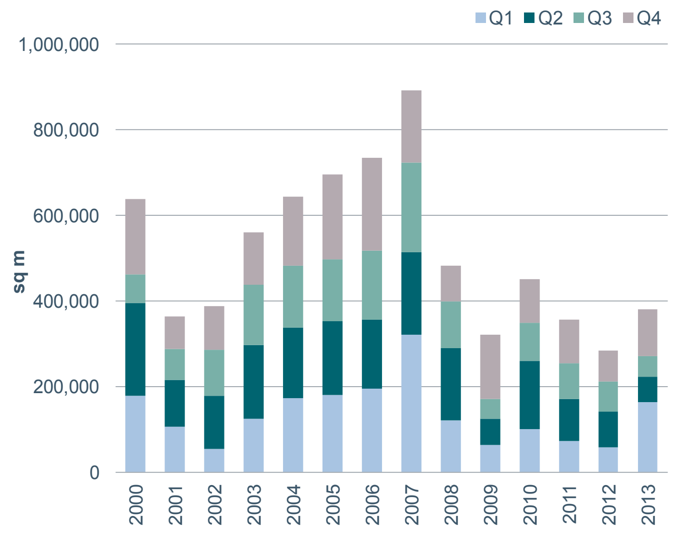
Market report
Madrid offices

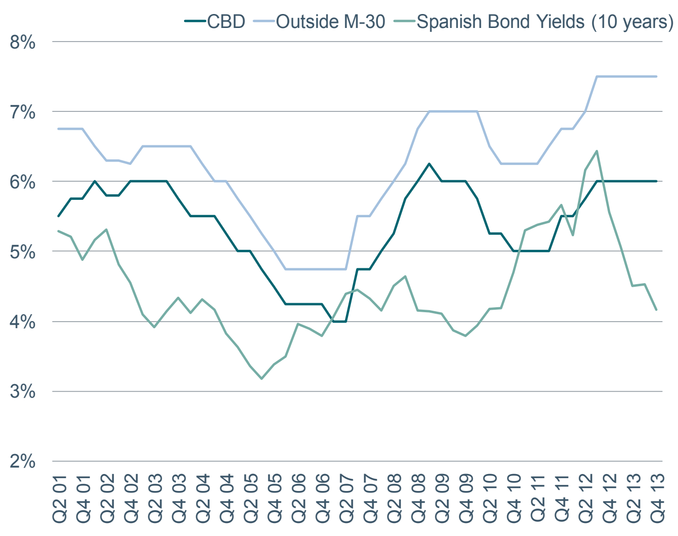
Q4 2013

GRAPH 1
Annual Take-up



Source: Savills

GRAPH 2
Prime yields vs Spanish bond yields



Source: Savills, INE

SUMMARY

Improved economic outlook bolsters market confidence

■ Take-up reached close to 385,000 sq m in 2013, which is a 35% y-o-y increase and the first positive growth since 2010.

■ One must take in to consideration that various mega lettings, such as Vodafone and Cepsa, heavily distorted this figure.

■ The number of transactions registered fell by 15% compared to 2012.

■ The overall market vacancy rate continues to stand at around 14%, although the CBD and the most consolidated areas are at between 4% and 6%. The outermost periphery far exceeds the market average, by as much as two or even three times .

■ For the first time in five years, closing rents in lettings signed in the CBD have increased very slightly, which justifies a 1% increase in the achievable value to €24.75 per sq m/month .

■ The improved economic outlook has restored international investor confidence in Spain.

■ The volume of investment transactions was at a similar level to 2012, about €500m, with a notable increase in international participation (55% in 2013 versus 24% in 2012).

■ Also of note is the increase in investment in yielding properties (80% in 2013, compared to 28% in 2012

■ The imbalance between supply and demand for prime properties could drive the achievable yield in the CBD to harden.

Economic situation

The Spanish economy ended 2013 with an optimistic outlook. According to data published by INE, GDP saw a q-o-q increase of 0.1% in Q3, coming off the back of nine consecutive quarters of decreases. Which means that the recession has come to an end.

On the other hand, domestic demand has begun to show signs of buoyancy. Despite its negative contribution to GDP growth, there has been a q-o-q improvement of 100 bps. The reason for this is the improved outlook over the short and medium term, as reflected in the variables such as total household consumption and the consumer confidence index. After five quarters of decline, total household consumption grew by 0.4% in Q3, while the Consumer Confidence Indicator recorded a 39.6% y-o-y increase in January 2014, reaching 77.77 points. GDP contribution from external demand was down 70% on the second quarter, mainly due to a 7% decline in export growth compared to the same period last year. We should also highlight the 6.8% cumulative improvement of the same figure over the first eleven months of 2013, compared to 3.7% over the same period the year before.

