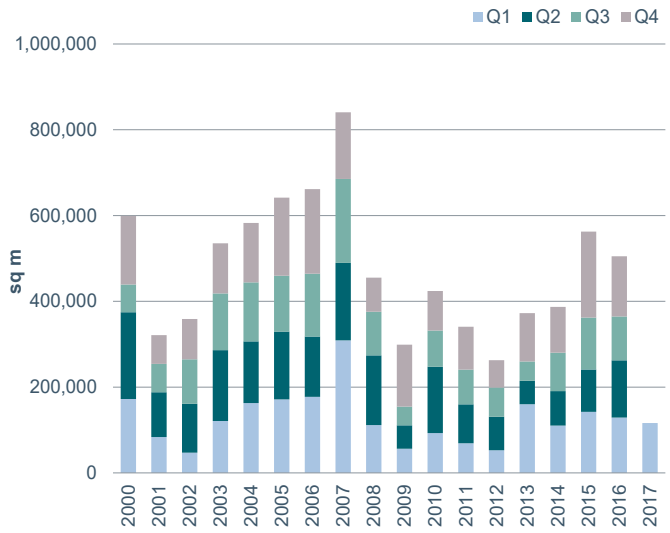
savills

Market in Minutes
Madrid Offices

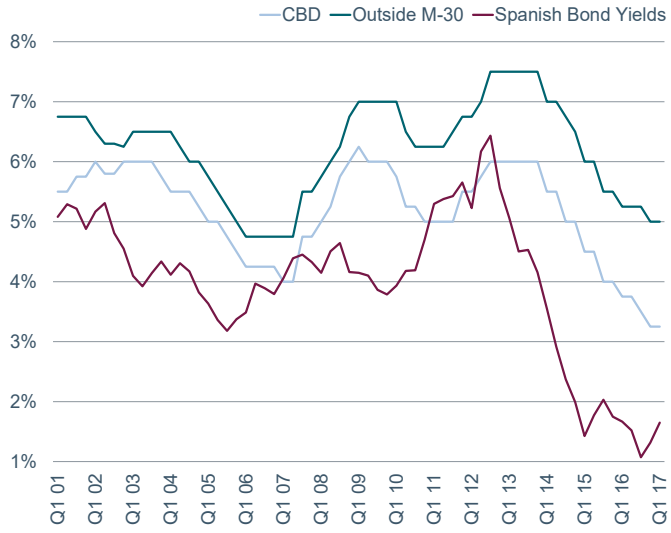
Q1 2017

GRAPH 1
Annual Take-up by Quarter



Source: Savills

GRAPH 2
Prime Yields vs. Spanish Bond Yields



Source: Savills / INE

SUMMARY

Average closing rents rally

■ The muted results posted for the occupier market in Q1 2017 came in stark contrast to the sharp growth seen in average closing rents.

■ As was the case in 2016, the year began without any mega-deals (>10,000 sq m), a factor which contributed to a low take-up figure: close to 116,000 sq m was registered, which was 10% down on Q1 2016.

■ The number of exclusive office and semi-industrial lettings was in line with Q1 2016, down by just 3%.

■ The vacancy rate remained stable, despite weakened market activity. This was a result of properties coming onto the market after undergoing a change of use, and properties being temporarily removed from the market due to current refurbishments/renovations, or to refurbishment projects that are scheduled in the short/medium term.

■ Nonetheless, the average weighted closing rent of office lettings reached €16 per sq m/month for the first time since 2011, up 13% y-o-y.

■ Closing rents grew across the board, except for specific areas of the outer periphery.

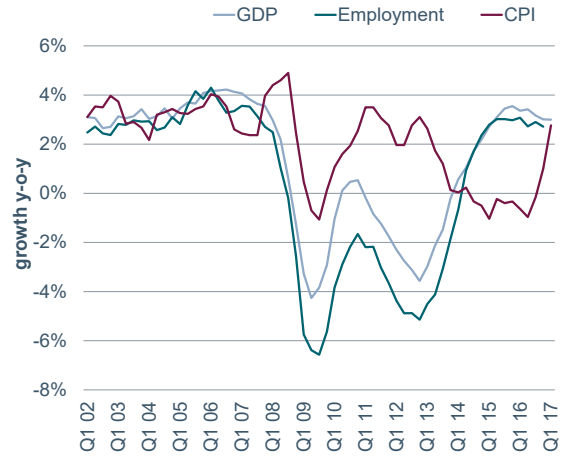
■ As of April, the investment market had already booked close to €580 million. The Q1 turnover of €370 million represented a 46% y-o-y increase, although negotiations for some of these transactions began at the end of 2016.

