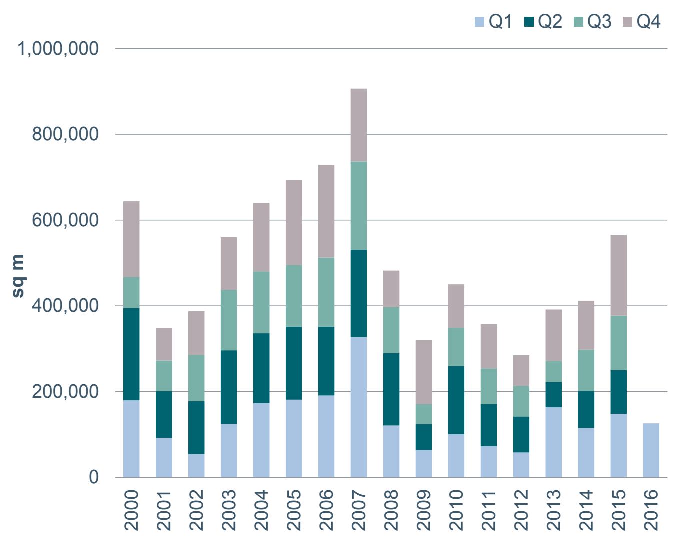
Market in Minutes
Madrid Offices

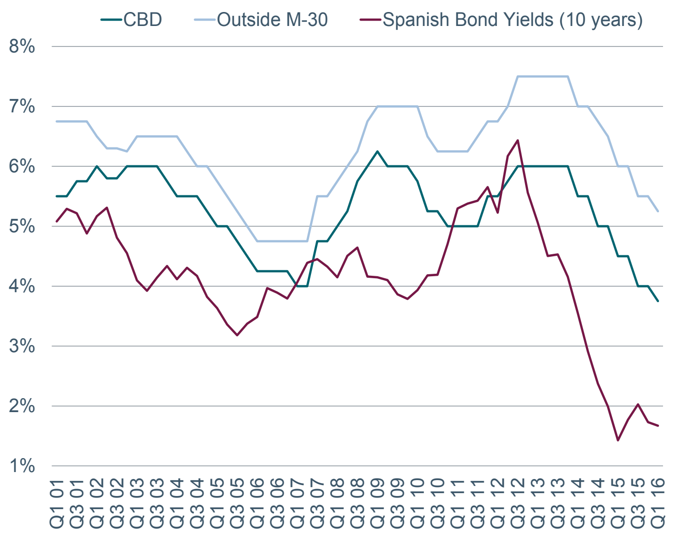
Q1 2016

GRAPH 1
Annual Take-up



Source: Savills

GRAPH 2
Prime Yields vs Spanish Bond Yields



Source: Savills / INE

SUMMARY

Insurance companies come back on to the investment market in force

■ The first quarter closed with take-up figures of circa 125,000 sqm, a 17% y-o-y increase if we disregard the two mega-deals in Q1 2015 (KPMG and BNP, both of which exceeded 10,000 sq m).

■ The achievable prime CBD rent increased to €27 per sq m/month, which equates to 5% y-o-y growth and 2% q-o-q.

■ The lack of quality space in the city has pushed occupiers to look further afield at more peripheral locations. For the first time since the beginning of the crisis, periphery areas have accounted for the most take-up and number of deals.

■ The knock-on effect: a drop in the average closing rents.

■ Vacancy rate continues to fall and stands at 10.4%. More than 65,000 sq m of empty refurbished space will come back onto the market over the next few months. Occupier response to this new supply will determine just how much the vacancy rate will vary.

■ The investment market has slowed following the frenetic activity registered in 2015 (which set the record for the highest number of properties transacted), primarily due to the lack of supply.

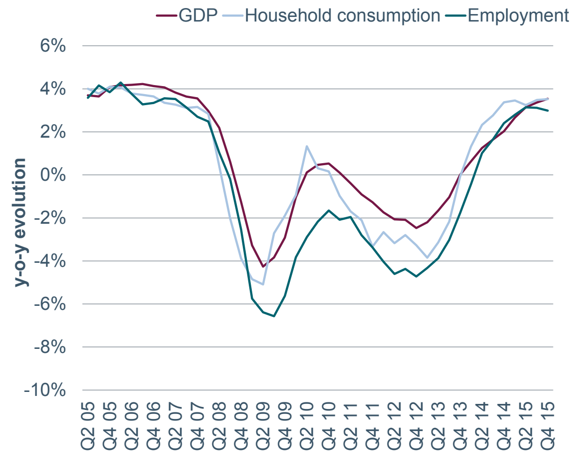
■ The circa €255m registered in Madrid equated to 50% of the figure registered for the same period last year.

