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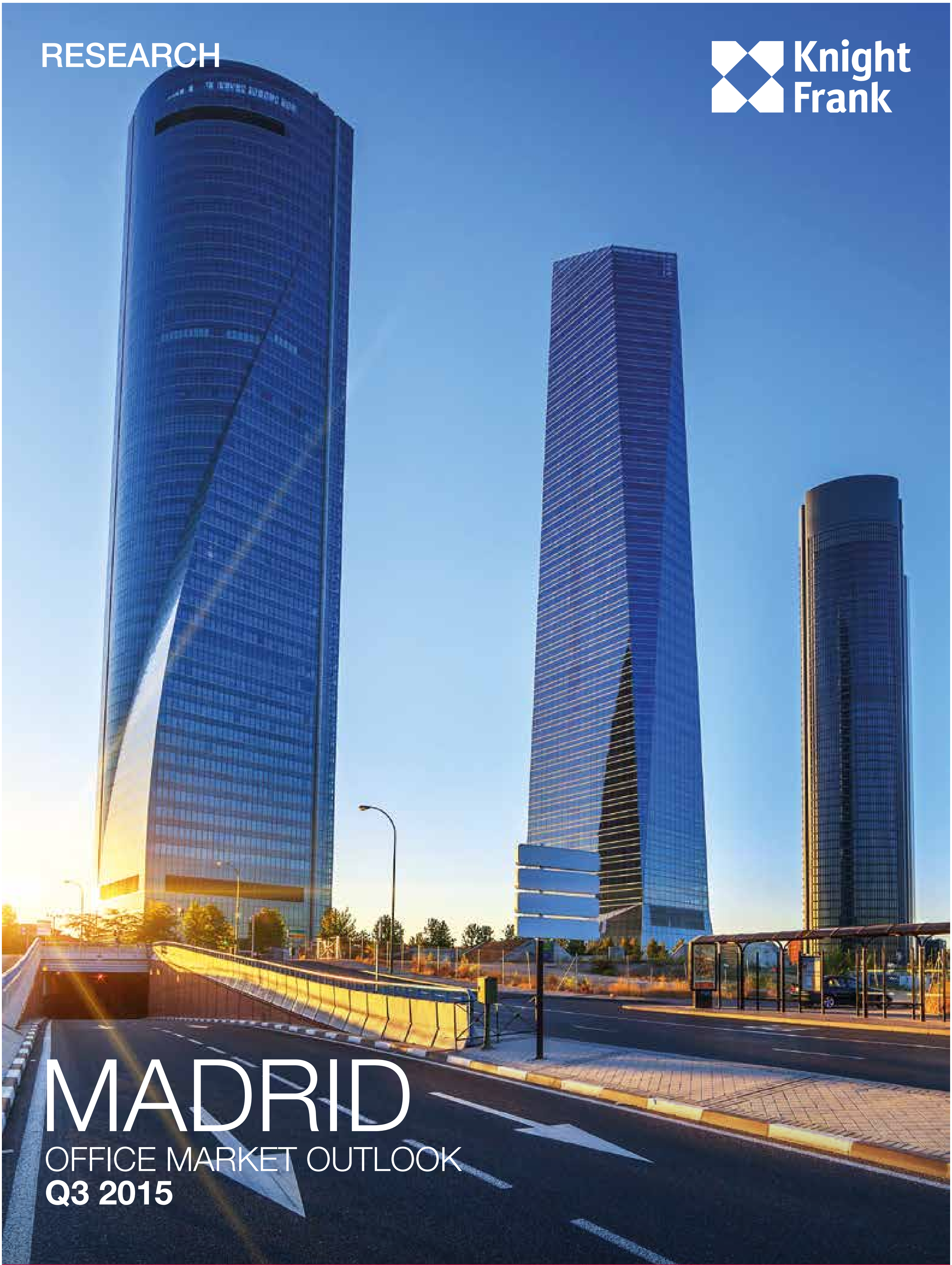


# MADRID

## OFFICE MARKET OUTLOOK

**Q3 2015**

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

# KEY FINDINGS

As macroeconomic variables, such as GDP and employment, show positive growth, real estate fundamentals should continue to improve

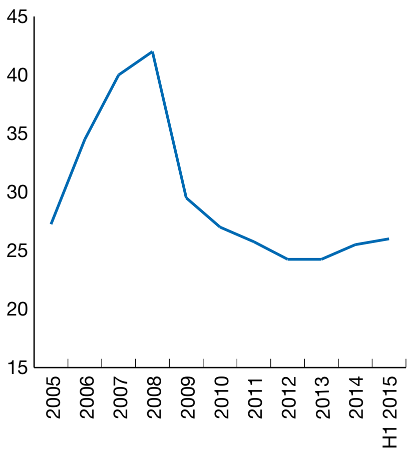
H1 turned in a strong performance, with take-up increasing by 30% on the same period in 2014