■ The market continues to see a lack of product being sold on-market, however this continues to be offset by the heightened levels of off-market activity.

■ A lack of comparables has led to stable achievable prime yields.

GRAPH 3

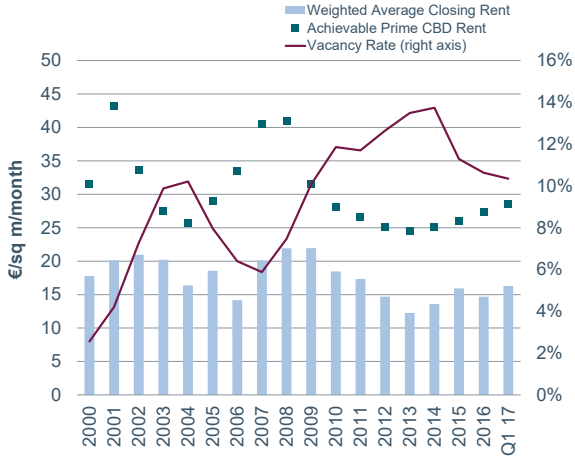
Main Economic Indicators



Source: INE

GRAPH 4

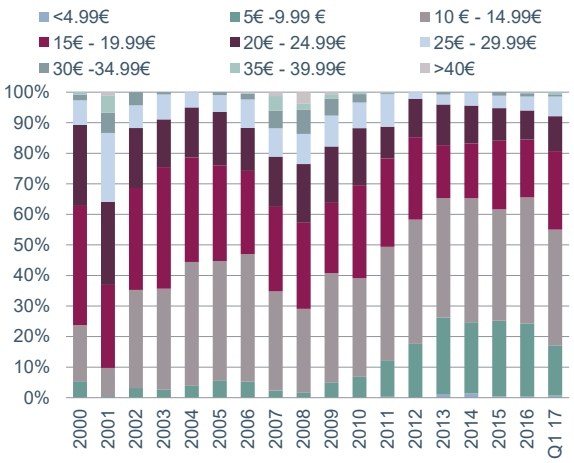
Vacancy Rate and Average Rent in the Madrid Office Market



Source: Savills

GRAPH 5

No. of Deals by Rent Range in Business Buildings (Exc. Office+HT)



Source: Savills

Economic Outlook

In spite of international political instability and the caretaker government in Spain, the Spanish economy ended 2016 in positive territory, registering 12 consecutive quarters of growth. Forecasts for the coming years outline further growth, albeit at a more moderate rate, with an average annual growth rate of 2.2% projected until 2020 (according to Focus Economics).

The latest figures from the EPA are also optimistic for the jobs market (18.6% unemployment in Q4 2016). Unemployment has continually fallen since mid-2013, and all signs point to this trend continuing into the coming years.

The latest indicators published in March confirm this favourable backdrop, with the number of job seekers down 48,559 q-o-q, and 161,752 more people registered with Social Security.

Business confidence, which measures companies' sentiment regarding their businesses, also started 2017 with positive y-o-y growth, comparing both Q1 (+1.6%) and Q2 (+2.8%). This is due to the increased number of companies with a positive outlook, the reduction in the level of pessimism regarding the immediate future, and the fact that fewer companies anticipate the current situation remaining unchanged.

As economic growth continues to consolidate, inflation will gradually inch towards 2%, as indicated by the advanced data for March which places the y-o-y increase at 2.3%.

Take-up and Demand

The start of the year was marked by a slowdown in some occupier market indicators. Between January and March, sole office and semi-industrial take-up stood in the region of 116,000 sq m, almost 10% down y-o-y and 5% below the historic average take-up figure for Q1.

The number of lettings was in line with last year's figure, down by just 3%, although up 10% compared to Q4 2016, defying the historic average of a 5% decline between the last and first quarters.

Deal Sizes

The decrease in gross take-up and the number of deals signed also contributed to the drop in the average size of space taken; a result of workspace optimisation, flexibility and versatility of workspaces, as well as the implementation of new ways of working (such as working from home and hot-desking).

