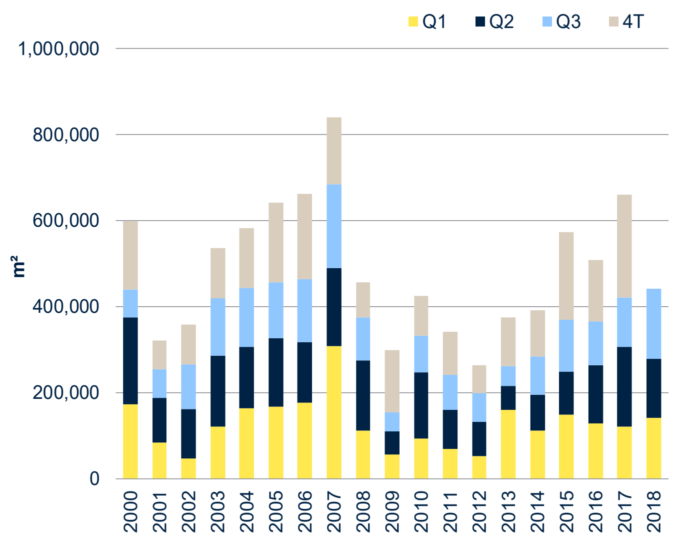
Market in Minutes
Madrid Offices

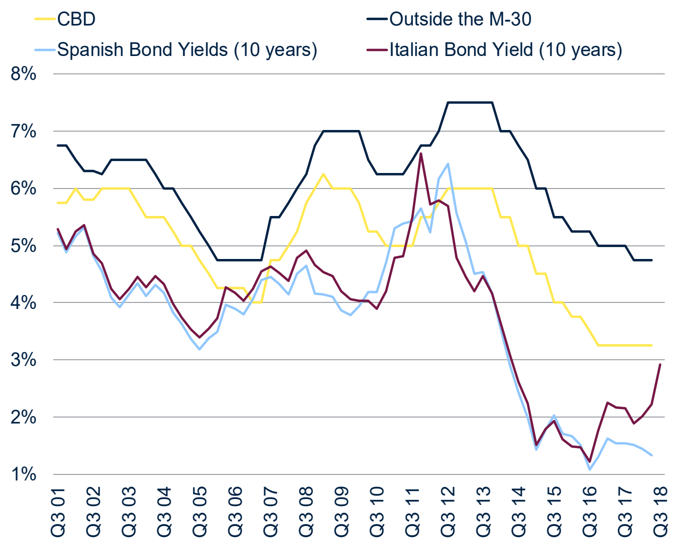
Q3 2018

GRAPH 1
Annual Gross Take-up



Source: Savills Aguirre Newman

GRAPH 2
Prime Yields vs Bond Yields



Source: Savills Aguirre Newman/ Eurostat

SUMMARY

Investment volumes recover, exceeding 2017 total as supply of product rises

■ Gross take-up volume in the third quarter (just over 160,000 sq m) brings the accumulated figure to 440,000 sq m, representing a 4% y-o-y increase.

■ The average deal size (950 sq m) grew by 12% compared to the first three quarters of 2017. The signing of Everis in Q1 (27,000 sq m in Manoteras) has had a discreet importance in the calculation. If we were to disregard it from the analysis, the average size taken would be 890 sq m.

■ The growth in the average size deal was due to the increase in transactions of ≥1,000 sq m. Primarily in the ranges between 5,000 and 10,000 sq m, which between January and September have already accumulated the same number of deals as those recorded in annual total for 2017.

■ The vacancy rate continues to trend downwards reaching 9.5% for the entire market. The prime areas, at 2.5%, have increasingly limited supply alternatives.

■ Over the next 15 months (Q4 + 2019), 280,000 sq m of spaces are expected to be incorporated, 35% of which are already committed and 65% of which will be delivered vacant.

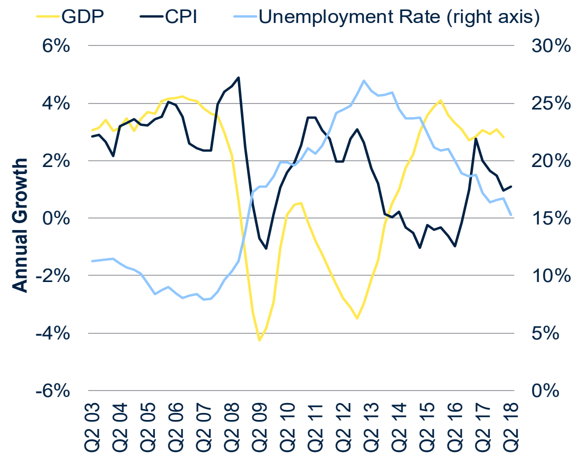
■ The average closing market values continue to trend upwards. The recorded rents in new and refurbished buildings have exceeded those in buildings showing signs of disrepair.

