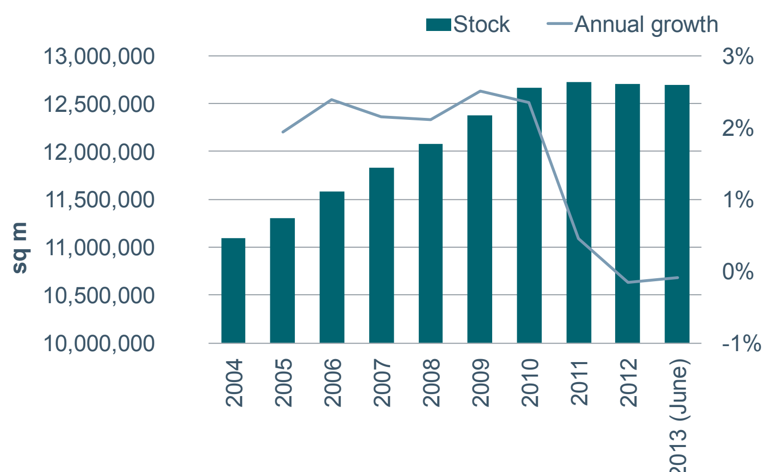
Conversely, others (who are restricted by a lack of liquidity or difficulties in acquiring financing) continue to wait and see if a tenant with a real interest approaches them, in order to then start refurbishment works.

GRAPH 7
Vacancy rate



Source: Savills

GRAPH 8
Stock evolution



Source: Savills

Rents adjust even further

Declines continue to prevail with regard to rental prices in general. However, rents in some consolidated areas are starting to stabilise, and in some areas have even started to rise, albeit in just a few cases, and for very specific properties.

The overall average rental value for business properties (exclusive office use and high-tech) since January has touched on €13.50 per sq m/month. As we mentioned previously, rents are continuing to decline; however they are falling at an ever-slower rate, at -5% year-on-year, which is similar to the figure registered in 2010 (-4.5%), when there was an upswing in the amount of space taken.

The minimum rent registered this quarter was between €4 and €5 per sq m/month, which was for space in an office building in the Alcobendas industrial estate. The owners have opted for an aggressive price based marketing strategy, in order to attract demand to a business area, which also includes industrial properties, and several occupiers have made the most of this opportunity. The lowest rental price has dropped 33% quarter-on-quarter and the volume of transactions in rental levels with only one digit has increased by just 1%, to 17% in Q1 and 27% in Q2. However, at a time where there is an excess of supply and ailing demand, price is one of the tools that owners use to attract new tenants, particularly for properties situated on the furthest outskirts of the periphery, where the vacancy rate stands at well above 20%.

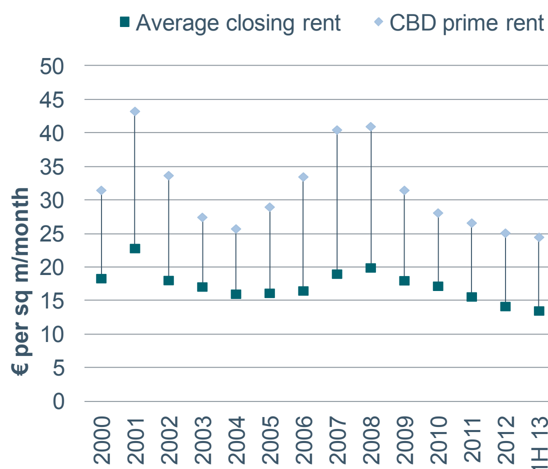
"Rents in the CBD are reaching their lowest level seen in the recession, and if history repeats itself as it did in the mid 90s, rents may well climb slightly at the end of 2013 and 2014"
Gema de la Fuente, Savills Research

Stability in the CBD

The tachievable rent in the CBD remains at €24.50 per sq m/month for the third consecutive quarter. The year-on-year figure remains negative (-3%), however the negative growth figure is becoming less and less pronounced over time. Contrary to the overall market situation, rents around the Castellana area have stabilised in recent months, due to a lack of quality properties and recurring demand. We are heading for a change in trend in the area, which will slowly but surely expand towards the periphery.

