

Madrid Offices



☞ 2023 ended with a weak quarter in terms of take-up, which weighed further on the annual decline. The 441,000 sq m represents a y-o-y decline of 17%, in a year that has been characterised by the large weight of medium- and small-scale deals ☞

3.4%
CPI January 24
Forecast 2024
2.5%

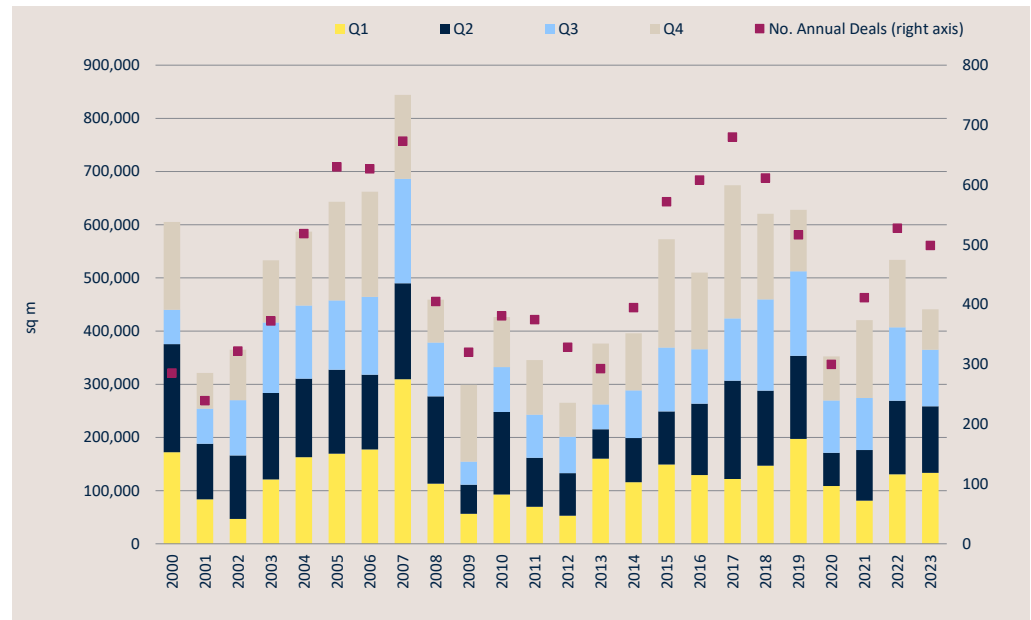
2.0%
GDP Q4 23
Forecast 2024
1.3%

11.8%
Unemployment
Rate Q4 23
Forecast 2024
11.72%

18.5%
2024
Forecast offices
employments

78.4
CCI 2023
+18% y-o-y

Annual Gross Take-up



Source Savills Research

Madrid Offices

Take-up and Demand

The year ended with weaker take-up figures in Madrid, despite the last quarter historically characterised by high activity. During Q4, around 76,000 sq m were registered, which is 40% less than in the previous year. This figure is also far from the average Q4 take-up, standing at 42% below it (130,700 sq m).

The downward trend in market activity in 2023 resulted in a total take-up of 441,000 sq m. One of the main reasons outlined for this 17% year-on-year adjustment is the market's own exhaustion - the economic instability caused by inflation, the wait for interest rates to fall, and context involving various military conflicts, has taken its toll on potential demand.

Tenants are feeling the fatigue of an unfavourable time for office take-up, and are postponing decisions, especially in the case of large size offices. In fact, it has been detected that negotiation processes were lengthened in 2023, up to double compared to 2019. It should be noted that small (<500 sq m) and even medium-sized (500 - 1,000 sq m) spaces are a more agile product to market compared to larger sizes, as both the implementation and relocation of a small workforce is easier in the event of a change of office.

Improving macro-economic conditions in 2024 invites optimism for the year ahead, as major companies are expected to finally make a decision later this year. As a result, it is estimated that while it

will be difficult to reach the level of 2022 (522,000 sq m), total take-up will be close to the historical average of 500,000 sq m.

Deal size

The main characteristic of the last quarter of the year was the take-up of low-volume spaces. The number of transactions (112) remained similar to Q3 (only four firms less), but the limited presence of large takeovers reduced the average closed area to 676 sq m, a ten-year low. The highest volume deal was under 5,000 sq m, and the next highest was 2,700 sq m, which is a rare range in the market.

On a yearly basis, the average deal size was 200 sq m higher than in Q4, at 884 sq m. For the first time since 2017, it has fallen below 1,000 sq m on average, a figure that had not been recorded even during the pandemic.