The downward cycle of the retail sales index since 2008 has turned a corner, and in Q4 2013 there appeared to be a clear change of course, reaching a value of 0.13% compared to -10.2% in the same quarter the year before. If this trend continues over the coming quarters, there could well be room for an increase in employment in this sector over the short to medium term.

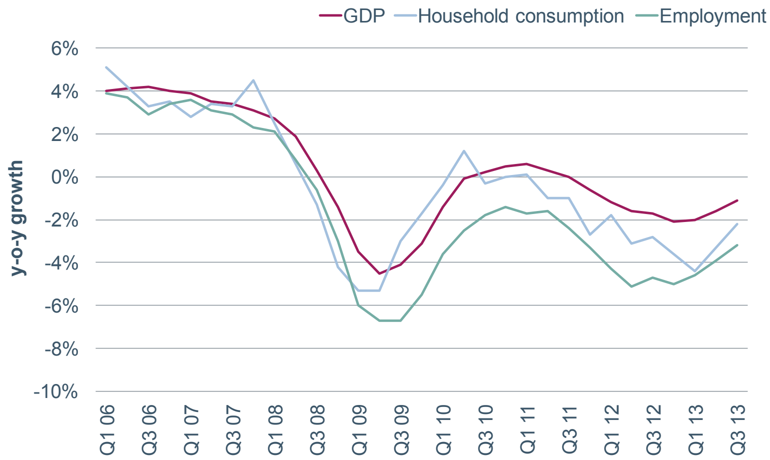
According to the Bank of Spain, the Spanish economy also has good financial standing for the first time in decades. As at November €11.26 billion (2.3% of GDP) was accumulated, driven primarily by the favourable current account balance to the gradual stabilisation of the deficit on the balance of payments of goods.

Labour reforms are beginning to bear fruit, and it would seem that employment forecasts made by various agencies are beginning to come about. Although the annual variation of those in full-time employment provided by INE in Q4 showed a decrease of -1.2%, this figure was actually up by 200 bps compared to the previous quarter. This kind of improvement has not been seen since before the crisis. As a result, we are optimistic about the future, bearing in mind that it will take several quarters for the positive figures to translate into net employment.

The improvement in most economic variables and the slowdown in the worsening of others, has led to international bodies such as the IMF providing improved forecasts for the Spanish economy, which as a result has boosted the confidence of international investors.

GRAPH 4

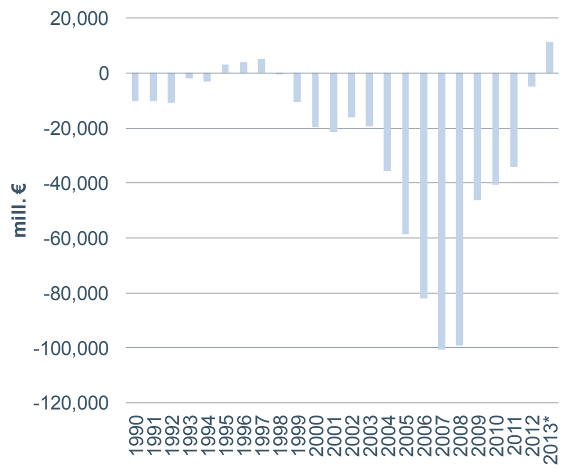
GDP, consumption and employment



Source: INE

GRAPH 3

Balance of payments



Source: Banco de España / * accumulated until November

TABLE 1

Economic indicators

Indicator	2012	2013*	2014*	2015*	2016*
GDP	-1.6%	-1.3%	0.8%	1.3%	1.6%
Household consumption	-2.8%	-2.5%	0.5%	0.9%	1.3%
Unemployment	25.0%	26.4%	25.9%	25.0%	23.7%
CPI	2.4%	1.5%	0.7%	1.1%	1.3%

Source: Focus Economics (February 2014) / * forecasts

Take-up and demand

According to the Business Demographic Study published in December 2013 by Informa D&B, as at November 86,440 companies had been created, representing an increase of 6.5% over the same period last year, and also indicates that Madrid is the region that recorded the highest number, with 21.13%, followed by Catalonia and Andalusia with 18.89% and 16.52% respectively.

