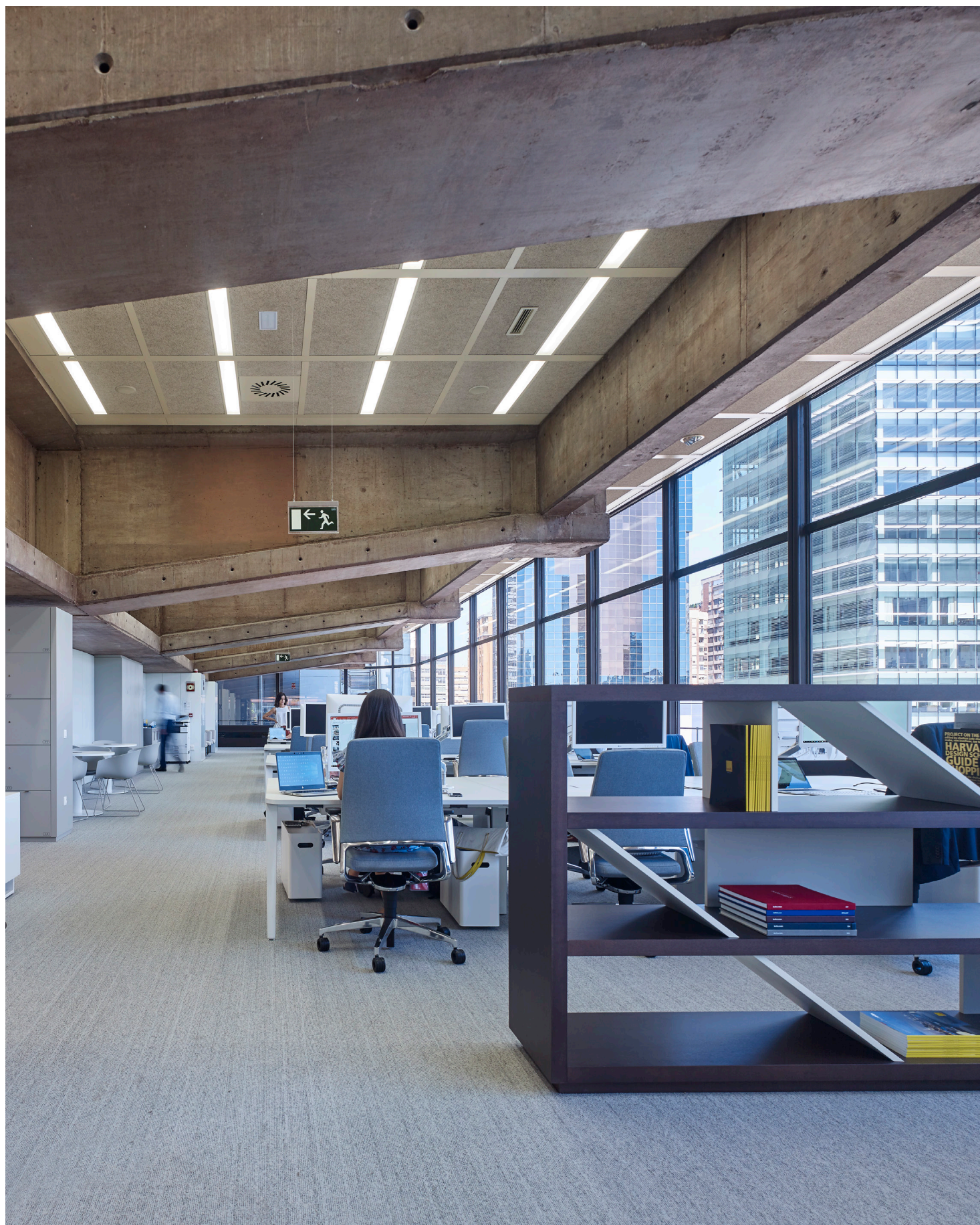


Madrid Offices



🗨️ The take-up volume in Q1 is cause for optimism. This is the highest figure in the last three years, a year-on-year increase of 66% and 46% compared to the Q1 average in the historical series 🗨️

