Research Spain – Q4 2021

SPOTLIGHT
Savills Research

Madrid Offices

"The market is picking up again. Since the beginning of the year, quarterly figures have steadily improved to almost 420,000 sq m of take-up, representing a 19% y-o-y growth"

Economic Overview

The emergence of the omicron variant has increased the sense of uncertainty. The speed of transmission has once again imposed certain restrictions and implemented recommendations aimed at curbing its expansion, which will have a direct impact on the evolution of economic activity.

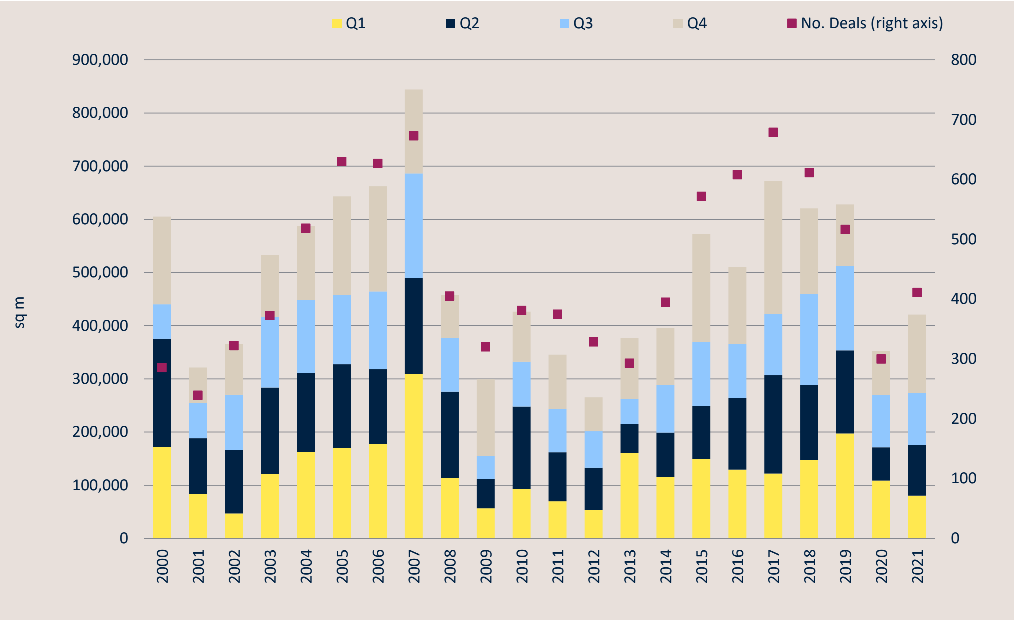
With the advanced GDP figure for Q4 growing at 5.2% year-on-year, 2021 ended at 5.5% compared to the previous year, surpassing the lower forecasts of several economic institutions in recent months. As for 2022, the inertia of the economic recovery is expected to allow the pace of growth to accelerate.

With regards to the labour market, the latest published data leads us to be optimistic. The number of unemployed registered with the State Public Employment Service (SEPE) offices in December stood at 3.1 million, which is the lowest figure since November 2019, maintaining the downward trend that began in May 2021, i.e. eight consecutive months of job creation.

Meanwhile, the number of people registered with Social Security, continues to grow. The year ended with close to 19.825 million members, the highest figure in the historical series. The number of workers protected by the furlough system (ERTE), just over 102,000 in December, represents 0.5% of the total number of people registered, which puts effective employment at 19.72 million workers.

Finally, according to EPA (Encuesta de población activa) for Q4, the number of employed reached 840,600 at the end of the year, the best figure since Q4 2005.

Annual Take-up



Source Savills Aguirre Newman Research

Madrid Offices

Take-up and Demand
Since the beginning of the year, the office market in the capital has been steadily gaining pace, with around 150,000 sq m in Q4. This is not only the highest quarterly volume in 2021, but also the highest level since mid-2019.

In the annual total, the year ended with close to 420,000 sq m, representing a 19% year-on-year growth.

The signing of two megadeals (≥10,000 sq m) contributed nearly 31,000 sq m to the take-up figure (7% of the total). However, if these deals are excluded from the analysis of the two years, the market shows signs of recovery, with an increase of 20%.

In terms of the number of transactions, the 411 deals identified represent 37% more than the previous year, putting it close to the annual average of the historical series (438 deals).

