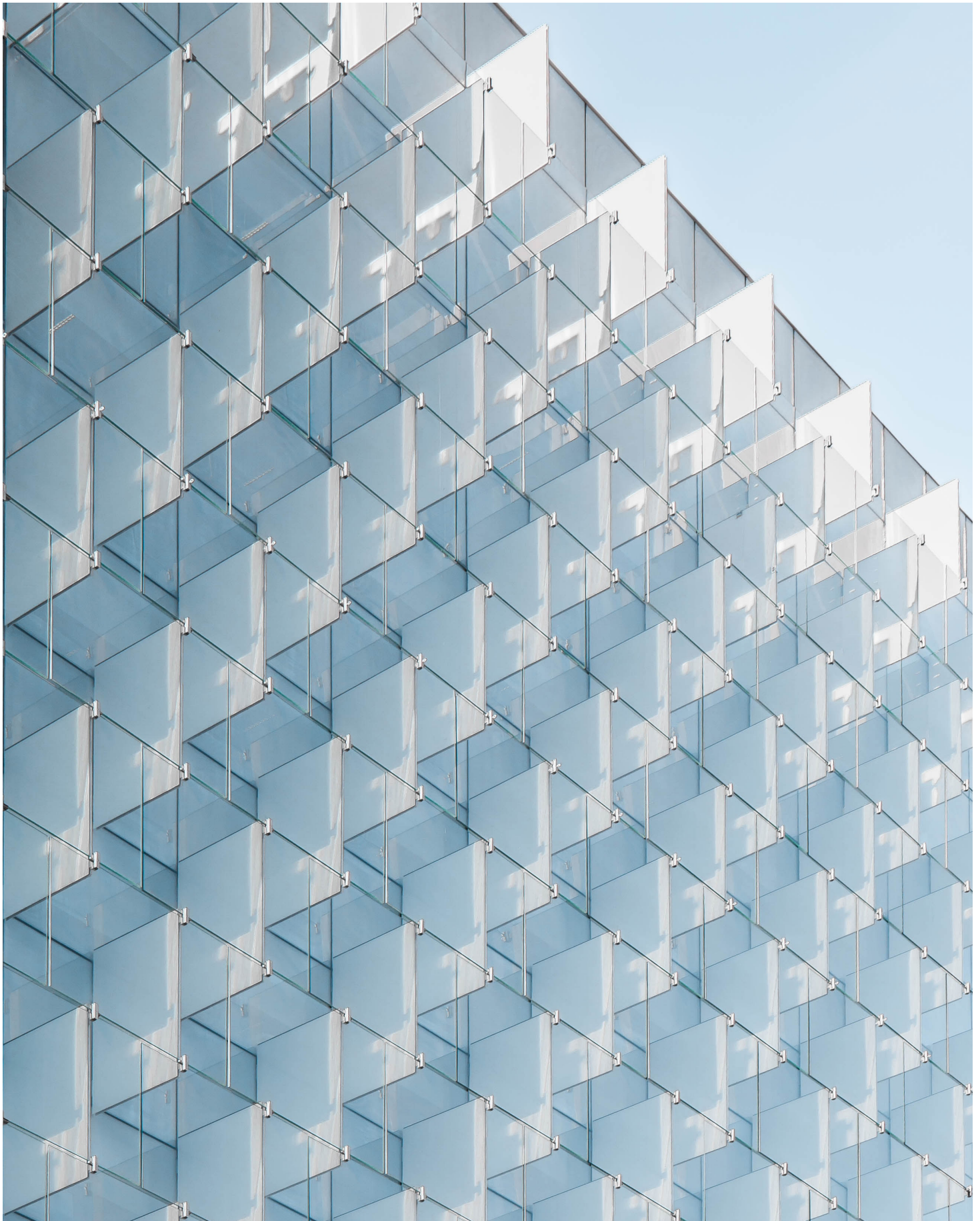


Madrid Offices



👉 The 410,000 sq m registered between January and September shows a year-on-year growth of 50%, an increase of 6% over the average of the last five years and already represents 98% of the annual total for 2021 🏆

