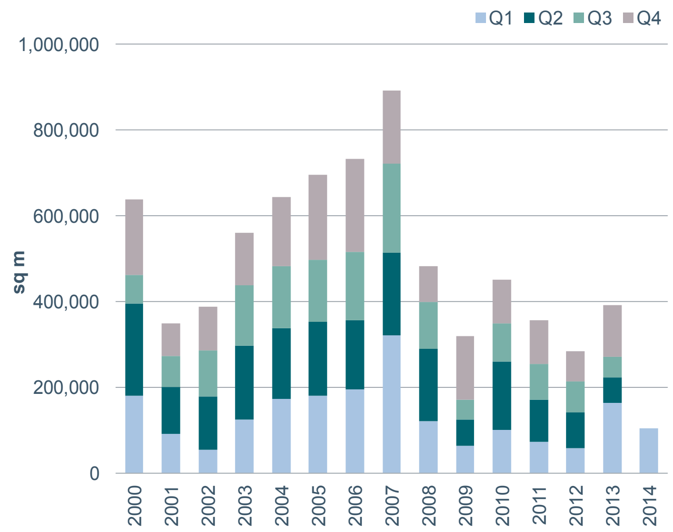
Savills World Research
Spain Offices

Market report
Madrid offices

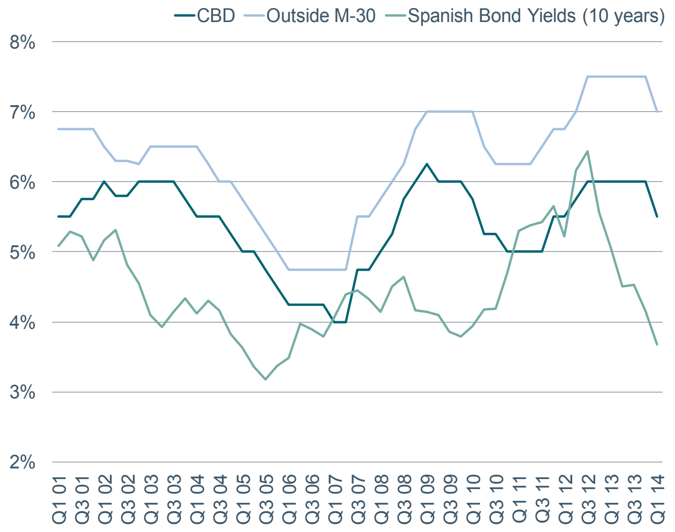
Q1 2014

GRAPH 1
Annual Take-up



Source: Savills

GRAPH 2
Prime yields vs Spanish bond yields



Source: Savills, INE

SUMMARY

International investors continue to gain ground in the market

■ Take-up in the first quarter of the year stood at slightly over 105,000 sq m. Which is a 36% decrease on Q1 2013, although this is skewed by a major (50,000 sq m) single deal that took place in Q1 last year.

■ The 9% increase in the number of signed transactions, would suggest a slight recovery in demand.

■ For the second consecutive quarter the overall market vacancy rate decreased slightly standing at 13.6%. The CBD and most consolidated business areas continue to have vacancy rates well below this level, whilst the outer periphery continues to see vacancy rates of double and even triple that figure.

■ The CBD and the areas closest to it are beginning to see signs of a recovery in rents. Meanwhile, the areas furthest out of the city, with over-supply and a lack of demand, continue to see rents fall, indicating a two-tier market.

■ The intense activity seen in the investment market at the end of 2013 continues apace. However, the ever greater demand is facing a significant shortage of product for sale. The end result is highly competitive sales.

■ The imbalance between general supply and demand is even more evident for prime product, which is driving yields to contract. In the absence of comparables, based on the offers received, the achievable CBD yield would now stand at 5.50%, which is 50 basis points below the level registered last year.

Economic situation

In late 2013 the Spanish economy technically came out of the recession, and according to forecasts from several competent bodies in this field, it appears that the growth trend will continue.

According to the latest data published by INE, the quarterly variation in GDP in Q4 2013 grew by 0.2%, although the annual variation was negative at -0.2%. Despite this, the moderation in economic slowdown suggests that the rate for Q1 2014 could reach a positive figure.

