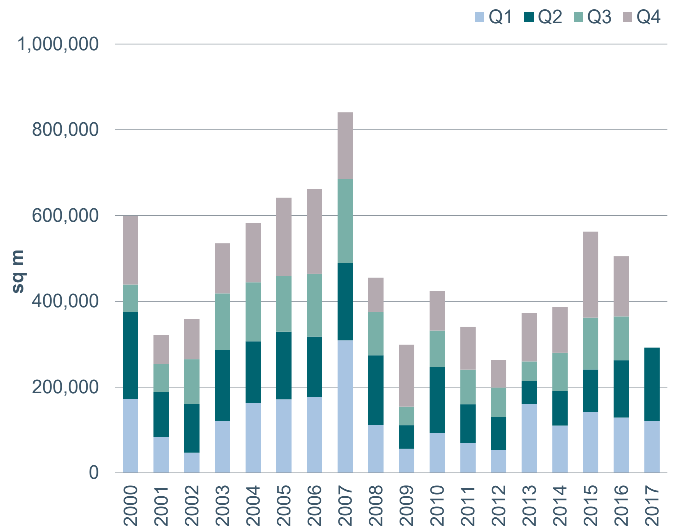
Market in Minutes
Madrid Offices

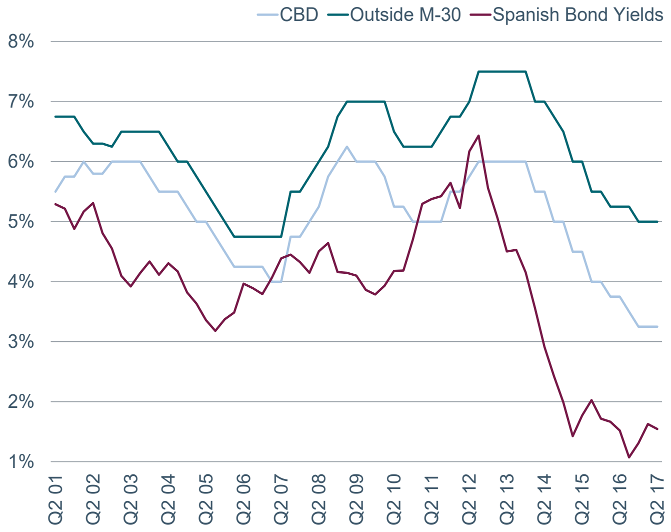
Q2 2017

GRAPH 1
Annual Take-up by Quarter



Source: Savills

GRAPH 2
Prime Yields vs. Spanish Bond Yields



Source: Savills / INE

SUMMARY

Occupier market indicators picking up

■ The upswing in gross take-up in Q2 (+27% y-o-y) offset the decline registered during the first few months of the year.

■ Take-up stood at almost 290,000 sq m to June, up 11% y-o-y. This is the best half-yearly figure since 2007, exceeding the historic average by 15%.

■ Despite the lack of very large lettings (≥10,000 sq m), the average size of space taken rose both q-o-q (23%) and in the half-yearly comparison (5%).

■ The overall market vacancy rate held firm at 10.3%, despite the amount of refurbished space coming back onto the market. AZCA was the area most affected by this, seeing the vacancy rate more or less double from 7.4% to almost 15% in just six months.

■ The average weighted closing rent for office lettings broke the €16 per sq m/month barrier for the second quarter in a row.

■ Close to €700 million was invested in the Madrid office market (+34% y-o-y), accounting for 56% of the total Spanish investment volume.

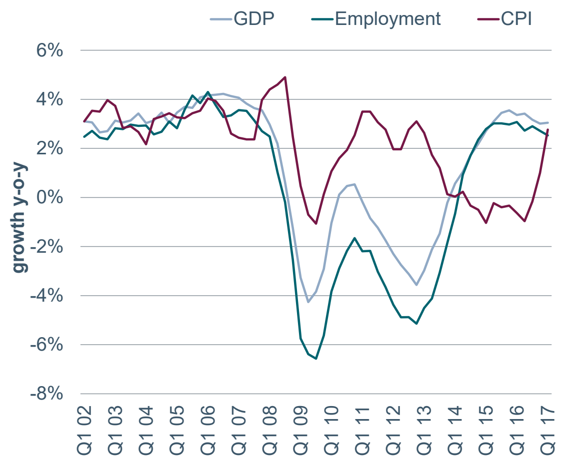
■ Compared to other commercial real estate segments, Madrid dominated the market. Socimis have without a doubt spurred the market, with average transaction volumes spiking considerably after they first emerged in 2014.

