OFFICE MARKET REPORT

MADRID & BARCELONA

AGUIRRE NEWMAN

January 2017

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1. General market overview

The Spanish economy has continued to grow for the past 3 years, with GDP growing at circa 3.3% in 2016. This growth, which is bolstered by both an improving job market and a steady rise in household disposable income, has meant that Spain now has one of the most dynamic economies within the European Union. In 2016 we have seen how the expansionary fiscal policy stance and the effects of cheap oil prices have mitigated the potential negative repercussions that Brexit or the long-winded caretaker government period could have had on our economy.

Most analysts are of the opinion that the main macroeconomic indicators will remain strong over 2017. Nevertheless, we expect that growth will slow slightly as various incentives that have been driving the Spanish economy in recent years come to an end. Despite this, the Spanish economy is expected to grow by around 2.5%, supported by a strong domestic market, input from foreign trade and an ever improving job market.

Gross take-up of office space in Madrid and Barcelona has been strong, exceeding historical averages in both markets. However, take-up in both markets has declined y-o-y. Rents have continued to rise, and average rental prices have increased in all areas analysed. Finally, the vacancy rate has fallen in both markets, primarily as a result of the lack of new supply.

Investment in the office market over 2016 stood at a combined total of €5,000 million for Madrid and Barcelona. This makes 2016 the third best year in terms of investment volume since records began, just behind 2007 and 2015. We would highlight the significant compression of yields over H2 in particular, as a result of strong demand but limited supply. In this regard, there were a few examples of deals closed below 3% in Madrid's Business District, and around 5.00-5.25% in certain decentralised markets close to the city centre.

The table below outlines the key variables in the Madrid and Barcelona office markets.

Key Variables	MADRID			BARCELONA		
	January 2016	January 2017	Change (%)	January 2016	January 2017	Change (%)
Stock at 1 January (sqm)	12,827,895	12,844,146	0.13%	5,885,653	5,944,153	1.0%
New Projects (sqm) Yearly	98,538	16,251	-83.5%	4,184	58,500	1298.2%
Gross Take-up (sqm) Yearly	572,967	496,108	-13.4%	420,448	330,282	-21.4%
Gross Take-up/Stock (%)	4.5%	3.9%	- 060 bp	7.14%	5.56%	- 160 bp
Vacancy (%) at 1 January	11.7%	11.4%	- 030 bp	11.50%	9.50%	- 200 bp
Vacancy CBD (%) at 1 January	6.2%	10.4%	- 420 bp	4.2%	2.9%	- 130 bp
Vacancy DEC (%) at 1 January	15.9%	15.5%	- 040 bp	16.3%	12.8%	- 350 bp
Average rental price CBD (€/sqm/month)	26.32	27.89	6.0%	16.01	16.80	4.9%
Average rental price DEC (€/sqm/month)	11.38	12.47	9.6%	12.42	13.49	8.6%
Initial Yield CBD (%)	4.50%	3.75%	- 075 bp	4.50%	4.50%	-
Initial yield DEC (%)	6.50%	5.75%	- 075 bp	6.50%	5.75%	- 75 bp

2. Conclusions: Madrid Market

At YE 2016 office stock stood at 12,854,146 sqm. During the past 12 months development has primarily focused on property refurbishments, with only 16,251 sqm of new office stock coming onto the market in Madrid. Office stock in Madrid rose by 0.13% last year.

The most noteworthy factor of 2016 has been the improvement of office stock via refurbishments. In total 96,249 sqm of office space was refurbished, of which we would particularly note Castellana 81, the Blue Building (Jose Lázaro Galdiano 6) and Avenida América 79.

The average rental price in the Prime area is €27.89/sqm/ month.

Demand for office space during 2016 has been reasonable, reaching gross take-up of 496,108 sqm, compared to 572,967 sqm in 2015, a 13.4% y-o-y decrease compared to the excellent results in 2015. This decrease was primarily due to fewer large-scale transactions. Lettings in 2016 were mainly for smaller spaces, with 78% being lettings of spaces below 1,000 sqm. During 2016 there were 561 transactions, 42 less than in 2015. Gross take-up in H2 2016 posted lower figures than in H1 2016, with 50,000 sqm less space taken in H2, due to the lack of activity in the summer months. During Q4 2016 several large transactions were completed, making the half-on-half difference less marked. The overall Madrid vacancy rate has fallen slightly in the past twelve months, from 11.7% in January 2016 to 11.4% in January 2017. There has been barely any change in the vacancy rate in the Business District area due to the high number of refurbishment projects that have been undertaken in this area. In absolute terms, vacancy fell by 32,977 sqm in 2016,with the current amount of office space ready for immediate occupation standing at 1,463,340 sqm. The vacancy rate in the Central Business District (CBD) rose to 10.4%, due to the completion of the refurbishment of the former BBVA tower (Castellana 81).

During 2016 there was a general increase in rents across all of the areas analysed, posting an average overall rise of 6.9% y-o-y, slightly higher than the figure registered in 2015. The average rent in the Central Business District (CBD) or the Prime area has risen to €27.89 per sqm/month, while average rents in the Decentralised Area (DEC) have reached €12.27 per sqm/ month. The fact that availability has increased in the CBD due to refurbishments is hampering higher rental growth.

There has been an overall upswing in rents in all areas of the market, with a 6.9% increase over the last 12 months.

2. Conclusions: Barcelona Market

As at 1 January 2017, office stock grew very slightly to 5,944,153 sqm. 59% of total office stock is located in the City Centre (CBD, RBD and RC). In 2016, 58,500 sqm of new office space came on to the market, of which more than 60% is already pre-let. The majority of new stock (70%) is located in the Decentralised (DEC) Area. The most noteworthy building is Cuatrecasas' head office in the 22@ area, comprising 22,000 sqm.

Take-up amounted to 330,282 sqm in 2016. If we compare this to historical take-up data, this is a reasonable figure. However if we compare this figure y-o-y, take-up has dropped by 21%. We would highlight that 2015 was an exceptional year, where we saw unprecedented levels of take-up that are not usually seen in the market, as a result of the Generalitat deal for instance, who let 46,000 sqm of space. Levels of demand during 2016 were very similar in the two halves of the year (160,615 sqm in H1 vs. 169,667 sqm in H2). Take-up has been strongest in the city centre. In the Central Business District (CBD), take-up amounted to 40,639 sqm, which is an 11.35% increase y-o-y and almost double the figures achieved in 2013 and 2014. On the other hand, we would highlight that take-up has fallen by almost 40% y-o-y in the DEC and OUT areas.

The vacancy rate has been falling steadily (-2%) as a result of rising demand and limited available supply that has come on to the market over 2016. The vacancy rate currently stands at 9.5% of the total stock figure. There are 564,975 sqm of office space available; which means that available space fell by 111,630 sqm over the past 12 months. The vacancy rate in the Central Business areas (CBD and RBD) is nominal, currently standing at below 3%. Rents in the Barcelona market have been strong in 2016, where they have increased by 6.1% on average. The average rent in the Central Business District (CBD) reached €16.80 per sqm/month, with lettings in some of the best properties in the area reaching above €21.50 per sqm/month.

There has been a sharp decline in the amount of available space - which has fallen by 2 percentage points over the last 12 months, and currently stands at 9.5% of the total stock figure.

2. Conclusions: Investment Market

There is strong interest in investing in office properties in Madrid and Barcelona, with 2016 being the third best year, only behind 2007 and 2015. Investment volume reached approximately €5,000 million, with 84% of deals completed in Madrid and 16% in Barcelona. The lower investment volume figure achieved in Barcelona is primarily due to a shortage of investment properties on the market, as opposed to subdued investor interest.

The lack of a central government and the resulting political uncertainity that has been rife over 2016 does not appear to have had repercussions on the property investment market. In actual fact, during the period of political uncertainty, both national and international investors maintained a close eye on the market, as initial yields required by investors compressed significantly.

Despite the wide range of risks, the office market has remained on investors' radars, looking at "core" buildings to out-and-out "value add" buildings, and even opportunistic. In this regard all submarkets in Madrid and Barcelona have been extremely active, with approximately half of deals signed for space located in out-of-town markets (DEC and OUT) and the remaining half in the city centre (BD and RC).

The most active investors in the market were Socimis, which accounted for over 50% of all investment volume in the market, but only accounted for 16% of all deals. In this regard we would highlight Merlin Properties' purchase of Metrovacesa's property portfolio. This transaction accounted for 36% of the total investment volume. As is common in our market, other types of investors such as institutional funds, private investors, insurance/mutual insurance companies and property firms have been very active on the buy-side of the market.

On the sell-side, non-property companies who have decided to sell some of the office buildings on their books have been highly active, some of which they occupy themselves and others which are let out to tenants. Some of the Sale & Leaseback deals completed include the sales of the Gas Natural and Vocento headquarters in Madrid and the sale of Nestle's headquarters in Barcelona.

Initial yields have hardened significantly, reaching previously unheard of figures in the Business District. Initial yields range between 3.75% and 6.75%, depending on the quality, location and tenants in the properties. Despite the fact that rents are well off their all-time highs, current yields have pushed prices per sqm within reach of those registered in 2007-2008.

* Including the Metrovacesa deal

3. Outlook: Madrid Market

Development activity in the coming two years is forecast to be higher than registered in recent years. Only 101,826 sqm of new space is expected to come onto the Madrid office market in 2017, 90% of which is pre-let/occupied as at 1 January 2017. In terms of size, we would also note Banco Popular's headquarters in the Decentralised Area (DEC). 157,753 sqm is expected to come on to the market in 2018, of which to-date, 100% is available to let.

Development activity in the coming years is forecast to be higher than registered in recent years.

In terms of new schemes that are coming on to the market, we would highlight that a considerable number of refurbished buildings mainly located in the city centre are benefiting from improved specification. Particularly noteworthy in this category are "Torre Europa", "Castellana 77" and "Ramírez de Prado 5".

Bearing in mind the expected improvement in the business sector, the reduced political uncertainty and take-up during 2016, with a lack of large-scale transactions, it is expected that office take-up in 2017 will reach close to 540,000 sqm. 2017 is expected to see an increase in mid-size and large office spaces, compared to those taken in 2016.

Vacancy rates will vary over the next year. Whilst vacancy rates will continue to fall in out-of-town areas (DEC and OUT) and the Rest of the City (RC), in the Business District, availability will remain at current levels or could even increase, as a result of the new refurbished supply available to let that will come on to the market, such as Torre Europa and Castellana 77.

Rental prices in 2017 will remain relatively unchanged compared to the last twelve months. New available supply coming on to the market will cause rental prices to increase slightly (5 to 10%) in the Central Business District (CBD) and Rest of the Business District (RBD). Rental prices in other areas will be strong, given the lack of new schemes in the pipeline and the quality of the buildings located in these areas.

3. Outlook: Barcelona Market

In terms of new projects, 35,550 sqm are forecast for 2017. We would highlight the construction of Torre Marina, a 20,000 sqm building that is currently under construction in the Porta Firal complex in the DEC area. Approximately 66% of the 35,500 sqm will be available to let.

Subsequently, in 2018 we expect a total of 93,000 sqm of new space to come on to the market in Barcelona, 23% of which will be pre-let, as some schemes already benefit from pre-lets agreed for future occupiers.

We expect that investors will remain active and that take-up could reach 340,000 sqm for 2017 as a whole. In 2017, we anticipate that the majority of space will be taken in the DEC and OUT areas, which is mainly due to the shortage of available supply in the city centre, particularly for large offices.

In terms of the vacancy rate, taking into consideration the good levels of demand and the low levels of new available space that will come on to the market, we expect to see the vacancy rate continue to adjust. This will be more notable in the periphery and outer city areas.

Given the strong level of market activity over the last year and the upswing in rents, we expect that rental prices will continue to rise in all areas, with rents increasing the most in the CBD and RBD, given the acute shortage of available space in these areas.

Rental prices will rise in all segments of the market, with the greatest increases in the CBD and RBD, as a result of limited vacant space in these areas.

3. Outlook: Investment Market

Activity will remain dynamic in 2017, thanks to high levels of liquidity globally and strong macroeconomic indicators, with substantial scope for growth.

International funds (institutional funds in particular) and Socimis will remain at the forefront of the investment market, as opposed to the opportunistic investors that came onto the scene in 2013 and 2014. Certain Socimis (e.g. Axiare and Merlin Properties) and listed property companies (e.g. Inmobiliaria Colonial) will continue to focus on the office market.

Demand in the market will continue to outstrip supply, which, when coupled with the high prices achieved, will become an issue for companies when it comes to making investment decisions. In terms of supply, Socimis will begin to rotate their non-strategic properties within their business plans. In addition, "outbound" institutional funds, i.e. those selling individual properties from portfolios they have purchased in recent years, and unlisted property companies will be equally key on the sell-side of the market.

The yields achieved in the Business District tend to suggest that yields will stabilise in this submarket. Further contractions in yields are more likely to be seen in Out-of-Town markets, the areas where yields have contracted the least over recent years and where yield corrections have still not reached the record lows achieved in 2007. Capital values will continue to rise as a result of the increase in rental prices and anticipated hardening of yields.

Lending will continue to improve via the main national and international banks specialised in the real estate industry and margins and LTVs will remain at very similar figures as those seen in 2016. LTVs between 60-70%, with maximums of 75% for the prime market and Euribor spreads from 175 basis points.

If the Bank of Spain's forecasts for 2017 ring true and GDP increases by 2.5%, investment could top €3,000 million, albeit this is lower than the levels achieved in 2015 and 2016. *

* Excluding corporate deals.

Madrid Market

4. Madrid Office Market

CBD AREA – Central Business District

The area from Plaza de Cibeles to Nuevos Ministerios, including the best buildings in Azca. Properties located in other nearby areas, whose features meet demand requirements for Grade A space are also included in this group. We should point out that the Cuatro Torres Business Area has been included in this area. E.g.: Castellana 110, Torre Picasso, Torre Europa, Torre Serrano, Serrano 55, Torre Espacio, Torre Cristal, etc.
PROPERTY TYPE: Castellana 9-11, Castellana 21, Torres de Colón, Castellana 81, Pirámide, Castellana 7, Castellana 41.

RBD AREA – Rest of Business District

This comprises the rest of the Business District in Madrid - Azca, Serrano, Velázquez, Príncipe de Vergara, Goya, etc. The area features multinational companies, insurance companies, financial institutions and other companies in the services sector.
PROPERTY TYPE: Puerta de Europa, Cuzco IV, Pº Recoletos 5, Príncipe de Vergara 110, Edificio Cubik, O´Donnell, 12, Mª de Molina 54, Torre Mahou, etc.