The job market is also showing slight signs of recovery. According to the latest data from the EPA (Q4 2013), the unemployment rate stood at 26.03%, in line with the previous quarter, suggesting that the rate of growth is beginning to wane.

On the other hand, according to data published by the Ministry of Economy, March registered an increase of 0.6% in the number of people signed up with Social Security compared to the same month the year before. This is especially relevant as no positive progress had been registered since 2008. Despite this, further efforts are still required in order to return to pre-crisis employment levels.

The increase in the consumer confidence index, published by the CIS, will impact on private spending in the short-term, which will affect national demand, contributing positively to GDP after six years of negative contribution.

Likewise, at the end of 2013 Spain achieved financial standing overseas. After 14 years with a negative balance of payments, the country experienced a surplus of €15.8bn, primarily due to the increase in exports, the reduction in imports and a continued increase in tourism.

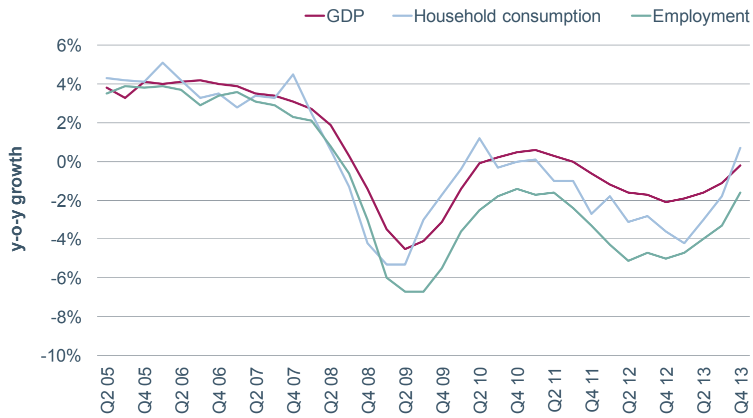
In the European context, the Spanish economy's growth rate is beginning to approach that of the Eurozone.

According to the latest Focus Economics forecast the economy will continue to grow in line with that of the Eurozone over the coming 24 months, and from 2015 onwards will register higher levels.

Despite the fact that it has not obtained the outstanding results registered in Ireland after the implementation of NAMA, the creation of 'Sareb' in Spain has helped clean up the country's financial accounts and has even helped the pace of the economy in 2013 to approach Ireland's levels.

GRAPH 4

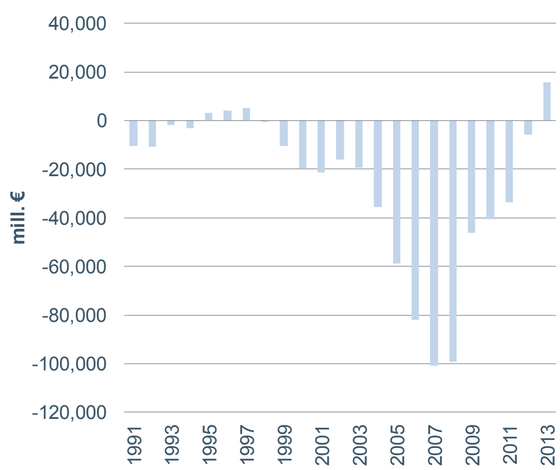
GDP, consumption and employment



Source: INE

GRAPH 3

Balance of payments



Source: Banco de España

TABLE 1

Economic indicators

Indicator	2013	2014*	2015*	2016*	2017*
GDP	-1.2%	0.9%	1.4%	1.7%	1.9%
Household consumption	-2.1%	1.0%	1.2%	1.7%	2.0%
Unemployment	26.4%	25.6%	24.5%	23.0%	21.8%
CPI	1.5%	0.4%	1.1%	1.3%	1.4%

Source: Focus Economics (April 2014) / *forecasts

Take-up and demand

Take-up registered over the first quarter of the year stood at slightly over 105,000 sq m, which is a 36% decrease on Q1 2013, however, we must not forget that the Vodafone transaction in Q1 13 2013 (50,000 sq m, the largest on record), considerably distorted the total, acccounting for almost a third of take-up. If we exclude this letting, the year-on-year variation would fall to -7%.