Despite an increasing number of companies opting to relocate to more spacious headquarters (either in the same building or to a new location, or a new company entering the market), the majority of companies still relocate to spaces of the same size. That said, new office designs allow for a considerable reduction of the space per employee ratio, without creating the sensation of overcrowding.

Current Supply

Madrid's overall market vacancy rate fell slightly compared to the previous quarter, standing at around 10.4%. Against expectations, the refurbished stock coming back onto the market barely affected the vacancy rate, which was offset by changes of use (such as Clara del Rey, 26, one of BBVA's former office buildings within the M-30 ring road) and properties undergoing refurbishment works.

The greatest impact was felt in the CBD, largely due to the considerable increase in supply in AZCA, rising from 7.5% at YE 2016 to 11.4% in March. Over the next few months, 25,000 sq m is set to come onto the market in AZCA, following the refurbishments of Paseo de la Castellana, 77 and General Perón, 40, which are likely to push up the vacancy rate. The rate at which the properties are let will dictate growth. In this regard, Torre Europa is of particular note, where available space has fallen by 60% since the last study.

Future Supply

Almost 65,000 sq m is expected to come onto the market before year-end, thanks to new developments (16%) and refurbishment projects (84%), as well as additional space added by small-scale renovations.

The key market players are gradually realising the importance of high quality spaces and improving occupancy rates and rental levels compared to their competitors.

Barely 15% of Madrid's total stock has been developed, refurbished or renovated in the last seven years. However, despite this, demand continues to favour the best properties, even though these have higher rents due to the lack of quality product (only 22% of currently vacant stock is considered new or renovated).

Rents

The decline in occupier market activity contrasts with the performance registered by closing rents.

The average weighted value of office buildings in Q1 exceeded €16 per sq m/month, up 13% y-o-y. The y-o-y variation in semi-industrial buildings was even greater, due to the letting of a high-tech property in an urban area which was signed at over €15 per sq m/month.

Closing rents for sole office buildings grew by 11% y-o-y. Lettings signed in the prime rent category (≥€25 per sq m/month) increased their weighting from 6% in 2016 to 8% in 2017. However, even more noteworthy was the considerable decline of the weighting of lettings signed for ≤€15 per sq m/month, which dropped from 66% in 2016 to just over 55% in Q1 2017.

Signs that the market's closing rents are trending upwards favoured an increase in achievable rents, which grew in both prime and secondary areas, within and outside of the M-30. The prime CBD rent reached €28.50 per sq m/month, 32% below the last market peak.

Investment Market

The overall investment volume between January and March came in at close to €826 million, more than doubling the figure registered in Q1 2016, representing almost 30% of the total YE 2016 figure. Two mega-deals (>€100 million) significantly spurred investment, amounting to just over a third of the total volume booked.

In the second week of January, Merlin Properties announced its €142 million acquisition of Torre Glories (formerly Torre Agbar). This was one of the largest transactions seen in Barcelona in recent years, only beaten by Deka's €145 million acquisition of the former Caja Madrid headquarters on Avenida Diagonal in 2010.

The other mega-deal was the Boston portfolio, comprising 14 BBVA office buildings (eight in Barcelona, five in Madrid and one in Valencia), which were acquired by Oaktree and Freo.

The significant number of properties sold in Barcelona (20 of the 34 that changed hands) has greatly increased its share of the total investment volume registered at the national level, rising from 20% in 2014 to 59% in Q1 2017.

The Madrid office market registered just over €370 million, across 12 properties, resulting in an average ticket of circa €31 million. Although this quarter's investor activity was centred in Barcelona, Madrid's average capital volume was still far superior, coming in 40% higher.

The capital investment volume grew 46% y-o-y, but we must bear in mind that the lion's share of transactions completed between January and March were set in motion towards the end of 2016. In Madrid one of the deals that stood out by size was the sale of the Barclays headquarters in Plaza de Colón, acquired by CBRE Global Investors for over €55 million.

This was one of the properties that came onto the market after last summer, highlighting that given the general lack of product, prime properties (in terms of technical quality and/or location) are very much in-demand.

The limited availability of properties on the market continues to be offset by off-market interest. Buyers are avoiding large-scale, competitive processes, in order to be more aggressive on pricing, and vendors are looking to obtain closing prices more aligned with their expectations.