■ Of particular note was the return of insurance companies to the market, which are focusing on yielding properties. The SOCIMIs (Spanish equivalent of REITs) continue to be on the scene, but are expected to focus more on managing their respective portfolios amassed over recent years.

■ The lack of product and ever increasing demand has caused yields to harden. Prime CBD and outer M-30 yields have fallen by 75 basis points compared to Q1 2015. They now stand at 3.75% and 5.25% respectively.

GRAPH 3

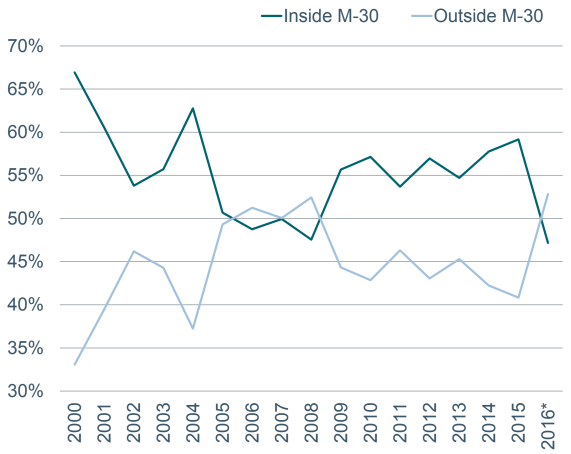
Economic Indicators



Source: INE

GRAPH 4

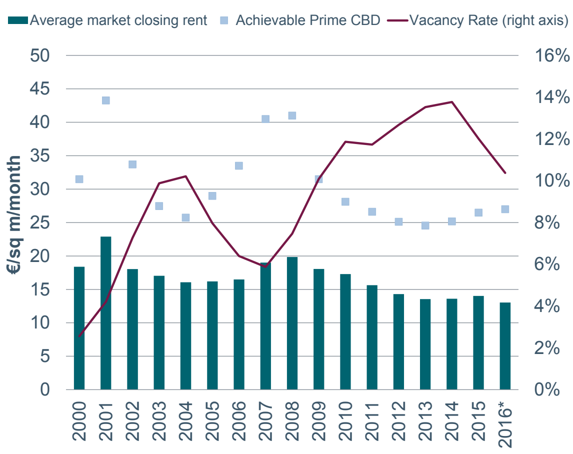
Distribution of Number of Deals Inside - Outside M-30 Ring Road



Source: Savills / *Q1

GRAPH 5

Vacancy Rate and Average Rents in the Madrid Office Market



Source: Savills / *Q1

Economic Outlook

The Spanish economy has been in a growth cycle since the start of 2013 and Q4 2015 registered the second year of growth, 3.5% according to the Spanish Statistical Office (INE). For the first time since the beginning of the recession, the annual increase stood at over the historic average of 2.5% since 1970, reaching 3.2% in 2015.

In terms of the job market, the unemployment rate continues to remain high, standing at 20.9% (National Census - EPA) in Q4 2015. Despite this, the unemployment rate has continued to trend downwards since the end of 2013, falling by almost 20% since Q1 2014. Furthermore, the job market is also showing signs of recovery, with Q4 2015 marking the seventh consecutive period of year-on-year growth, with a 3% increase.

However, domestic demand continues to be the main growth driver. The continuing fall in prices -thanks to the drop in oil prices -along with an increase in employment levels and a drop in interest rates have facilitated an increase in household spending power and final consumption. According to the INE, consumer spending grew by 3.5% in Q4 2015, which is the second highest increase in the last eight years.

Hence, one can conclude that 2015 was the second consecutive year of recovery for the Spanish economy. That said, the sensitive political situation in which Spain currently finds itself, coupled with a number of obstacles in the global economy, have caused economic forecasts for the coming years to look somewhat gloomy.

Take-up and Demand

Businesses in Madrid continue to keep the office market busy. Close to 160 deals were registered in the first three months of the year, in line with Q1 2015 figures.