Meanwhile, the number of transactions increased by 9% y-o-y, which would suggest a slight recovery in demand.

The success of the capital's office market is confirmed by the latest data published by the Community of Madrid's Statistics Institute on business demographics in the region, which shows a slowdown in the decline of businesses at the end of 2013 and, after several years of negative figures, the creation of new companies outweighs the closure of others.

Increase in large transactions

There has been a noteable increase in large-scale transactions (exceeding 1,000 sq m), which accounted for 27% of take-up, compared to 22% in 2013. Spaces exceeding 3,000 sq m accounted for almost a third of this group.

The largest transaction, 14,000 sq m, corresponded to the future relocation of various ICEX headquarters (Foreing Trade Institute) and other organisations linked to internationalisation and exports, which will be brought under one roof in one of the buildings Repsol used to occupy on the final stretch of the Paseo de la Castellana.

This has been the only public sector transaction since mid last year, but the three administrations maintain their policy of active space optimisation, streamlining of work spaces and adaptation to the actual needs of each agency, therefore they will continue to actively take part in the office market, either in the occupier market or as a vendor in the investment sector.

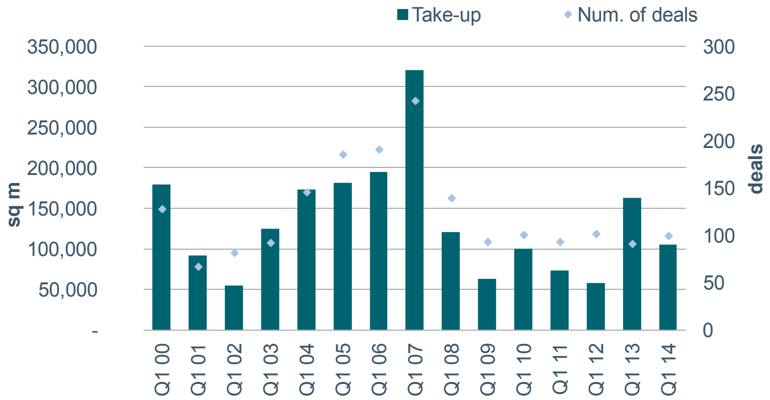
Sector activity

The business services sector continued to show signs of strength and since 2010 has been the stand-out performer in both occupier acquisitions and lettings, continually increasing its market share in the occupier market. Advisory companies, law firms or training companies, accounted for 52% of signed transactions and comprised 38% of the quarterly gross take-up, as opposed to 33% and 28%, respectively.

The completion of one-off mega-deals with companies related to technology, industry, distribution, etc. has favoured a modest increase in percentage take-up, but up until now, no business segment has stood out from the rest in terms of driving the market.

GRAPH 5

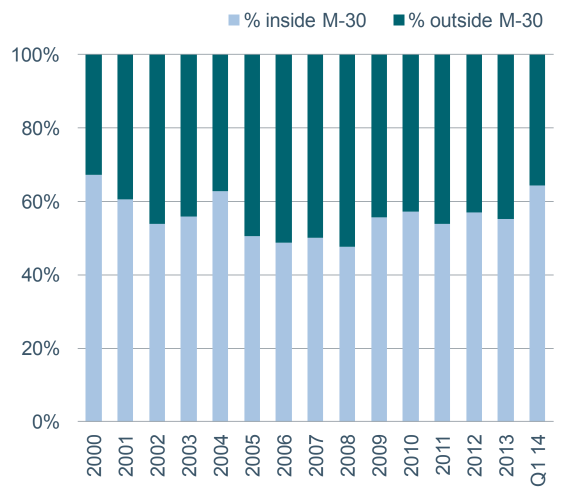
Historic trend in demand



Source: Savills

GRAPH 6

Deals with regards to the M-30



Source: Savills

The positive economic outlook could mean that credit will begin to flow again, which will reactivate investment in companies, business growth and the gradual recovery in employment to a healthier level.