RC AREA - Rest of City

This area encompasses the capital's historic city centre, as well as the rest of the Central Core, which is not included in the above areas.
PROPERTY TYPE: Gran Vía 39, Alcalá 21, Edificio Compostela, Gran Vía 30, Princesa 3, etc.

DEC AREA - Decentralised

This is the decentralised area of Madrid, and includes the catchment area located between the M-30 and the M-40. Large multinationals have been attracted to this area, which includes Campo de las Naciones, Méndez Alvaro and Las Tablas.
PROPERTY TYPE: Complejo Triada, Gorbea 3, Edificio Herre, Torres de Méndez Álvaro, Parque Norte, Ed. Iris, Torres Ágora, Cristalia, Distrito C, etc.

OUT AREA – Outside of the City

This includes the office buildings located outside of the municipality of Madrid, or those that are located just outside of the city centre. There are four different sub-zones in this area - Tres Cantos, A-1, A-2 and A-6.
PROPERTY TYPE: San Fernando Business Park, La Finca Business Park, El Plantío Business Centre, Euronova Business Centre, Las Rozas Business Campus.

4.1 Office Stock and New Projects

The total office stock in Madrid reached 12,854,146 sqm as at January 2017, which is a very minor rise in stock of 0.13% compared to January 2016. A limited number of new schemes came on to the market in 2016. Just 16,251 sqm of new stock split over two new schemes came on to the market. These include the final phase of BBVA's new headquarters in Las Tablas, comprising 10,000 sqm and the new development situated on Calle Manuel de Falla 7 (6.251 sqm).

Of particular note is the number of refurbishment projects that are currently underway in the Madrid market, particularly within highly outdated buildings situated in the city centre and areas close to the M-30. The most significant refurbishment project this year was Paseo de la Castellana 81. The tower, situated in a prime location, provides 36,000 sqm of accommodation and underwent a comprehensive refurb. We would also point out the refurbishment of Avenida America 79, as well as Vodafone's old head office in Alcobendas (Avenida Europa 1-3) comprising approximately 12,500 sqm and the refurbishment of the 9,200 sqm "Blue Building" located at Calle Jose Lazaro Galdiano 6. As these are refurbishment projects and not new stock per se, they have not been included as additions to the total office stock figure. They do nevertheless increase the vacancy rate for high spec office space in the Madrid market.

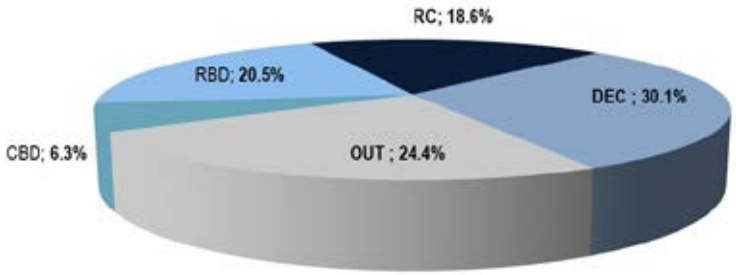
The table below highlights the change in office stock over the past year and its distribution by area.

Change in Office Stock in Madrid (January 2016 / January 2017)

Area		Area (sqm) January 2016	%	Area (sqm) July 2016	%	Area (sqm) January 2017	%	Variation (%)
BD	CBD	811,904	6.4%	811,904	6.3%	811,904	6.3%	0.0%
	RBD	2,633,041	20.7%	2,639,292	20.6%	2,639,292	20.5%	0.2%
RC		2,393,865	18.8%	2,393,865	18.7%	2,393,865	18.6%	0.0%
DEC		3,855,401	30.29%	3,855,401	30.0%	3,865,401	30.1%	0.3%
OUT		3,133,684	24.62%	3,133,684	24.4%	3,133,684	24.4%	0.0%
TOTAL		12,827,895	100.0%	12,834,146	100.0%	12,844,146	100.0%	0.13%

The following graph shows the distribution of stock in Madrid by areas, demonstrating that out-of-town areas are continuing to see an increase in office stock. In January 2017, these areas accounted for approximately 54% of all office stock.

Distribution of Stock - January 2017

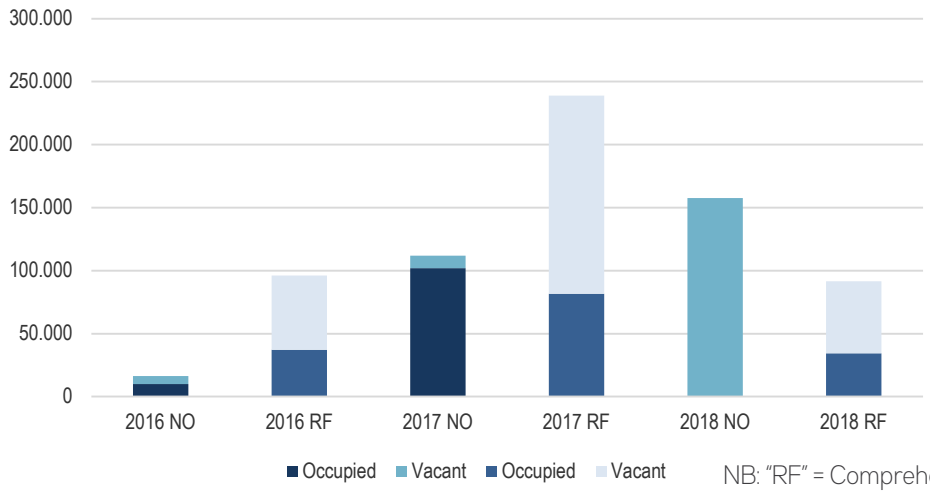


In 2017 developer activity will continue in the same vein as recent years. In terms of volume, we would highlight the opening of Banco Popular's new head office comprising 100,000 sqm on Calle Juan Ignacio Luca de Tena, Madrid and the speculative development of the Discovery office building at Calle Estebanez Calderon, extending to 9,903 sqm. There will be a significant change in trend in 2018, as 157,753 sqm of new office space will come on to the market, all currently available to let. New supply in the pipeline for 2018 will largely be located in the A-1 national highway catchment areas. This will include Merlin-Isla's Chamartin schemes (16,400 sqm), Oxxeo (13,500 sqm) and Adequa (45,002 sqm) in Las Tablas, and in the catchment area of the A-2, with schemes including Helios (35,000 sqm) in Campo de las Naciones and Julian Camarillo 29-31 (36,000 sqm).

In addition to the construction of new schemes that will increase the total supply figure, a number of landlords will remain committed to improving the specification of their buildings to ensure that they meet tenants' new requirements. We expect that over 30 buildings will be refurbished between 2017 and 2018. This equates to over 300,000 sqm of new refurbished space in the pipeline, of which 214,505 sqm is currently available to let. Of particular note would be the comprehensive refurbishments of Torre Europa, Castellana 77 and Ramirez de Prado 5. We would reiterate that these buildings that are due to be completely refurbished do not add to the level of existing stock, although they will increase the vacancy rate in the market accordingly.

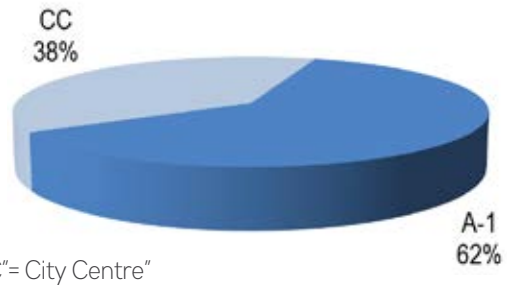
The graph below outlines the new supply that came on to the market in 2016 and the pipeline of future supply for 2017 and 2018. This year refurbishment projects will be the stars of the show, increasing available supply in the market, given that the majority of new schemes in the pipeline for this year are already pre-let, such as the Banco Popular scheme. However, things will shift in 2018 and all new schemes are currently available to let.

New Projects (2016-2017)



NB: "RF" = Comprehensive Refurbishment

New Projects per National Highway 2016 (sqm)

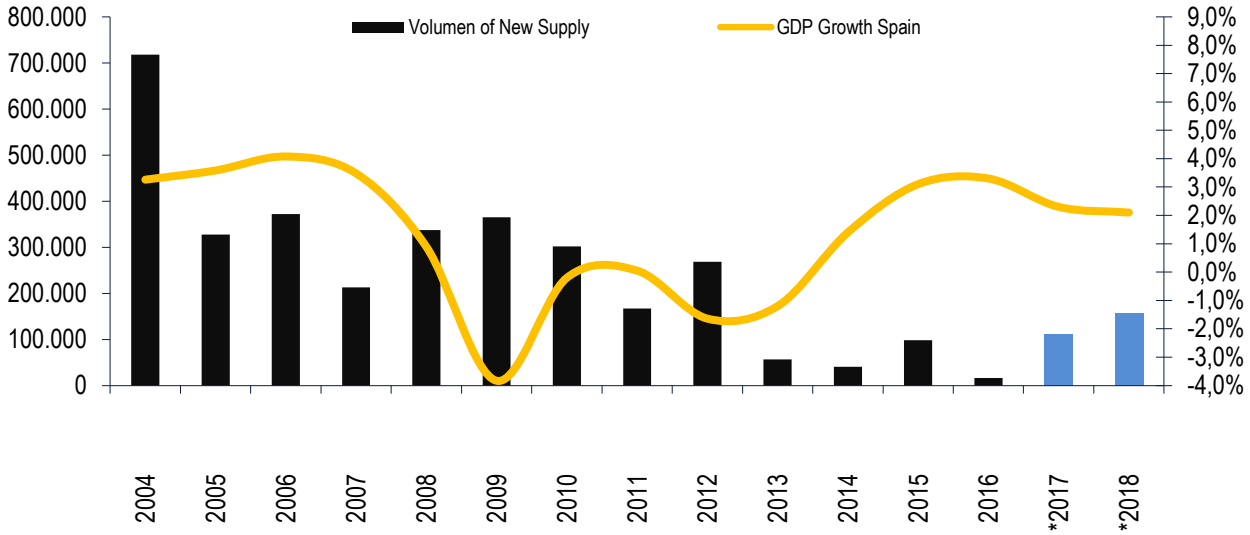


Note: "CC"= City Centre"

New Projects per National Highway 2017 (sqm)

Note: "CC"= City Centre"

The graph below indicates the change in new office supply in Madrid since 2004, as well as projections for the next two years and its relation with the change in GDP. From 2017 onwards there will be a slight increase in new stock coming on to the market. This will start to stabilise in 2018, with stock increasing to the highest levels we have seen over the last 5 years. Nevertheless, development of new office supply is at an all-time low. The limited amount of new stock in the pipeline over the 2017-2018 period will be offset by the high number of comprehensive refurbishment projects that are already included in the existing stock figure.



4.2 Demand

Over 2016, gross office take-up in the Madrid market shrunk by 13% y-o-y to 496,108 sqm. Nevertheless, despite this drop, take-up has remained above the historical average. This is positive given that 2016 has been an unprecedented year, characterised by a high level of political and economic uncertainty, which has affected companies' decision-making. In H2, gross take-up amounted to 223,089 sqm.

During 2016, take-up fell the most in the CBD (Central Business District), at -58.8% compared to 2015. This is due to the lack of large-scale deals in 2016 compared to 2015, where we saw companies such as KPMG and E&Y relocate their head offices to the CBD. Nevertheless, the figures for the CBD in 2016 are normal and in line with take-up figures that we have typically see in this area, at around 35,000 sqm per year.

The 17.1% decline in take-up in the Rest of the Business District (RBD) has led to a lack of available space in this market. The highest performing area compared to 2015 was the Rest of the City (RC), where annual take-up of office space in 2016 has risen by 24.3% to 53,769 sqm.

Take-up in H1 2015 and H1 2016 was very similar (273,019 sqm H1 2016 vs 262,790 sqm H1 2015). However, in H2 2016 we saw a significant decline compared to the same period in 2015 (223,089 sqm in H2 2016 vs 310,177 sqm in H2 2015). 2015), which is mainly due to the decline in the number of large-scale transactions.

The table below indicates the change in gross take-up figures by areas and by semesters in 2015 and 2016:

Area		2015		TOTAL	2016		TOTAL	Change (%)
		H1	H2	2015	H1	H2	2016	2015-2016
BD	CBD	40,294	39,476	79,770	20,750	12,089	32,839	-58.8%
	RBD	43,399	84,615	128,014	54,289	51,849	106,138	-17.1%
RC		34,105	9,151	43,256	28,462	25,307	53,769	24.3%
DEC		96,961	105,822	202,783	105,527	91,310	196,837	-2.9%
OUT		48,031	71,113	119,144	63,990	42,534	106,524	-10.6%
TOTAL		262,790	310,177	572,967	273,019	223,089	496,108	-13.4%

The table below highlights the number and volume of transactions over the past two years per size category. A significant number of deals have been signed in 2016 - 561 in total, albeit this is 7% down y-o-y, as a result of the political uncertainty that has had repercussions on demand for office space. The considerable number of deals signed in 2016 despite the challenging political climate indicates that there is strong demand for offices, which, on the other hand is only natural given the level of economic growth Spain is experiencing.