In the analysis of demand by surface area, large surfaces were less present. While four mega-deals (>10,000 sq m) were signed in 2022, only one was closed in 2023, in Alcalá 544 (Q3). If the range is extended to deals above 5,000 sq m, they account for 1.9%, which is lower than in the previous four years. The same result is obtained when comparing closings >3,000 sq m: their weight fell from 7.4% in 2022 to 5.7% in 2023 (39 deals vs. 28).

Medium-sized transactions, between 500 and 1,000 sq m, are the only ones to have increased their

“The commitment to refurbishments tips the balance of works towards the interior of the M-30, where 63.4% of the space planned for the next two years is located. The updating of the stock will not only come from development activity, but also changes of use will lead to a ‘cleaning’ of the stock”

percentage, almost three and a half points more than in the previous year (23.4%). Smaller surfaces (<500 sq m) continue to account for the majority of demand, (representing 52.2% of the total). This figure is expected to decrease with the closing of the larger demand-side deals currently being negotiated

Quality of Buildings

Companies want to set up in quality offices, even if it means paying higher prices. In 2021 and 2022 it was noted that, despite being a more expensive product, absorption in A-rated assets represented 56% and 48%, respectively. The consequence of the high demand for these spaces was a decrease in supply in 2023, with the diversion of contracts to B-quality buildings, which accounted for 54.3% of the take-up.

The average contract size by building grade is evidence of the preference of large corporations, which generally have the largest contracts, for quality buildings. The average surface area was 1,400 sq m, 720 sq m and 600 sq m for grades A, B and C respectively.

In terms of average closing rents, the best buildings have the highest values, growing by 4.5% compared to 2022. Category B product grew more moderately (2%), while C buildings recorded a 13% decline.

Activity by Market Zone

Market activity is concentrated inside the ring road, both in terms of transactions (51.2%) and take-up (53% compared to an average of 46% over the last five years). Although the percentage difference between the submarkets inside and outside the M-30 ring road is narrowing, the interest in central areas with close connection to public transport networks remains the same for yet another year.

Companies looking for headquarters in an urban location are finding an answer in the supply available to date. Of the nine transactions above 5,000 sq m, six were closed in the Urban Area, and one in Prime (the pre-let at Pº de la Castellana 14). All will involve single-tenant arrangements.

Demand for the best areas is still intact, and off-plan contracts prove it: The Ruiz Picasso Building is already 100% committed, as is the building mentioned above at Castellana, 14.

The immediate consequence is the reduction of available surface area (4.20% on average within the M-30 in Q4 23), which, in the short/medium term, will shift activity towards

assets located in the submarkets in the vicinity of the main motorway with good communications.

In the comparison by submarkets, and despite the business community's preference for central offices, Arroyo de la Vega (Outer Periphery) was the area with the highest take-up volume in 2023 (7%). Azca was only a few square metres behind in second place, with 6.6% of the total take-up. In the Ruiz Picasso Building alone, which is about to reopen after months of refurbishment, almost 12,000 sq m were signed.

Castellana's Prime axis accounted for 5.3% of the surface area taken up, with even more deals being closed than in Arroyo de la Vega (24 compared to 22 deals).

Of the office parks closest to the M-30, MadBit accounted for 5.4% of the take-up, the third highest percentage in the distribution by submarkets. The mega-deal of almost 10,500 sq m in Alcalá 544 made up for a modest year in this zone.

The Outer Periphery was noteworthy for moving closer to the nearest submarkets in terms of take-up: 23% vs. 24%. It is not only the good performance of Arroyo de la Vega that is driving the take-up of the more decentralised markets; the revival of the A6 was another major catalyst. Pozuelo alone accounted for 4% of the surface area signed, and in Las Rozas, both Tripark and the XiMad Building are gradually beginning to see more and more users moving into their offices.

Stock and Current Supply

A much lower absorption than expected for the fourth quarter, combined with the entry of more than 44,000 sq m of new and refurbished vacant space in the northern part of the market, increased the vacancy rate in the final stretch of the year to 9.87%, three tenths of a percentage point higher than in the previous quarter. The impact of the low take-up failed to cushion the impact of the nearly 30,000 sq

m of office stock that were removed during Q4 23 due to change of use, mainly to residential.

The almost 1.4 million sq m of supply is unevenly distributed, with the M-30 being the boundary that marks the widening gap. Only 17% of the available space is located in the Prime, CBD and Urban Area submarkets, which have increasingly tight vacancy rates, averaging 4.30%. Outside the ring road, this percentage rises to 13.34%. It is worth highlighting the minimal overtaking by the border areas with respect to the Outer Periphery, with 13.4% compared to 13.3%, a situation that worries the main agents in the sector, given that historically the good performance was centred on the Outer Periphery.