GRAPH 9

Average closing rents vs CBD prime rents



Source: Savills

TABLE 2

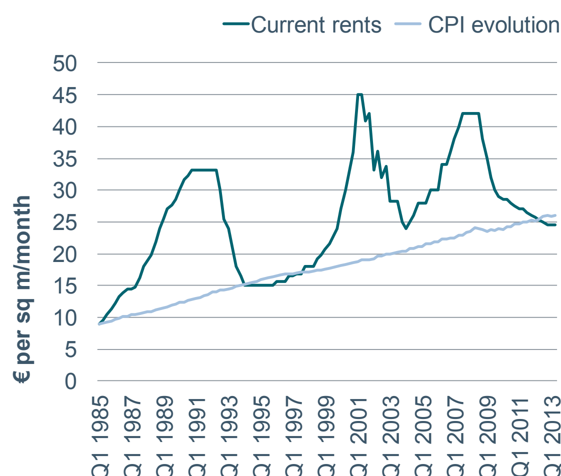
Main transactions - Q2 2013

User	Zone	Floor area (sq m)	Activity sector
Aegis Media	East	5,000	Business services
Santa Lucía *	East	3,900	Insurance
Confidential	Urban area	3,400	Confidential
Enterprise-Atesa	South	2,600	Business services
Elavon	A-1	2,300	Bank

Source: Savills / *sale deal for own occupier

GRAPH 10

CBD rent



Source: Savills / INE

Investment market

The investment market is beginning to awaken from its slumber and the Madrid office market is slowly beginning to become more active. Investment volumes in Q2 amounted to €155m, which far exceeds the €45m registered over the same period last year. If we compare the half yearly figure (just over €200m) with the first half of 2012, investment has increased fourfold (however, this obviously does not include the Torre Picasso deal).

Nevertheless, despite the fact that the market is gearing up to get going again, the lack of deals signed over the first half of the year (six in total), contradicts the increasing investor interest in the market and the fact that both domestic and international buyers are actively searching for properties.

Key deals

Sale & leaseback deals prevail in the market, with two out of the four deals signed in Q2 in this category. Deutsche Bank and the Madrid City Hall were the vendors. A private investor acquired the German bank's headquarters at Paseo de la Castellana, 18, and the local government's Town Planning department, in the Apot building at Campo de las Naciones, is now part of Rilafe's portfolio. Two domestic buyers and two prime locations (within and outside of the M-30, respectively).

The most sought after properties are prime buildings on the Castellana CBD area, with solvent tenants, and long-term leases at market rents. However, these types of properties are also the most scarce, which means that investors are forced to expand their search criteria, both in terms of location and the type of property they are looking for.

Deutsche Bank's headquarters fulfils all of the aforementioned factors, however, the fact that it is a multi-owned property, did slightly penalise the deal.

The remaining two acquisitions were for vacant properties, however they deserve a special mention as the new owners in both cases are new market players.

The business group Pescaderías Coruñesas got on to the real estate ladder by acquiring Plaza de Canalejas 3, which Havas Media occupied before it moved to Torre Cristal. Hence, the building is currently unoccupied. Another recent newcomer to the market is the British firm Meyer Bergman, which acquired Serrano 60. Meyer Bergman is predominantly linked to retail properties in the UK and Central and Eastern Europe. Serrano 60 is an office building, with a significant retail component in one of the capital's retail hot spots. It is the first deal that the company has signed in Spain; however we should highlight that opportunistic transactions have been on their radar over the past few years. Ultimately, they chose a prime property with added value.

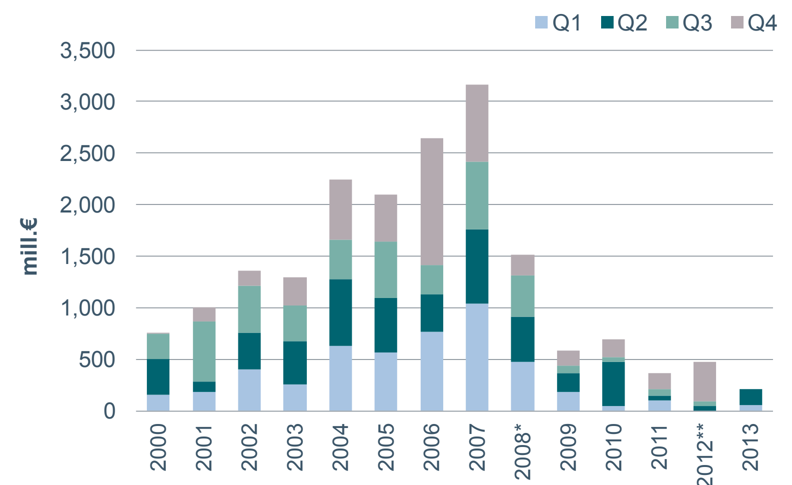
National vs international

The market continues to be dominated by domestic capital. 59% of the cumulative volume over the first half of the year related to Spanish investors; however this is its lowest figure over the past five years.