Economic Overview

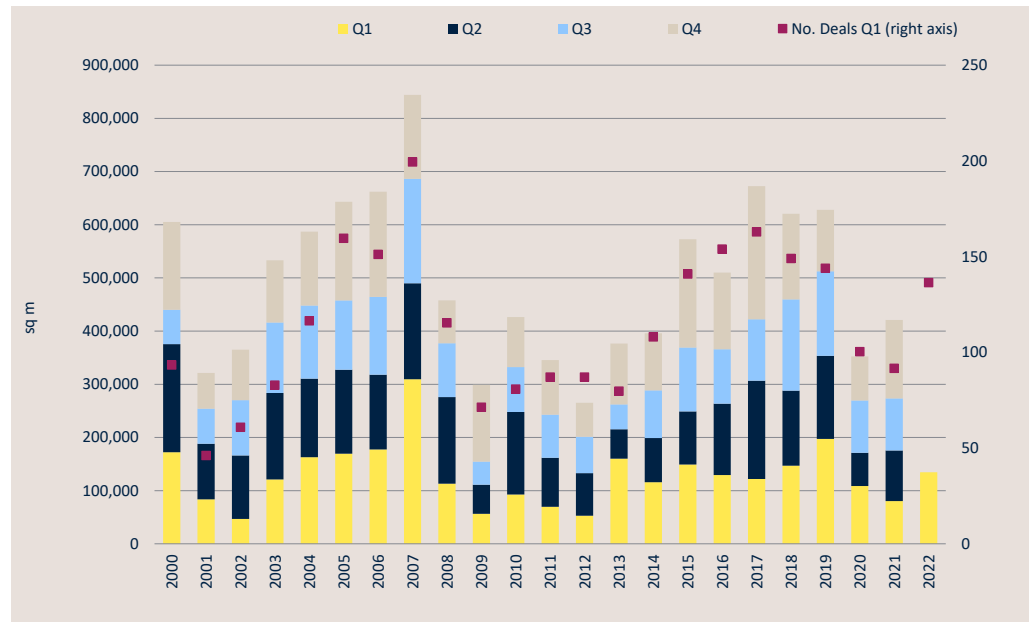
A new threat is looming over the global economy. The conflict between Russia and Ukraine has led to an increase in uncertainty that could affect global economic growth, which could stagnate in the first half of the year. That is to say, the evolution of GDP would slow down before reaching recovery after two years of the pandemic.

Although the exposure to the Spanish economy is very limited due to minimal trade relations with the countries involved in the conflict, an immediate impact will come with the rise in the CPI. After several months of escalation, there has been an increase in the price of electricity, petrol and household consumption, and this could even reach double digits. This will in turn affect private consumption, the capacity for business investment and the growth of the labour market.

Projections for the main economic indicators have already been revised downwards by various national and international institutions, and these will vary as the conflict intensifies or the scenario changes.

Meanwhile, the labour market continues to move in a positive direction. According to the latest data published by the State Public Employment Service (SEPE), the number of unemployed fell by almost 3% in April compared with March.

Annual Take-up



Source Savills Research

Madrid Offices

Take-up and Demand

The Madrid office market recorded its best first quarter since 2020 in Q1 2022. The close to 135,000 sq m represented a growth of 66% compared to the same period of last year (which was affected by the third wave of COVID and storm Filomena), and 24% compared to Q1 2020 (which was already impacted by the health crisis, albeit to a lesser extent). Compared to the previous quarter (Q4 2021), there was only a 7% contraction, which sends an encouraging message to the market, taking into account that the second and fourth quarters usually record the best figures.

It should also be noted that no megadeals ($\geq 10,000$ sq m) were signed in Q1, which reinforces the idea of a healthy and balanced market growth.

In terms of deals, the 137 signed represent the best figure since mid-2019, a clear reflection of the market's gradual gain in momentum. The summer of 2020 marked a general return to the office and since then each quarter has exceeded 100 deals.

Deal Size

The average deal size was 990 sq m, slightly lower than the annual total for 2021 and Q1 2021 (-3% and -11%, respectively), and the average for the last five years and 10 years, both annual and Q1.

By surface area range, the 250-500 sq m segment continues to account for a large part of market

activity (30%) and is two percentage points above the historical average. The ranges of 1,000-3,000 sq m (22% of the total) and 3,000-5,000 sq m (5%) were also higher compared to historical data, in this case by 4 and 1.5 percentage points respectively.