There is more space available outside the M-30, with submarkets not only exceeding double-digit vacancy rates, but even exceeding 20%. Vía de los Poblados, with the 14,600 sq m of the Cadenza Building still empty, does not drop below 26% of its available stock; nor does Manoteras, which is slow to market the large Polaris North development, which is joined by the newcomer SkyLight Madrid, registering 25% at the end of the year.

It's not all bad news outside the central core - in fact, five of the six largest deals of the quarter were signed between the A1, the A6 and PAU's. Arroyo de la Vega recorded the sharpest year-on-year decrease, reducing its vacancy rate by six tenths of a percentage point to 11.88%, the best figure since 2009. On the A6, Las Rozas is experiencing, for the first time since before the pandemic, a reduction in supply, thanks to the gradual occupation of Tripark (17% compared to 18% the previous year).

As for the areas closest to the ring road, Campo de las Naciones (9%), MadBit and the 1st stretch of the A2 remain at the top of the markets with the lowest vacancy rates, although the two in the eastern area exceed the Madrid average (10.4% and 10.0%, respectively).

Main Deals - Occupier Market Q4 2023

Tenant	Zone	Floor area (sq m)	Activity Sector
Informa	La Moraleja	4,700	Business Services
Emerson	PAU's	2,600	IT
Bluetab Solutions	Azca	2,100	IT
Ria	Alcobendas	1,800	Bank
Grupo Gestair	Arroyo de la Vega	1,700	Business Services

Source Savills Research

🏡 **Building quality, central location, and ESG criteria are the main factors favouring rental growth. The shortage of availability in A-grade buildings is driving activity towards B-grades, where closing values are also growing** 🏡

Future Supply

Over 2024, development activity is set to rebound on the back of refurbishments. The refurbishments will represent 70% of the more than 271,000 sq m planned, a total of 190,000 sq m of floor space coming out of stock to adapt to the main ESG criteria, and will reduce the high percentage of obsolescence experienced by the market. This is a record figure for renovation since records have been kept.

As for new construction, its weight is down to 30%, well below the 73% average of the historical series. This trend will continue in 2025, when property developers will continue with “catch-up” work on major assets, but on a smaller volume of floor space: 102,500 sq m, 67% of the area to be developed.

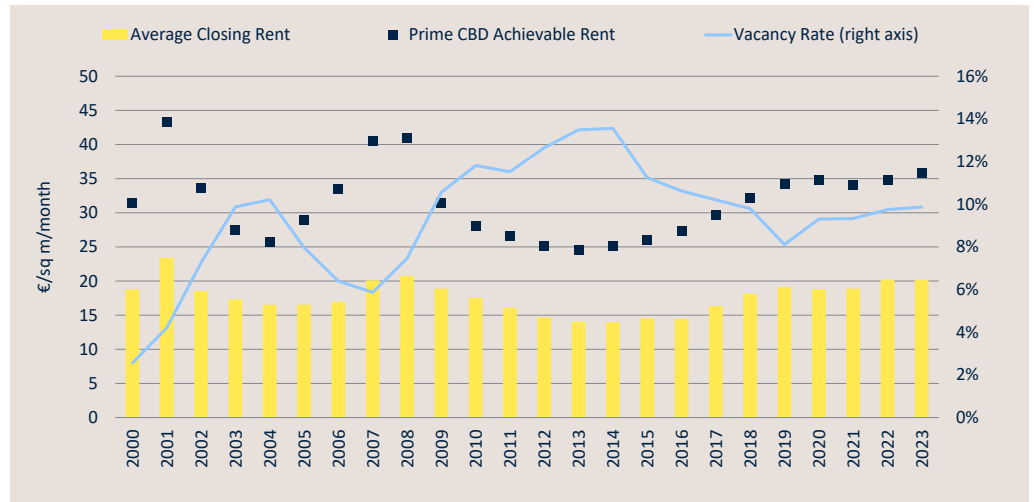
In total, 423,500 sq m of new and/or refurbished space is expected to be added by 2025. In 2024 only 30% will be committed, while in the following year it will be 100% speculative space, if there is no pre-letting contract until then. The distribution of the committed surface area reflects the clear preference of demand for the area inside the M-30, where about 93% of the spaces that already have a tenant are concentrated.

The commitment to refurbishments tips the balance of works towards the interior of the M-30, where 63.4% of the space planned for the next two years is located. Méndez Álvaro tops the list of the submarkets with the largest area to be delivered, thanks to the Madnum macro project (56,000 sq m), and the 20,000 sq m of Torre Catalana.