Structural reforms and financial measures adopted by the Government have clearly improved Spain's image abroad, which in turn has improved international investor confidence, who believe that the market has bottomed out and now is the best time to buy.

GRAPH 11

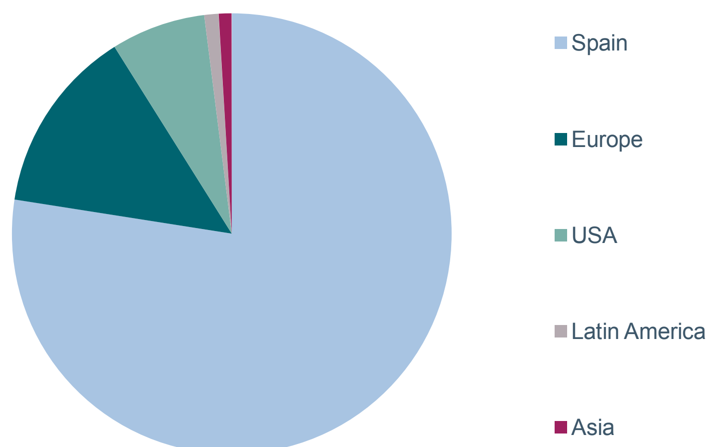
Investment volume



Source: Savills / *excluding Ciudad Financiera Santander / ** excluding Torre Picasso

GRAPH 12

Investment volume by purchaser origin 2009-1H 13*



Source: Savills / * excluding Torre Picasso

"German institutional funds have returned to the commercial property investment market. Deka purchased an office building in Barcelona's CBD, and Union Investment, a hotel, also in Barcelona. Their arrival in the Madrid office market is just a matter of time." Pablo Pavía, Spain Investment

German institutional funds, who were regular faces in the market years ago, have returned to the commercial property investment market. No deal has been signed as of yet in the Madrid office market, but it is only a matter of time. A few months ago, Deka completed a deal for an office building on the outskirts of Barcelona's CBD, and at the beginning of the year, Union Investment agreed to acquire Hotel Raval from the hotel chain Barceló, which will continue to operate the hotel under the brand name for 20 years. Other renowned German firms in the Spanish market, given their active presence in the market prior to the crisis, are scouring the market for opportunities that meet their investment criteria.

New investors in the market

The arrival of new investors is driving the office market in Madrid. Over the past 18 months, 28% of completed deals, related to buyers who had not previously been involved in the market.

We should highlight that these newcomers are both domestic and international investors; however in this case cross-border deals far exceeded local deals: 91% compared to 9%.

International newcomers include Autonomy Capital, which took 44% of space in this category, signing three transactions. The arrival of South American investors is also noteworthy. They are making the most of the language advantage and cultural similarities to do business in Spain, which also enables them to use Spain as a gateway to other European countries.

However, new investors are not just looking at the Madrid office market. Barcelona, in second place, has also seen deals completed by buyers who to date were unknown. In addition to Autonomy Capital, which recently purchased a building in the 22@ district, other British and Canadian investors have purchased real estate.

Sareb

International funds will be the main players in auctions of property portfolios transferred by the banking sector to Sareb. The name of the first buyer of what is known as "Operation Bull" will be announced shortly. Interested parties who made offers include Cerberus, Centerbridge, Colony Capital, Texas Pacific Group and Lone Star. The outcome of the auction will be the best way to test the ability of attracting investors with the message of "there are opportunities to be had here".

However, despite the lack of commercial property, a portfolio of office buildings (many of which are occupied) will come onto the market after the summer.