City centre vs out-of-town

Occupiers and buyers continue to show a clear preference for central locations compared to out-of-town areas. Sharp adjustments in rents from pre-crisis levels, as well as the improvement in the quality of available space due to refurbishments and the renovation of various business areas, has favoured this trend. We obsserve the return of companies that were forced to move out of town due to the scarcity of available space and high rents, and the relocation of others that were already located in the centre, but who are taking advantage of the current optimal conditions.

Between January and March, 64% of lettings signed were located in the CBD and the inner urban sub-markets, which is the highest percentage since 2009, when the number of lettings outside of the M-30 began to edge over the 50% mark.

Current supply

At the end of Q1, there was 1.74 million sq m of available space in the Madrid office market, which puts the vacancy rate at 13.64%. For the second consecutive quarter this figure fell very slightly compared to the previous quarter, although there is still not enough demand to absorb the over-supply.

However, vacancy rates in the CBD and the strongest and most consolidated business areas remain well below market average, whilst sub-markets in the peripheries furthest from the city centre continue to have vacancy rates twice or triple that of the overall rate.

City centre

The high degree of obsolescence of the Madrid office market mainly affects properties in central urban areas, but it should be noted that 61% of the space that has adapted to new technical and technological requirements, undertaken since 2008, is located within the M-30, which once again has helped to draw demand in to the city centre.

Sustainability certificates

It is important to note that, despite the large volume of supply, the quality of space is not uniform, which at times makes it difficult to adapt occupier's needs to the existing available space.

In this respect, international sustainability certification systems are a guarantee not only for the quality of the specifications but also offer cost efficiency.

Nevertheless, it is worth noting that only 3% of vacant office space in Madrid has a LEED or BREEAM international certificate, or is in the certification process.

Only 6% of all office space in Madrid has a green certificate, 70% of which has been carried out by the end-user either tenant or owner-occupier.

New projects

No new development will come on to the market over 2014. The approximately 60,000 sq m of new space in the pipeline, corresponds to refurbishment projects. The slow-down in new projects will gradually begin to realign the imbalance between supply and demand. Meanwhile, several owners are looking to renovate their out-dated office space.

Among those refurbishments with delivery scheduled up until December, there are also three projects opting for, or that already have, an international LEED or BREEAM certificate. The old Telefónica R+D headquarters on the first stretch of the A-2 is in the process of acquiring LEED certification and another two buildings are linked to BREEAM certification: Paseo de Recoletos, 4 and Génova, 17. These projects comprise 58% of the total space in the pipeline and 65% of speculative space.

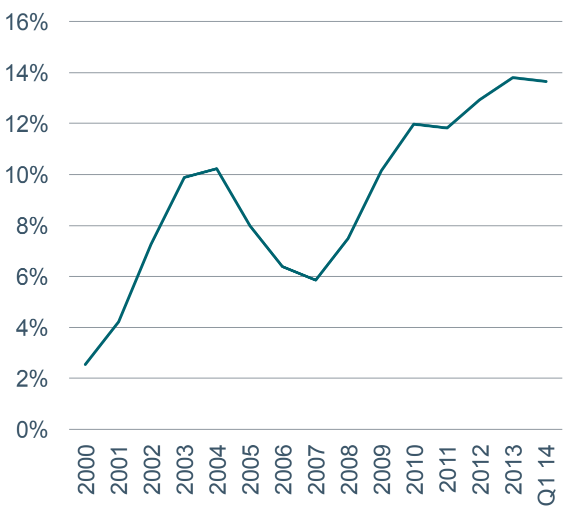
Commited space

In 2014 only 10% of space expected to come on to the market will be owner-occupied. So far there have been no pre-let agreements signed and the remaining 90% is actively being marketed.

If we extend the delivery date to 2015, the amount of committed space rises to 78%, whether for own use or with a pre-let agreement, due to the delivery of the second phase of the new BBVA headquarters in the northern area of the market, and the ICEX pre-let on the final stretch of the Paseo de la Castellana. Both projects are being developed to LEED sustainability and energy efficiency specifications.