■ The transacted volume up to July approached the €900 million mark. Although the market remains shaped by a lack of product, there is a development pipeline of almost €1,000 million, of which nearly €300 million could be closed in the coming weeks.

■ Prime yields remain stable. Value uplift will be achieved via rental growth, which is already being seen in most submarkets (except for very specific areas in the outer periphery).

GRAPH 3

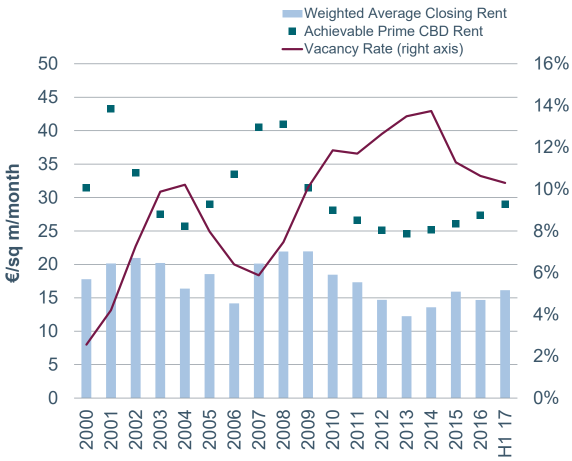
Main Economic Indicators



Source: INE

GRAPH 4

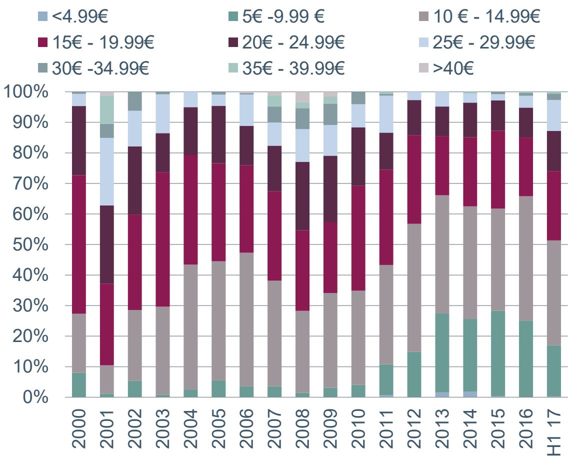
Vacancy Rate and Average Rent in the Madrid Office Market



Source: Savills

GRAPH 5

No. of Deals by Rent Range in Commercial Office Buildings*



Source: Savills/ * Including High Tech Buildings

Economic Outlook

The Spanish economy continues to grow in line with expectations, albeit at a slightly more subdued rate. The annual growth forecast stands at between 2.9% and 3.1% according to various public and private institutions, although it is worth highlighting that all forecasts have been revised upwards.

In terms of the jobs market, the number of social security registrations remains promising, rising by 708,430 in H1 2017 according to the Ministry of Employment and Social Security. These indicators would suggest that the unemployment rate in Spain will continue to trend down towards 17.5% in 2017 and even reach 16% by 2018, according to Focus Economics.

The Stability Programme Update published in April detailed the Spanish government's budgetary projections for the coming years. The main aim of the fiscal strategy until 2020 is to restructure public finances, in order to gain a tight rein on public debt and gradually reduce it. Generating a surplus would reinforce the strength and credibility of the Spanish economy.

Take-up and Demand

Madrid's office market had a positive first half of the year, mainly thanks to the momentum seen in the second quarter.

Office take-up to June (sole-use offices and semi-industrial properties) stood at close to 290,000 sq m, up 11% y-o-y. The half-yearly take-up figure was the highest recorded since the market peaked in 2007 and 15% above the historic average. Almost 60% of take-up was registered between April and June.

Letting activity also recorded its best half-yearly figure since 2007, with almost 345 leases signed. Although this was only up 4% y-o-y, it is proof that the market has been continually expanding since 2013.