Economic Overview

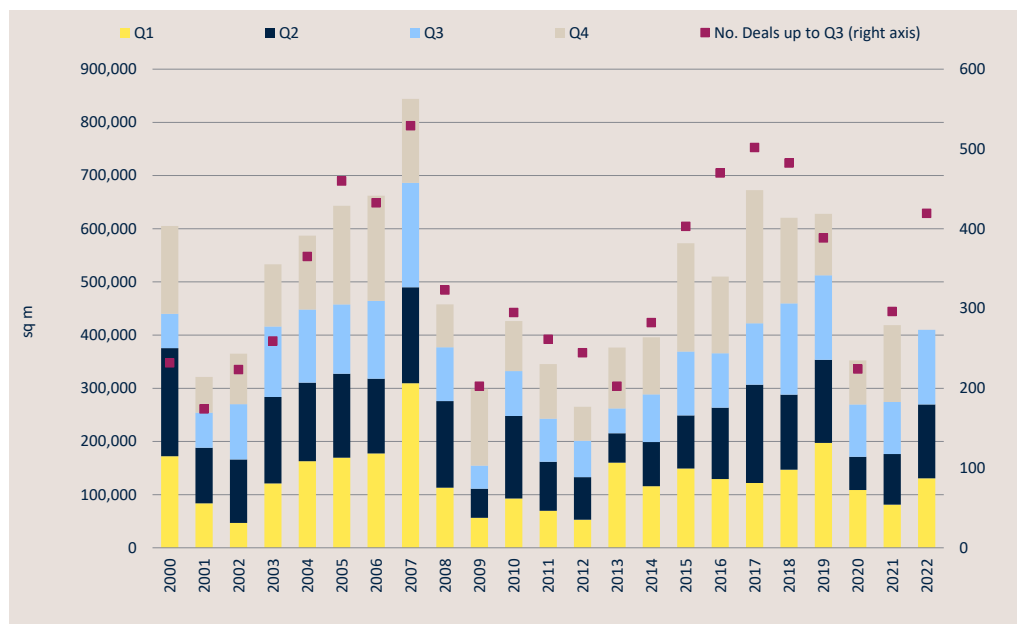
Following the ECB's 50 basis point (bps) rate hike in July, the regulator implemented a further increase of 75 bps in September. Furthermore, they warned that the rate hike policy will continue in the coming months, in order to control the unstoppable rise in prices in the eurozone as well as reinforce the euro, which has been severely weakened in the midst of the energy crisis, falling to parity with the dollar.

As a knock-on effect, the backdrop of rising interest rates could lead to a weakening of the economy and slow down the pace of GDP growth. According to Focus Economics' October 2022 forecasts, the year will close at around 4.3%, a few tenths of a percentage point above the projections published in previous months. However, it has significantly reduced the projected level for 2023, which is now set to stand at 1.4%.

For its part, the labour market continues to show positive figures. Despite its seasonal nature, a total of 20.03 million people were registered with Social Security at the end of September, a slight increase over the previous month (almost 1%) and the best September figure in the historical series.

The Focus Economics unemployment rate forecast shows a decline of almost two percentage points from the annual total in 2021, to 13.1%. After a year of stability, a period of steady downward adjustments is projected to begin from 2024 onwards.

Annual Gross Take-up



Source Savills Research

Madrid Offices

Take-up and Demand

Madrid's office market continues to perform well. The cumulative take-up volume up to September stood at 410,600 sq m, which is 50% higher than the figure for the same period last year, already representing 98% of the annual total for 2021.

All signs indicate that the 500,000 sq m barrier –which is the average annual take-up volume in the historical series– will be reached (and even exceeded), a reflection of the optimum health of the market.

Regarding the number of deals, 420 have been identified, 42% higher than the figure for the first three quarters of 2021 (296) and already 10 more than the annual total (410) for that year.

The quarterly analysis of take-up volume (141,000 sq m) also shows a year-on-year increase of 44%. It should be taken into account that in Q3 two megadeals ($\geq 10,000$ sq m) were closed, which amounted to nearly 30,000 sq m. Even discounting these outliers (transactions of $\geq 10,000$ sq m represent only 1% in the historical series), the market grew by 15% and also increased in number of deals (136 up from 109 in Q3 2021), a clear signal of the increased activity in the occupier market.

Deal Size

The average deal size stands at around 900 sq m, which is broadly in line with the figure for Q3 of the

previous year (slightly higher including megadeals (+6%), and slightly below excluding them (-1%)).