GRAPH 7

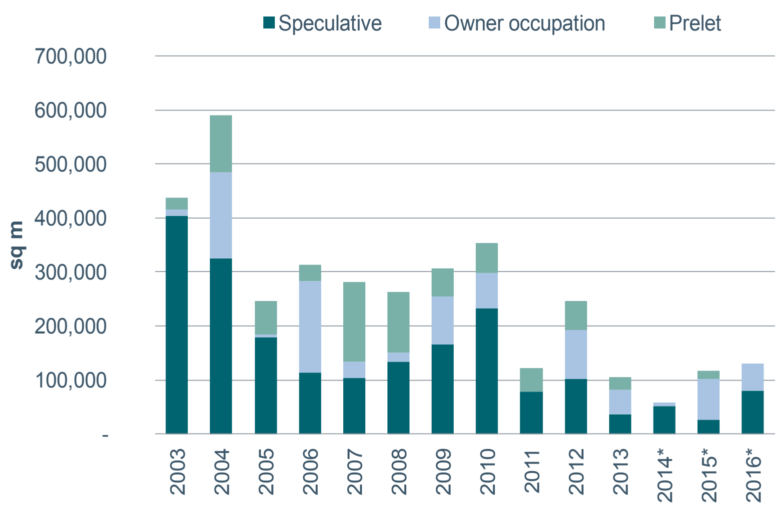
Vacancy rate



Sourc: Savills

GRAPH 8

New developments and refurbishment projects



Source: Savills / *forecasts

Slowdown in rental corrections

Rental corrections have begun to slow in the Madrid office market. The average value of all rents signed in office buildings (exclusive office use and semi-industrial) during Q1 2014 has touched on €13.50 per sq m/month, which equates to a decrease of 0.35% y-o-y.

The weight of transactions in exclusive office use office buildings, the inflow in to the city centre and the occasional register of values over €25 per sq m/month have been key factors in reigning in the negative figures.

On the other hand, semi-industrial properties continue to see rents fall. In comparison with 2013 data, the year-on-year variation exceeds -15%.

CBD, rents consolidate

Prime CBD buildings are the main drivers of an upturn in rents. The limited availability of high quality buildings on the Castellana and its immediate surrounding area, means that we have been able to leave the achievable level at €24.75 per sq m/month, which is an increase of 1% on the same value in early 2013.

However we would point out that there have been some lettings above this figure. The excitement around the cycle change has led some owners to raise asking prices in the hope of attaining higher closing prices, although it is important to remember that prices should be in line with the quality of the property and market conditions.

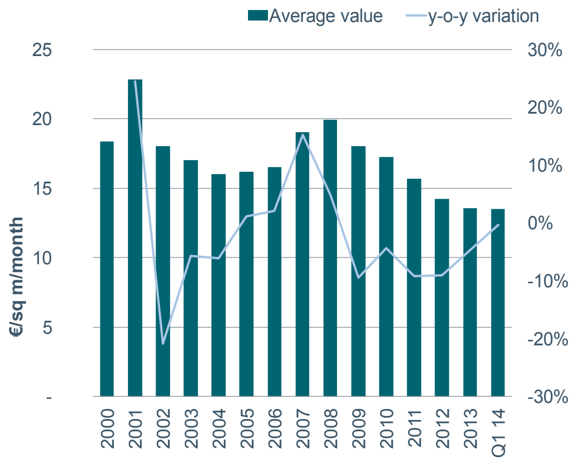
Minimum rents

Minimum rents remain at industrial prices, although we have noted a slight reduction in the number of single digit transactions signed. In 2013 these accounted for 20% of the total and in Q1 2014 hardly amounted to 19%.

"The CBD has continued to see a slight increase in rents in Q1 2014, due to the limited supply and strong demand in the best properties in the office market. It will not take long for the symptoms of recovery to start filtering down in to the main urban sub-market". Gema de la Fuente, Savills Research