Meanwhile, the latest data from the Business Confidence Index published by INE rose 0.8% in the first quarter of 2014 when compared to the previous quarter, thus recording four consecutive quarters of growth. The upturn in business confidence came as a result of improved expectations and a more positive assessment of the recently completed quarter.

The growth of the corporate sector and increased confidence of actors within the sector tally with the higher take-up levels of the Madrid office market. Annual gross take-up reached close to 385,000 sq m in 2013, representing both an increase of 35% over the previous year and the first year of positive growth since 2010.

A detailed review of the data shows that this figure was heavily distorted by several mega-deals, among which were Vodafone moving to the Avenida de America 115 Business Park and CEPSA's letting of Torre Foster. Between them these transactions accounted for 23% of the total.

However, the reality of the matter is that the market as whole is far from recovered and the lack of demand is reflected in the 15% reduction in the number of leases signed.

City centre vs out-of-town

Occupiers continue to show a clear preference for central locations compared to out-of-town areas. Since 2009, there has always been a greater preference for offices in the city centre compared to those located around the M-30 ring road, with over 50% of deals signed in the former. The increase in quality vacant space in the urban area (thanks to refurbishment projects or minor renovations) and the continued correction in rental prices have enabled many companies that had to leave the city in the last property cycle to return to the centre.

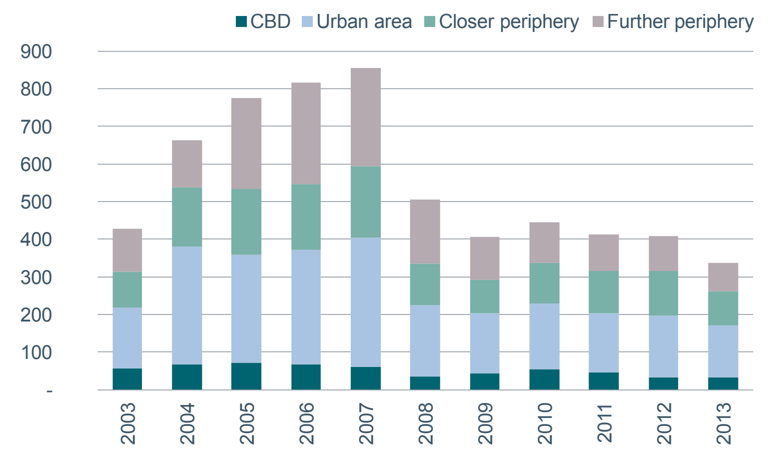
In 2013, 56% of deals were signed for space located within the M-30 and we would highlight that the least consolidated areas and those furthest from the central core, only accounted for 3% of demand.

Average floor space

The significant increase in take-up and the fall in the number of lettings signed have meant that there has been a significant increase in the average size of office space taken, both inside and outside of the M-30.

GRAPH 5

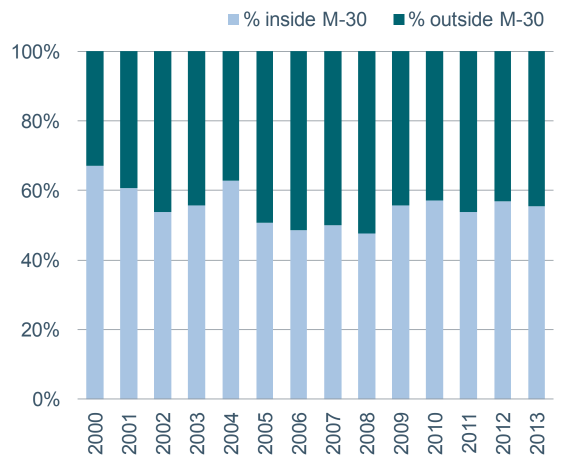
Deals by zone



Source: Savills

GRAPH 6

Deals with regards to the M-30



Source: Savills

The average of almost 1,150 sq m, is 58% higher than the average figure registered in 2012.

Excluding the two largest deals (Vodafone and Cepsa) from the analysis, the average size of deals in urban areas is stable compared to previous years, while the periphery continued to grow.

Thus it would seem that demand for large office spaces continues to be focused outside the M-30, although central downtown buildings that have been well refurbished have little trouble finding a new tenant.