In terms of take-up, the close to 125,000 sq m registered reflects a drop of 15%, though one should bear in mind that the volume for the same period in 2015 was heavily distorted by the KPMG and BNP Paribas deals, which accounted for more than 25% of all take-up.

If we disregard these mega-deals (>10,000 sq m), the current market stands at 17% above the Q1 2015 figure.

Size of deals

The absence of mega-deals between January to March is surprising, given that at least one deal larger than 10,000 sq m has been registered ever since 2013.

The largest deal this quarter was just over 5,000 sq m and was located in ONO's former headquarters in Pozuelo de Alarcón. The deals segment below 500 sq m accounted for slightly more than 50% of take-up, 5% below the historical average. It was complemanted by the increase in take-up in the 500 to 1,000 sqm and 1,000 to 3,000 sq m brackets, which were respectively 5% and 2% above the average.

The average size of space taken in the first quarter stands at around 800 sq m, which is 10% more than the figure in 2015, excluding the two mega deals in Q1 2015.

City Centre vs Periphery

The lack of quality space in the central core of the city has pushed occupiers further afield to peripheral locations. For the first time since the crisis began, almost 60% of take-up and more than 50% of deals took place outside M-30 ring road.

Current Supply

The vacancy rate continuing to fall. Supply in the Madrid market accounts for 10.40% of total office stock. 7% of this lies within the M-30 ring road, while peripheral areas are at above 12%. In any event, there are notable differences between submarkets, depending on how established the area is.

New Office Space

Despite the vacancy rate continues to trend downwards, there is more than 400,000 sq m of new space on offer or in the process of being refurbished, which is expected to come on to the market up until 2018, of which only 30% is committed and which will be either owner-occupied or let to a tenant.

The Madrid office market continues to be upgraded and refurbished, in order to reduce the high level of out-dated properties, particularly in the city centre.

The distribution of new and refurbished properties in terms of the M-30 ring road is well balanced (49%-51% inside and outside respectively), although the difference between both areas is very much based on the type of project. There tends to be more new developments in peripheral areas, while the city centre tends to have more refurbishment projects.

Rents

The achievable CBD prime rent now stands at €27 per sq m/month, which equates to growth of 5% y-o-y and 2% q-o-q. The best properties in the best areas are now definitely seeing rental growth, but they are only rising moderately for now.

The average rental value of signed office deals has decreased slightly compared to 2015, primarily due to less demand for properties inside the M-30 ring road.

Virtually 90% of deals were signed at below €25 per sq m/month, with the lowest segment up to €10 per sq m/month seeing an increase and the number of lettings between €15 and €25 seeing a decrease.

The top rent for the month easily surpassed €32 per sq m/month, although this was for a 250 sq m office. The second highest rent for the quarter, which was also above €30, was for a prime property in a prime location and was over 1,000 sq m in size and is therefore a good growth indicator in order to set the achievable rent.

Investment Market

The office market has slowed following the frenetic activity registered in 2015. Spain's overall investment volume between January and March stood at circa €385m, which is only 50% of the same figure in 2015.

Various deals were completed over the past few weeks, hence the total investment volume now stands at over €400m.

Madrid, with €255m, has strengthened its position as the leading market, accounting for 65% of all investment.

The drop in investment volume is not due to a decrease in demand, but rather due to the lack of available office product on the market.

Despite this drop in activity, both in terms of volume, as well as the number of deals, eleven in total, the average lot size remained stable compared to the same period last year, at €25m.

The average investment volume per deal in the area around the M-30 stood at below €20m, whereas the average in peripheral locations stood at €30m.

Investor Profile

Insurance companies accounted for almost 30% of activity and 40% of investment volume. They registered the highest average investment deal lot size, above €34m. Although their initial search generally starts out in the city centre, the lack of product that meets their investment criteria means that they tend to then look outside of the M-30 ring road.

The SOCIMIs continue to be active in the market, although they appear to have slowed their buying activity to focus more on the management of their portfolios that they have been amassing over the past few years.

Type of Transaction

In terms of type of deals, insurance companies and SOCIMIs are focusing on yielding properties, while funds and private investors are interested in vacant properties or those with potential for refurbishment or a change of use.