Deal Size
The average deal size (1,030 sq m) decreased due to the fact that in 2020 four megadeals were recorded, accumulating around 17% of the surface area, but when comparing transactions of <10,000 sq m (99% of deals since 2000), the average deal size remained at around 1,000 sq m.

By surface area range, deals signed in spaces of <250 sq m accounted for around 21% of the total, remaining below the historical average of 25%. Regular occupiers in spaces of this size now find an alternative in flex offices, where they have modern features and services adapted to their particular needs in a wide range of locations.

Transactions between 250 and 500 sq m continue to account for a large part of the market activity (29%) and are gaining presence, with an increase of two percentage points up from the previous year and almost one point compared to the historical series.

This is due, on the one hand, to the fact that smaller companies have fewer barriers to decision-making, which allows them to be more agile in the event of a change of headquarters and, on the other hand, to the slowdown in the activity of deals of >3,000 sq m.

The most active segment in the market was the range of 1,000-3,000 sq m, which increased its market share by almost five percentage points compared to both last year and the historical series, from 18% in 2020 to 23%.
The other ranges remained stable, with fluctuations of around one percentage point above or below the historical figure.

"The increasing vacancy rate, which began in Q1 2020, has been slowed down by the recovery in take-up. The estimated net take-up, based on the difference in occupied space, is once again positive"

The largest deals of the year, both >10,000 sq m and signed in Q4, were found in decentralised locations within the M-30. CUNEF has reached an agreement with Merlin to progressively occupy the 17,000 sq m of the Jose Maria Churruca School. Meanwhile, Sociedad Mercantil Estatal de Gestion Inmobiliaria de Patrimonio (SEGIPSA), part of the Ministry of Finance, has acquired the second building of the Rio 55 complex, with nearly 14,000 sq m, owned by AEW, in the south-west of the city.

Activity by Market Zone

The interior of the M-30 continues to attract demand, accounting for 51% of signed transactions (211), although the scarcity of large spaces diverts part of the search towards the periphery. In fact, almost 40% of the deals signed outside the ring road were 1,000 sq m or more, while only 20% were in the central hub.

In terms of take-up, the inner periphery accounted for a third of the total, with the focus on the north and east zones, which made up almost 25%, the same level of take-up as the entire outer periphery.

The submarket with the best records, both in terms of take-up volume and deals, was MadBit. The following factors are attracting numerous companies to this area: situated in a revitalised urban environment with quality buildings, ease of access via the metro (as it has several stations in the area), as well as its proximity to the A2, the M-40 and the airport.

Flexible Offies

Flex operators have resumed their expansion plans, albeit at a slower pace than before the pandemic. During 2021, 12 transactions were recorded, accounting for 5% of take-up (around 20,000 sq m signed), bringing the average surface area to around 1,600 sq m. Although this represents significant progress compared to 2020 figures (seven deals, 2.4% of take-up and 1,200 sq m average size), there is still some way to go to recover pre-COVID levels with an average of 60,000 sq m, 20 deals and 2,700 sq m average deal size.

Operators' growth plans are always aligned with the operational metrics of the centres. After 2020, a year marked by the health crisis, flex spaces are making a strong comeback as another alternative for office occupiers, reaching occupancy rates of between 70 and 80% on average. Some centres are even registering levels of 50% at the time of opening.

The success of centres is related to various factors, such as the location, the size of spaces, the distribution of work and dispersion areas, as well as the range of services, among others.

The key to location is ease of access by public transport, either in the city centre (within the M-30) or in the periphery. The type of company and the number of workstations also play a role. Companies that opt for offshore centres are generally small in size (<10 workstations) and value proximity to their residence. Meanwhile, companies that choose centres in and around the Castellana axis generally occupy >10 workstations and prioritise the prestigious aspect of the space and the area.

Current Supply

The capital's office market makes up just over 14 million sq m, with the vacancy rate dropping for the second consecutive quarter to 9.3%. This is only a difference of two tenths of a percentage point and 17,000 sq m compared to Q3, but it points directly to the recovery of the market.

When analysing areas, Prime and CBD registered a slight increase, due to the reintroduction of numerous second-hand spaces to the market, including some of the city's most emblematic buildings. Alongside this is the new Mutua Madrileña development in AZCA (Edificio Growth, located behind the Edificio Alfredo Mahou).

As this is a very small market (with a stock below two million), any variation in the level of supply has a more obvious impact on the vacancy rate. In this case, the 27,000 sq m extra available space represented an almost two percentage point increase in the vacancy rate (7.1% overall).