The Prime section of Castellana is also undergoing a renovation process with 52,000 sq m, of which 20,000 sq m are about to be inaugurated in the new Colón Towers. Numbers 4, 14, 19 and 44Bis of the emblematic Paseo de la Castellana account for the remaining 32,000 sq m, with Castellana 14 already pre-let by the National High Court.

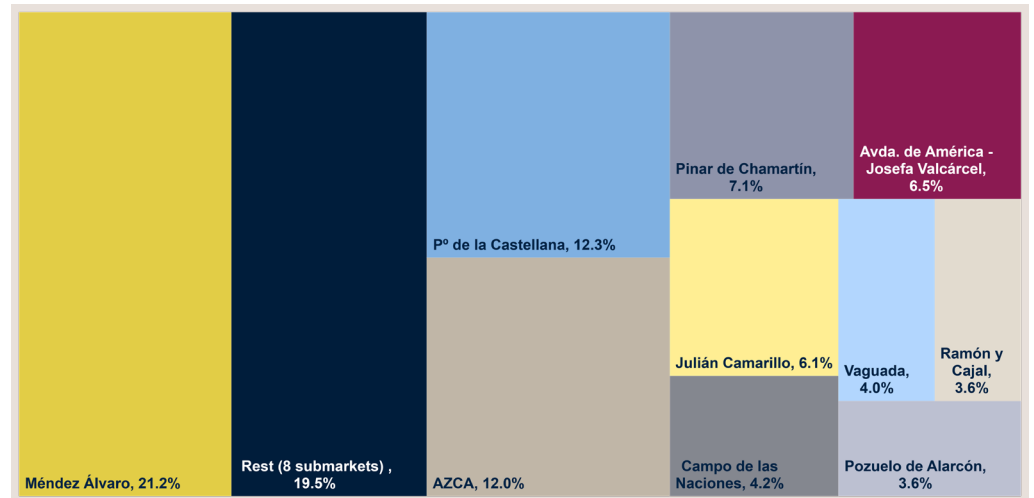
Outside the central core, the bulk of the development is concentrated in the Inner Periphery, where nine of the 13 buildings are located, with the five largest having surface areas of more than 13,000 sq m. The year begins with the completion of the works at One Ágora in Pinar de Chamartín, 30,000 sq m, which will enter the market with 7% pre-let. The former Post Office HQ at Via Dublin, 7, will also be handed over, adding a further 17,700 sq m to the Campo de las Naciones stock.

Vacancy Rate and Rents



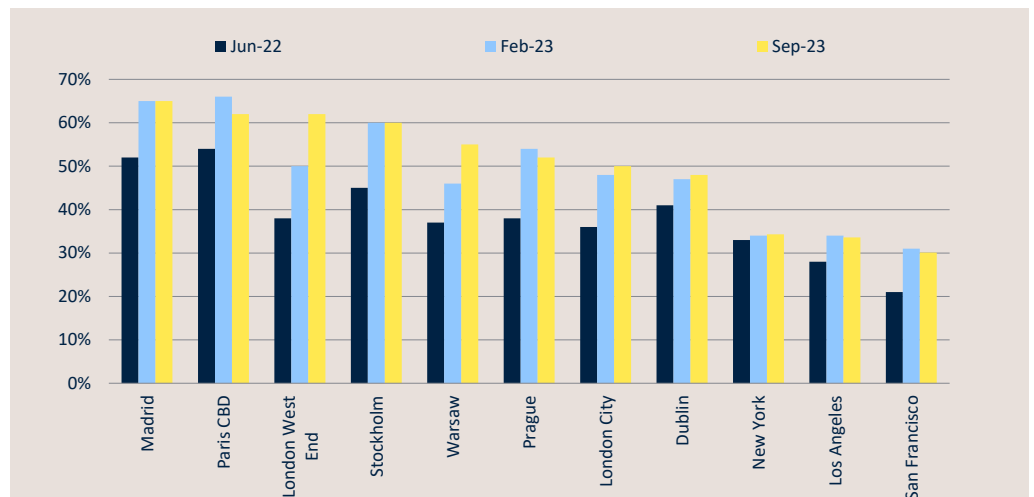
Source Savills Research

Future Empty Supply by Market Submarket (2024*-2025*)



Source Savills Research / *previsión

European and US office utilization rates (%)



Source Savills Research

👉 Interest rate stability will provide greater visibility and certainty on financing costs, which will favour the reactivation of institutional investment, as long as it is a core or core+ asset at a market yield. Yields will continue to expand in the short term 🏹

Rents

The “anomalous” market behaviour did not translate into reductions in prices. The average closing rent (calculated with all values of signed transactions in exclusive and high tech buildings) in Q4 23 was €19.77/sq m/month, 8.5% higher than in the previous quarter, and in line with Q4 22. On an annual basis, average prices in both 2022 and 2023 remained in line, despite the large difference in take-up and demand.