Among the smaller deals (<250 sq m), it has been identified that the range of <200 sq m has fallen in presence, while the range of 200- 250 sq m has gained significant presence (15% of the total, compared to 8% in the historical series).

This can be attributed to occupiers of smaller spaces turning to flexible office operators, who are absorbing a large part of this demand. Meanwhile, some flexible space customers have grown significantly (both in terms of business volume and resources) and have a more obvious medium and long-term viability (>20 spaces). These companies are abandoning shared spaces to establish themselves in a traditional office.

Activity by Market Zone

The interior of the M-30 continues to gain presence, as companies are clearly prioritising central locations in their search for new offices. Regarding the number of transactions, 58.5% were signed in buildings within the central hub, the fifth best quarterly record in the historical series (which has an average of 47%). In terms of take-up volume, quarterly take-up was distributed evenly,

“ The level of availability continues to slowly decrease, favoured by the positive performance of demand as well as the slowdown in the entry of new and refurbished space into the market ”

at around 50% inside and outside the ring road, whereas typically the take-up volume in the periphery has more weight than that of the urban environment, averaging 60%-40% respectively.

The boost in take-up within the M-30 has been driven by the increase in large transactions (>1,000 sq m) in the city. Between January and March, 56% of large transactions were recorded within the M-30, compared with only 40% in the historical series.

Large spaces in quality buildings (new or refurbished) are rarely available, and demand quickly takes them off the market, provided that they also meet the criteria of location and transport links at an adequate price.

The largest transaction in the quarter (8,400 sq m) was recorded in MadBit, which was also the submarket with the highest take-up figure, accounting for 21% of the total. MadBit also accounted for four of the 10 largest transactions (≥3,000 sq m). Within the M-30, the most active submarket was AZCA, with 12,000 sq m, making up 9% of the total.

The active transformation of both areas, which are already home to large corporations, is capturing the interest of a large part of the demand.

Flexible Offices

Flex operators continue to expand their network of centres in the capital. In Q1, five deals were recorded, accounting for 8.5% of the total take-up, returning close to the level of 2019, when flex spaces made up 8.7%.

For the first time, three of the new flexible spaces are located outside the M-30, albeit in well-established submarkets, such as MadBit, around Diversia (A1) and Paus (inner northern periphery).

Among the operators with new openings, IWG, the world's largest provider of flexible and office space, will launch new centres with two of its three brands operating in Spain (Regus, Spaces) as well as the first Signature centre. The latter is its most exclusive brand, which will open its doors in the heart of the Salamanca neighbourhood, in a recently refurbished building on the corner of Velazquez and Goya.

The coexistence of flexible spaces and

traditional office spaces is possible. In fact, buildings with both options are able to achieve a level of synergy, because tenants with a specific need for extra space linked to a project can find a quick solution. In other words, they have access to additional rooms or collaborative spaces, etc. without being tied in for a long period of time.

Flex operators integrated in large real estate companies are also likely to find potential clients for traditional spaces when an occupier has acquired sufficient size and decides to opt for a traditional office.

Current Supply

The downward trend in the vacancy rate that began after the summer of 2021 has continued, standing at 9.23% at the end of Q1. This is a drop of just half a percentage point compared to the first half of 2020, but already reflects the recovery of demand, which has somewhat returned to normal after two years of the pandemic.

The positive performance of take-up within the M-30 has been accompanied by a reduction in supply within the central hub, which stood at 5.68%. Meanwhile in the periphery, the vacancy rate increased slightly to 11.48%.

The availability level has also been maintained because evictions that were planned a few months ago have ultimately not taken place. This confirms that, with the return to the office, some companies are in need of more space than planned at the beginning of the pandemic.

The incorporation of only one new building into the market has also tempered the evolution of supply, although the return of demand will cushion the potential growth of new supply over the coming months.

Future Supply

By the end of 2023, almost 520,000 sq m of new developments (41%, 15 buildings) and comprehensive refurbishment projects (59%, 29 buildings) are expected to enter the market. The prominence of office refurbishment projects is directly related to ESG policies, as refurbishment works reduce the negative impact on the environment compared to the construction of a new building. This brings the asset up to current quality and safety standards, improving energy efficiency, accessibility, health, acoustic insulation, etc.