Business sectors

The professional services sector remains the most active with 46% of transactions and 35% of take-up. Vodafone increased the tech sector's market share of take-up to 24%, compared with an average of 15% in recent years, although we must remember that this should be considered a one-off event and not as a potential demand stream with the capacity to revive the market.

The improvement in the volume of take-up is linked to the recovery of the economy, the return of financing, the regeneration of the business sector and job creation.

Current supply

The vacancy rate continues to stand at around 14%, although we would point out that this has fallen slightly compared to Q3. In total, there is more than 1.76 million sq m of available space ready for immediate occupation. The distribution of supply is uneven, as is the change in vacancy rates. Whilst the CBD and the more consolidated areas have a vacancy rate of between 4% and 6%, the areas furthest from the city significantly exceed the market average, as much as doubling or tripling it.

Significant new projects

By the end of 2013, Madrid office market stock hardly increased by even 3% compared to the figure for the previous year, and this was driven by the slowdown in development of new premises. Among new supply we would highlight, by volume, the first phase of BBVA's new headquarters at the beginning of the A-1 motorway, and Torre Titania, built on the site of the former Edificio Windsor in AZCA.

However, these have not been the only new arrivals on to the market. Earlier this year the Castellana 200 business complex was extended; adding 5,000 sq m to building 1, and architectural firm Allende opened its new headquarters in the Chamberí district.

Overall the year has seen the addition of approximately 65,000 sq m of office space on to the market, although it is important to note that only a third of this was added to available supply, given that the rest was developed for owner occupancy or was pre-let.

Refurbishment projects

Given developers' reluctance to develop speculatively, the intense activity in refurbishment projects is of note. Just over 35,000 sq m underwent various levels of refurbishment and reconditioning of spaces and installations to suit market requirements. All of these projects are located within the M-30 ring-road, with the Castellana accounting for 71% of all refurbished spaces.

Despite an increasingly large number of refurbishments being carried out, a large part of the Madrid office market continues to be out-dated, mainly in the city centre, and as a result refurbishment projects garner significant interest and lettings are often finalised prior to the property coming on to the market. 71% of refurbished space delivered in 2013 were pre-let prior to the completion of the project. Only Castellana 7 came onto the market with a significant amount of unlet space, which is slowly but surely filling up.

Future supply

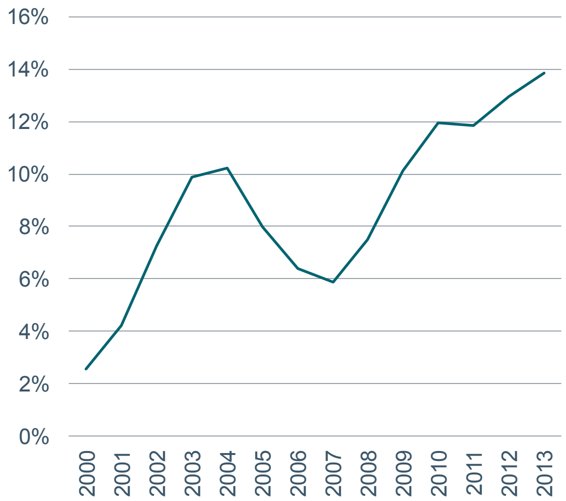
Over the coming 24 months some 180,000 sq m of new and refurbished projects are expected to come onto the market, of which only 45% are new developments, lead by the second phase of BBVA's financial city. There will continue to be heightened levels of activity in the refurbishment sector.

In fact, only refurbished product is expected to come onto the market in 2014 and so far only 14% will be owner-occupied. In terms of location, 63% of this space will be located in the CBD and its surrounding areas. Only one project is located outside of the main ring road, at the start of the A-2 motorway. The former headquarters of the innovation division of Telefónica Group will come back onto the market after being fully refurbished and the property has already obtained LEED Platinum pre-qualifying classification for energy efficiency and environmental sustainability.

Relocations of major corporations such as Repsol, Vodafone and BBVA are also significantly adding to the amount of vacant space, however this space has yet to be added to available supply. The buildings that they are vacating have yet to be added to available supply, as they need to be refurbished. In the majority of cases, works will be conducted on the basis that there is a tenant showing genuine interest.

