Economic Overview
Global economic activity has been impacted by the health crisis caused by the outbreak of COVID-19. It is still too soon to measure the full extent of the impact on national economies, as this will depend on the duration of the health crisis, estimated to last for several months, as well as on the capacity for recovery once it is over.

The GDP figures for Q1 2020 revealed more pronounced repercussions than expected. The slowdown of economic activity and consumption during the second half of March crippled the Spanish economy, which recorded the largest quarter-on-quarter decline in the historical series (-5.2%).

According to national accounting data from the Active Population Survey (EPA, Encuesta de Población Activa), job creation has registered the first negative growth since 2014 (-1.93% q-o-q), reflecting an increase in the Q1 2020 unemployment rate to 14.41%.

The March data published by the State Employment Service (Servicio Público de Empleo Estatal) showed an increase of just over 302,000 job seekers, with the April figure leaving the number of unemployed at 3.83 million.

In order to alleviate the adverse effects of this unprecedented situation on the national economy, the government has approved several measures that will try to mitigate the economic downturn of businesses and the labour market. The EU is also focusing its assistance on containing unemployment in its member countries.

The Q1 2020 take-up figures (nearly 110,000 sq m) were affected by the COVID-19 outbreak, standing at 26% below the average level of Q1 for the last five years.

Take-up and Demand
The take-up during the first quarter, just over 110,000 sq m, indicated the initial effects of the lockdown which was enacted through a state of emergency in mid-March. This is the lowest figure since 2012, 26% below the average of the first quarters for the last five years.

The year-on-year comparison reflects a 47% decline. However, it should be noted that in Q1 2019 the two largest transactions of the year were signed (both >30,000 sq m), accounting for 40% of the quarterly total. Excluding these agreements, the decrease would be 17%.

Furthermore, the Q1 2020 figure is similar to that registered in Q4 2019, which already marked a moderate decrease of activity compared with the previous quarters of 2019 (in the historical series, the even quarters register a better performance than the odd).

The number of deals also reflected a decrease of 28% compared to Q1 2019 and 19% compared to Q4 of the same year.

Deal Size
The transactions of <500 sq m continue to lose importance in the capital’s office market (40% compared with 53% in the historical series), leading some to opt for the tailored solutions of flexible operators.

The medium-sized segment (between 500 and 1,000 sq m) registered a notable increase, going from barely 22% on average since 2000 to 35% in Q1 2020. On the other hand, the group of large transactions (those of >1,000 sq m) represented 26% of the total, remaining stable in line with the historical data.

With regards to the M-30, particularly striking is the balanced distribution of deals in the central hub of >1,000 sq m (46% of the total inside and 54% outside). It is worth taking into account that barely 40% of the buildings with available space inside the M-30 offers more than 1,000 sq m, while this figure is close to 65% outside.

Activity by Market Zone
The scarcity of available space inside the M-30 has slightly decreased activity within the main ring road, accounting for just over 43% of deals.

By areas, the presence of those with a shortage of supply, such as Prime and CBD, has been reduced in terms of transactions and take-up. Within the M-30 only the urban area increased in gross take-up, from 22% in the previous year to 27% (also exceeding the average level in the historical series). However, its presence in number of deals has been reduced (30% in 2019 and 27% in Q1 2020).
Operators of flexible spaces remained active during Q1 2020. Secondary locations are becoming increasingly important.

In the periphery, the submarkets located between the M-30 and M-40 posted the largest increase in activity. These rose by three percentage points in take-up, but in number of deals they went up by ten percentage points to reach almost a third of the total. The business centres in the inner periphery that experienced activity in Q1 2020 are mainly located in the northeast quadrant of the market.

The outer periphery grew five percentage points in take-up (23%) thanks to the largest transaction of the quarter (10,700 sq m signed by a technology company in the A-6 hub). However, in terms of number of deals it remained stable (25% in Q1 2020 compared to 24% in 2019).

Flexible Offices
Flexible office operators remain active in the market. Between January and March, three deals were recorded, totalling 5,500 sq m. The average deal size stood at just over 1,800 sq m, representing a steep upward trend. The difference with respect to the average size taken in 2019 was -45% and -20% compared to the historical average.

All three agreements were signed within the M-30, but submarkets further away from the CBD are increasingly becoming more important.

The most notable transaction of the three was Aticco, not only because it was the largest, but also because it represented the entry of the Catalan operator into the Madrid market.

Flexibility of lease contracts is one of the main advantages of flexible space operators, which has led to a considerable increase in the cancellation or non-renewal of agreements by their occupiers. This same aspect will be a key positive factor once the health crisis is over, as it will allow the immediate take-up of office space for a much shorter period than the duration of traditional office lease contracts.

Although almost all operators have areas for collaborative work and hot desks, we need to dissociate the relationship between flexible spaces and coworking spaces which has diminished.