Take-up	2015		2016		Change in Transactions (%)	Change in Floor space (%)
	Transactions	sqm	Transactions	sqm		
< 200 sqm	114	15,349	107	14,316	-6%	-7%
201-500 sqm	253	84,210	207	69,942	-18%	-17%
501-1,000 sqm	132	94,598	124	87,312	-6%	-8%
1,001-3,000 sqm	73	124,356	92	158,475	25%	27%
> 3,000 sqm	31	254,454	31	166,063	0%	-35%
TOTAL	603	572,967	561	496,108	-7%	-13%

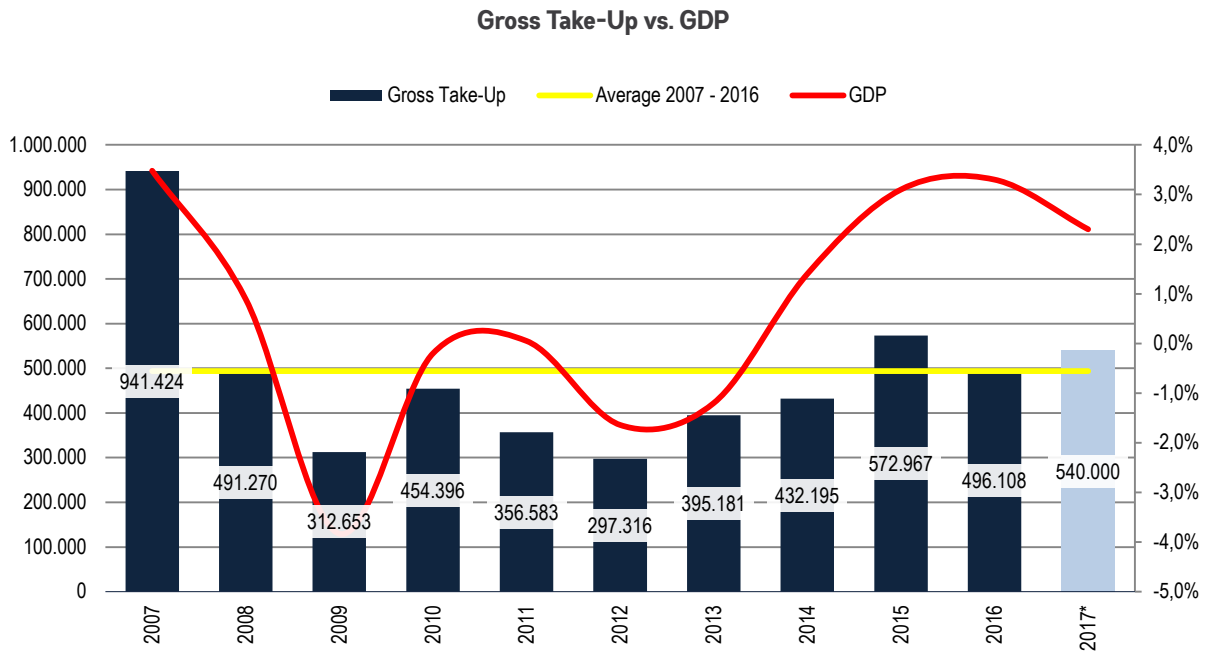
Take-up per size category in 2016 remains unchanged y-o-y. There has been a reduction in the number of deals in all space brackets, with the exception of floorplates between 1,001 and 3,000 sqm. There has been a 25% increase in the number of deals in this bracket, and a 27% rise in the size of floorplate let. There has been a significant decline in the take-up of offices with large floorplates. In H1 2016, the largest transaction was Banco Popular-e (WiZink) at Calle Ulises 18, comprising approximately 8,000 sqm. This clearly demonstrates the subdued level of activity for these types of transactions. From October onwards, in line with a greater period of political stability, we have noted an increase in the demand for offices with larger floorplates (> 10,000 sqm), from companies such as Huawei, Renault and Amazon, amongst others.

The following table details take-up in 2015 and 2016 by business sector occupiers. "Business services" continued to be the driver behind demand, which tends to be the norm in Madrid, accounting for 30% of all take-up and accounting for 30% of transactions. In 2016 there was a surge in occupier demand from the "insurance", "sales and distribution" and "telecoms" sectors - in some cases take-up has doubled compared to 2015. Finally, the "Public Sector" remains sluggish - the amount of office space taken by occupiers in this segment has halved over the last 12 months. The only signs of life in this segment have been the occasional embassy deal, which for the purposes of this report are included in the Public Sector category. Over the next 2 years we understand that activity from the public sector will increase, as they are currently seeking office space.

One can see that the average size of space fell in 2016 to 884 sqm, from 950 sqm in 2015, this was primarily due to the lack of large-scale lettings.

SECTOR	2015					2016				
	Area (sqm)	%	No.	%	Average Area (sqm)	Area (sqm)	%	No.	%	Average Area (sqm)
Business services	202,724	35%	193	32%	1,050	148,947	30%	166	30%	895
Electronics/IT	64,531	11%	86	14%	750	60,101	12%	69	12%	870
Banking and Finance	62,792	11%	68	11%	923	44,366	9%	60	11%	745
Sales and Distribution	22,204	4%	47	8%	472	44,159	9%	52	9%	857
Industrial and Manufacturing	27,668	5%	43	7%	643	42,267	9%	40	7%	1,054
Telecoms	21,817	4%	19	3%	1,148	35,835	7%	16	3%	2,185
Chemicals and Energy	36,824	6%	37	6%	995	26,383	5%	32	6%	828
Construction and Real Estate	9,703	2%	21	3%	462	22,081	4%	33	6%	676
Insurance	12,692	2%	16	3%	793	18,320	4%	12	2%	1,489
Media	59,188	10%	23	4%	2,573	11,915	2%	27	5%	445
Public Authorities	15,837	3%	8	1%	1,980	7,205	1%	5	1%	1,413
Other	36,987	6%	42	7%	881	34,527	7%	50	9%	698
TOTAL	**572,967**	**100.0%**	**603**	**100.0%**	**950**	**496,108**	**100.0%**	**561**	**100.0%**	**884**

The graph below indicates the historic change in take-up in Madrid, as well as Aguirre Newman's forecast for 2017. This data is compared with the average take-up figures over the past 10 years and GDP performance over the same period.



The graph demonstrates the direct correlation between GDP performance and annual gross take-up, given that both variables are intrinsically linked to the job market. Unlike in 2015, net take-up in 2016 has been very low, due to a lack of companies moving to larger offices.

Forecasts for 2017 suggest that take-up will register moderate growth compared to 2016, reaching circa 540,000 sqm. We expect that there will be some pent-up demand for large-scale transactions that did not complete in 2016, but instead will be signed in 2017, and we expect there to be a rise in take-up from public sector occupiers. These two factors, combined with a more favourable political and economic climate in Spain, are more positive indicators.

4.3 Vacancy

As at 1 January 2017, the vacancy rate across all office stock stood at 11.4%, which is a total of 1,463,340 sqm of office space available for immediate occupation. In general the vacancy rate has continued to fall as it has done since 2013. However, subdued net take-up figures, with occupiers primarily focused on relocating as opposed to letting larger offices (or taking only slightly larger floorplates), coupled with an increase in the number of refurbished offices coming on to the market, has slowed the drop in vacancy rate somewhat.

The table below breaks down the the vacancy rate for the areas analysed in this market study. Of particular note is the increase in availability in the Central Business District (CBD) as a result of a number of fully refurbished offices coming back on to the market, such as Paseo de la Castellana 81, in addition to firms such as EY and KPMG vacating their large offices in the AZCA financial district. The vacancy rate in the most exclusive area of the city (CBD), stands at 10.4%, having increased 34,604 sqm in the past twelve months.

The area with the lowest vacancy rates are the Rest of the Business Distruct (RBD) with 5.7% of all all stcok available and the are between the Business District and the M-30 known as the Rest of the City (RC), with a vacancy rate of 3.8%. The largest amount of available space is located in the out-of-town areas of the city (DEC and OUT), with more than 1.1 million sqm of office space, equating to 78% of available space.

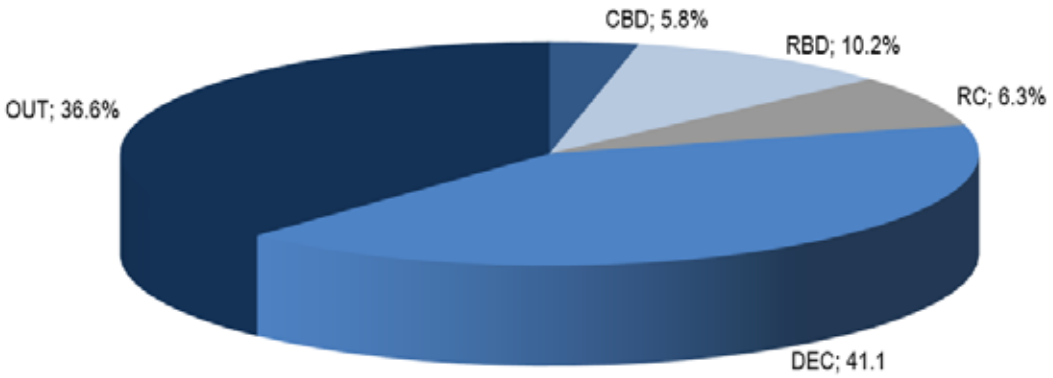
Over the past 12 months, available space fell by slightly more than 33,000 sqm.

Area		Vacancy (sqm) January 2016	(*)	Vacancy (sqm) July 2016	(*)	Vacancy (sqm) January 2017	(*)
BD	CBD	49,998	6.2%	53,290	6.6%	84,603	10.4%
	RBD	150,958	5.7%	142,909	5.4%	149,609	5.7%
RC		111,923	4.7%	121,584	5.1%	92,142	3.8%
DEC		613,270	15.9%	604,594	15.6%	601,027	15.5%
OUT		570,168	18.2%	561,028	17.9%	535,959	17.1%
TOTAL		**1,496,317**	**11.7%**	**1,483,405**	**11.5%**	**1,463,340**	**11.4%**

(*) Percentage of stock in each area

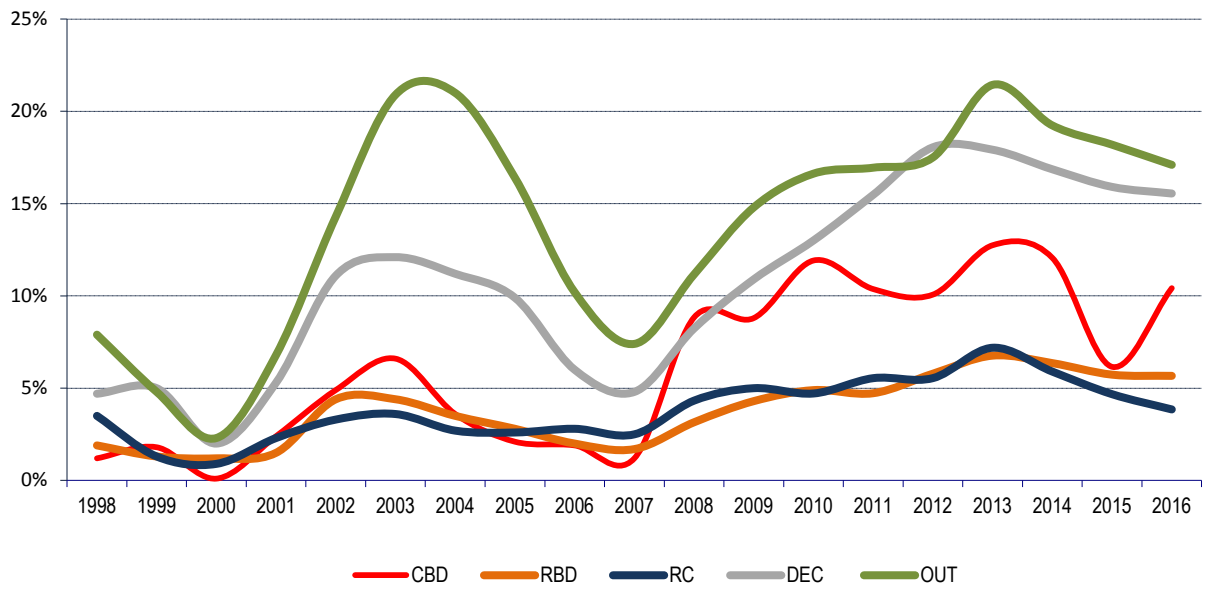
The breakdown of total available space by zones in Madrid is shown below.

Vacancy by Areas (%)



The graph below shows the marked fall in the vacancy rate in all areas from H2 2013 onwards. We can clearly see how the vacancy rate has dropped in almost all areas of the market over the past year, with the exception of the Central Business District (CBD). The political uncertainty that was rife over the first three quarters of 2016, coupled with concerns over the repercussions that certain external factors could have on the global economy - i.e. Brexit and the US elections - have caused some companies to put the brakes on their decisions to relocate or take more office space.

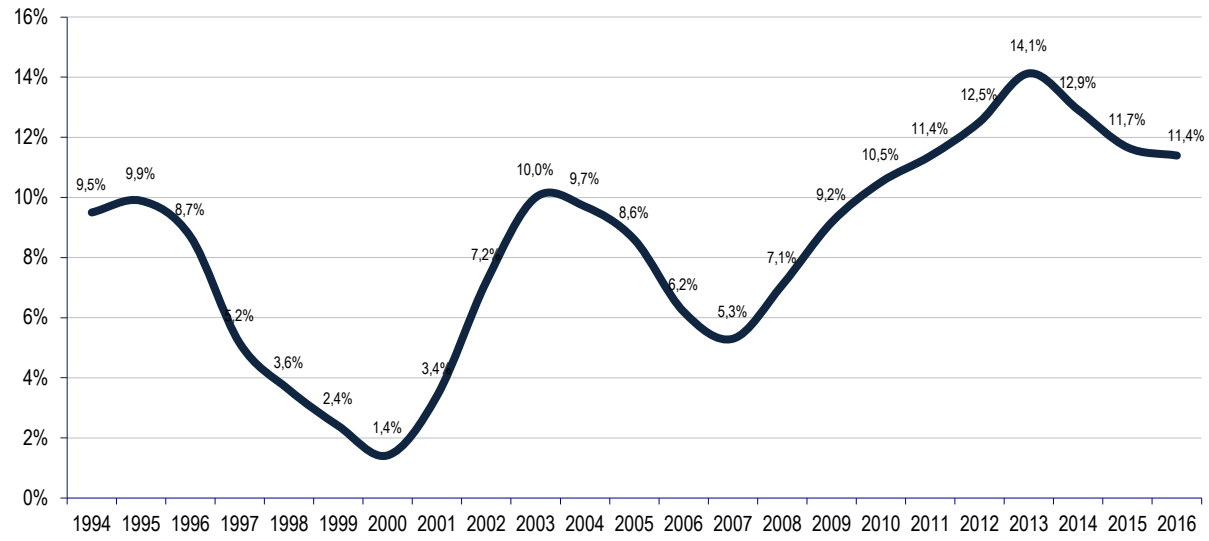
Historic change in the vacancy rate by areas



Below, one can see the historic change in the Madrid overall vacancy rate since 1994. After six consecutive years of seeing the vacancy rate grow (2007-2013), a new cycle began in 2013. During the past 12 months, the drop in the vacancy rate has been more subdued.

The significant amount of available supply in the pipeline over the next 24 months, as a result of the new stock that is going to come on to the market and the completion of a number of comprehensive refurbishments, means we must exercise caution when suggesting that the vacancy rate will drop considerably. We understand that the vacancy rate will likely stabilise at around the 10-11% mark, and could rise in areas where there is more available space coming on to the market. In short, the vacancy rate in the CBD is likely to rise in the short-term.