Deal Sizes

Despite the current trend to optimise workspaces and create multipurpose areas, companies are starting to let larger spaces, as demonstrated by the H1 2017 figure for the average space taken.

At just over 840 sq m, this equates to an 5% increase, and 23% in the q-o-q comparison (at close to 930 sq m).

A third of total lettings completed were signed with either newly created companies or companies that were upsizing, up from 26% in 2016.

It is also worth noting that these figures were achieved even though no very large lettings were signed (≥10,000 sq m).

The largest letting, in which just over 9,000 sq m were taken, was signed with a bank in Manoteras and this was, followed by the CTO centre of studies on Julián Camarillo.

Sector Activity

The Public Authorities have returned to Madrid's office market. Since 2012, public institutions had only accounted for an average of 3% of take-up, yet by June alone, they already represented 7%.

The leases signed in Q2 are also particularly noteworthy given that they all exceed 2,000 sq m: The Bank of Spain in the Julián Camarillo area; the Foreign Office next to the National Music Auditorium, and the Madrid Regional Government in what was the Unilever headquarters up until 2008.

Current and Future Vacancy

Available space at the end of June stood at almost 1.34 million sq m, taking the vacancy rate to 10.3%, a similar figure to the last quarter. Despite the amount of refurbished office stock coming back onto the market, most notably in the CBD, the overall vacancy rate remained stable. This is mainly due to the sharp increase in supply in AZCA, which practically doubled over the course of six months from 7.4% (end-2016) to almost 15% (June 2017).

Over the next 18 months, 210,000 sq m of new or refurbished space is expected to come onto the market.

After years of refurbishment projects dominating the pipeline, new developments are now starting to flourish, accounting for almost two thirds of future supply. Of this, 85% are located outside of the M-30, which will drive demand in out-of-town areas.

Rents

The recovery in rental levels is now well and truly underway.

Heightened activity in the occupier market was accompanied by significant growth in rental prices.

The average weighted closing rent for office buildings in H1 exceeded €16 per sq m/month for the second consecutive quarter, up almost 14% y-o-y. This growth affected both sole-use and high-tech office buildings.

The weighting of the prime rent category (≥€25 per sq m/month) almost doubled from 6% in 2016 to 13% in H1 2017. In fact, by June 2017 the market had already equalled 2016's total year-end figure, having registered 6 lettings ≥€30 per sq m/month.

In contrast, the number of lettings ≤€15 per sq m/month continues to decline, accounting for 66% of demand in 2016 and just 51% in H1 2017.

Signs that the market's closing rents are climbing has put upward pressure on achievable rents, which grew in both prime and secondary areas, within and outside of the M-30. Prime CBD rent grew 7.4% y-o-y to €29 per sq m/month, 31% below the last market peak.

Investment Market

The half-yearly results for the investment market also paint a positive picture. Almost €1,250 million was invested across Spain, up 46% y-o-y. By city, the volume invested in Madrid grew by 34% y-o-y, whilst in Barcelona it tripled. The acquisition of Isla Chamartín in Manoteras was one of the biggest deals closed in Madrid. Tristan Capital Partners acquired the four-building complex for €103 million, with the property also securing the largest letting of Q2 (9,000 sq m). This was one of the few transactions financed by foreign capital, against an investment backdrop dominated by domestic investors.

Socimis are the most active national players, accounting for just over half of the total volume invested in Madrid. These are followed by private investors who represent 25%.

If the various sources of investment in recent years are analysed, it is clear that the market has been undoubtedly buoyed by the financial strength of Socimis. During the post-crisis years, the average transaction size stood at €23 million, since 2014 it has jumped 35% to €31 million

Investment from cross-border players has grown at a slower rate of just over 25%, from €33 million between 2008 and 2013 to €41 million between 2014 and mid-2017.

The average price per sq m fell by 6% to July, affected by the large amount of supply outside the M-30. The price per sq m in out-of-town areas dropped by 21%, although the central core continues to grow (+11% y-o-y).

The total investment year-to-date stands at almost €900 million, almost 40% of 2016's total year-end figure. And the market could see a further circa €1,000 million invested before year-end, €300 million of which is already either in the due diligence phase or advanced negotiations and expected to be completed before the summer ends.