GRAPH 7

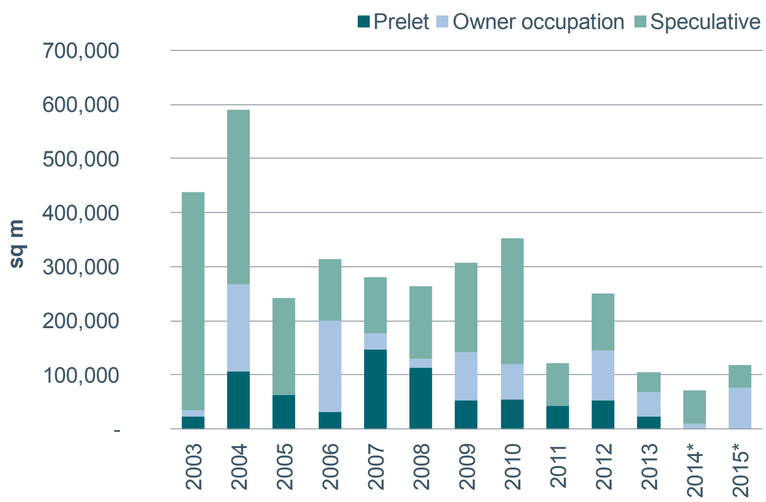
Vacancy rate



Source: Savills

GRAPH 8

New developments and refurbishment projects



Source: Savills / * forecasts

Turning point?

Slowly but surely the market is beginning to show signs of recovery. Over the last three quarters the average figure for all rents signed in commercial properties (sole-use and high-tech) registered a slight increase from both a q-o-q, and a y-o-y perspective. The continued inflow in to the city centre (with higher rents than in out-of-town locations) and with a number of deals having been signed at rents close to €30 per sq m/month have favoured this moderate upturn.

In any event, caution is advised because detailed analysis of the main submarkets demonstrates continuing adjustments particularly in those hardest hit by oversupply.

The CBD - the epicentre of change

After five years of continued decline, transactions signed in the CBD are seeing a slight increase in rental levels, which would suggest we are on the brink of seeing an upturn in the market.

This, coupled with an improvement in market sentiment, justifies raising the achievable closing value in the CBD to €24.75 per sq m/month, barely 1% higher than last year.

After the CBD consolidates, the recovery will flow concentrically out to the rest of the market.

"After continuous corrections since 2008 and four consecutive quarters of stability, the achievable closing rent in the CBD grew slightly. This trend will begin to slowly but surely spread out to the remainder of the market". Gema de la Fuente, Savills Research

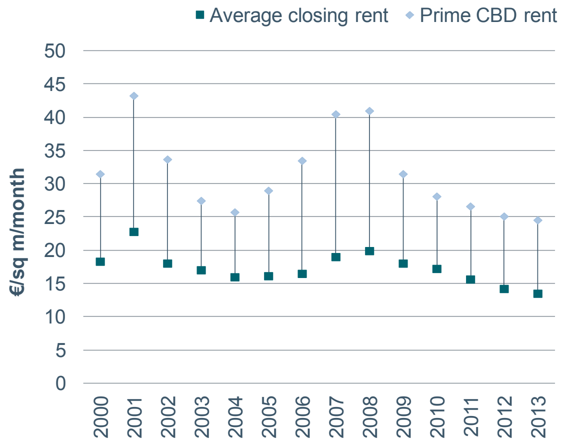
More corrections in out-of-town locations

In the meantime, the periphery continues to see further corrections. Minimum rental levels continue to be in the single digits and in some cases are on a par with industrial properties. The number of transactions signed below €9 per sq m/month in office properties continues to grow, 33% up on the figure recorded in 2012, which accounts for 20% of all transactions, up from 13% the previous year.

A recovery in demand will be the key factor in order to increase the number of lettings and reduce supply. Until these factors balance out, low rents will continue to be used by landlords in order to attract potential tenants.

GRAPH 9

Average closing rents vs Prime CBD achievable rents



Source: Savills

TABLE 2

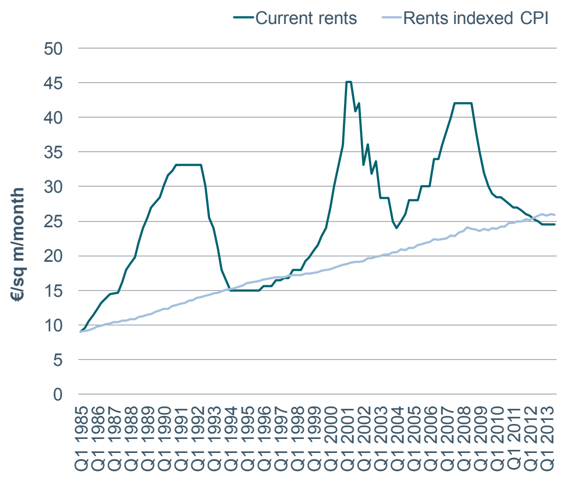
Main deals - Occupier market - Q4 2013

User	Zone	Floor area (sq m)	Activity sector
CEPSA	Urban area	36,000	Industry
Confidential	North	10,000	Bank
Volvo Trucks	A-6	6,000	Industry
Wincor Nixdorf *	North	3,000	Technology
Carl Zeiss Vission	Tres Cantos	2,800	Industry