Historic Change in the Vacancy Rate (%)



4.4 Price Levels

Madrid office rental prices have performed well over the past 12 months, with all areas analysed registering a general increase in average rents. For the second year running, the increase in rental prices has been more notable in H2 2016, above all in the Business District. Average rental growth in the past twelve months in the Madrid office market stood at 6.9%.

During the past year, average rents in the Central Business District (CBD) increased by 6.0%. Average rents stand at €27.89/sqm/month, whilst maximum rents in the area have hit €34.00/sqm/month. Forecasts that were made two years ago suggested a greater increase in rents in the most exclusive area of the city. The political uncertainty within Spain and the instability we have seen on an international scale has had a knock-on effect on demand and in turn on real changes in rental prices.

There were greater percentage increases in rents over the last 12 months in the out-of-town areas. In the Decentralised area (DEC), average rents have risen by 7.8% on average, whilst in the the Outside of the City (OUT) area, rents inreased by 14.2% over 2016. This increase is predominantly due to the significant amount of deals over the last year that have been signed for the very best buildings in these areas.

Average rental prices in the Decentralised (DEC) area reached €12.27/sqm/month, achieving a maximum of €18.00/sqm/month for the very best buildings in the northern area and Campo de las Naciones, or €16.00/sqm/month in the Méndez Álvaro area.

The table below details the semester change in average and maximum prices in the Madrid office market over the past 18 months. In addition, the two tables below reflect the change in rental prices over the last 6 and 12 months.

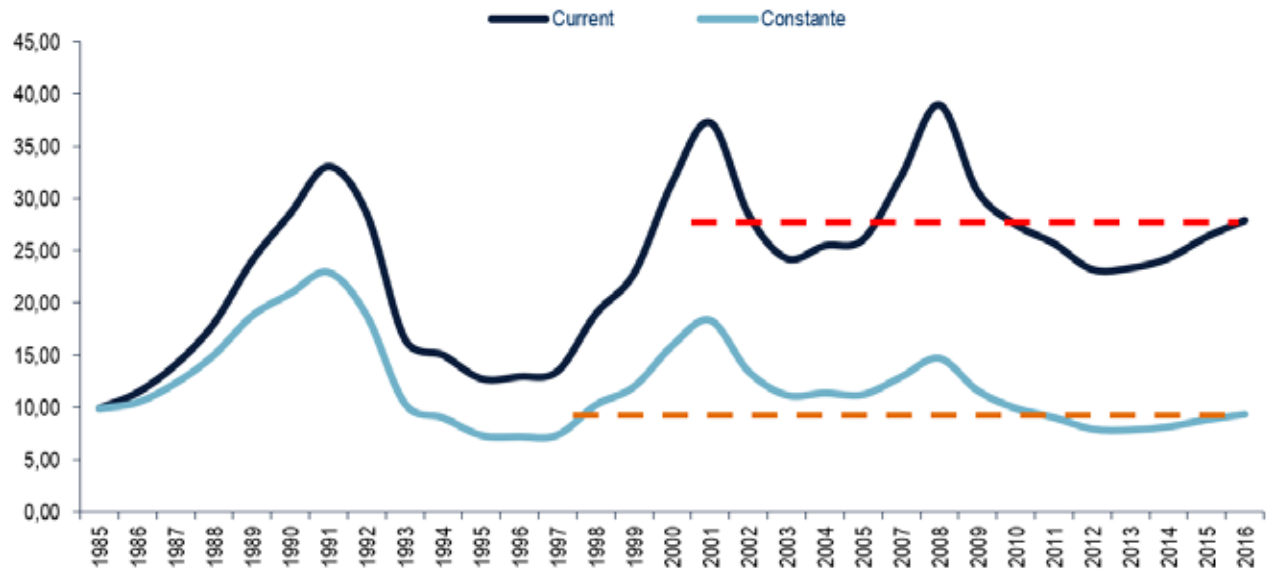
Area		H2 15		H1 16		H2 16	
		Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)	Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)	Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)
BD	CBD	33.00	26.32	34.00	26.88	34.00	27.89
	RBD	27.00	19.59	27.00	19.81	27.00	19.91
RC		18.00	13.75	19.00	14.02	20.00	14.40
DEC		16.50	11.38	18.00	11.95	18.00	12.27
OUT		13.50	8.27	13.00	9.08	14.00	9.45

Change in prices Last 6 months		
Zone	Maximum Prices	Average Prices
CBD	0.0%	3.8%
RBD	0.0%	0.5%
RC	5.3%	2.7%
DEC	0.0%	2.6%
OUT	7.7%	4.0%
AVERAGE		2.7%

Change in prices Last 12 months		
Zone	Maximum Prices	Average Prices
CBD	3.0%	6.0%
RBD	0.0%	1.6%
RC	11.1%	4.8%
DEC	9.1%	7.8%
OUT	3.7%	14.2%
AVERAGE		6.9%

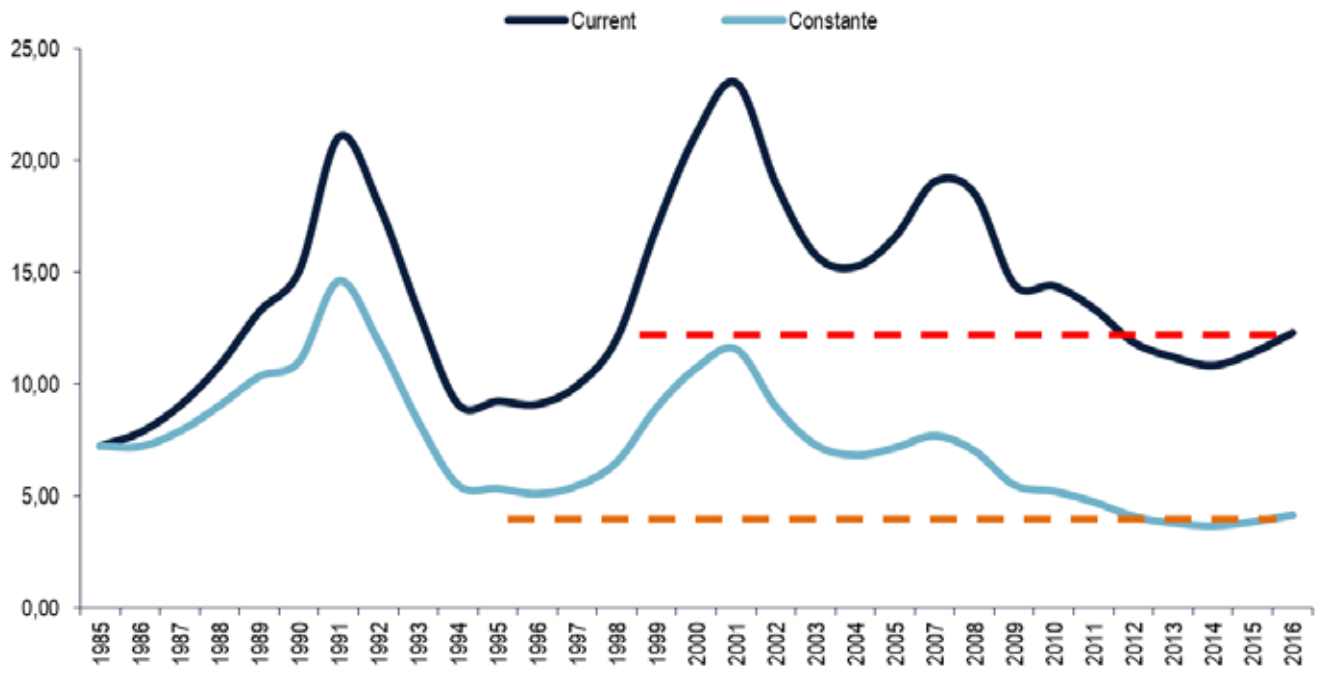
The graph below highlights the change in current and constant average rental prices in the CBD (not including annual CPI increases to the 1985 base). One can see that there was a change in trend that started in 2013 after 6 consecutive years of major corrections in rental prices.

Change in Average Rental Price (CBD)



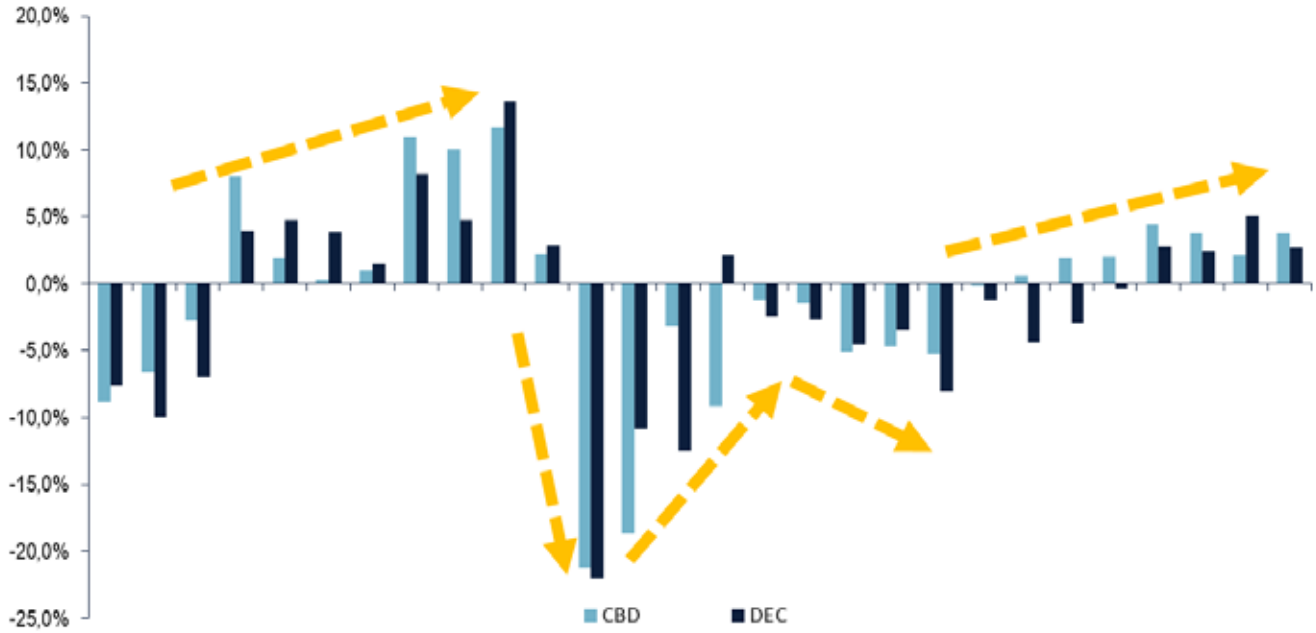
We can see how current prices in the Decentralised (DEC) area continue to exceed historic lows (not accounting for inflation). Prices in this area continue to rise, which started at the end of 2014.

Change in Average Rental Price (DEC)



The graph below shows the percentage q-o-q change in rental prices in the CBD and DEC areas since 2003. One can see how average prices in the Central Business District (CBD) have been consistently rising for the past three and a half years, while in the Decentralised area (DEC) the rise in rents has been noted over the past two years.

Change in Average Rental Prices (%) CBD and DEC



The graph below indicates changes in the vacancy rate and rental prices in the CBD. One can see how historically the change in rental prices in the office market tends to have a certain lag time, from when there is a change in the vacancy rate.

Rental Price in the CBD vs. Vacancy Rate

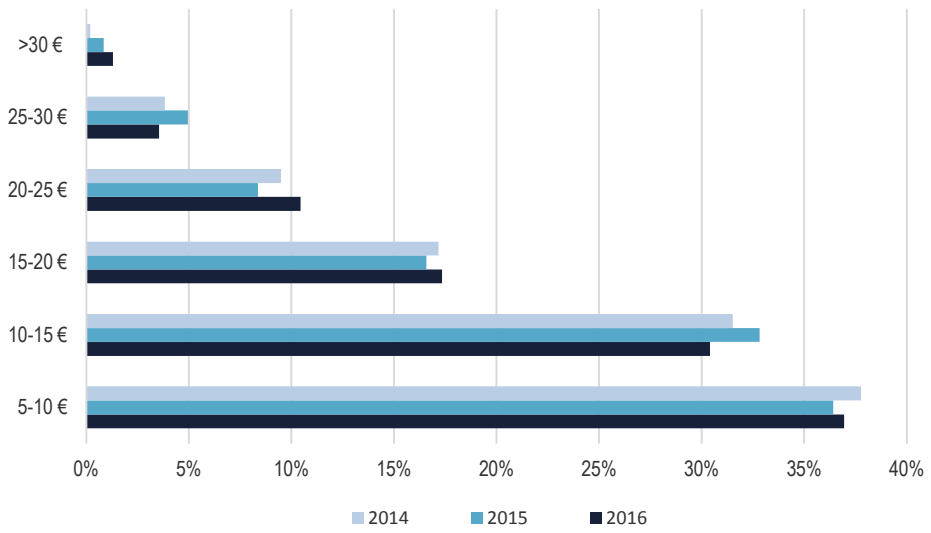
Over the last 12 months, negotiation margins that are applied to asking rents have gradually continued to fall. Landlords are taking a more rigid approach when it comes to negotiation margins and other lease terms such as rent-free periods in particular. Nevertheless, the high level of vacancy in some markets puts tenants in a good position, with discounts being offered on asking prices.

Negotiation Margin	2014	2015	2016
CBD	6,0%	5,2%	5,0%
RBD	9,0%	7,0%	6,0%
RC	5,6%	5,5%	6,0%
DEC	8,5%	8,0%	8,0%
OUT	12,5%	12,0%	11,0%
Media	8,32%	7,54%	7,20%

The table below outlines demand for office space based on different rental brackets. We can see how even in the Madrid office market, 67% of transactions are completed at rental prices below €15/sqm/month. If we analyse this data since 2014, we can see how the number of deals signed for space in the lower rental bracket has gradually been falling and there has been a clear increase in the number of transactions for rents in the >€30/sqm/month bracket.

Take-up by price range	2014		2015		2016	
	SQM	No. TRANSAC	SQM	No. TRANSAC	SQM	No. TRANSAC
€5-10	37%	38%	41%	36%	38%	37%
€10-15	32%	32%	28%	33%	35%	30%
€15-20	19%	17%	14%	17%	15%	17%
€20-25	9%	9%	6%	8%	9%	10%
€25-30	3%	4%	11%	5%	3%	4%
> €30	0%	0%	1%	1%	1%	1%
TOTAL	100%	100%	100%	100%	100%	100%

Take-up (sqm) by rental range. (€/sqm/month)



Barcelona Market

5. Barcelona Office Market

CBD AREA – Central Business District

This area is located along the length of Paseo de Gracia and Avenida Diagonal, from Plaza Francesc Macià to Gran Vía de Carlos III. Paseo de Gracia is seen as the traditional Central Business District and Avenida Diagonal as the city's modern Central Business District.
It is the most prestigious area in the city's office market and features the highest rental prices. The most important national and international companies are located in this area.