It should be noted that the disruption in the supply chain of materials that started at the onset of the health crisis has been exacerbated by the transporters' strike and the war in Ukraine. This has led to further price increases and affected construction schedules, which could result in possible delays in project delivery.

So far, just over 26% of the total planned area is already committed, although it is worth highlighting that a large part of the occupancy corresponds to owners, including Acciona in the northern part of the inner periphery and Catalana Occidente in Mendez Alvaro.

The submarkets that will incorporate more supply (available space) are now headed by Azca, accounting for 11% of the total (45,300 sq m) distributed across just two projects, followed by MadBit, which has dropped to second place after the delivery of Om Infinito (36,500 sq m). Madrid's technology district will take up 43,300 sq m over the coming months, spread across six buildings.

Rents

The average closing rent for the Madrid market in Q1 2022 (calculated using all data collected from transactions in business buildings) continues to climb. At the end of Q1 it was already above €19.50

Main Deals - Occupier Market Q1 2022

Tenant	Market Zone	Floor Area (sq m)	Activity Sector
Servinform	East	8,400	IT
Digi Móvil	A1	6,600	IT
Hypatia Formación	East	6,000	Education
Ontier *	Urbana Area	4,350	Business Services
Celonis *	CBD	4,200	IT

Source Savills Research / *deal advised by Savills

☞ Prime CBD rents and those in the best buildings in well-established submarkets are starting to rise slightly. This product always meets the highest quality standards, complies with ESG policies, and has some form of sustainability certification ☞☞

per sq m/month, a quarter over quarter increase of 3% and a year over year increase of 13%.

The intense activity within the M-30 and the clear preference of demand for quality buildings (which reach the highest values in the market) are the main drivers of this growth.

It should also be noted that increasingly more deals are being recorded at higher rental levels. For example, between January and March, nine deals of $\geq$ €35 per sq m/month were registered, while 13 were identified during the whole of 2021.

By zone, we can note general stability, with upturns in the best buildings in the top submarkets that meet ESG criteria with good transport links. Meanwhile, at the other extreme, there are outdated buildings in environments with very weak market fundamentals, where rent adjustments and increased incentives will continue as a stimulus to attract demand.

In terms of achievable values, only Prime CBD increased by 1% to €34.50 per sq m/month. Prime rent outside the M-30 continues to sit around €18 per sq m/month. Secondary rent within the M-30 remained at €24 per sq m/month and secondary outside the M-30 at €11 per sq m/month.

Investment

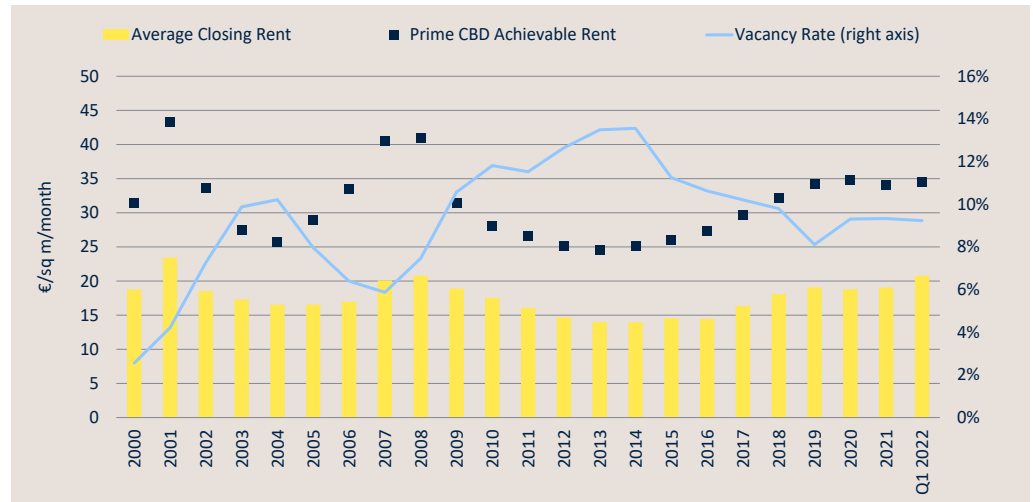
The return to the office has been one of the factors driving investment activity in the office sector. During the first quarter of the year, the market registered €563m. Although this barely represents 15% of the total commercial sector, it is almost double the €287.5m recorded in Q1 2021.