Source: Savills / * advised by Savills

GRAPH 10

Prime CBD achievable rental level



Source: Savills / INE

Investment market

Investor activity is back on the up. The improvement in economic expectations has restored investor confidence in Spain. As of January, Spain's sovereign debt held by foreigners has gradually increased, whilst the three big credit rating agencies - Moody's, Fitch and Standard & Poor's improved their outlook on the country. The Spanish premium has gone from 640 basis points in July 2012 to an average of 200 in January 2013.

The annual investment volume in Spain reached approximately €1bn, which is over a 22% y-o-y increase. Madrid continues to be the most mature and solid market in Spain, however, the difficulty of entering the market due to the aggressiveness of the main players, made Barcelona the most consistent alternative over the first half of the year. The largest deal in the sector, and one of the biggest of the year in the office market, took place in Barcelona: AXA Reim purchased a portfolio of 13 properties from the Generalitat for €172m.

In Madrid, the total investment volume for 2013 was close to €500m, which was in line with the same figure in 2012 (excluding Torre Picasso), just 3% higher. As for the number of deals, this was also similar to the previous year, 21 versus 19 respectively.

Type of deals

The lack of deals is in stark contrast to growing investor appetite. Previously their expectations were limited, among other reasons due to a lack of product, at least in open market sales.

But it is interesting to note the significant increase in the number of investment transactions of yielding properties being carried out. Putting to one side the Torre Picasso deal, acquisitions relating to yielding properties in 2012 accounted for only 28% of the total, whilst in 2013 the same figure reached 80%.

It is also of note that opportunistic funds decided to concentrate on the residential market after having ascertained that price corrections on commercial properties, including offices, did not meet their expectations.

Origin of investors

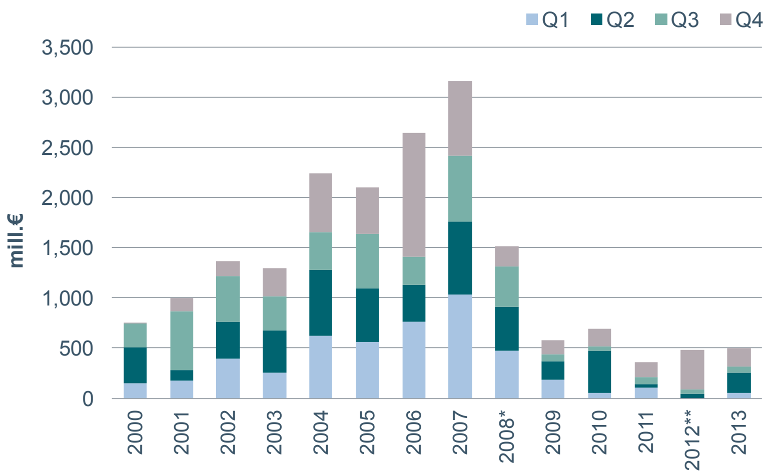
Investors, especially international investors, have actively returned to the market. After years of monitoring the economy and real estate indicators from a distance, they have launched themselves back in to the fray, so as not to miss out on the opportunity of acquiring good assets at the bottom of the cycle.

The involvement of international funds in Madrid's office market has increased from 33% in 2012 (again excluding Torre Picasso from the analysis) to almost 55% in 2013, which therefore confirms that Spain is back on international investor's radars.