■ Two months before the closing of the year, the investment market already exceeds the volume transacted in 2017. Four megadeals (≥€100m) have accounted for 45% of the total registered up to October. Three of the megadeals took place during Q3.

■ The yields remain stable. Prime CBD stands at 3.25% and prime yield outside of the M-30 ring road at 4.75%, although the periphery could register adjustments.

GRAPH 3

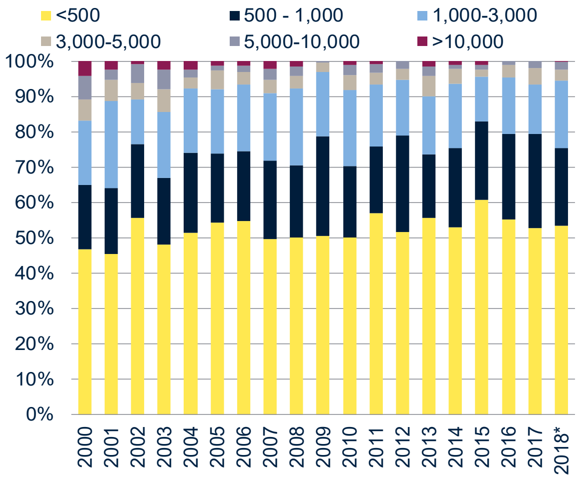
Main Economic Indicators



Source: INE

GRAPH 4

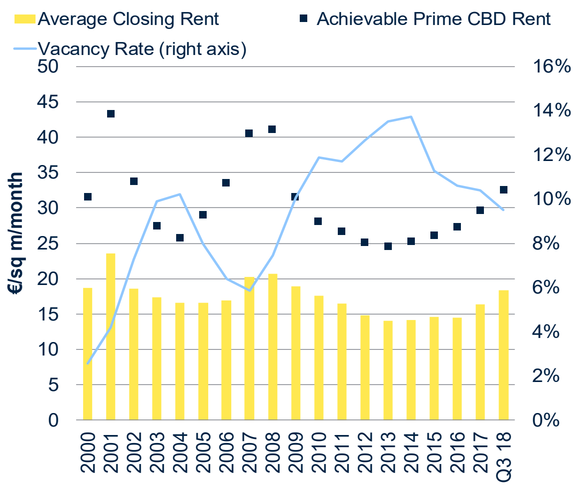
Transactions by Deal Size



Source: Savills Aguirre Newman / *up to Q3T

GRAPH 5

Rents and Vacancy Rate



Source: Savills Aguirre Newman / *Exclusive Office Buildings

Economic Overview

The Spanish economic growth is slowing down. The data forwarded for Q3 reflects a y-o-y variation of 2.5%, although the Focus Economics forecast for the end of 2018 remains at 2.7%. By 2022, the market will advance positively moderating its growth, which would register an annual average of 2%.

According to national accounting data, the number of full-time jobs (ETE) grew by 2.5% in Q2 as well. The favourable results are also reflected in the number of people registered with Social Security, which at the end of September almost reached 19m workers, representing a 3% y-o-y increase. In Q3 2018, based on the latest data published by the Spanish EPA, the unemployment rate stood at 14.55%, linking 22 consecutive quarters that have shown a decrease. The INE also indicates that the administrative office activities and other related services posted a growth of 71.6% y-o-y and appear among the top 56 sectors that create the most employment in Spain. The forecast of Focus Economics maintains that the unemployment rate will continue to trend downwards, with 2022 figures set to fall at 12%.

Meanwhile, the business confidence index shows a moderate growth of 0.4% due to the slowdown of the last two quarters of this year.

Take-up and Demand

The Madrid office market ended the third quarter with positive results. The discreet result of the previous quarter (with barely 140,000 sq m taken) would have been compensated with deals that delayed the closure in Q3. Take-up volume recorded between July and September slightly exceeded 160,000 sq m, representing a 40% y-o-y increase. The number of deals and average spaces taken up also increased.