The performance of the various surface area ranges has remained very stable, varying upwards/downwards by maximum three percentage points.

The most significant increase in presence is the range of 1,000-3,000 sq m, which has risen to 21% in 2022 (compared to 18% in the historical series). It should also be noted that between January and September, 28 transactions of $>3,000$ sq m were registered, three more than the annual total for the same range in 2021.

Regarding the surface area that lost the most market share, spaces of <250 sq m accounted for 22% of the market between January and September, three points below the average in the historical series.

The breakdown of transactions of <250 sq m shows a decline in all ranges except the largest (200-250 sq m). Smaller companies find it easier to meet their needs in flex office space than in the conventional office market, providing strong competition for older buildings, where smaller office space is generally found. In fact, for buildings where deals of <200 sq m have taken place, the average age is 30 years old. Nevertheless, 46% of these properties were built after 2000, a figure which has increased steadily in recent years. This indicates that,

“ The vacancy rate continues to fall within the M-30, as well as in the submarkets of the inner periphery closer to the ring road that are easily accessible by public transport and with a quality offering ”

assuming that more modern buildings have better features, occupiers strongly value building quality within a limited budget.

Quality of Buildings

In terms of take-up volume, Grade A-quality buildings continue to lead the way, with 49% of the total. This tends to be the choice of large companies, as the average deal size (around 1,300 sq m) is 42% above the market average, almost double that of Grade B buildings (780 sq m) and three times that of Grade C buildings (500 sq m).

With regards to rental levels, both Grade A and B assets grew in double digits compared to the previous year (between 10% and 12%), while the most outdated buildings (Grade C) recorded a decline of 3%.

Activity by Market Zone

The interior of the M-30 accounted for 53% of deals and 51% of take-up volume. This was driven by the signing of the two largest transactions in the quarter (and of the year up to Q3), registered in two submarkets in the urban area.

Urban location is becoming a necessary requirement for part of the demand, which considers it an essential component for attracting and retaining talent, as it favours a harmonious professional and personal life.

Despite the scarcity of large spaces within the M-30 ring road, large corporations are moving closer to the centre. The distribution of transactions of >1,000 sq m was even at 50%, while >3,000 sq m and >5,000 sq m reached 47% and 40%, respectively.

Flexible Offices

Flex operators continue to gain a foothold in Madrid's office market, albeit at a slower pace than in the years before the pandemic. In the year up to September, around 18,000 sq m of space was signed by flex operators. This represents just over 4% of the total, a similar presence to 2021, but there is still some way to go to reach the figures of 2018 (11%) and 2019 (9%).

Occupiers of conventional offices in business buildings have already seen the added value of having flex space within the same building, which is encouraging many owners to incorporate this option, either through an operator or by managing the service directly.

In the total office market, flex space represents only 1.5% of the stock (14 million sq m). Although the interior of the M-30 accounts for 40% of the total office stock, it accounts for 80% of flex space, placing the percentage of flex vs. total office stock at 3%. Analysis by submarkets shows the highest concentration of flex space in the vicinity of Plaza de Cuzco (around 8%) and in Azca (7%).

All signs indicate that the percentage share will grow progressively in the coming years, although the growing interest in this type of space has led to the model being adopted in other real estate sectors, including retail, hotels and residential (increasingly present in new developments, whether for purchase and sale or the rental market).

Current Supply

The vacancy rate at the end of the summer remained at similar levels to Q2, driven by the positive performance of demand along with the gradual delivery of projects. As of 1 October, the Madrid market had close to 1.32 million sq m of space available for immediate occupancy, bringing the vacancy rate to 9.38% (compared to 9.43% in Q2 2022).

In contrast to the first half of the year, and the estimate for the last quarter of the year, between July and September only around 25,000 sq m of office space was added to the stock, spread across four refurbishment projects. The interest in quality spaces within the M-30 has meant that two of them are no longer available (pre-let of Habana Building and the signing of Miguel Ángel 23 in Q3), leaving 12,400 sq m available, just under 50% of what was delivered during Q3.

The Outer Periphery has continued to trend upwards in terms of vacant space, now sitting close to 14% availability. Submarkets such as Las Rozas and El Plantío-La Florida, which had healthy

supply figures until the coronavirus crisis, are struggling to adapt to the new requirements of potential tenants (sustainability, quality, central location, public transport, etc.).