The Urban Area and Inner Periphery remained stable at 5.9% and 10.2% respectively, despite incorporating an extra 3,600 sq m of supply, while the most notable decrease took place in the Outer Periphery, with a difference in availability of almost 46,000 sq m, cutting the vacancy rate by 1.2 percentage point to 12.3%.

Future Supply

Over the next two years, 525,000 sq m of new and refurbished space is expected to enter the market, distributed very evenly between 2022 and 2023, with just over 260,000 sq m in each year. Refurbishment projects are once again gaining prominence, accounting for two thirds of the buildings in the pipeline and 57% of the surface area. It is worth noting that, at a time when environmental awareness is so important, building refurbishment generates less waste and reduces the environmental impact. Although most of the refurbishment work is located within the M-30, it is increasingly common to find assets undergoing refurbishment in the submarkets in the periphery.

Of the total amount of new space planned, 20% will be occupied, either by the owner or a tenant who has signed a pre-let contract. In 2022, the approximately 85,000 sq m of committed space represents 32% of the total, while the current figure of occupied space in 2023 (17,000 sq m) accounts for 9%.

The geographical distribution by submarkets of new vacant space (420,500 sq m) is led by MadBit (68,000 sq m across six assets). Almost 50% of the surface area is concentrated in the Edificio OM Infinito, which will enter with part of the surface area already occupied (4,300 sq m).

Main Deals - Occupier Market Q4 2021

Tenant	Market Zone	Floor Area (sq m)	Activity Sector
CUNEF	Urban Area	17,000	Education
SEGIPSA *	Urban Area	14,000	Public Administration
Indra Sistemas	A2	7,300	IT
UNIE	Urban Area	6,800	Education
Arval	A1	6,700	Business Services

Source Savills Aguirre Newman Research / *deal advised by Savills Aguirre Newman

> “Demand, increasingly committed to ESG criteria, is looking for buildings that reflect the same commitment to social and environmental aspects and is willing to assume the corresponding rise in rent”

Rents

The average closing rent for the Madrid market in 2021 (calculated using all data collected from transactions in business buildings) was slightly above €18 per sq m/month, which represents a 2.3% y-o-y increase and is in line with the level achieved in 2019 (only four tenths of a percentage point lower).

The rise in rental values directly relates to the increase in quality standards in office buildings. In 2021, just over one-third of deals were registered in buildings with sustainability certificates (LEED or BREAM), accounting for almost 50% of the take-up.

The quality of property is valued by demand, which is willing to take on the corresponding increase in rent. The difference between certified buildings and the rest of the market ranges from barely one euro in the outer periphery to six euros in prime and CBD. On the other hand, the commitment to ESG criteria is becoming increasingly widespread in the business sector and companies are looking for properties that reflect their commitment to the environment and society.

In terms of achievable values, there is a general trend of stability. Only Prime CBD increased slightly, from €34 to €34.25 per sq m/month.

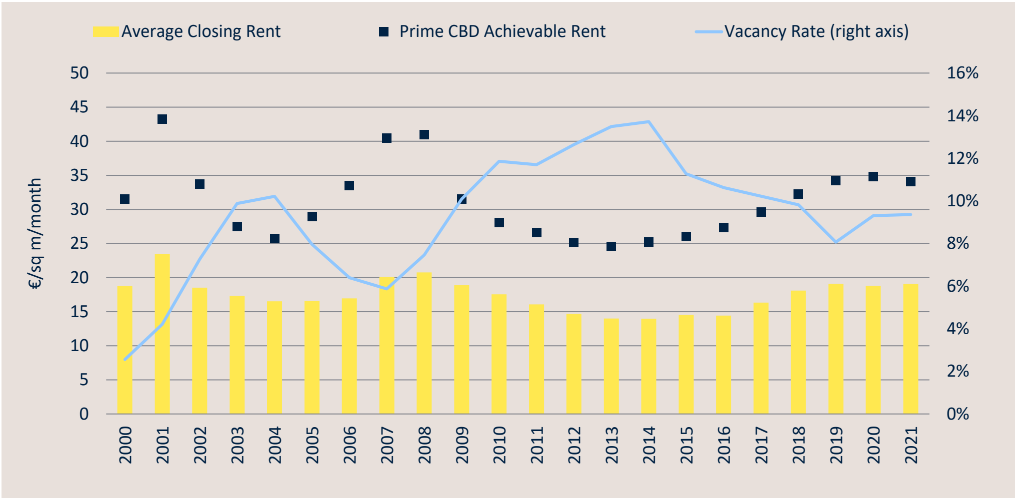
Investment

The Madrid office market ended 2021 with close to €680m in investment transacted, down 52% on the previous year's figure, although it should be noted that close to 50% of the total was concentrated in five megadeals (≥€100m).