In the accumulated computation, the market registered an increase of 4% in take-up (440,000 sq m), whilst the number of deals was reduced. The average deal size (950 sq m) grew by 12% compared to the first three quarters of 2017. The Everis megadeal in Q1 (27,000 sq m) has influenced the increase in size. However, if we were to disregard it from the analysis, the comparison would continue to be higher, even if growth is reduced to 6%.

Deal Size

The lack of megadeals in the market (only one has transpired in nine months) has not prevented the growth of the average deal size. This has been driven by the increase in deals of >1,000 sq m, which accounted for 24% in the accumulated 2018 figures compared to almost 21% in 2017. The ranges with the best performance were those from 1,000 to 3,000 sq m and those from 5,000 to 10,000 sq m. In fact, between January and September, the same number of deals between 5,000 and 10,000 sq m has already been recorded in the annual total of 2017, although with an average size higher (7,900 sq m in 2018, compared to 6,300 sq m in 2017).

Activity Sectors

The professional services sector continues to dominate the market, accounting for 36% of the take-up and 35% of the number of deals. Within this sector, coworking companies already accunt for more than 40,000 sq m in Madrid. The development activity of this model, which evolved from traditional business centres, started from just 1% in 2014 to 10% in the accumulated period for the first three quarters of the year.

The entry of new operators in 2015, the adaptation of the traditional business centre model to coworking companies (as Regus did with Spaces in 2016), the setting up of the headquarters of world leader We Work in 2017, as well as the support and commitment of several major landlords of the office market for this business (such as the participation of Colonial and Merlin in Utopicus and Loom House respectively) have been some of the factors that have influenced the growth of this activity.

On the demand side, the advantages of the model would be the flexibility in terms of continuity, the license to use workspaces in different centres by the same operator, and the design focused on collaborative work. Operators already present in the market have also an ambitious expansion plan, centered not only in Madrid and Barcelona as the main business areas in Spain, but also in secondary cities such as Valencia, Sevilla, Malaga and Alicante.

In Madrid, interest is currently focused on locations close to the main business hubs within the M-30, whilst the activity up to 2014 was distributed equally both inside and outside of the M-30 ring road.

Current and Future Supply

The just over 1.26m sq m available for immediate occupancy in the Madrid office market place the vacancy rate at 9.6%. Therefore, the market continues to gradually adjust the supply volume downwards.

The prime area (the core prime location of the CBD), with just over 2.5% vacancy rate, has increasingly limited supply alternatives. Several new and refurbished buildings, recently delivered or reincorporated into the CBD market, still have available spaces, placing the vacancy rate at 7.6% (the highest level of the three zones within the M-30). It is important to note that the demand clearly believes in this type of quality spaces, which register, not only an average deal size greater than that of outdated buildings, but also higher rental values.

Outside of the M-30 ring road, both inner and outer periphery exceed 10% of vacancy rate, although the analysis by submarkets shows some very similar characteristics to the Castellana prime hub.

Over the next 15 months, the entry of just over 280,000 sq m of new and refurbished sq m into the market is expected, 180,000 sq m of which (65% of the total) are still available. Inside the M-30, with 66,000 sq m, will account for 36% of the total speculative spaces, distributed between the urban area and CBD. In the periphery, the first section of the A2 stands out, with 31,000 sq m distributed over three projects and Vía de los Poblados, in the nearby area of Campo de las Naciones, with new 33,000 sq m in the Helios project.

Rents

The weighted average rent for the third quarter almost reached €17.50 per sq m/month, similar to the figure accumulated between January and September, which stood at €17.15 per sq m/month, representing a 3% y-o-y increase. So far, the ten largest deals (between 6,000 and 27,000 sq m) recorded an average rent of €13.20 per sq m/month, which has limited the increase in the weighted surface area. The five highest rents, all with ≥€34 per sq m/month, were completed in spaces measuring 350 sq m on average in prime and CBD areas, although there were also deals of >1,000 sq m with rents of >€30 per sq m/month, all of them in Azca.

With regards to achievable values of the quarter, prime CBD advances to €32.50 per sq m/month, growing by 8% compared to Q3 2017, and prime achievable values outside of the M-30 stand at €17 per sq m/month, 6 % more than the same period of last year.

Investment Market

The Spanish investment office market already exceeds €2,100m which is already over 90% of the annual total of 2017. The office segment represents only 32% of the total commercial market, way below the level of 42% in the historical series.

Madrid, with just over €1,400m , accounts for 70% of the national figures (aligned with the participation of the investment capital in the historical data). It is also important to note that the accumulated volume exceeded 21% of the average transactions during the first three quarters of the historical series.