GRAPH 9

Average closing rent



Source: Savills

TABLE 2

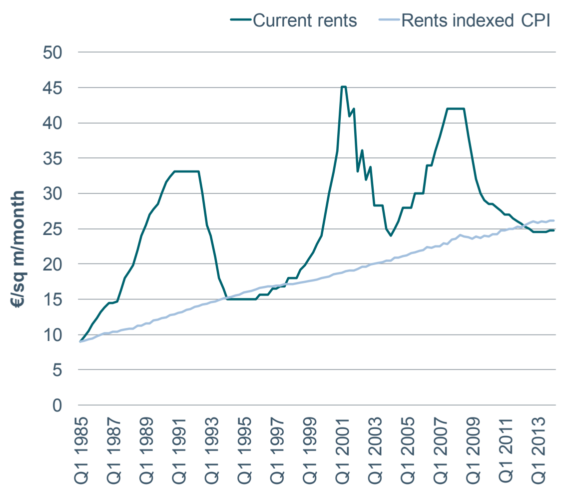
Main deals - Occupier market - Q1 2014

Tenant	Zone	Floor area (sq m)	Activity sector
ICEX	Urban area	14,000	Public administration
Alstom	East	6,000	Engineering
ITP	A-1	5,500	Industry
Instituto Claudio Galeno *	A-1	3,700	Business services
Confidential	North	3,600	Business services

Souce: Savills / *advised by Savills

GRAPH 10

Prime CBD achievable rental level



Source: Savills / INE

Investment market

Along the same lines as at the end of 2013, the office investment market continues to see intense activity. The total national investment volume registered for Q1 2014 in the commercial market was close to €350m, which is a little over a third of the total registered in 2013, and, unlike in recent years, national investors only accounted for 37% of the total.

The announcements by various international bodies of an improvement in the economy are consistent and have increased investor confidence in our market.

Origin of investors

International investors continue to gain ground in the market. In 2009 they drastically reduced their market share, accounting for just 2% of the total volume, and since 2012 have continued to be ever more present in the market. Between January and March 2014 international capital accounted for 62% of the total, divided across several transactions in Madrid and Barcelona.

In fact, two of the largest transactions were carried out by overseas investors. The first being the acquisition of the new Vodafone headquarters in Madrid, 50,000 sq m on the A-2, by London Regional Properties for €117m. And the second, the acquisition of the former Telefónica headquarters in Barcelona by an Indian tycoon for €56m, with the intention of converting it in to residential use.

Interest in Madrid

Madrid returned to being the top investment destination with close to €200m, almost 53% of the total transacted volume, securing its leading position in the market, and also reflecting a strong year-on-year increase. The comparison to the just €50m recorded in the same period last year shows that something has changed in the market.

With regard to the number of agreements reached, the city also outstripped the number of transactions signed in the same period last year.

However, despite the increase in volume recorded in the office market, this increase does not accurately reflect interest from buyers, whose expectations are not being met due to the lack of product on the market, which is causing sales processes to be over-crowded and highly competitive. For example, the commercial property complex at Paseo de la Castellana 200 (Reyal Urbis's last jewel in the crown), which is yet to be signed, has received around 20 offers.

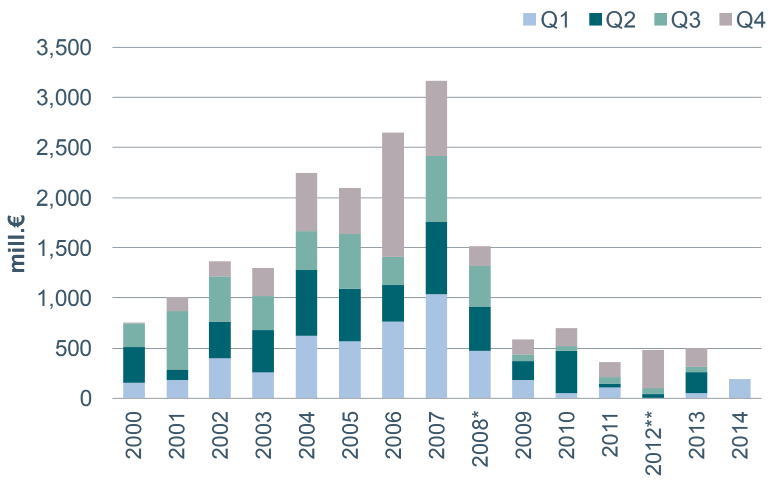
Type of transactions

As in 2013, there has been renewed interest for income-producing transactions. 88% of the quarterly volume was focused on these kinds of transactions. Although the total was heavily influenced by the €117m Vodafone headquarters transaction, if we exclude this, 66% of the volume was concentrated on income-producing properties.