81% were from European countries. Those with the highest levels of activity were: France, United Kingdom, Germany and Switzerland. IBA Capital (France) was the most active investor in the commercial property market, purchasing three retail properties and two office buildings, both of which were located in the northern area of Madrid. One of them was the largest deal carried out in the market. Torres Ágora, the temporary headquarters

GRAPH 11

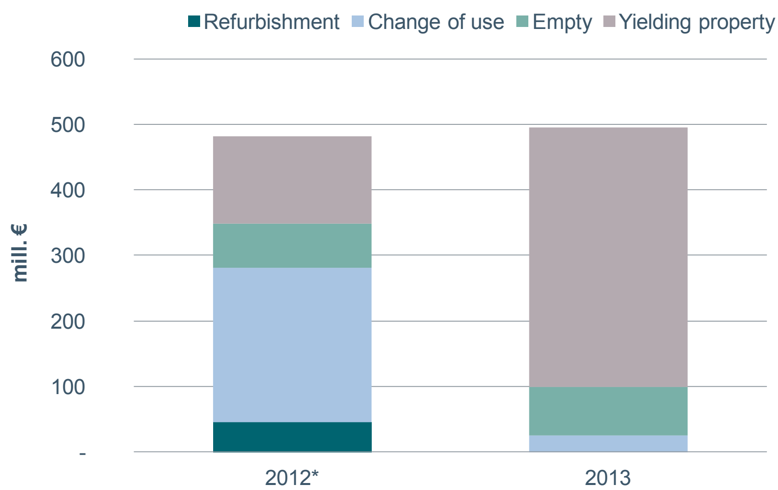
Investment volume



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

GRAPH 12

Investment volume by type of deal



Source: Savills / * excluding Torre Picasso

> «Over 2013 some financing activity was detected, although only in very specific cases, at high prices and with a LTV of around 50%. A more stable economic situation could herald in a speedy recovery in financing» Pablo Pavía, Inversión Nacional

of the Ministry of Foreign Affairs, has swelled the asset portfolio of the newcomers by €75m. The other property was Union Editorial's headquarters that went with the sale of Reyal Urbis's inner city ABC Serrano shopping centre.

Location of the assets

The CBD continues to be the focal point for both national and international investors, but possibilities are very limited due to a lack of product. Over 2013 only two transactions were registered on the Castellana, both of which were for the same property. Before the summer Deutsche Bank sold its headquarters at Paseo de la Castellana, 18 to a private investor, who a few months later then sold it on to another private investor.

In the absence of asset transactions in the CBD, the downtown urban area has become an attractive alternative, provided the property is centrally located or is close to the CBD. 52% of transactions recorded in 2013 met these criteria and accounted for almost a third of the total transacted volume. Location is one of the key factors, in fact it is almost more important than the state of repair of the property, given that several of the deals signed have been for vacant properties or projects subject to a change of use.

Business parks outside the M-30 ring-road have also attracted the attention of investors. In this case, location is one of the most important factors, as well as the other usual investment fundamentals. All of the deals were signed in consolidated business areas (Arroyo de la Vega, Pinar de Chamartín, the first stretch of the A-2 motorway, Campo de las Naciones and Las Rozas) and all properties were fully let (some under sale & leaseback) or had acceptable levels of occupancy.

The return of financing

A more stable economic outlook could mean that we are on the brink of seeing a return of financing.

In fact, over 2013 some improvement was already detected in the financing of real estate transactions, albeit for very specific deals, at high prices and with a loan to value limit of around 50%.

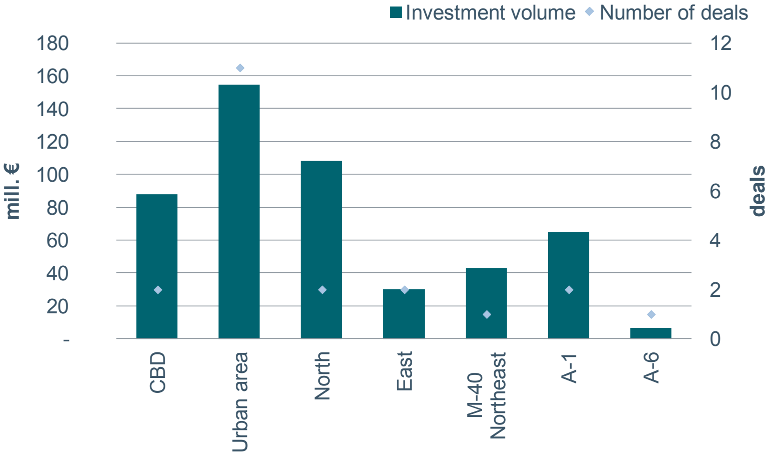
Yields

The imbalance between supply and demand for prime properties could drive the achievable yield in the CBD to harden. This is only our perception of the market, as no deals have been registered in this category. Our achievable yield level therefore continues to be 6% for the best buildings on the Castellana, but this is clearly trending downwards.