RBD AREA – Rest of Business District

Estas zonas suponen una alternativa a las zonas Prime, por poseer edificios modernos a precios sensiblemente inferiores, buenas comunicaciones mediante transporte público y numerosos servicios en la zona al coincidir con la zona de influencia del tradicional centro del distrito de negocios.
Dentro de esta definición incluimos: Avda. Diagonal, entre Francesc Macià y Pau Claris, Avda. Josep Tarradellas, c/ Tarragona, Vía Augusta, Plaza Catalunya, Gran Vía Carlos III, entre otras.

RC AREA - Rest of City

This is primarily comprised of the Ensanche Barcelonés, which is predominantly a residential area with 70-80s style office buildings, which were constructed in the boom of that period, although it now features some modern and exclusive office buildings that have lower prices than in the Business District.

DEC AREA - Decentralised

The increase in economic activity over the past few years has given rise to various different areas, which were traditionally seen as periphery areas, now becoming new central business areas. These areas are the ones known as New Central areas.
In these areas we include: Villa Olímpica, Plaza de las Glorias, World Trade Center, Plaza Cerdà, Zona Franca, Diagonal Mar and the whole regeneration of Pueblo Nuevo, 22@ as well as Plaza Europa (L'Hospitalet).
The change of uses, the change in the road network, the improved transport systems and new facilities, have allowed the various different office projects in this area to consolidate.

OUT AREA – Outside of the City

Over the past few years, the out of town area has played a more important role in the real estate market as a whole. The lack of land and inefficient properties in the traditional city centre are just some of the factors that have favoured the development of important projects on the outskirts of the city.
This area includes: Sant Joan Despí, Esplugues, Sant Just Desvern, Mas Blau-Aeropuerto, Cornellà, Sant Cugat and Viladecans. We would highlight the extreme disparity and inconsistency between these areas and the micro markets.

5.1 Office Stock and New Projects

The Barcelona office market ended 2016 with a total stock of 5,944,153 sqm. 58,500 sqm of new schemes were handed over in Barcelona in 2016, which is slightly above the figures for 2014 and 2015, edging closer to a total office stock figure of 6,000,000 sqm.

Supply has increased y-o-y in the Decentralised (DEC) area as a result of four new schemes coming onto the market, three of which are located in District 22@. We would point out that two of the three new buildings that came on to the market in 22@ were fully pre-let. We would also note that 8,000 sqm of new space came on to the market in the Outside of the City (OUT) area, thanks to the opening of a new scheme to let in Cornella de Llobregat. Finally, in the Rest of the City (RC) area, La Rotonda, a highly prestigious building, has been extended and refurbished, and is already partially let.

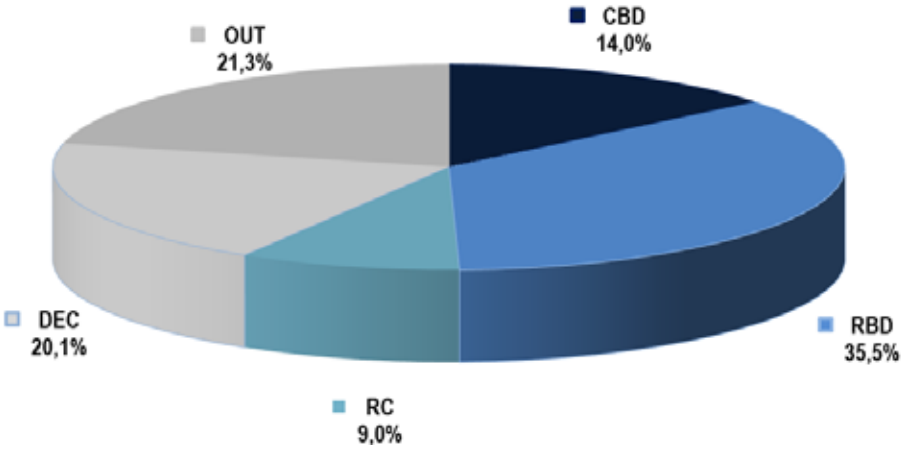
The table below highlights the change in office stock over the past year and its distribution by area. As one can see, the size of the market grew by 0.45% compared to July 2016.

Change in Office Stock in Barcelona (January 2016-January 2017)

Area		Area (sqm) January 2016	%	Area (sqm) July 2016	%	Area (sqm) January 2017	%	Variation (%)
BD	CBD	834,600	14.2%	834,600	14.1%	834,600	14.0%	0.00%
	RBD	2,112,100	35.9%	2,112,100	35.7%	2,112,100	35.5%	0.00%
RC		527,190	9.0%	527,190	8.9%	536,490	9.0%	1.76%
DEC		1,152,606	19.6%	1,184,606	20.0%	1,193,506	20.1%	0.75%
OUT		1,259,157	21.4%	1,259,157	21.3%	1,267,457	21.3%	0.66%
TOTAL		5,885,653	100.0%	5,917,653	100.0%	5,944,153	100.0%	0.45%

The pie chart below indicates the distribution of total stock per area analysed:

Distribution of Stock - January 2017



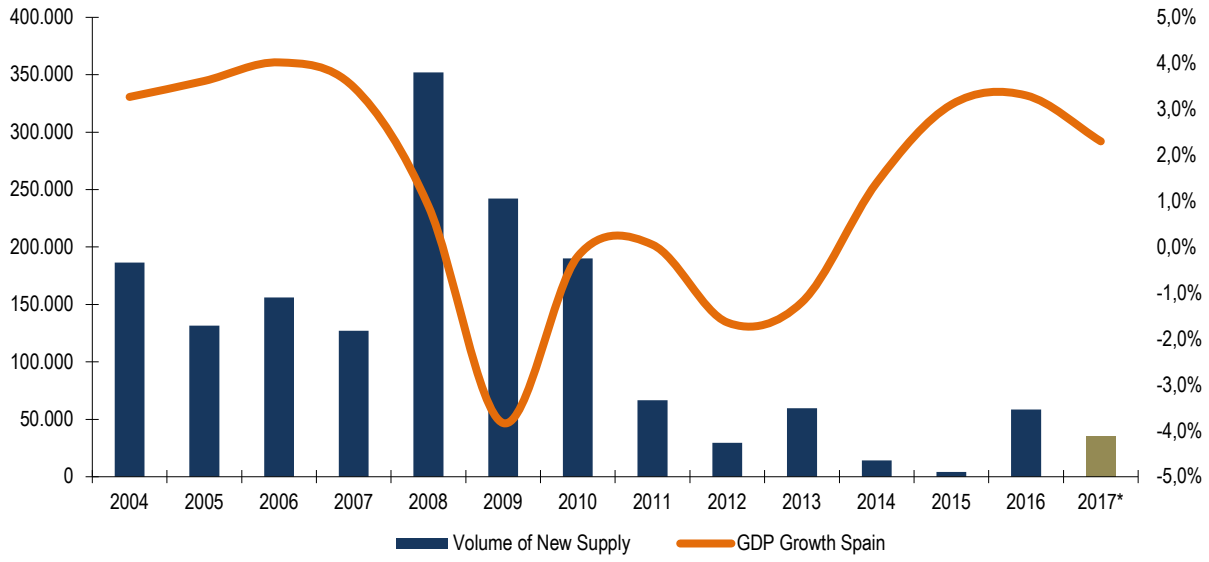
The low levels of development activity means that distribution of stock by areas is very similar to that seen 12 months ago. The Out-of-Town areas currently account for 41.3% of office stock, while the Business District (CBD+RBD) accounts for 49.6%.

In terms of new stock, we have started to see periphery areas playing more of a leading role in the Barcelona office market, which is having a negative effect on the city centre markets. As we have stated in previous reports, there are two key factors that are driving this trend. Firstly, the shortage of land allocated for office development in the city centre, coupled with the fact that rents in the city centre are higher for other uses, such as residential in particular, means that a number of landlords who own outdated office buildings are contemplating a change in use.

The graph below outlines new supply that has come on to the Barcelona market since 2004 and forecasts for 2017. In this regard, once again we would highlight the lack of new schemes in the pipeline for 2017. The situation will be very similar to what we have seen in recent years; we do not expect more than 35,550 sqm to come on to the market. As we can clearly see in the relevant section of this report, this subdued level of new supply is causing a sharp decline in the vacancy rate.

New openings in the pipeline for 2017 will predominantly be situated in the 22@ and Zona Fira areas, both of which are located in an area we refer to as DEC, and in the OUT area in Sant Cugat. 33% of new supply that will come on to the market in 2017 will be pre-let.

Historic Change in New Projects



5.2 Demand

In 2016, gross take-up in the Barcelona office market stood at 330,282 sqm in 2012, down 21% y-o-y. Despite this decline, we would point out that take-up in 2016 has been strong, standing at above the historical average. The drop in gross take-up y-o-y is certainly not a reflection of subdued demand - but rather the take-up figure achieved in 2015 was very strong, significantly above normal take-up figures for the Barcelona market. In H2 2016 gross take-up amounted to 169,667 sqm.

It is worth mentioning that despite the decline in take-up compared to 2015, there are certain markets in the city centre where take-up has increased y-o-y. On the other hand, take-up has fallen y-o-y in the out-of-town markets (DEC and OUT). There are a few examples of occupiers moving from peripheral areas to the city centre markets. This however will be limited given the lack of available space in the Business District (BD).

The table below highlights the changes in gross office take-up in Barcelona, both in terms of semesters and geographical areas of the city.

The table below highlights the changes in gross office take-up in Barcelona, both in terms of semesters and geographical areas of the city.

Total Take-up by Areas

Area		2015		TOTAL	2016		TOTAL	Variation (%)
		H1	H2	2015	H1	H2	2016	2015 - 2016
BD	CBD	19.904	16.594	36.498	26.455	14.184	40.639	11,3%
	RBD	21.945	12.935	34.880	18.888	18.920	37.808	8,4%
RC		32.002	52.021	84.023	46.821	38.935	85.756	2,1%
DEC		52.968	100.674	153.642	38.094	56.802	94.896	-38,2%
OUT		50.680	60.725	111.405	30.357	40.826	71.183	-36,1%
TOTAL		177.499	242.949	420.448	160.615	169.667	330.282	-21%

The following table details the number of transactions and the amount of space taken by size range in 2015 and 2016.

Total Take-up by Size Categories

Take-up	2015		2016		Change in Transactions (%)	Change in Floor Space (%)
	Transactions	sqm	Transactions	sqm		
< 200 sqm	165	20,124	197	25,026	19.7%	24.4%
201-500 sqm	205	64,979	227	78,144	10.8%	20.3%
501-1,000 sqm	90	64,781	98	69,497	8.3%	7.3%
1,001-3,000 sqm	58	89,165	52	80,029	-10.0%	-10.2%
> 3,000 sqm	23	181,399	15	77,586	-36.4%	-57.2%
TOTAL	541	420,448	589	330,282	8.9%	-21.4%

Take-up in 2016 was primarily comprised of transactions for space below 500 sqm, which accounted for almost 72% of transactions and 32% of take-up. The high number of transactions in this bracket is understandable, as SMEs are a key focus of the City of Barcelona's business framework.

There has been a significant drop in the number of transactions and take-up over 2016 in the >1,000 sqm bracket. This is particularly relevant for large-scale transactions >3,000 sqm, which were 36.4% down y-o-y in 2016, with 57.2% less space taken y-o-y. Although we have excluded the large-scale transaction that closed in 2015 as it could distort the figures, we would note that take-up of large-scale offices has fallen by almost 43%.

The political uncertainity over 2016, particularly over the second half of the year, has caused large-scale occupiers to put the brakes on their decision-making. There are currently a significant number of large-scale transactions that were initially going to complete in 2016 but have been pushed back to 2017.

Below we detail gross take-up by business sub-sectors:

Take-up by Business Sectors

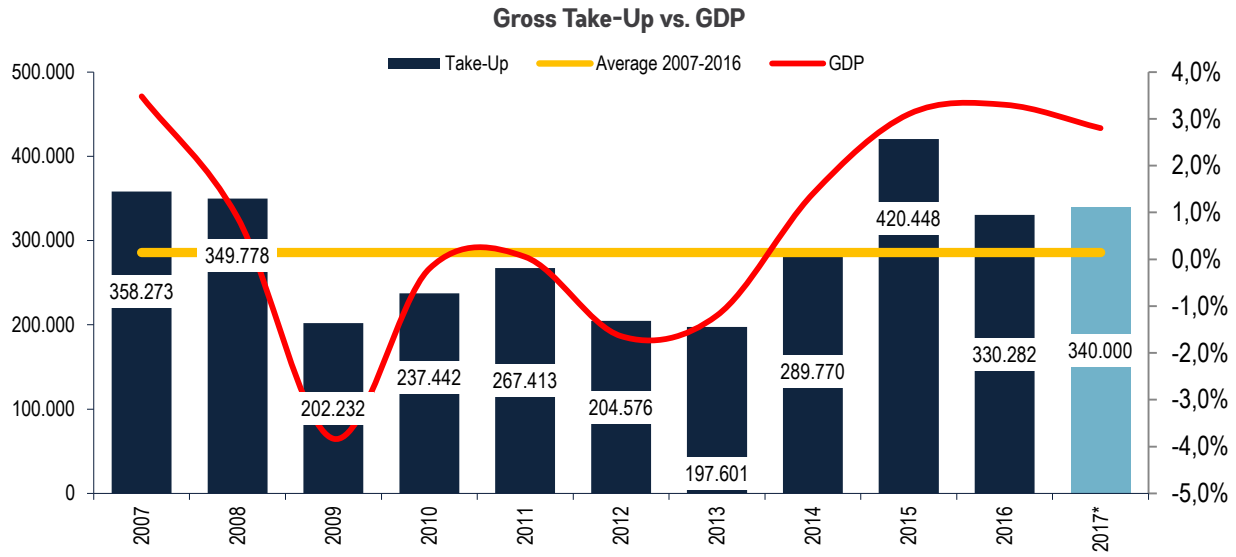
SECTOR	2015					2016				
	Area (sqm)	%	No.	%	Average Area (sqm)	Area (sqm)	%	No.	%	Average Area (sqm)
Business Services	117,258	27.9%	200	37.1%	586	138,144	41.8%	236	40.0%	586
Electronics and IT	57,373	13.6%	98	18.2%	585	59,911	18.1%	116	19.7%	518
Chemicals and Energy	37,284	8.9%	29	5.4%	1,286	46,200	14.0%	65	11.1%	707
Public authorities /official organisations	69,069	16.4%	11	2.0%	6,279	16,558	5.0%	37	6.3%	449
Sales and Distribution	49,570	11.8%	61	11.3%	813	16,025	4.9%	23	3.9%	696
Insurance	21,787	5.2%	17	3.2%	1,282	9,523	2.9%	21	3.6%	445
Industry and Manufacturing	8,961	2.1%	26	4.8%	345	8,884	2.7%	35	6.0%	253
Construction and Real Estate	10,111	2.4%	20	3.7%	506	8,485	2.6%	9	1.6%	928
Banking and Finance	19,716	4.7%	32	5.9%	616	2,892	0.9%	8	1.3%	384
Telecoms	7,844	1.9%	20	3.7%	392	1,036	0.3%	7	1.3%	139
Media	2,695	0.6%	7	1.3%	385	274	0.1%	1	0.3%	183
Other	18,830	4.5%	18	3.3%	1,046	22,348	6.8%	30	5.1%	744
TOTAL	420,498	100.0%	539	100.0%	780	330,282	100.0%	589	100.0%	561

In terms of demand per business sector, we can see how the "B2B" sector remains at the forefront of the market for another year. We would highlight the "electronics and IT sector" in particular, which is linked to the rise in e-commerce and the internet, which is expanding at a faster rate than traditional sectors of the economy.