Some vacant property transactions have been registered and, up until now, no change of use transactions have been registerered.

GRAPH 11

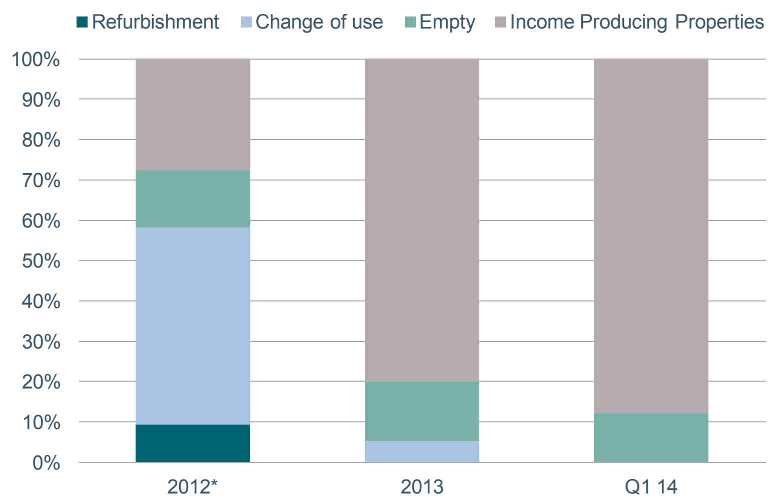
Investment volume



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

GRAPH 12

Investment volume by type of deal



Source: Savills / *excluding Torre Picasso

"The first signs of economic recovery and positive prime rental trends have attracted the attention of a large group of investors for Spain. Everything would suggest that the investment volume over the first half of the year will be higher than that of the past five years". Pablo Pavía, Spain Investment

One of the first deals of the year was Manuel de Falla, 7. One of the assets that formed part of the Copérnico deal (liquidation of the assets of the old Eurohypo German bank, currently known as Hypothekenbank) purchased by the Anchorage and Värde funds at the end of 2012. The new owner is a Spanish company that will carry out a refurbishment project before putting the property back onto the market.

It should also be noted that the market is moving very slowly given that the time needed to make a decision is becoming ever more protracted. All transactions registered over Q1 began negotiations almost a year ago and it seems that this lack of agility in negotiations will persist in 2014, which could delay some agreements.

This would not be the case for a prime investment opportunity, which continue to be of interest to both national and international investors, but these are also the rarest. The marked adjustment in prices per sq m compared to the top of the market, as well as the expected growth in rents in the short/medium term will require investors to be quicker off the mark.

Return of financing

It is not just international funds that have added Spain to their investment list again. International banks are also interested in providing credit, as long as they are highly secure transactions, albeit still at very high prices. In any case, all transactions signed so far, and all agreements currently underway, are being carried out by equity buyers.

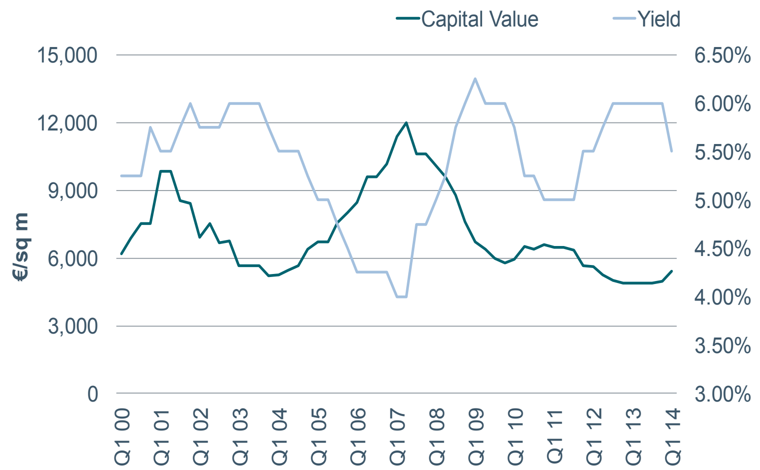
Yields

The imbalance between supply and demand for prime properties could drive the yield in the CBD to harden further. This is only a perception of the market, as no deals have been registered in this category, but based on offers received in processes located close to the prime area, it appears that the achievable yield has fallen by 50 basis points, both in the city centre, as well as outside the M-30 and that it now stands at 5.5% and 7% respectively.