The star segments between January and March were multifamily, with just over €1,000m and 29% of the investment market, and hotels with close to €900m, which represented 25% of the total.

The Madrid office market, with close to €430m, is once again leading investment activity at national level, although the shortage of product continues to be the market's limiting factor. In recent weeks, several orderly sales processes have been launched, but among the transactions registered so far, most have been closed off-market.

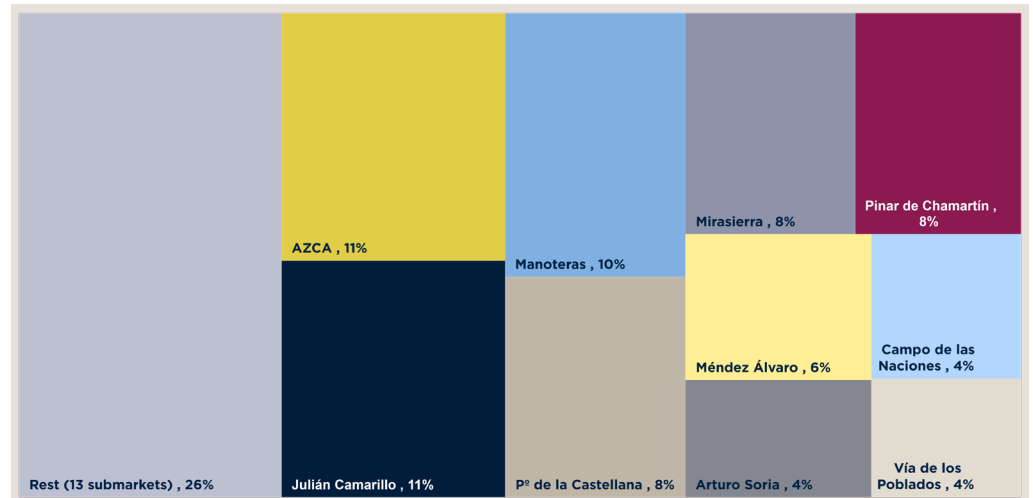
The average price of assets transacted has grown steadily since Q2 2021, now close to

Vacancy Rate and Rents



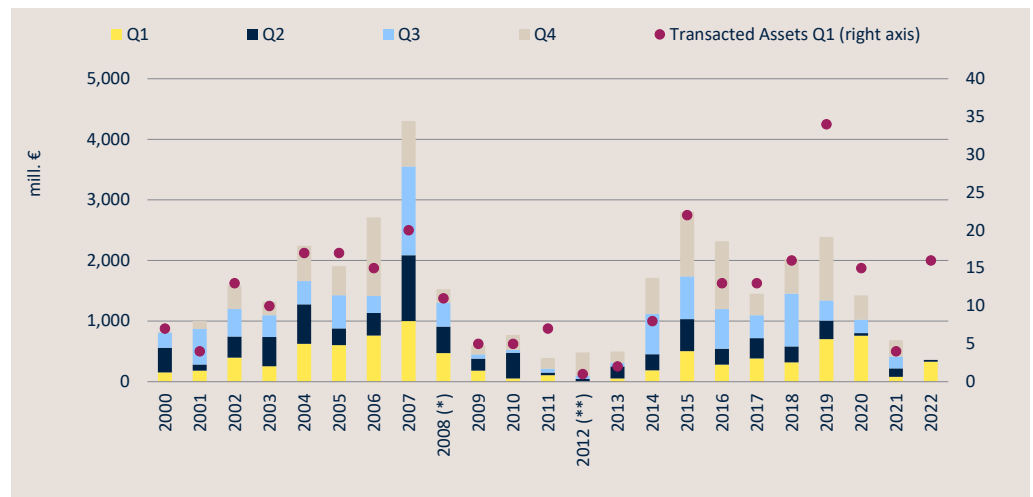
Source Savills Research

Available Future Supply by Submarket (2022*-2023*)



Source Savills Research / *forecasts

Investment Activity in Madrid



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

“ The entry of open sales processes has been a driving factor for activity in the investment market. Meanwhile, off-market activity continues, but at lower levels than in 2021 (40% of the expected pipeline, compared to 61% of the total in 2021) ”

€26m, which is within the range of volumes in which domestic investors typically move.