Limited development activity is expected to drive vacant space down and prompt further rental growth

Office investment volumes are forecast to reach €1.8 billion in Madrid by the year-end

Prime yields are expected to harden further as the office market grows in popularity with investors

FIGURE 1
**Prime office rents**
€ per sq m per month




**Source:** Knight Frank Research

# OCCUPIER MARKET

## Although take-up is yet to reach its pre-recession peak, occupier sentiment saw considerable improvement in the first half of 2015.

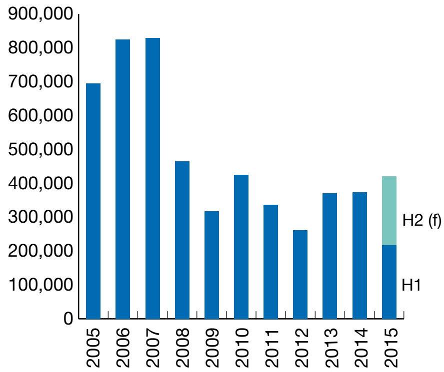
Madrid's office sector turned in a strong performance in the last twelve months, as Spain's economy continued to strengthen. Following a healthy end to 2014, where office take-up in Madrid reached c.375,000 sq m, 2015 has been encouraging with occupier activity in H1 increasing by 30% year-on-year to reach 218,000 sq m – the highest half yearly total since 2010.

Numerous leasing deals in excess of 5,000 sq m contributed to the high figures, which included BNP Paribas' pre-leasing of 19,150 sq m in the Emilio Vargas 4 building and the Olympic Broadcasting Services' deal on Torrelaguna 75, both located just outside of the central district. However, in terms of location, the majority of space occupied was in the CBD, including the largest deal of the year so far, KPMG's leasing of 19,680 sq m in the Torre de Cristal building for their new headquarters.

With take-up at healthy levels, despite the scarcity of good quality office space, vacancy rates have declined from 11.9% in H1 2014 to 10.7% in H1 2015. The fall in the vacancy rate has also been driven by a rise in the volume of space being redeveloped from offices to residential, retail or hotel use, and the lack of development activity seen throughout the city. H1 2015 saw no new space entering the market, although about 85,000 sq m is forecast to complete by the end of the year, of which only 17% is vacant. The remainder has already been pre-leased by Spanish bank BBVA for their new headquarters.

The absence of good quality space, together with rising tenant demand, has pushed prime office rents up by 6% to €26 per sq m per month in the last 12 months. The occupier market has become less favourable for tenants and, with the second half of the year expected to remain strong, tenants are likely to face higher rents in order to secure good space. Such conditions are beginning to push occupiers to consider looking in secondary locations, where rents can be at least €10 lower.

FIGURE 2
**Office take-up**
sq m



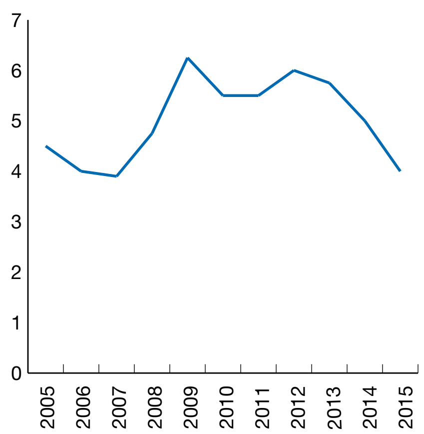

**Source:** Knight Frank Research

**Key office leasing transactions in 2015**

| Address, Building | Tenant | Size (sq m) |
|---|---|---|
| Pº de la Castellana 259, Torre de Cristal | KPMG | 19,680 |
| Av. América 79, Emilio Vargas 4 | BNP Paribas | 19,150 |
| Calle Torrelaguna 75 | Olympic Broadcasting Services | 11,170 |
| Ribera de Loira 56-58, Edificio A and B | Dentix | 8,200 |
| Marie Curie 17-19, Edificio 2 | Oesia | 6,600 |
| Príncipe de Vergara 125 | Reale Aseguradora | 5,990 |
| Orduña 1 | GFT | 5,290 |