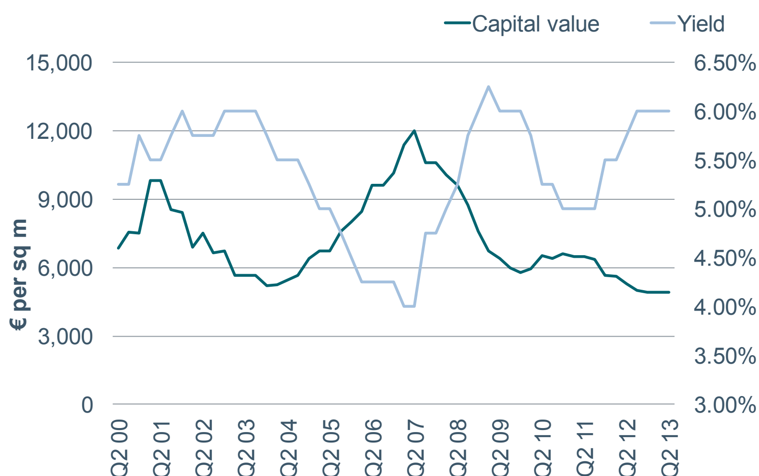
Yields

The lack of comparables in the CBD makes it difficult to establish how yields are faring; however the clear buyer interest and a lack of properties should cause yields to fall and harden even further when rental values for prime properties stabilise.

In any event, in view of the absence of clear comparables, we have left the achievable yield at 6%. However, yields for trophy assets could be lower than the achievable yield.

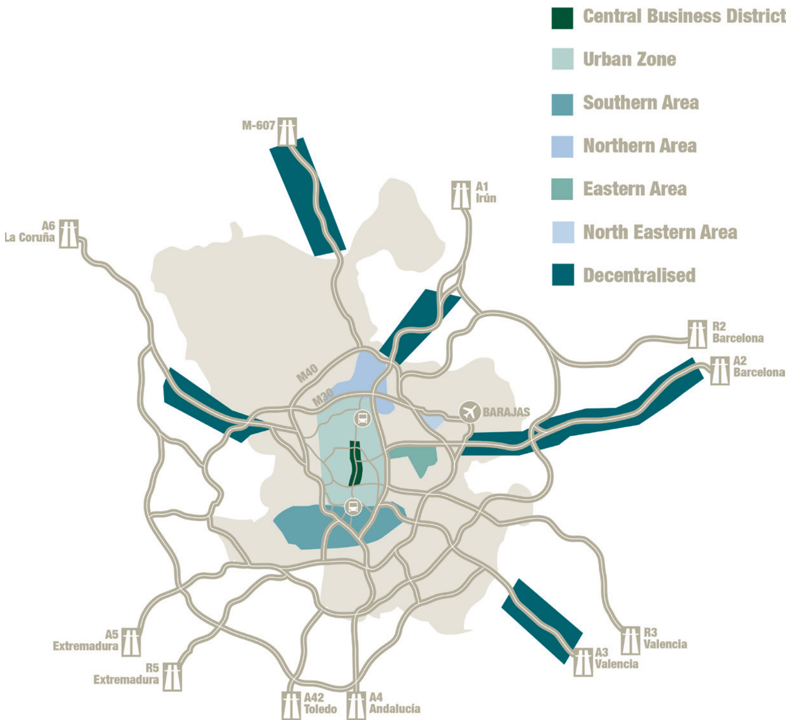
GRAPH 13

CBD indicators



Source: Savills

MAP 1
Madrid office market



OUTLOOK

2013

■ The excellent take-up figure registered up to June will mean that the figure will easily exceed 2012's annual figure. However weakening levels of demand, which are not showing any sign of increasing, will become more noticeable. This is particularly true as companies tend to consolidate and relocate rather than expand.

■ The fact that BBVA has started to move to its new financial city, as well as large firms vacating buildings to move to their new headquarters (such as Vodafone), will cause the vacancy rate to shoot up, despite the slowdown in new or refurbished space coming onto the market.

■ The imbalance between supply and demand suggests that we are likely to see further rental adjustments. Rents in the CBD are reaching their lowest level seen in the recession so far, and if history repeats itself as it did in the mid 90s, rents may well climb slightly at the end of 2013 and 2014.

■ The buyer interest we mentioned a few months ago is starting to materialise into deals, many of which are by market players who up until now were unknown. This has driven investor activity; however we should also point out that international investors who know the market very well and who had an active presence prior to the crisis, have also come back onto the scene. We are optimistic with regard to the second half of the year.

Savills team

For further information please contact:

Luis Espadas
Capital Markets
+34 91 310 10 16
lespadas@savills.es

Pablo Pavía
Spain Investment
+34 91 310 10 16
ppavia@savills.es

Ana Zavala
Office Agency
+34 91 310 10 16
azavala@savills.es

Gema de la Fuente
Research
+34 91 310 10 16
gfuente@savills.es

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company, established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 500 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This bulletin is for general informative purposes only. Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. It is strictly copyright and reproduction of the whole or part of it in any form is prohibited without permission from Savills Research. © Savills Commercial Ltd