We would also highlight that activity in the "Public Sector/Official Bodies sector" has been subdued. This is one of the reasons why the total take-up figure for 2016 has reduced so much compared to 2015 - a year when the public sector took a significant amount of space.

The average total size of space taken per transaction in 2016 was 561 sqm, which is a significant decrease compared to 780 sqm in 2015. As we analysed previously, in 2016 there has been a significant rise in the number of transactions for office space comprising <500 sqm, which has reduced the average size per deal.

The graph below shows how gross take-up has evolved in Barcelona over the past 10 years, as well as take-up forecasts for 2017 as a whole. It also includes the average take-up over the past ten years, as well as GDP performance over that period.



We expect that take-up will be slightly higher in 2017 compared to 2016, as a result of an anticipated increase in the number of large-scale transactions. Total take-up is estimated to come in at around 340,000 sqm, which would be higher than the past 10 year average.

5.3 Vacancy

As it did in 2015, the vacancy rate continued to improve during 2016. On 1 January 2017, the vacancy rate stood at 9.5% of total stock compared to 11.5% a year ago. This suggests that there is 564,975 sqm available for immediate occupation, which is 111,630 sqm less than a year ago.

The table below indicates vacancy based on Aguirre Newman's zoning of the market.

Vacancy Rate

Area		Vacancy (sqm) January 2016	(*)	Vacancy (sqm) July 2016	(*)	Vacancy (sqm) January 2017	(*)
BD	CBD	35.278	4,2%	29.941	3,6%	24.460	2,9%
	RBD	73.575	3,5%	56.408	2,7%	49.618	2,3%
RC		147.631	28,0%	126.089	23,9%	124.453	23,2%
DEC		188.036	16,3%	173.825	14,7%	152.572	12,8%
OUT		232.085	18,4%	226.090	18,0%	213.872	16,9%
TOTAL		**676.605**	**11,50%**	**612.353**	**10,35%**	**564.975**	**9,50%**

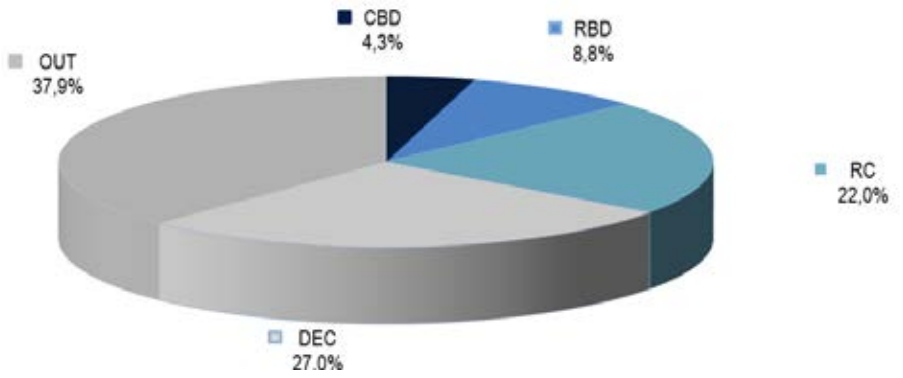
The vacancy rate has shrunk in all areas in Barcelona over the last year, with a sharpdecline in the market overall. Of particular note would be the drop in the vacancy rate in peripheral markets, where it has fallen to 12.8% of the total figure in the DEC market and 16.9% in the OUT market. Within the DEC area, we would highlight the decline in availability in the 22@ market.

Finally in the Business District (BD), there is a clear imbalance between demand and supply given the lack of existing available space, at a meagre 75,000 sqm. In the BD, the majority of deals relate to SMEs relocating to more high-profile areas.

Over 2017, and as a result of the moderate levels of new office space coming available and the expectation of good take-up figures, it is expected that the vacancy rate will continue to fall in all areas of the market.

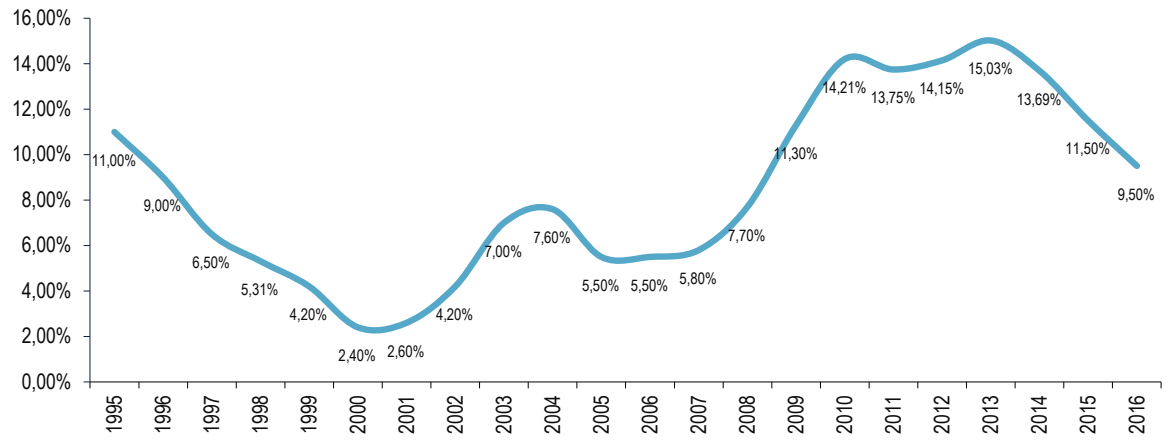
The pie-chart below shows the distribution of all of the available space on the Barcelona office market, per area. We can see how around 65% of vacant space in the market is located in peripheral areas of the city. 22% of vacant space in the office market is situated in the RC area, which is an area characterised by outdated, unappealing office space.

Distribution of the Vacancy Rate in Terms of Total Available Space



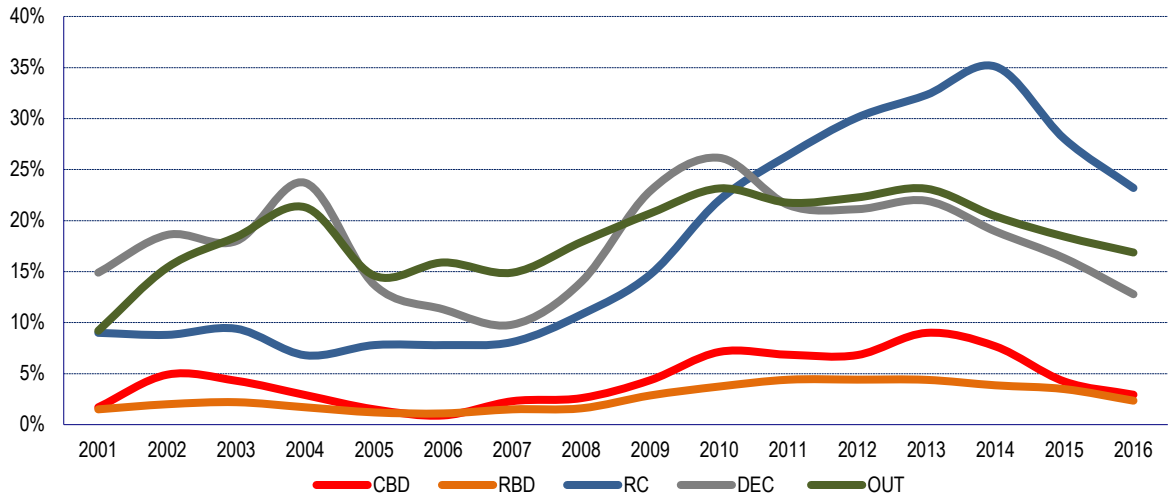
The below graph details the historic change in the vacancy rate in Barcelona. The graph shows that the downward trend clearly started at the end of 2013, and given the limited amount of new supply in the pipeline and occupier demand, we expect the vacancy rate to decline further in 2017.

Change in Vacancy Rate (%)



The graph below shows the downward trend in the vacancy rate in all of the areas studied and how it now stands at virtuallt residual levels in the CBD and RBS areas.

Change in Vacancy Rate (%) by Areas



5.4 Price levels

Rental prices in the Barcelona office market have generally continued to rise in all areas of the city, continuing on with the trend started in 2014.

During the past year, average rental prices grew by 6.1%, with increases in all areas of the market. The key market indicators in the Barcelona office market, i.e. take-up and the vacancy rate, have been strong, with take-up increasing and a rapid decline in the vacancy rate. This in turn has enabled average and maximum rental prices to rise.

As was the case in 2015, the area that registered the highest average price increase was the Decentralised area (DEC), with the average rent reaching €13.49 per sqm/month in 2016. In the very best and most high-profile buildings in the market such as 22@, maximum rental prices stand at €17.75 per sqm/month. The average rent in the Central Business District (CBD) reached €16.80 per sqm/month, while top rents in the best properties on the Diagonal reached €21.50 per sqm/month.

The tables below provide in depth details of changes in rental prices over the past year in the City of Barcelona.

Change in Average Rental Prices (%)

Area		H2 15		H1 16		H2 16	
		Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)	Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)	Maximum Prices (€/sqm/month)	Average Prices (€/sqm/month)
BD	CBD	19.75	16.01	20.75	16,77	21.50	16.80
	RBD	17.00	13.43	17.50	14.50	18.00	14.40
RC		13.75	11.12	14.50	11.92	15.00	11.71
DEC		16.00	12.42	16.75	12.83	17.75	13.49
OUT		12.05	7.22	12.50	7.55	12.50	7.55

Change in Average Rental Prices (%)

Last 6 months		
Zone	Maximum Prices	Average Prices
CBD	3.6%	0.2%
RBD	2.9%	-0.7%
RC	3.4%	-1.8%
DEC	6.0%	5.1%
OUT	0.0%	0.0%
AVERAGE		0.6%

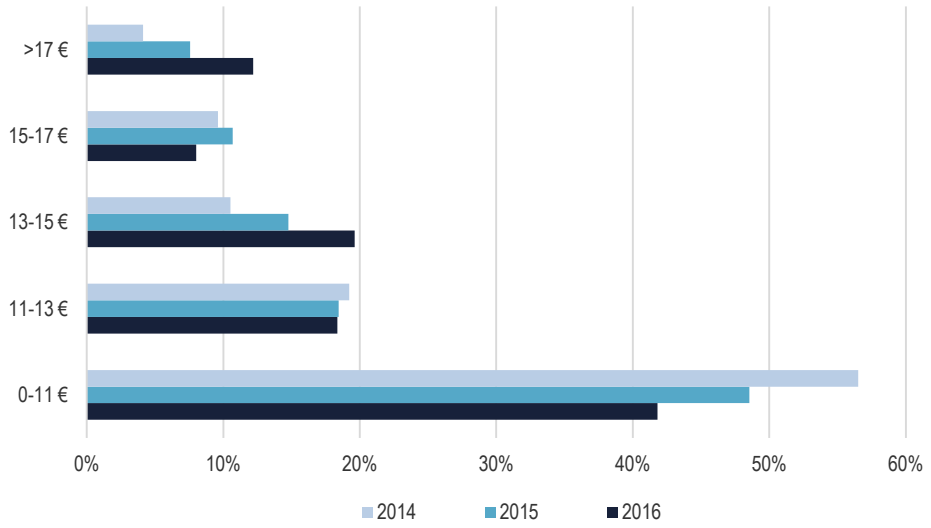
Last 12 months		
Zone	Maximum Prices	Average Prices
CBD	8.9%	4.9%
RBD	5.9%	7.2%
RC	9.1%	5.3%
DEC	10.9%	8.6%
OUT	3.7%	4.6%
AVERAGE		6.1%

If we analyse completed transactions per rental price bracket, it is clear that the majority of transactions (60%) in Barcelona are signed for space <€13.00 per sqm/month. This is understandable if we take into account the considerable number of deals signed in peripheral markets (DEC and OUT) and in the Rest of the City (RC) area, where rents are generally in the lower bracket.