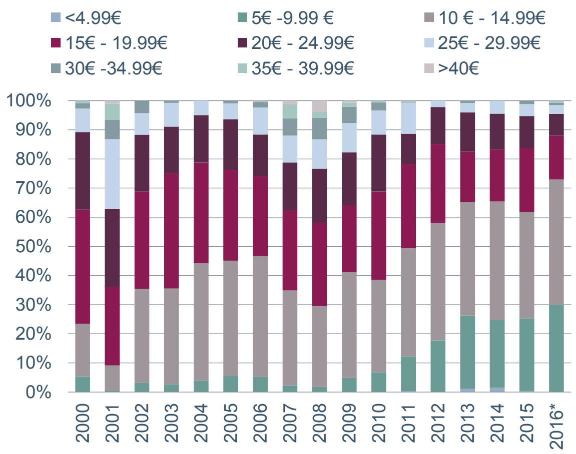
Yields

The achievable prime yield in the CBD now stands at 3.75%. The imbalance between supply and demand and the expected increase in rents has adjusted yields 25 basis points compared to at the close of 2015 and 75 compared to Q1 2015.

Yields have also hardened for properties outside of the M-30 ring road, due to the upturn in demand, with investors now turning their attention to highly consolidated peripheral areas, due to the lack of supply in the city centre. Yield levels therefore now stand at 5.25%.

GRAPH 6

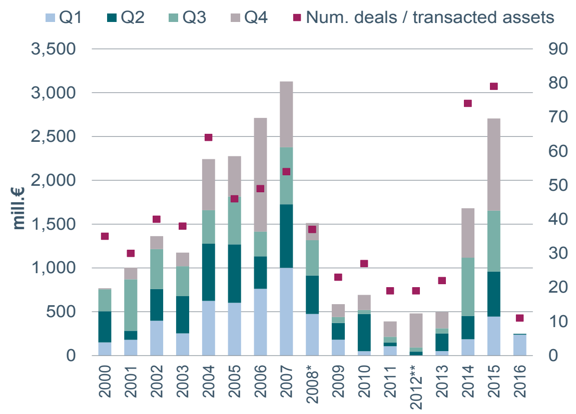
Rents Histogram



Source: Savills / *Q1

GRAPH 7

Investment Volume by Quarters



Source: Savills / *excluding Ciudad Financiera / **excluding Torre Picasso / 2016, until April

TABLE 1

Main Deals - Occupiers Market Q1 2016

Tenant	Area	Surface (sq m)	Activity Sector
Avintia	A-6	5,400	Property Company Developer
SAS	North Area	4,700	IT
Auxadi	A-2	3.800	Bank - Finance
Aegon	Campo de las Naciones	3,650	Insurance
Willis Tower Watson	East Area	3,600	Insurance
Avanza	A-2	3,300	Distribution

Source: Savills

TABLE 2

Main Deals - Investment Market Q1 2016

Asset	Area	Purchaser	Vendor
Avda. Manoteras, 48	North Area	Trajano Iberia Socimi	Lone Star
Albarracín, 33	East Area	Grupo Zurich	Metroinvest
Príncipe de Vergara, 110	Urban Area	Mutualidad de la Abogacía	IVG
Espronceda, 32-34	Urban Area	Eurostone	BBVA
Monasterio de Suso y Yuso, 34	North Area	Catalana Occidente	Blackstone
Serrano, 240 *	Urban Area	AEW Europe	CPI Group

Source: Savills / *deal advised by Savills

OUTLOOK

2016

■ The business sector is improving and is expected to continue to grow. The political and economic situation are very much going hand-in-hand, although it appears that for the moment, the lack of government is not affecting the economy in any great shape or form, but it is putting some decision making on hold.

■ The return of refurbished office product back on to the market will alleviate the lack of good quality space inside the M-30 ring road. Occupier response to this new supply will determine just how much the vacancy rate will vary.

■ As has been the case in previous years, occupiers will welcome this type of quality product and this in turn will increase take-up within the M-30, as well as the average office rental value.

■ Offices being vacated by occupiers relocating to other properties are being modernised and adapted to the new ways of working, which is reducing the high number of out-dated properties in the Madrid office market.

■ The best properties in the most established business areas, both inside and outside the M-30, are now seeing prices rise. Rents in secondary properties have now stabilised, while the areas furthest from the city centre continue to show no clear signs of improvement.

■ New product will come onto the investment market, which will be of interest to a wide range of investor profiles.

Savills Team

For futher information please contact:

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

Pablo Pavía
Investment Spain
+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

Isabel Abella
Research
+34 91 310 10 16
iabella@savills.es