The current situation will compel traditional offices to reinforce efforts of hygiene and control the flow of people in the work environment, limiting activity in common areas as much as possible and ensuring the social distancing recommended by the authorities. The final objective is to transform work spaces into safe areas for the development of the business activity of their occupiers.

The profile of occupiers of flexible spaces was originally start-ups and small companies with a small group of employees, self-employed individuals, etc. However, it is increasingly common to find among customers large corporations that choose to hire flexible spaces to solve specific needs for additional space.

The advantages that operators of flexible spaces offer, such as flexibility, immediacy of use and wide range of facilities, will work in the favour of this type of business. To ensure social distancing for a given period, large companies will take this into consideration in their contingency plans as an alternative to the extension of workspaces.

Stock and Current Supply
The stock of the Madrid office market now exceeds 13.65m sq m, 8.4% of which is immediately available (1.15m), representing a slight increase of three tenths compared to the 2019 closing figures.

Between January and March, the office stock incorporated just over 35,000 sq m, of which 15,500 sq m were already occupied (new headquarters of Roche and GE in MadBit and the new WeWork centre on Fernando el Santo). In terms of volume, the new Los Cubos building stands out, reincorporating 18,000 sq m of available space after its refurbishment was completed.

With regards to availability, the supply of office space in the interior of the M-30 continues to decrease, while the periphery has more vacant space than in the last quarter. The vacancy rate inside the ring road is now below 4% (3.96%), while the vacancy rate outside the M-30 stands at over 11% (11.15%), the supply increased by just over 54,000 sq m in one quarter).

Future Supply
By the end of the year, it is expected that approximately 190,000 sq m will enter the market, 162,000 sq m (86%) of which will be available.

Of the 26,400 sq m that will be incorporated occupied, most of it is within the M-30. By volume, the headquarters of D.G. de Seguros y Fondos de Pensiones on Paseo de la Castellana 44 stands out. This is followed by Serrano 88, which was pre-let by Gala Capital at the end of 2019, Goya 36, the former Union Fenosa building in the process of being refurbished to house another WeWork centre in the Salamanca district, and the Axis building (Plaza de Colón i) where Caixabank will set up its flagship branch in Madrid. The only pre-let recorded outside the M-30 corresponds to the Celes building on Juan Ignacio Luca de Tena, where Grupo Planeta will occupy five of the six floors.

Table 1: Main Deals - Occupier Market Q1 2020

<table>
<thead>
<tr>
<th>Tenant</th>
<th>Market Zone</th>
<th>Floor Area (sq m)</th>
<th>Activity Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vector SW</td>
<td>A6</td>
<td>10,700</td>
<td>IT</td>
</tr>
<tr>
<td>BBVA</td>
<td>North</td>
<td>9,000</td>
<td>Bank - Finances</td>
</tr>
<tr>
<td>Tech Company</td>
<td>East</td>
<td>5,300</td>
<td>IT</td>
</tr>
<tr>
<td>Prosegur</td>
<td>East</td>
<td>4,900</td>
<td>Business Services</td>
</tr>
<tr>
<td>Grupo Lexer *</td>
<td>Urban Area</td>
<td>4,200</td>
<td>Business Services</td>
</tr>
<tr>
<td>The Valley *</td>
<td>Urban Area</td>
<td>3,550</td>
<td>Business Services</td>
</tr>
<tr>
<td>General Electric Power</td>
<td>East</td>
<td>2,750</td>
<td>Energy</td>
</tr>
<tr>
<td>Aquila Capital *</td>
<td>CBD</td>
<td>2,400</td>
<td>Bank - Finances</td>
</tr>
</tbody>
</table>

Source Savills Aguirre Newman / *advised by Savills Aguirre Newman
The new developments will represent 60% of the space to be delivered during 2020 (113,000 sq m, available and committed). However, in 2021 the refurbishment projects will regain prominence (representing 63% of the almost 290,000 sq m), while 66% of the new surface area will enter the market available (193,300 sq m).

The two submarkets with the highest development activity are MadBit and Paus, where the delivery of 85,000 sq m of new space is expected by 2021. This will be distributed over five projects (three in MadBit and two in Las Tablas). Within the M-30, the new supply will be concentrated mainly in Barrio de Salamanca, where the refurbishment of six assets will add up to just over 45,650 sq m and represent 25% of the total planned in the city’s central hub.

**Rents**

The average closing rent calculated with all known values signed in business buildings (exclusive and semi-industrial) stood at just over €16.80 per sq m/month at the end of Q1 2020, registering a 3% y-o-y increase.

The most common rental range continued to be between €10 and 20 euros per sq m/month (56% of the total, 55% in 2019), but it should be noted that there was an increase in the range between €20 and 25 per sq m/month (15% compared to 11% in 2019).

The highest rental value (€35 per sq m/month) was recorded in one of the most representative buildings of the AZCA area, across several deals in modules of <500 sq m.