Take-up (sqm) by rental range. (€/sqm/month)

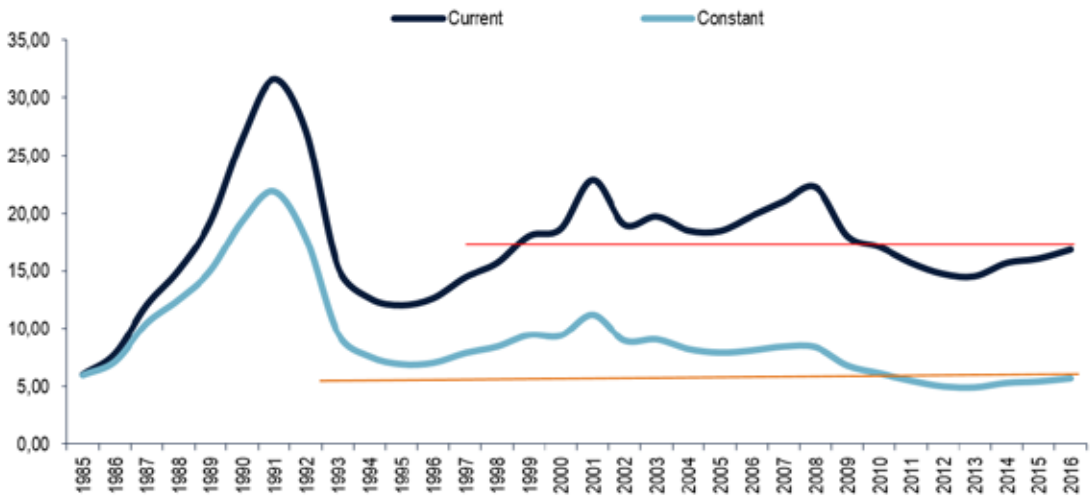
Take-up by price range	2014		2015		2016	
	SQM	No. TRANSAC	SQM	No. TRANSAC	SQM	No. TRANSAC
€4-11	59%	57%	49%	49%	39%	42%
€11-13	15%	19%	28%	18%	12%	18%
€13-15	18%	11%	9%	15%	20%	20%
€15-17	6%	10%	8%	11%	12%	8%
€25-30	2%	4%	5%	8%	17%	12%
TOTAL	100%	100%	100%	100%	100%	100%

Take-up (sqm) by rental range. (€/sqm/month)

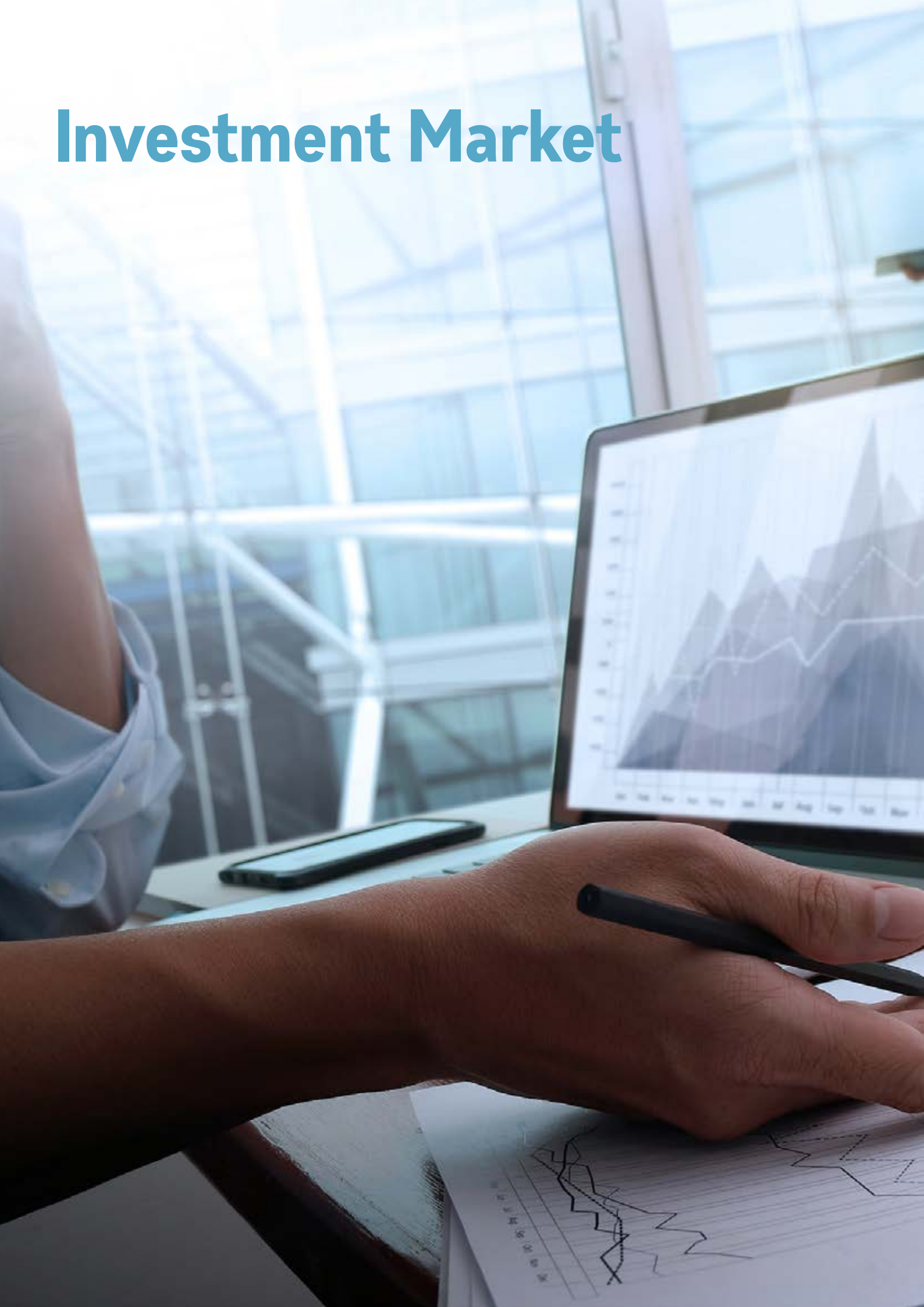


In the graph below, one can see how in constant terms (discounting the effect of inflation) prices in the Central Business District (CBD) in Barcelona are below record lows, except for the recovery in recent years. Passing rents peaked at the end of 2013 and are still a way off the maximum rents achieved in the previous cycle.

Change in Average Rental Prices in the CBD



Investment Market



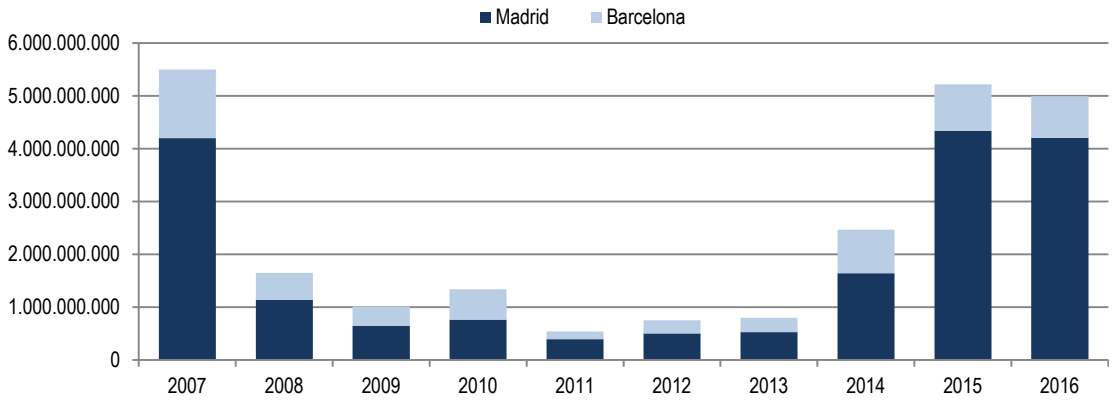
6. Investment Market

Office investment over 2016 stood at €5,000 million for the two main markets in Spain, Madrid and Barcelona. This investment volume, along with that of 2007 and 2015, was an all time record for the office market. Once again, as regards the investment volume, the office market has been the star of the show, with the total investment volume substantially above the €3,500 million invested in the second most active market - shopping centres.

The amount of investment in income-producing office properties in Madrid reached €4,200 million, close to the €4,300 million transacted in 2015. Investment volume in Barcelona exceeded €785 million, slightly below the €880 million registered in 2015. 84% of investment volume was concentrated in the Madrid market, while the remaining 16% were deals completed in Barcelona. The subdued investor activity in Barcelona is primarily due to the limited supply in the market as opposed to a lack of investor appetite.

The lack of a central government and the resulting political uncertainity that has been rife over 2016 does not appear to have had repercussions on the property investment market. The reality is that even during a period of political uncertainty, both national and foreign investors have maintained a keen eye on the market, given the sharp contraction in required yields.

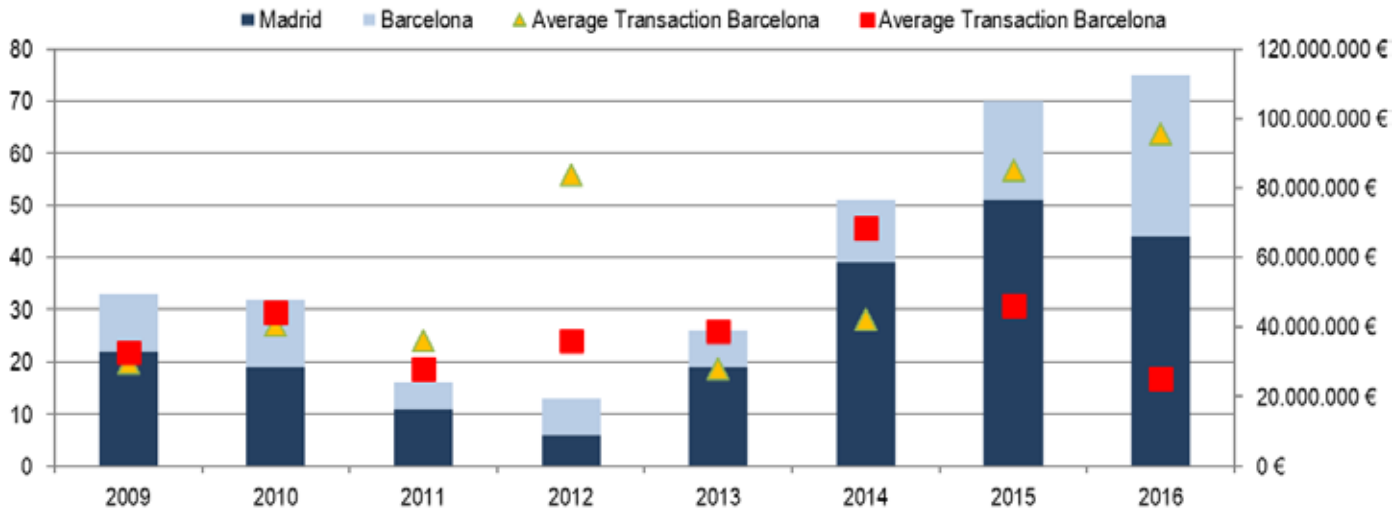
Office Market Investment Volume (€)



In terms of number of deals, 75 deals were completed across both markets in 2016, which equated to the sale of 138 office properties, which is much higher than figures seen in recent years. 44 deals were completed in Madrid, accounting for the sale of 95 properties, whilst 31 were completed in Barcelona, which accounted for the sale of 43 office properties.

The average lot size of the transactions was in the region of €95 M in Madrid and €25 M in Barcelona. We would point out that Merlin Properties' purchase of Metrovacesa's property portfolio equated to the sale of over 35 properties in just one transaction.

Number of Investment Transactions (left axis) and Average Lot Size (right axis)

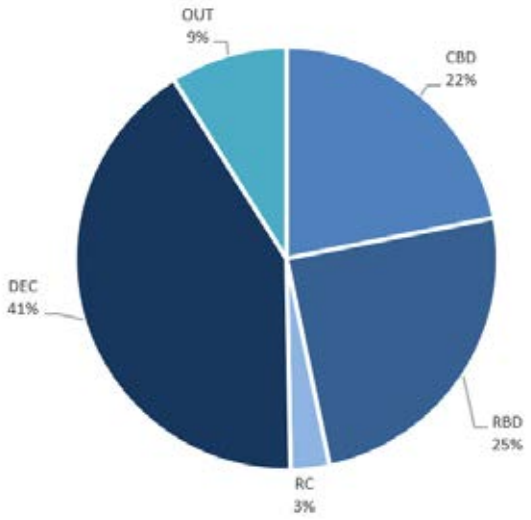


Despite a wide range of risks, investors have demonstrated an appetite for a range of properties in the market, looking at "core" buildings to out-and-out "value add" buildings, and even opportunistic properties. In this regard, there have been a number of deals for space located in all submarkets of Madrid and Barcelona, with approximately half of the transactions completed in periphery markets (DEC and OUT) and the other half in the city centre (BD and RC).

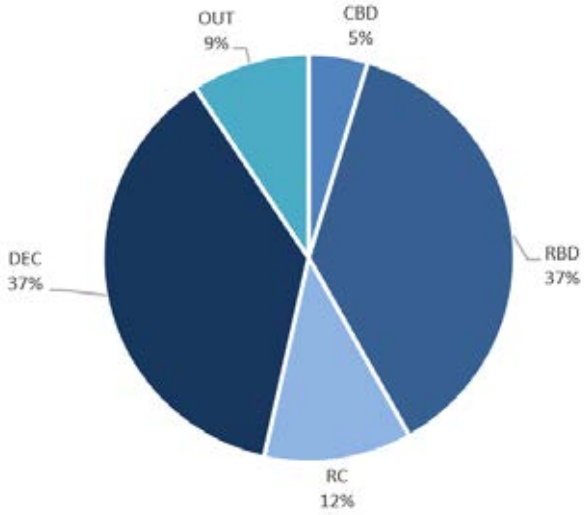
Once again, the shortage of "core" properties in the market has increased demand for "value add" buildings, given their high vacancy rates or need for capital expenditure to ensure they meet tenants' requirements. Finally, within the speculative development market, we have seen a number of acquisitions of schemes under construction or those that have been put on hold for a number of years, with investors looking to develop them out and subsequently put them on the market.

The "value add" and "opportunistic" markets are bolstered by economic recovery in Spain and more precisely, the strong performance of the regional economies in Madrid and Barcelona, as well as improvements in key aspects of the office market.