In prime areas outside the city, properties that meet investment requirements could reach 7.50%. The increase in available supply has led us to maintain that figure for the short to medium term.

GRAPH 13

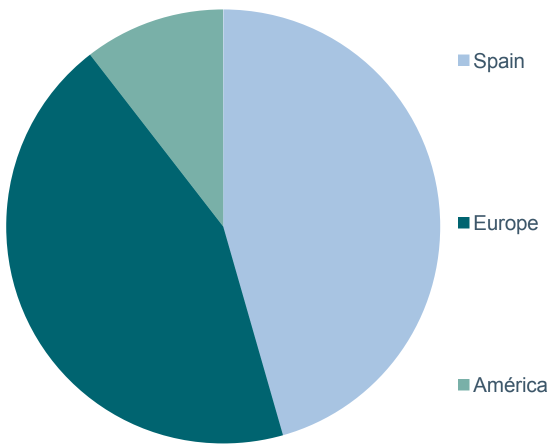
Investment volume by market zone in Madrid Accumulated 2013



Source: Savills

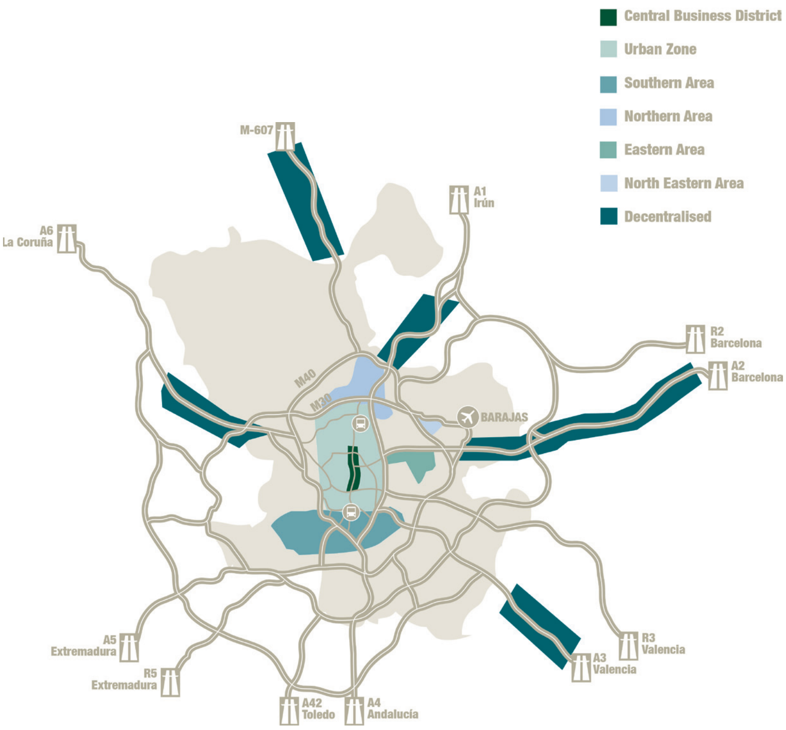
GRAPH 14

Investment volume by purchaser origin - Madrid 2013



Source: Savills

MAP 1
Madrid office market



OUTLOOK

2014

■ The recovery of the office market is very much dependent on a recovery in the employment market. The business sector is confident about the outcome of 2014, but the employment situation is still holding back the highly sought after growth.

■ The drop in speculative development of new projects will mean that there will not be a major increase in available supply in the market or an increase in office stock. In 2014 the speculative projects that do come onto the market will be refurbishment projects. The space freed up by the large relocations seen over recent months is not considered as current supply, as these properties will have to undergo refurbishment. These will increase supply in the short to medium term, should the property undergo refurbishment works prior to having a tenant lined up.

■ The upcoming rental growth in the CBD will progressively filter out to the rest of the market. Downtown central areas and prime areas outside the M-30 are approaching levels of stability. Periphery areas continue to see rental corrections.

■ The investment market is expected to continue to be active. On the demand side, new players are approaching the market looking for opportunities, whilst open market transactions are on the up. The lack of prime product and ever more aggressive levels of demand will drive yields down.

Savills Team

For further information please contact:

Luis Espadas
Capital Markets
+34 91 310 10 16
lespadas@savills.es

Pablo Pavía
Spain 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

Savills plc
Savills is a leading global real estate service provider listed on the London Stock Exchange. The company, established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 500 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.