On the other hand, the vacancy rate is continuing to fall both in the markets within and closest to the ring road. In the Prime area, the vacancy rate has dropped again for the third consecutive quarter and now stands at 6.36%. The CBD and Urban Area are close to 5% vacancy, the lowest level since 2019.

A further decline is noted in the Inner Periphery, with its percentage of availability on the verge of falling below double figures: 10.09%. Once again, MadBit tops the ranking of the best performing submarkets near the M-30, and its supply stands at 7.2%.

Future Supply

If the estimated deadlines are met, during Q4 almost 146,000 sq m of space will be added to the Madrid stock, both new and refurbished, the highest figure in 2022. In fact, this would surpass the volume delivered up to October (124,000 sq m). Among the projects that will be completed, the new Acciona headquarters in Arturo Soria is the largest new development of the year, with 39,000 sq m (even more than OM Infinito), accounting for 27% of the volume in Q4. With three new buildings, MadBit comprised 26% of the new supply, including another headquarters (belonging to L'Oreal).

Just over 284,000 sq m is expected to enter the market next year, of which only 12.4% will be occupied. For the first time since the development of the four towers, the largest project is located in the CBD. The Ruiz Picasso Building (Azca) will bring 37,000 sq m to the market by the end of 2023. This is followed by the refurbishment of Torres Ágora - One Ágora (30,000 sq m) and the

Main Deals - Occupier Market Q3 2022

Tenant	Market Zone	Floor Area (sq m)	Activity Sector
Confidential	Méndez Álvaro	14,100	Technology
Confidential *	Chamberí	14,000	Education
McKinsey *	Almagro	7,500	Business Services
Worldline *	MadBit	4,600	Technology
Confidential	Tres Cantos	4,300	Media

Source Savills Research / *advised by Savills

☞ Demand preference for central location and building quality is driving rents in the city centre, while submarkets further out with weak fundamentals continue to record declines ☞

new development of the Sky Light Madrid Building in Pinar de Chamartín and Manoteras respectively, two submarkets with no development activity in 2022.

In terms of distribution by area, of the 12 projects planned between October and December, five refurbishments are located within the M-30, accounting for 38,200 sq m and 26% of the total new supply. Outside the central hub, the remaining seven developments are located in the submarkets closest to the M-30, with MadBit's developments in the eastern part of the city standing out. For the time being, no new and/or refurbished space will be incorporated in the Outer Periphery.

During 2023, the main opportunity to develop new buildings within the ring road will be concentrated in Méndez Álvaro. Torre Catalana Occidente will have more than 20,000 sq m of space, to be delivered in the first half of next year, along with InmoCaixa's Ed. Visionary (8,000 sq m). After a year without activity, development works will return to the prime area, and in the second half of 2023 the refurbishment works of Castellana 14 and Castellana 19, undertaken by Consorcio de Compensación de Seguros, will be completed. The inner periphery will continue to be home to the majority of works outside the M-30, and there will be movement on the A6, with the refurbishment of two of the five buildings at Cerro de los Gamos 5 in Pozuelo.

Rents

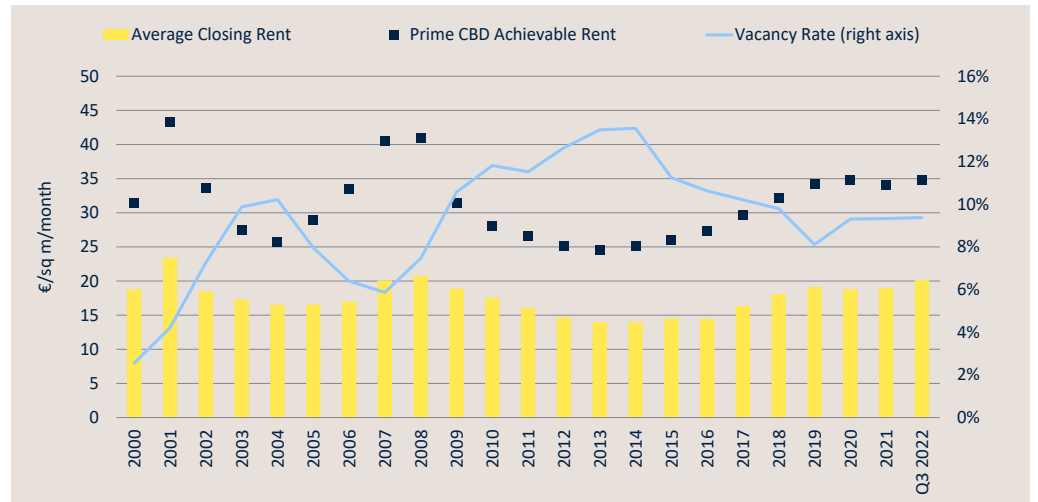
The average closing value of transactions registered in Q3 was close to €19.90 per sq m/month, due to the interest from demand inside the M-30 alongside the growing activity in Grade A buildings.