Although there is a continued lack of available product on the market product, the outlook for the second half of the year is positive.

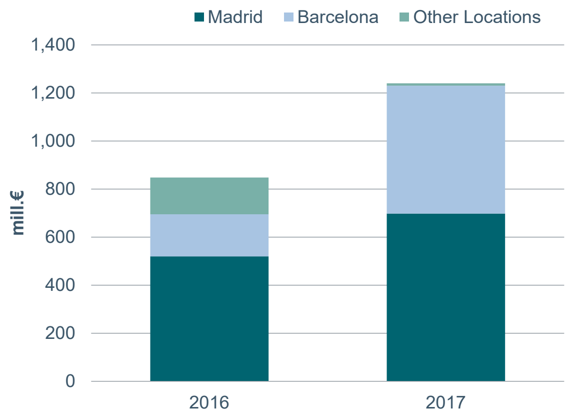
Bearing in mind that in recent years, the second half of the year has accounted for an average of 70% of the total yearly investment volume, 2017 could well reach a similar level to 2016.

Yields

The situation remains unchanged 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. Despite this, some transactions have been closed at levels below the achievable yields for each market given that forecasts are finally playing out and rents in most submarkets are starting to rise.

GRAPH 6

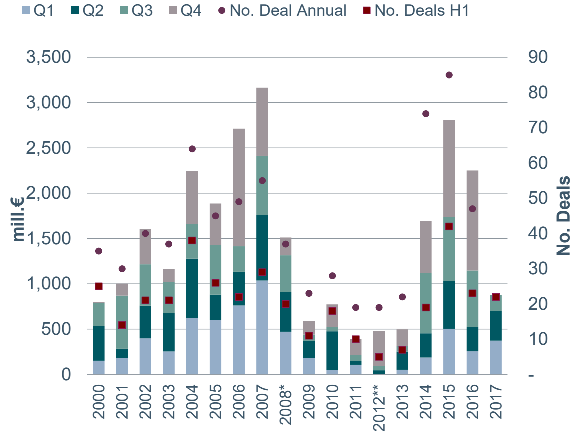
Investment Volume Transacted in H1



Source: Savills

GRAPH 7

Investment Activity



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

TABLE 1

Main Deals - Occupier Market Q2 2017

Tenant	Area	Floor Area (sq m)	Activity Sector
Confidential	North Zone	9,400	Bank-Finance
CTO Group	East Zone	7,000	Training
CAM	Urban Area	6,250	Public Administration
360 Experience	Urban Area	5,500	E-commerce
Baker&McKenzie	Urban Area	4,200	Professional Services
Regus	Urban Area	4,100	Professional Services

Source: Savills / *advised by Savills

TABLE 2

Main Deals - Investment Market Q2 2017

Asset	Area	Purchaser	Vendor
Avda. Manoteras, 20	North Zone	Tristan Capital	Lone Star
Manuel Cortina, 2	Urban Area	GMP	Mapfre
Campo de las Naciones*	Northeast Zone	Confidential	Confidential
Suero de Quiñones, 40	Urban Area	Private Investor	Hispania
Alcalá, 17	Urban Area	Private Investor	Private Investor

Source: Savills / *advised by Savills

OUTLOOK

2017

- The occupier market has started to pick up following the impetus of the investment segment.

- Although the trend towards space optimisation and creation of multipurpose areas continues, take-up grew on the back of increasing demand, thus proving that very large lettings (≥10,000 sq m) are not imperative to market growth.

- Closing rents rose once again. Growth is forecast across all areas for the next few years (4.4% average annual growth), although in certain out-of-town micro-markets the recovery is still getting off the ground.

- In recent years, the second half of the year has accounted for an average of 70% of the total yearly investment volume. If this proves to be the case once again, 2017 may register a similar figure to 2016. The continuing lack of available product on the market has spurred off-market activity and led investors to adopt more innovative investment strategies.

- The prime CBD achievable yield stands 75 basis points below the last market peak. The supply-demand imbalance spells further yield tightening, although at the moment, all signs suggest that value uplift will be achieved 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