Deals in excess of €40/sq m/month, a rarity in the market only seen in very exceptional buildings, have stood out for their presence: 2.5% of the transactions exceed this value (11 deals in total). This figure is only surpassed by the 13 signings in 2008. Furthermore, these values are no longer exclusive to Prime and CBD, as these rents have been achieved in assets in the Urban Area portion of the Salamanca district.

In general, demand above €20/sq m/month continues the upward trend that began seven years ago and has a weight of 43%. It is not only the effect of inflation on prices that has to be taken into account, but also the concessions that owners grant to users in negotiations in order to be able to keep the asking prices of their buildings as high as possible.

The abrupt slowdown in activity in the last quarter of the year triggered caution in the sector, despite good annual fundamentals inside the M-30. As a result, the achievable value in Prime CBD is up 3% year-on-year, reaching €36.25/sq m/month. This is the second year in which this value has increased quarterly.

The rest of the zones remain stable, although a possible increase in the achievable rent of the Urban Area is foreseen in view of the continuous decrease in its availability. The secondary area outside the M-30 is penalised by submarkets that still have large pockets of vacancy, with little attraction for them (€10.25/sq m/month).

Investment

Investment activity in the office market registered close to €1.3 billion at the national level, a 50% contraction from the previous year's figure, in line with the adjustment of the total tertiary direct investment market, i.e. excluding corporate transactions which in 2023 considerably increased the share of the hotel sector.

In the European comparison, Spain is not only among the five countries with the best investment figures in the office market, but also among the five with the lowest year-on-year decline. The steepest drops (between 80 and 90%) did not follow a locational pattern as they affected both Eastern European and Mediterranean Arc locations, but also impacted some of the major German cities.

In the breakdown of total commercial investment by segment, the office market accounted for only 14%. Since 2020, the share of offices has been steadily declining due to, on the one hand, the incorporation of new segments (such as various living formats) and, on the other, the high potential for attracting capital to segments with strong fundamentals, such as hotels.

Furthermore, the negative sentiment from office markets in the United States has been extrapolated to Europe without taking into account that neither the macro conditions of each country (socio-economic indicators), nor the micro particularities of each city (size, infrastructure provision, extension and capillarity of the public transport network, market vacancy rate, etc.) are comparable.

In this regard, despite the slowdown recorded in 2023 in the volume of take-up, Madrid heads the list of large cities in which the utilization rate, measured through the use of access cards, has been monitored since June 2022.

It should be noted that the sample corresponds to several office-only buildings in the Prime CBD axes of each city, but data from the Madrid City Council on weekday road traffic in the vicinity of the main submarkets in the near periphery (and some in the far periphery) since 2021 show a 5% growth in the first ring and 17% in the outermost areas, where access by public transport is more complicated.

The good results of the occupier market inside the M-30 (low vacancy rate, >50% of the take-up and number of operations, average take-up size slightly higher than in the periphery, etc.) have

been reflected in the investment market, which accounted for almost 60% of the annual volume (€540 million of the total annual volume of €920 million).

The focus on high demand areas is a further manifestation of the risk aversion that is evident, with 80% of the investment distributed between core and core+ operations.

Obsolete product that do not comply with ESG criteria in locations with low office demand and potential for change of use also remains on the radar of investors and specialist operators. The most common use is residential, but hotels, healthcare and storage (storage units) are becoming more common.

Yields

The achievable Prime CBD yield level closed the year at 4.85%, 10 bps above Q3 23, 85 bps above Q4 22 and 160 bps above Q2 22, just before the European Central Bank (ECB) started the rate hike.

From September 2023 the regulator maintains rates at 4.50%, with the estimation of a possible cut in the summer, provided that inflation reaches the target level of 2% in the medium term and that no new geopolitical risks emerge.

The beginning of the adjustment path will reduce uncertainty in the investment market and, in theory, will be the lever for yield compression.

The forecast for the office market at the end of 2024 maintains the expansionary phase, albeit at a slower pace.

Main Deals - Investment Market - 2023

Asset	Zone	Purchaser	Vendor
Francisco Gervás, 10*	CBD	IBA Capital Partners	Blackstone
General Perón, 27	CBD	Ibervalles	Allianz
Costa Brava, 12	North	Bancalé	Sareb
Ramírez de Arellano, 15	East	Invermik	Colonial

Source Savills Research / *advised by Savills



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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