The main reason for the significant drop was the shortage of available product to meet the expectations of demand, which favoured the search for off-market assets, accounting for 61% of the total transacted. This demonstrates the high level of interest in Madrid. However, it should be noted that, of the assets mandated, several had been available on the market for more than a year.

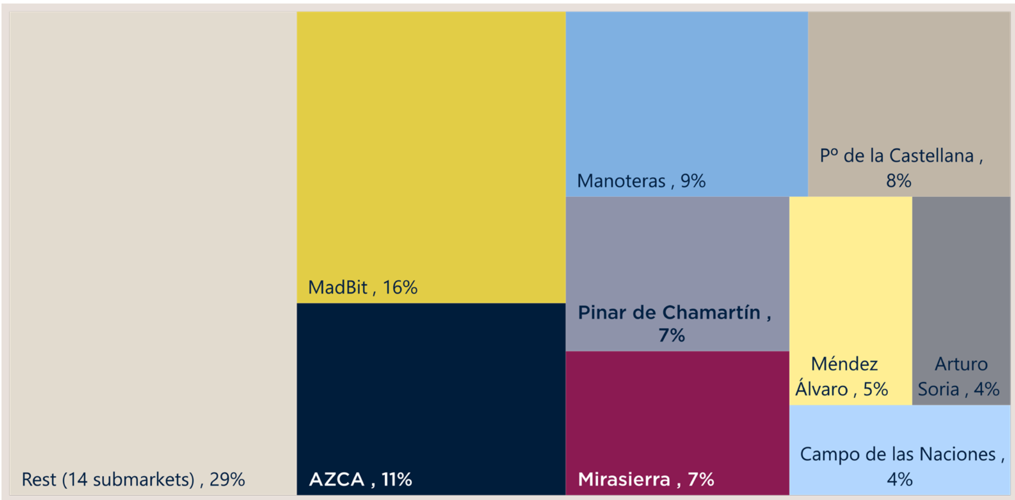
Investment activity increased steadily during the year, from €80m across four deals in Q1 to € 270m and 12 deals in Q4. The average price remained at around €20m.

Vacancy Rate and Rents



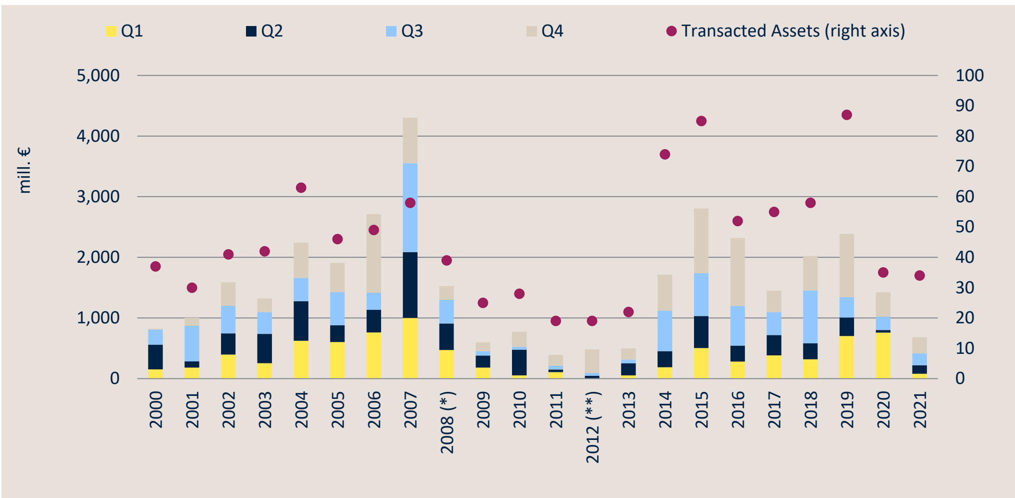
Source Savills Aguirre Newman Research

Available Future Supply by Submarket (2022*-2023*)



Source Savills Aguirre Newman Research / *forecasts

Invstment Activity in Madrid



Source Savills Aguirre Newman Research / *excluding Ciudad Financiera / **excluding Torre Picasso

“There is scarcity of product available on the market as well as interest from investors in Madrid. This has diverted part of the activity to the off-market channel, which accounted for 61% of the volume and 59% of the assets transacted”

Despite the uninterrupted increase, the weight of Madrid in the national total barely reached 27%, which contrasts with 67% in the last ten years and 69% in the historical series.