So called trophy assets, prime buildings in prime locations, with a solvent tenant and market rents, with lot sizes in the region of €30m or less, could reach levels closer to 5%.

GRAPH 13

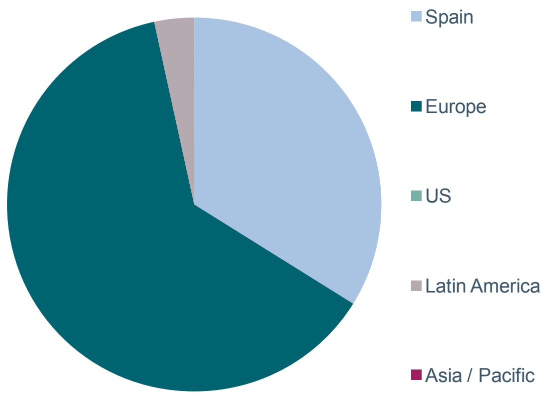
Prime CBD investment indicators



Source: Savills

GRAPH 14

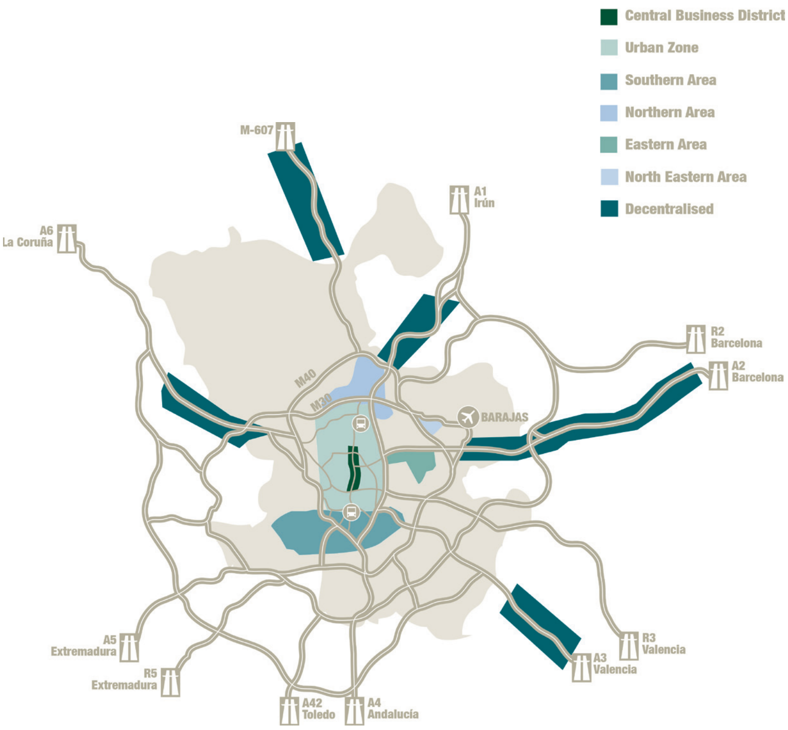
Investment volume by purchasers origin - Q1 2014



Source: Savills

MAP 1

Madrid office market



OUTLOOK

2014

■ It is expected that the slight upturn in the occupier demand throughout 2014, which would favour an upswing in the overall take-up volume.

■ The rise in take-up will help to reduce the vacancy rate, although some occupiers are focusing their attention on refurbishment projects that were not included in the available space figure.

■ Over the coming 24 months refurbishment projects will account for 100% of all speculative office space. There is just one new building being developed.

■ Achievable rental levels in the CBD could increase slightly towards the end of the year, as there are ever fewer prime buildings on the market in the CBD.

■ Strong demand for investment properties is being held back due to the lack of product for sale. Despite the above, several properties are under negotiation, of which several are off market. If all of them complete, the volume for the first half of the year could reach around €700m.

■ Growing demand and the lack of quality product in the best areas in the market, will set the yield mark.

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