The achievable Prime CBD rent remained at €35 per sq m/month and registered a 4.5% y-o-y growth, while the Prime rent outside the M-30 stood at €18.50 per sq m/month, a 1.4% increase over Q1 2019. Both values are still far from the levels posted in the previous market peak (-17% and -29%, respectively).

**Investment**

The volume of investment transacted in the office market during Q1 2020 slightly exceeded €875m at a national level, representing a 6% y-o-y increase. The boost was due to three megadeals (≥€100m), which accounted for close to 47% of the total.
Investors remain interested in the market, albeit with caution due to the impact of COVID-19 on the office sector. 68% of the pipeline continues to be active, with final decisions affected by delays or extensions of deadlines.

With regards to distribution by location, Madrid accounted for 71%, with €618m. The year-on-year comparison in the capital indicates a negative balance of -11%.

Despite the fact that the three megadeals in the office market were recorded in Madrid, the quarterly volume did not exceed the figure for Q1 2019, directly related to the significant portfolio transactions that took place (five in total, which accumulated 65% of the total for the quarter, although only one of them exceeded €100m).

Moreover, Q1 2020 posted a 27% decline in number of deals (12 agreements in Q1 2020 compared with 17 in Q1 2019), which represented a decrease of nearly a third when looking at the number of assets transacted (33 in Q1 2019).

The average price per deal in Q1 2020 increased by 14% compared to Q1 2019. But when comparing only single asset transactions, the average of €51.5m represents more than double the figure recorded in the same period of last year.

The distribution of the capital transacted was determined by the location of the largest transactions. The Northeast Zone accounted for 30% of the total due to the acquisition of the Helios complex by the South Korean firms Inmark Asset Management and Kiwoom Securities. The Castellana Norte Business Park, acquired by Harbert Management Corporation, raised Paus’s stake to 21%. The inside of the M-30 represented 36% of the total, driven by the deal of the Axis building on Plaza de Colón, which accounted for 49% of the total registered in the central hub.

The market continued to evolve around core and core+ products (accumulating just over 90% of the total between them), with the remaining 9% in value added (a building that will change use and another that will undergo a refurbishment project).

With regards to the origin of capital, international funds continue to dominate the market, with 74% of the total. By region, the nationality of buyers of megadeals clearly established the distribution. Asian capital (Helios building) accounted for 30%, followed by the United States (Castellana Norte complex). It is important to highlight the direct participation of Asian companies in commercial real estate, which emerged on the scene in 2019 after several years of being channelled through management companies and other investment vehicles.

After the state of emergency was declared, almost all deals that were underway are still active, although they have been extended pending visits, progress on tasks that involve physical presence or extended periods of analysis. Only 15% fell through, but it should also be noted that one has been closed in a consolidated market in the inner periphery (between M-30 and M-40).

Investors remain active and confident in the market, although with a cautious attitude, waiting to see the full impact of COVID-19 on the office sector.

Yields
The prime yield level remains stable, both in the business district (3.25%) and outside the M-30 (4.75%).

There is much speculation about a potential price adjustment due to COVID-19. Although there is currently no evidence of a decline in capital values, there may be some expansion linked to aspects of financing or to the extension of marketing periods, but we must note that the market is in a period of maximum liquidity with low interest rates.

<table>
<thead>
<tr>
<th>Table 2: Main Deals - Investment Market Q1 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset</td>
</tr>
<tr>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Helios</td>
</tr>
<tr>
<td>Castellana Norte *</td>
</tr>
<tr>
<td>Axis</td>
</tr>
<tr>
<td>Fray Luis de León, 11</td>
</tr>
<tr>
<td>Las Fuentes</td>
</tr>
<tr>
<td>Gobelas, 35-37 *</td>
</tr>
</tbody>
</table>

Source: Savills Aguirre Newman / *advised by Savills Aguirre Newman
Savills Aguirre Newman Research
We carry out a thorough and objective analysis of the real estate market in order to provide our clients with accurate information on the current situation in each of the sectors, helping them make the right decisions at each moment.

Offices

Hipólito Sánchez
Head of Offices
+34 93 439 54 54
hipolito.sanchez@savills-aguirrenewman.es

Ana Zavala
Director Office Leasing
+34 91 319 13 14
ana.zavala@savills-aguirrenewman.es

Ángel Estebaranz
Director Office Leasing
+34 91 319 13 14
angel.estebaranz@savills-aguirrenewman.es

José María Revuelta
Associate Director in Capital Markets
+34 91 319 13 14
jm.revuelta@savills-aguirrenewman.es

Research

Gema de la Fuente
Research
+34 91 319 13 14
gema.fuente@savills-aguirrenewman.es

Pelayo Barroso
Research
+34 91 319 13 14
pelayo.barroso@savills-aguirrenewman.es

Isabel Gil
Research
+34 91 319 13 14
isabel.gil@savills-aguirrenewman.es

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