The quarterly investment figures (close to €800m) have been boosted by three megadeals (≥€100m) that accumulated €511m. By volume, it is important to highlight the portfolio of eight buildings owned by Colonial (mostly coming from the portfolio of Axiare) which has changed hands to Tristan. The divestment asset strategy of Colonial has also affected Alcalá, 30-32, also acquired in Q3 by Real IS.

The other two deals of ≥€100m were completed involving Edificio Pórtico, in the nearby area of Campo de las Naciones, the first acquisition by Amundi in Spain and the headquarters of FCC in PAU de Las Tablas, the second transaction by Safra Sarasin in the market.

Although the distribution of the assets transacted between January and October regarding the M-30 has been compensated (19 buildings within and 19 outside), this distribution of investment volume shows a clear trend towards the periphery (with just over 80%) due to the importance of the largest transactions.

The international capital investment continues to gain ground in the Madrid office market, accounting for 77% of the total, once again due to the highest level of ticket transactions.

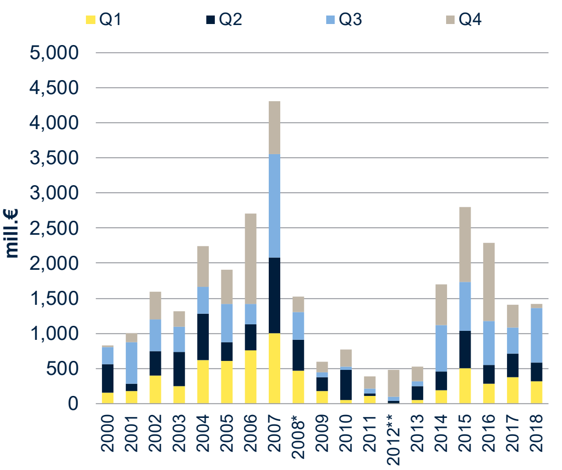
Yields

Yields remain stable compared to the previous quarters. Prime CBD continues at 3.25% and prime decentralised yield (outside of the M-30 ring road) at 4.75%.

In the absence of available products for sale in prime CBD, investors are already diverting their attention to strongly consolidated periphery submarkets with solid market fundamentals. Buying pressure could adjust yield levels in the periphery, in both prime and secondary products.

GRAPH 5

Madrid Office Investment Volume



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

TABLE 1

Main Deals - Investment Market Q3 2018

Asset	Market Zone	Purchaser	Vendor
Portfolio Colonial*	Several locations	Tristan	Colonial
Ed. Pórtico	Northeast	Amundi	Union Investment
FCC HQ	Northh	Safra Sarasin	Gorbea
Ed. Novus	Northh	Zambal	AXA Reim
B.P. Ávalon (5 bld.)*	East	Barings	Meridia
Alcalá, 30-32	Urban Area	Real IS	Colonial
Albarracín, 34	East	AXA Reim	Green Oak
Gran Vía, 43*	Urban Area	Henderson	Mutualidad de la Abogacía

Source: Savills Aguirre Newman / *advised by Savills Aguirre Newman

OUTLOOK

2018

■ The upbeat performance of the market during the third quarter of the year allows us to forecast a take-up volume of more than 600,000 sq m.

■ The supply coming from new developments and refurbishment projects will reduce the lack of quality products in the market. The demand will continue to strongly commit to buildings with amenities above the market average despite the fact that this implies higher rents.

■ Rents will continue to trend upwards driven by new and refurbished products that meet new quality standards of current demand.

■ The strong dynamic levels of demand and the increase of products for sale in open processes imply that the annual volume will close around the figures registered in 2016, exceeding the figures set in 2017 by more than 50% (€1,400m).

Savills Aguirre Newman Team

For further invormation please contact

Pablo Pavia
Investment Offices
+34 91 319 13 14
pablo.pavia@savills-aguirrenewman.es

Ana Zavala
Agency Offices
+34 91 319 13 14
ana.zavala@savills-aguirrenewman.es

Ángel Estebaranz
Agency Offices
+34 91 319 13 14
angel.estebaranz@savills-aguirrenewman.es

Gema de la Fuente
Research
+34 91 319 13 14
gema.fuente@savills-aguirrenewman.es

Pelayo Barroso
Research
+34 91 319 13 14
pelayo.barroso@savills-aguirrenewman.es

Isabel Gil
Research
+34 91 319 13 14
isabel.gil@savills-aguirrenewman.es