The cumulative figure up to September stood at €19.15 per sq m/month, representing an increase of 6% up from 2021.

It should be noted, however, that the market is moving at two speeds. While the interior of the M-30 is performing positively, the periphery continues to adjust downwards. Factors such as the fundamentals of the submarket, the location of the asset and the quality of the property, among others, contribute to the evolution of rents.

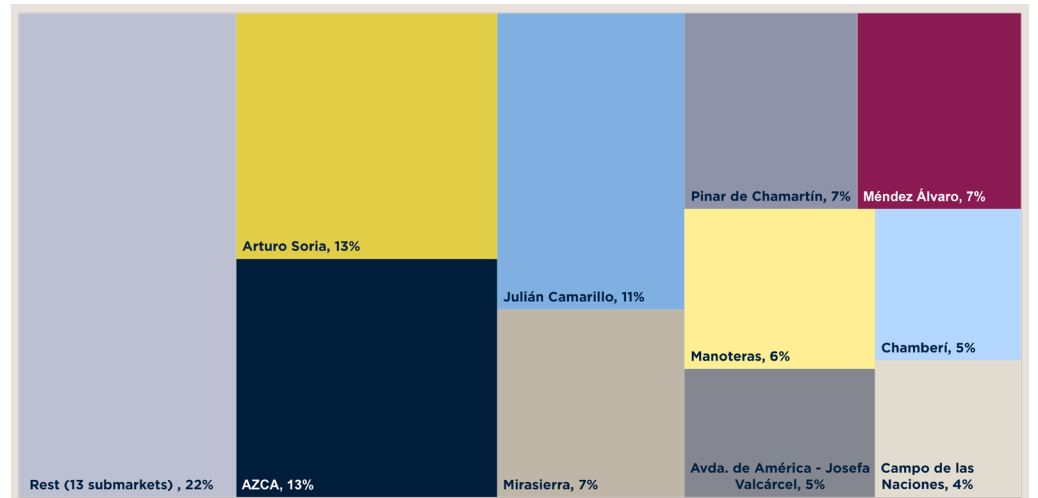
The achievable values are reflecting the market situation. Prime CBD increased slightly to €35 per sq m/month, although the highest value of the quarter reached €43 per sq m/month, for a small office in a building

Vacancy Rate and Rents



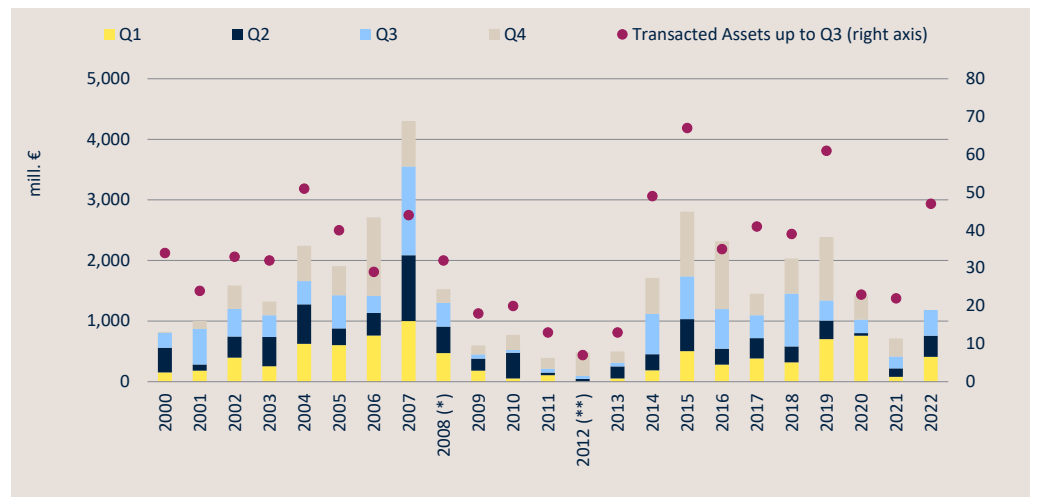
Source Savills Research

Future Supply by Market Submarket (Q42022*-2023*)