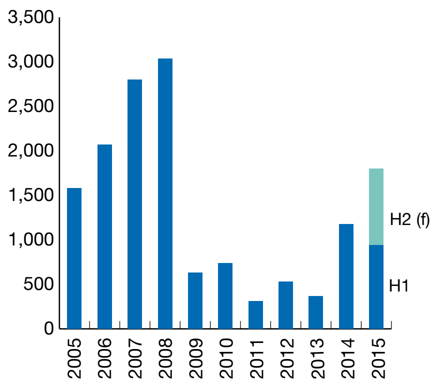
**Source:** Knight Frank Research

FIGURE 3
**Prime office yields**
%




**Source:** Knight Frank Research

FIGURE 4
**Madrid office investment volumes**
€ million




**Source:** Knight Frank Research

# INVESTMENT MARKET

Commercial property investment in Spain improved significantly in the last 12 months, following the country's continued economic recovery. After a weak start to 2014, full-year volumes for office investment in Madrid went on to total approximately €1.2 billion, the most successful year since 2008.

Although figures are considerably lower than those achieved prior to 2009, the rise has evidently increased investor confidence – an impressive €940.4 million was transacted during the first six months of 2015, the highest half-yearly total since 2008, and forecast to reach €1.8 billion by year-end. The sale of Ahorro Corporación's 20,000 sq m headquarters for €147 million was the largest deal of H1 2015, with the building yielding an estimated 4.0% for buyer's Corporación Financiera Alba.

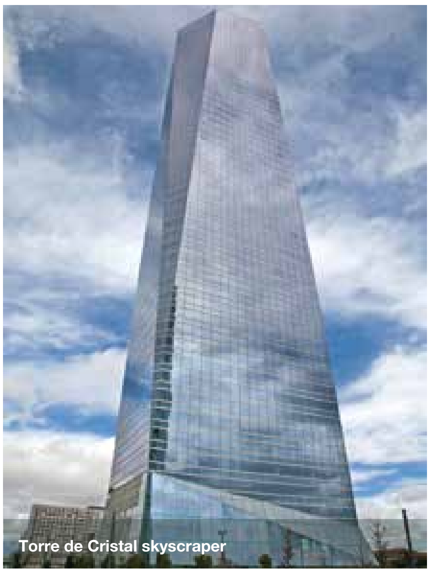
While demand remains robust, the scarcity of good quality assets in prime locations will continue to constrain office investment volumes in Madrid. Greater investor competition, particularly from local players who are looking to capitalise on the favourable market conditions, could prompt increases in asset prices. This should help keep volumes at healthy levels, although the actual number of deals is expected to remain low.

Prime office yields have hardened rapidly, reaching 4.0% in H1 2015, a 100 bps reduction in just 6 months. Madrid's remarkable market recovery could drive yields further down, to reach levels seen in major cities such as London and Paris.

**Key office investment transactions in 2015**

| Quarter | Property | Seller | Buyer | Approximate price (€) |
|---|---|---|---|---|
| Q2 | Pº Castellana 89 | Ahorro Corporación | Corporación Financiera Alba | 147,000,000 |
| Q3 | Calle Rios Rosas 26 | ING Group | M&G Real Estate (Prudential Plc) | 90,000,000 |
| Q1 | Torre Saint Gobain | Grupo BBVA | GMP | 88,500,000 |
| Q3 | Independencia 6 | Mutualidad Notarial | Mapfre | 82,000,000 |
| Q2 | Padilla 17 | SAREB | Axiare | 51,000,000 |
| Q2 | Cristalia 5&6 | Deutsche Bank | Axiare | 49,000,000 |

**Source:** Knight Frank Research


Torre de Cristal skyscraper

## KNIGHT FRANK VIEW

As occupier demand gets stronger, we could see office take-up in Madrid reach 420,000 sq m in 2015, the highest annual figure since the global crisis. Although this is far off the high occupancy figures seen in the early 2000s, the positive market sentiment seen in the last 12 months demonstrates that the city's office market is recovering well. The lack of new stock entering the market could restrict leasing activity to some extent but is expected to promote significant rental growth in the next few months, particularly in the central locations where rents could rise to at least €27 per sq m per month by the year-end.

Investment performance has historically correlated with economic trends, and although GDP and employment are showing positive growth, office volumes are unlikely to reach their pre-crisis peak this year. Nevertheless, we still expect Madrid's office sector to continue its gradual upward trend, as full-year investment volumes look set to reach a post-crisis record of €1.8 billion, especially if the sale of the Torre Espacio office building closes at the €500 million asking price.

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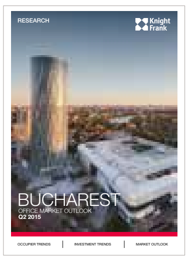


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