In fact, contrary to the overall trend in the commercial investment market, where 74% of the quarterly figure corresponds to international capital, in the office segment it is domestic players who head the ranking of nationalities, with 59% of the total.

Among international investors, the return of Deka stands out. After nine years without any buying activity in the office market, they acquired Ancora 40 in the vicinity of Atocha station.

The largest transaction (€80m) was led by two national companies on both the buying and selling sides. GMP continues to divest as part of its portfolio rotation plan, while InmoCaixa has acquired Condesa de Venadito 1, a 20,000 sq m building located on the first stretch of the A2 axis.

In terms of areas, the interior of the M-30 continues to attract investors' interest. The lack of product in the vicinity of the Castellana is shifting the search towards other consolidated areas of the city, with a particular focus on the area around Mendez Alvaro, although opportunities can arise in almost any location.

RevCap is the new owner of a complex of several active buildings on the outskirts of Plaza de Toros de las Ventas, which until now housed the corporate headquarters of MMT (Mutua Madrileña del Taxi) and its workshops. The complex will undergo a thorough refurbishment project which, according to industry sources, has already been committed to an occupier.

Outside the M-30, MadBit remains on the radar of investors who are seeking value added product to reposition, as has been the case with Meridia's purchase of an empty building with the aim of upgrading it into a modern office building. This is already Meridia's fourth active asset in the area.

Also worthy of special mention is the acquisition of office buildings in various submarkets, both inside and outside the M-30, which will be taken out of stock through change of use. Many of them are focused on residential use and its variants.

Yields

For prime areas, achievable yields remain stable at the lowest levels in the historical

series, both CBD and outside the M-30. After the 15 bps decline in mid-2021, they stood at 3.10% and 4.60% respectively.

In any case, buying pressure and product shortages could force some compression in grade A product

in prime locations, with good covenants and long-term contracts at market rents.

Main Deals - Investment Market - Q1 2022

Asset	Market Zone	Purchaser	Vendor
Condesa de Venadito, 1	East	InmoCaixa	GMP
Áncora, 40	Urban Area	UK & European	Deka
Goya, 36	Urban Area	Yukon Capital	Excem + Merlin
Marqués de Mondéjar, 27	Urban Area	RevCap	MMT
Francisca Delgado, 9	A1	Inovalis Real Estate	Merlin Properties Socimi

Source Savills Research

Outlook

- The strong performance of Q1, both in terms of take-up and number of deals, gives us an optimistic outlook for the annual total for 2022. According to internal estimates, based on active demand, gross take-up could exceed the historical average of 500,000 sq m.
- Hybrid working and flexibility will consolidate as a megatrend, but the easing of COVID restrictions has accelerated the return of face-to-face working, which is also necessary to foster teamwork and a sense of belonging within the group.
- After two years of subdued activity in the occupier market, there is interest from demand to move to a new workplace in this post-COVID era, which will drive some of the market activity.
- Occupiers with strong ESG convictions will look for assets that share their commitment to social and environmental issues, focusing their search primarily on buildings that meet the highest quality standards and have a sustainability certificate.
- There is renewed demand and a moderation in the entry of new supply, which will cushion the potential increase in the vacancy rate. Meanwhile, we will see an increasing number of outdated office buildings that, due to their location or condition, will change their uses, contributing to the resizing of certain submarkets.
- The rotation of assets will favour the market entry of several orderly processes in consolidated secondary locations, boosting investment activity in the submarkets with the strongest fundamentals (low vacancy rate, steady demand and expected rental growth).
- While yields are expected to remain stable in more decentralised areas, core capital will target more stabilised and higher quality assets, which could lead to some yield compression in these locations.



Savills Research

We carry out a thorough and objective analysis of the real estate market in order to provide our clients with accurate information on the current situation in each of the sectors, helping them make the right decisions at each moment.

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