Source Savills Research / *forecasts

Investment activity in Madrid



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

“ Location and quality are the main requirements of buyers. ESG aspects also enter more frequently into the equation, increasing the liquidity of the building ”

in the Castellana axis. The other areas (secondary within the M-30, prime outside the M-30 and secondary outside the M-30) remained stable.

Investment

The investment market is once again facing a time of uncertainty. Beyond the ravages of the health crisis, the delicate geopolitical situation has triggered turbulent events in the economy, leading to an unusual increase in CPI.

The rise in interest rates initiated by the ECB in July will slow down the economy in the coming months through the containment of consumption. However, it will also push up the price of money, leading to a slowdown in the closing of transactions and a decline in the price of certain assets.

Contrary to expectations, the change in financing conditions has not discouraged the market. In fact, there is still a significant volume of investment looking for allocation, and Spain remains on the radar of investors. According to the Savills Autumn 2022 Europe and Middle East investor sentiment survey, Spain is ranked fourth in the top 5 countries generating the most interest, with CBD offices being one of the sectors in the spotlight, led by the beds & sheds (living and logistics) segments.

Up to September, the office market accumulated close to €2,300m, representing 18% of the total commercial market (including multifamily and student residences). This is still far from the almost 40% share it has recorded in the historical series, but it should be noted that in recent years the investment market has grown in terms of product diversification, leading to a decline in the share of traditional sectors.

Madrid, with just over €1,200m, made up 51% of the national total. After relatively little activity in 2021 (barely €710m), the arrival of product sales processes adapted to the requirements of different investment profiles has shown that investors remain interested in the capital.

The two primary factors for buyers are location and quality. Assets within the M-30 continue to be the focus, making up 60% of the total transacted, as they are guaranteed easy access by public transport (usually a metro station). Nevertheless, in the periphery, highly consolidated submarkets with some form of nearby

public transport are also of interest (while access to metro is particularly valuable, in its absence, light rail or commuter trains are also highly valued).

In terms of asset quality, ESG aspects are increasingly entering the equation, not only for landlords but also for tenants. A growing number of companies, especially multinationals, have strict guidelines when it comes to choosing a new location, discarding all assets that do not have a sustainable certificate. In this regard, investors are looking for products that already have a green seal, that are in the process of certification or that, after a refurbishment and repositioning project, are expected to qualify for a seal of environmental and human sustainability.

Office buildings that meet ESG criteria significantly increase their liquidity as, along with being higher quality buildings, they perform better in terms of marketability. According to an internal analysis of Leed and Breeam-certified building activity, in 2021, these buildings accounted for 48% of the total take-up, with the average deal size (1,620 sq m) being almost double that of the rest of the market (837 sq m), while the average rental

level in green buildings was 6% higher. In absolute terms, the difference was 70 cents in the outer periphery, between €1.50 and €2 in urban and inner periphery and around €6 in prime and CBD.

Yields

The rise in interest rates in July and September suddenly made financing more expensive, acting as a lever to increase achievable yield levels, which rose a further 50 bps (65 bps since the beginning of the year). At the end of Q3, Prime CBD stood at 3.75% and Prime outside the M-30 at just over 5%.

The ECB's announcement of further hikes up until the end of the year points to additional growth in the short term which will imply which will imply further outward yield movement.

Main Deals - Investment Market - Q3 2022

Asset	Market Zone	Purchaser	Vendor
Pº Castellana, 51	Prime	Inmocaixa	Caixabank
Porfolio El Corte Inglés (2 buildings.)	North and A2	Saint Croix	El Corte Inglés
Fray Luis de León, 13	Embajadores	Perial Asset Management	Azora
Julián Camarillo, 16	MadBit	Corum AM	Meridia Capital
Cristalia 9	Vía de los Poblados	Vyosa	Cerro de los Gamos

Source Savills Research





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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