The largest transaction (>€50m) took place in Q4. The French asset management company Ardian took over the former Cetelem headquarters in the Méndez Álvaro submarket. This is a privileged location, with maximum visibility from the M-30, in a highly consolidated environment where important developments will be incorporated in the coming years. The immediate future of the property is to undergo a comprehensive refurbishment to adapt the building (constructed in the early 90s) to the needs of current demand.

The M-30 continues to be a psychological barrier. The general interest of investors is concentrated within the M-30, although there are attractive opportunities in peripheral markets. In this regard, MadBit remains on the investment radar of both national and international companies, which continue to be committed to the capital’s so-called technology district. During 2021, four transactions were registered in this submarket (all off market), three of which took place in Q4, totalling around €62m, accounting for 20% of the total amount transacted outside the M-30.

Within the context of uncertainty, risk aversion is clearly reflected by investors’ commitment to core and core+ products, which accounted for 70% of the annual volume. Value added activity was mainly located within the central hub, but it is also worth noting the signing of some assets in locations with very solid fundamentals, including MadBit, as well as a building in the outer periphery of the A1 in a portfolio mainly comprised of logistics products.

The competitive advantage of national investors is their great knowledge of the office business in the capital, also evidenced by the share of their acquisitions in the off-market (>60% both in volume and transactions). When comparing mandated and off-market products, the difference between international transactions is hardly representative (only 2% higher in on-market assets). However, in domestic deals, off-market purchases (where they avoid the competition of mandated processes) exceeded mandated assets by 13%. It should be taken into account that more than 70% of core and core+ product was transacted off-market.

Yields

Yields remain stable. After the 15bps drop in Q2, Prime CBD continues to stand at 3.10% and Prime outside the M-30 at 4.60%. In any case, it should be noted that buying pressure could compress the yield of a certain product as long as it meets the criteria of location, quality of the property, solvent tenant and a long-term contract.

The modest increase in rents identified in Prime CBD will progressively extend to the best buildings in consolidated submarkets, which will affect capital values.

Main Deals - Investment Market - Q4 2021

Asset	Market Zone	Purchaser	Vendor
Retama, 3 *	Urban Area	Ardian Real Estate	BNP Paibas
P.E. Euronova	Outer Periphery	Stoneshield	Cain + Freo
Arapiles, 14	Urban Area	Saint Croix	Acción contra el hambre
Institución Libre de Enseñanza, 43 *	Inner Periphery	Private Investor	Marathon AM

Source Savills Aguirre Newman Research / *deal advised by Savills Aguirre Newman

Outlook

- The year started with a number of deals in the negotiation process that will be completed throughout 2022, providing an optimistic outlook.
- It should also be noted that, after the Christmas break, significant activity has returned to the market in terms of new active demand, visits, etc., which is accelerating as the impact of omicron fades.
- On the other hand, the recovery of the office market will have an important impact in the reactivation of the economy, which could grow by around 6%. The year could end with an increase in take-up of between 15% and 20%, again approaching the 500,000 sq m mark.
- Flex spaces will continue to be an interesting alternative for part of the business sector. It is the most obvious option for small companies with a need for <10 workstations, but also for large corporations with temporary space needs. The existence of operators in the same building or in the immediate surrounding areas gives added value to a property.
- The favourable performance of demand will have a positive impact on availability levels. The interest in quality buildings will, as the year progresses, reduce the volume of supply from new developments and refurbishments (now quantified at 420,500 sq m), which will also help to control the vacancy rate.
- Rent recovery will be closely related to asset quality. Slight increases are expected in the achievable values of the best buildings in the Castellana axis and its immediate surroundings, which will later reach the submarkets outside the M-30 ring road. In any case, the contributions of owners are maintained (rent-free period, contributions to works, etc.).
- As in the occupier market, some investment deals have been carried over to 2022 and will be completed shortly. The entry into the market of several processes will ensure transactional activity, although alongside this the off-market product will continue to be very active.

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

Daniel Norrby
Associate Capital Markets
+34 91 319 13 14
daniel.norrby@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