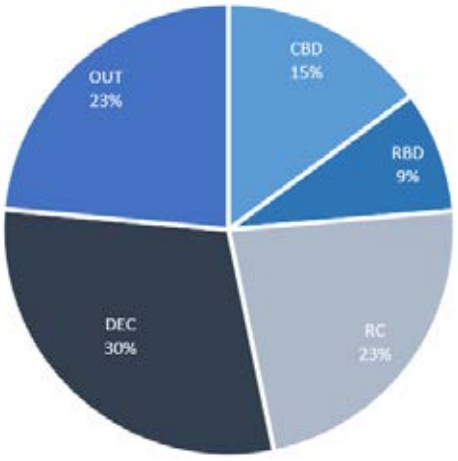
Investment Volume by Areas (%) Madrid



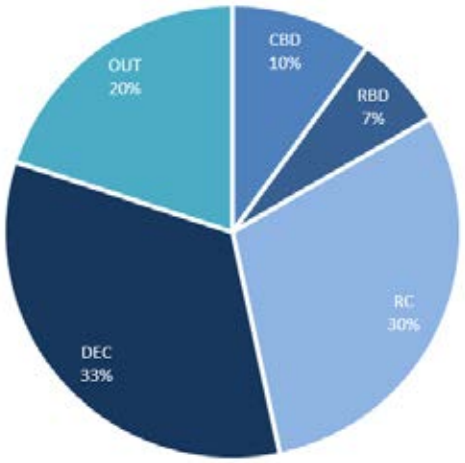
Number of Transactions by Areas (%) Madrid



Investment Volume by Areas (%) Barcelona



Number of Transactions by Areas (%) Barcelona



The positive elements that propelled the property investment market in 2015 continued well into 2016. From a macro perspective, the consolidation of economic recovery has been key, where GDP is expected to have grown by 3.3% y-o-y. In addition, expectations for growth in 2017 and 2018 are around 2 to 2.5%. Whilst we will not quite reach the levels of growth achieved in 2015 and 2016, nevertheless this is still a reasonable figure, and is clearly above the average growth figure for the EU. At a micro level, whilst demand in the office market is not quite as high as it was in 2016, it is in line with historical average data.

Rental prices have continued to creep up in 2016, whilst the vacancy rate has continued to fall. We should keep a close eye on these two factors in 2017, given the significant amount of new speculative office space in the pipeline, mainly in Madrid's Business District.

Monetary policy has continued to generate a high level of liquidity in the market given the potential to access finance at a relatively low cost. In addition, the low returns or excessive volatility of alternative non-property related investments are additional factors to consider.

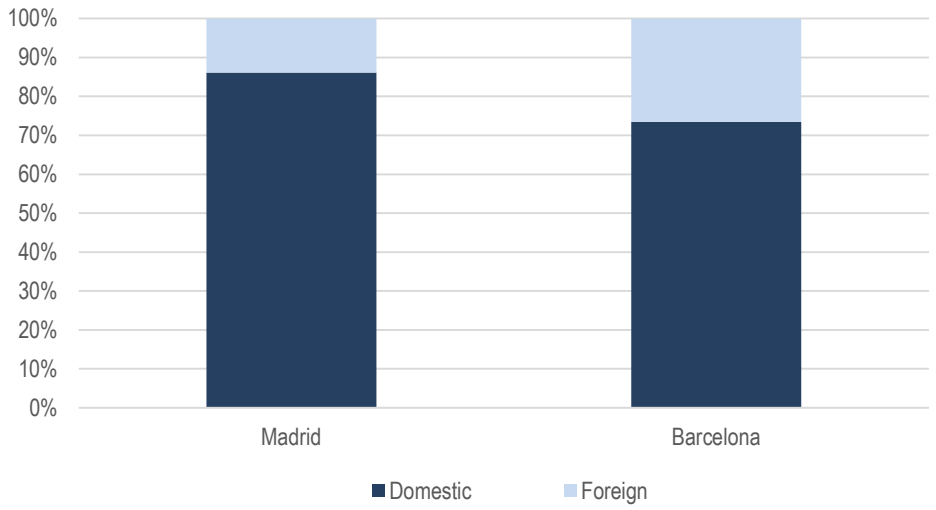
Below we detail the main market drivers during 2016.

1. Source of investment. National vs. International

The most active investors in the market during 2016 were national investors, which carried out 72% of deals and 84% of investment volume. On the other hand, in Barcelona, foreign investors have taken centre stage, with a higher percentage of transactions completed by foreign investors.

It is not clear if the uncertainty generated by the lack of government has stopped foreign investors in their tracks. A significant number of foreign investors have been analysing and acquiring office buildings over the last 12 months. However, we must take into account that some investors who are considered to be national investors are essentially investing with capital raised from foreign investors, so they are not technically 'national' investors.

Number of Deals by Source of Investor

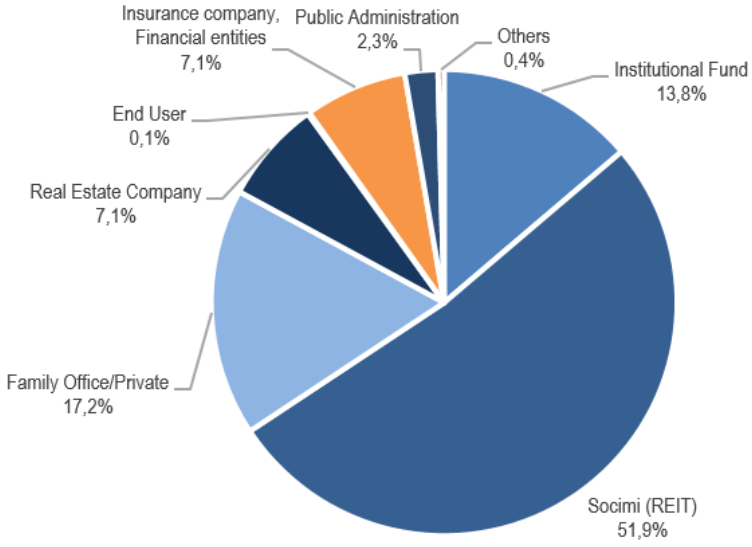


2. Type of investors. Investment volume.

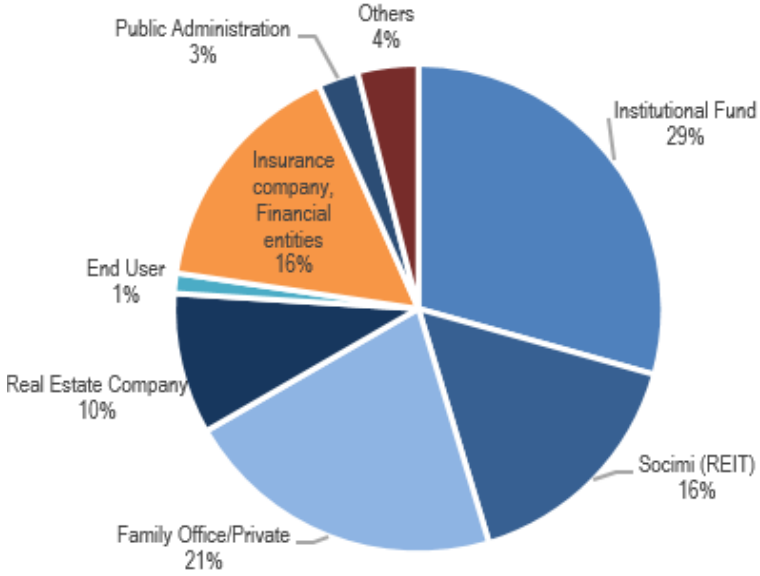
The most active investors in the market were Socimis, which carried out 50% of all investment volume in the market, but only accounted for 16% of all deals. This mismatch is a result of Merlin Properties' purchase of Metrovacesa's property portfolio - although this was just one transaction, it amounted to 36% of the total investment volume. Institutional funds and private investors have equally been highly active in 2016. We would highlight in particular Pontegadea's purchase of Torre Cepsa for around €500 million.

Insurance companies and property firms have played a key role in 2016, where they accounted for 26% of all deals. In terms of property firms, Inmobiliaria Colonial has been involved in the majority of acquisitions in the market. Just as they did in 2015, they have been highly focused on expanding their portfolio by purchasing properties situated in the Business District in both Madrid and Barcelona.

Investment Volume by Investor Type (%)



No. of Deals by Investor Type (%)



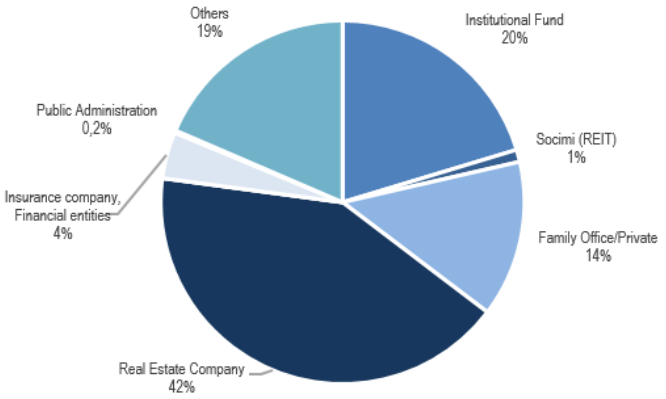
3. Type of Seller. Investment volume.

Property firms, who are highly dependent on the vendor side of the market, have been at the helm of the market. An example of this is the aforementioned sale of Metrovacesa's property portfolio to Merlin Properties. In addition, institutional investors and private investors/family offices purchased a significant number of offices in 2016. In terms of institutional investors, we would highlight the sales completed by Standard Life Investment and Lone Star, each of which have very different strategies. As regards the former, SL is selling off its property portfolio as it has reached maturity, whilst in the latter case, Lone Star is making the most of the opportunities that the market has to offer, so that it can sell individual properties from the portfolios it has purchased in recent years.

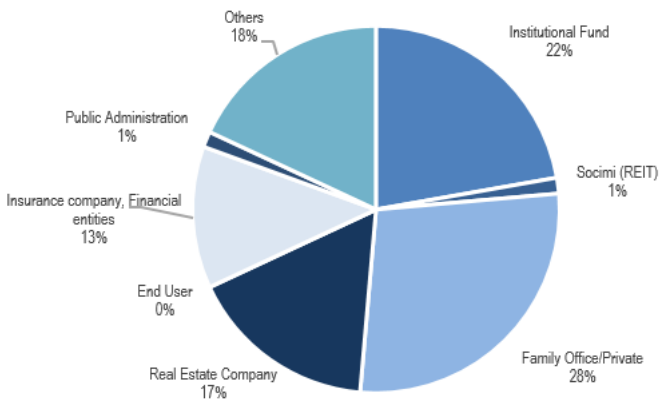
As regards private investors/family offices, we would note the two sales completed in Madrid by Finaccess, the investment company of one of the founding families of the Modelo Group, which at the time of writing this report was a private investor/family office. Nevertheless, these investors have been selling a number of properties in Barcelona and Madrid.

Finally, we would highlight that vendors classed as "other" have been very active. This group includes non-property companies who have decided to sell office buildings they own, some of which they occupy themselves and others which are let out to tenants. Some of the Sale & Leaseback deals completed include the sales of the Gas Natural and Vocento headquarters in Madrid and the sale of Nestle's headquarters in Barcelona.

Investment Volume by Investor Type (%)



No. of Deals by Investor Type (%)



Over H2 2016 initial yields have hardened significantly, reaching previously unheard of figures in the Business District. Initial yields in the Madrid market range between 3.75% and 6.75%, whilst in Barcelona they range between 4.5% and 6.75%, depending on the specification of the building, location and if there is a tenant in place. The yield compression that started at the end of 2013 in prime markets and followed suit in the remaining areas as of 2014, appears to have accelerated during the past 6-9 months.

It is difficult to imagine that there will be further contractions in yields in the Business District, particularly in Madrid, and we could potentially see further reductions in the out-of-town markets, which is where yields have contracted the least in recent years, and where we have still not reached the levels achieved in 2007.

As we have indicated in previous reports, despite the initial yields achieved in the office market, the yield spread between the office market and the Spanish and German 10 year bond remains at an all-time high. Over the past 20 years, the average yield spread for the CBD market in Madrid versus the Spanish and German bonds has been 116 bp and 209 bp respectively. At the moment the yield spread stands at 210 bp and 325 bp, which is significantly above the historical average. In terms of the Barcelona market, this yield spread is slightly higher. When analysing property yields in the medium-term (2/3 years) we should be aware that there could be further interest rate rises in the US, as a result of the new government's economic and fiscal policy. In the same vein, the latest inflation figure was 1.1% in the Eurozone, 1.7% in Germany and 1.5% in Spain. This is putting pressure on the ECB to start to standardise monetary policy.

Office Initial Yield (%)

Madrid	2015	2016
CBD	4.50%	3.75%
RBD	5.25%	4.50%
RC	6.75%	5.75%
DEC	6.50%	5.75%
OUT	7.25%	6.75%

Barcelona	2015	2016
CBD	4.50%	4.50%
RBD	5.25%	5.00%
RC	5.75%	5.50%
DEC	6.50%	6.50%
OUT	7.25%	6.75%

We expect that the positive indicators that have been driving the market forward over recent years and that have enabled the market to achieve all-time highs will continue to drive the market in 2017. We should nevertheless monitor some markets given the significant amount of new supply in the pipeline in the short-term, and the effects that this could have on vacancy rates and rental prices.

Some market indicators will not be as strong as in previous years, as the market will be restricted by elements such as the limited supply of income-producing properties in the market and the anticipated decline in the amount of acquisitions by Socimis.

As we have previously stated, the yields achieved in the Business District suggest that they could stabilise. Further contractions in yields are more likely to be seen in Out-of-Town markets, the areas where yields have contracted the least over recent years and where yield corrections have still not reached the record lows achieved in 2007.

AGUIRRE
NEWMAN

Contact:

Pelayo Barroso
Director of Market Research and Analysis
+34 91 319 13 14
pelayo.barroso@aguirrenewman.es

Ángel Estebaranz
Director of Business Space
+34 91 319 13 14
angel.estebaranz@aguirrenewman.es

Gonzalo Ladrón de Guevara
Director of Investment Office
+34 91 319 13 14
gonzalo.ladron@aguirrenewman.es

Aguirre Newman Madrid
C/ General Lacy, 23
28045 - Madrid
Tel +34 91 319 13 14
asesores@aguirrenewman.es

Aguirre Newman Barcelona
Avenida Diagonal, 615
08028 - Barcelona
Tel. +34 93 439 54 54
asesores.barcelona@aguirrenewman.es

Aguirre Newman Málaga
C/ Puerta del Mar, 18, 8º-D
29005 - Málaga
Tel. +34 952 062 782
asesores.malaga@aguirrenewman.es

Aguirre Newman Lisboa
Praça Marquês de Pombal, nº 16-7º
1250 - 163 Lisboa
Tel. +351 21 313 9000
portugal@aguirrenewman.pt

Aguirre Newman London
10 Stratton Street
Tel. +44 (0) 2079112918
Cell. +44 (0) 7702759023
london@aguirrenewman.com

Aguirre Newman México
Monte Pelvoux 120, Piso 3
Lomas de Chapultepec, México D.F.
Tel. +52 (55) 5202 2045
asesores.mexico@aguirrenewman.com

Aguirre Newman Colombia
Calle 93 # 11 A - 11
Of. 602, Bogotá D.C.
Tel: +57 1 7957498
asesores.bogota@aguirrenewman.com

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