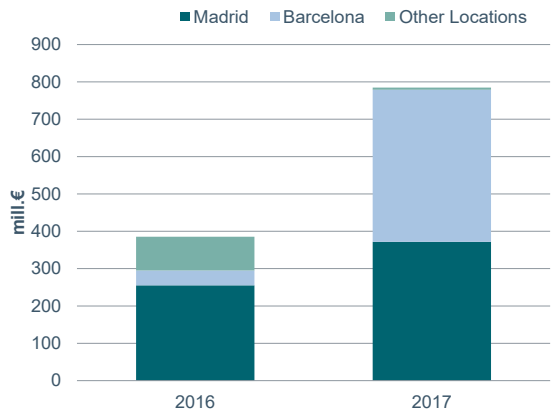
Faced with the lack of product, more creative deals have started to emerge, such as Axiare's acquisition of a multi-owned property (Miguel Ángel, 23), with a view to vacating it in the medium term, in order to refurbish and upgrade it before putting it back on the market.

Yields

Nothing has changed in terms of yields. The sluggishness of the prime market has kept the achievable yield at 3.25% for prime CBD properties, and at 5% for prime properties outside of the M-30.

GRAPH 6

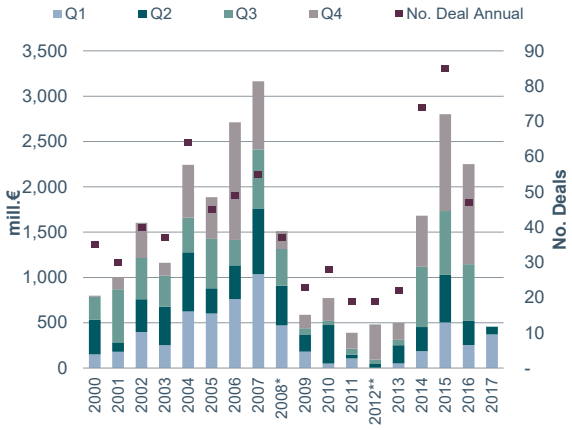
Investment Volume Transacted in Q1



Source: Savills

GRAPH 7

Investment Activity



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

TABLE 1

Main Deals - Occupier Market Q1 2017

Tenant	Area	Floor Area (sq m)	Activity Sector
SAGE	A-1	5,100	Professional Services
AMEX	Northeast Zone	4,700	Bank Finance
Liga Española de Fútbol	East Zone	4,200	Professional Services
IATA	CBD	4,000	Professional Services
Freshfields	CBD	3,800	Professional Services
Cámara de Cuentas de Madrid *	East Zone	3,300	Public Administration

Source: Savills / *advised by Savills

TABLE 2

Main Deals - Investment Market Q1 2017

Asset	Area	Purchaser	Vendor
Portfolio Boston (5 buildings).	Periphery	Oaktree + Freo	BBVA
Plaza de Colón, 1*	Prime	CBRE GI	Barclays
Miguel Ángel, 23	CBD	Axiare	Several private investors
Anabel Segura, 11	A-1	Axiare	Blackstone
Puerto de Somport, 8*	North Zone	Axiare	GMP

Source: Savills / *advised by Savills

OUTLOOK

2017

■ The notable increase in average closing rents for office properties highlights that the market backdrop is stronger, despite the fact that activity slowed in Q1.

■ During 2017, the amount of office stock in Madrid will remain similar, due to the low levels of development activity. Office stock will only increase by 55,000 sq m, of which 80% equates to the new Banco Popular headquarters. New developments which began in 2016 are set to be delivered in 2018, with some possibly coming onto the market in 2017. In total, close to 125,000 sq m is in the pipeline, although the construction timeline, and even the project start-date, will at times be dependent on pre-letting figures. All of the new space in the pipeline is currently speculative (vacant), whilst a further 30,000 sq m will be added via full-scale refurbishment projects, other factors which will also dictate the pace of construction works depending on the pre-letting rates.

■ Despite the uptick in the transacted volume in the first quarter, buyer activity is projected to remain at modest levels until after the summer. The lack of available product has considerably slowed on-market sales processes, but has not brought them to a halt. Off-market options, which are becoming both increasingly frequent and accepted by the market, have accounted for almost a third of the total transacted volume in recent years.

■ Achievable yields remain stable. Value uplift will materialise via rental growth.

Savills Team

For further information please contact:

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

Pablo Pavía
Office 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

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