

RESEARCH



OFFICES

2018 MADRID AND BARCELONA

A year that will be shaped by the political backdrop, mega-deals, the technological revolution and new more-efficient workspaces focused on employee well-being.

ECONOMIC
BACKDROP

TRENDS AND
CHALLENGES

MADRID:
A SUPER CITY

OCCUPIER MARKET
AND INVESTMENT

ECONOMIC BACKDROP

RISING BUSINESS CONFIDENCE REFLECTS INCREASINGLY SOLID ECONOMIC RECOVERY

Seventy-five percent of the world's economy is contributing to the current phase of economic growth, with activity levels going from strength to strength. According to the IMF, in 2017 the world economy grew by 3.8%, exceeding last autumn's forecasts by 0.2 percentage points. The Fund has also revised its 2018 and 2019 growth forecasts up to 3.9%. This upward revision is proof of the favourable financing conditions and the strength of demand, particularly investment and mainly in advanced economies.

Spain closed 2017 with a growth rate of 3.1%, a figure which was higher than the European Union average. Although economic activity is performing extremely well, growth will start to ease off slightly over the coming years as pent-up demand is gradually placed and oil prices start to edge up.

Against this favourable economic backdrop, the European Central Bank has announced that it plans to gradually ease the monetary stimulus. In fact, it has already started to wind down its debt purchasing programme, which - once sufficiently reduced - is expected to lead to slight interest rate increases.

The uncertainty surrounding the political sit-

uation in Catalonia is a major challenge that Spain must face head on in 2018. So far, the current situation has had a limited impact on Spain's economic growth forecasts, however, this could all change if the situation is drawn out even further and a favourable solution is not found.

BUSINESS CONFIDENCE AND NUMBER OF COMPANIES

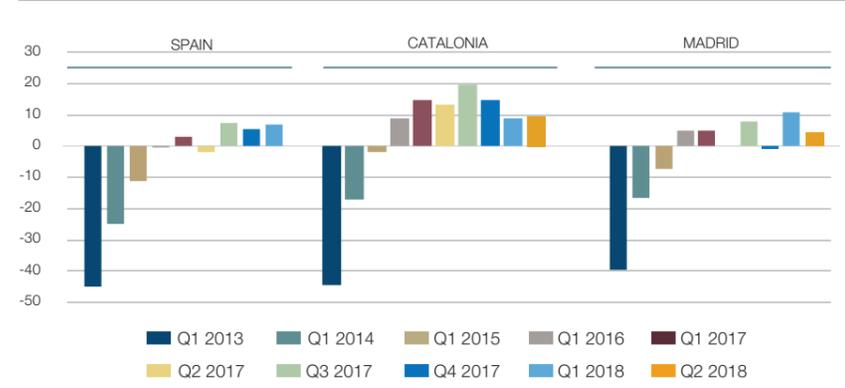
The Business Confidence Indicator (BCI hereinafter) is compiled by INE and based on a survey which asks business owners both their opinion of how their businesses have performed in the previous quarter and their expectations for the upcoming quarter. The BCI is the difference between the percentage of favourable and unfavourable responses.

The positive trend seen in the Indicator in recent years is a sign of the economy's solid recovery. Catalonia and Madrid usually register higher values than the country as a whole, given that they are the powerhouses of the Spanish economy. More Catalan business owners have a favourable

opinion regarding their business' Q4 2017 performance, than negative. As a result, the indicator remains positive, and continues to highlight the economic drive of the Catalan economy and its importance to the Spanish economy as a whole. However, this difference also narrowed gradually over the year, highlighting the effects of the political instability and the drop in tourism that is affecting businesses.

In parallel, the rate at which new businesses are being created has also been gradually slowing since summer in Catalonia. In contrast, new business creation has been growing in the Madrid Region, breaking above the 185,000 barrier in terms of the number of companies registered with Social Security at the start of 2018.

GRAPH 1
Business Confidence Index
Compiled using the survey completed among business owners, regarding the previous quarter's performance.

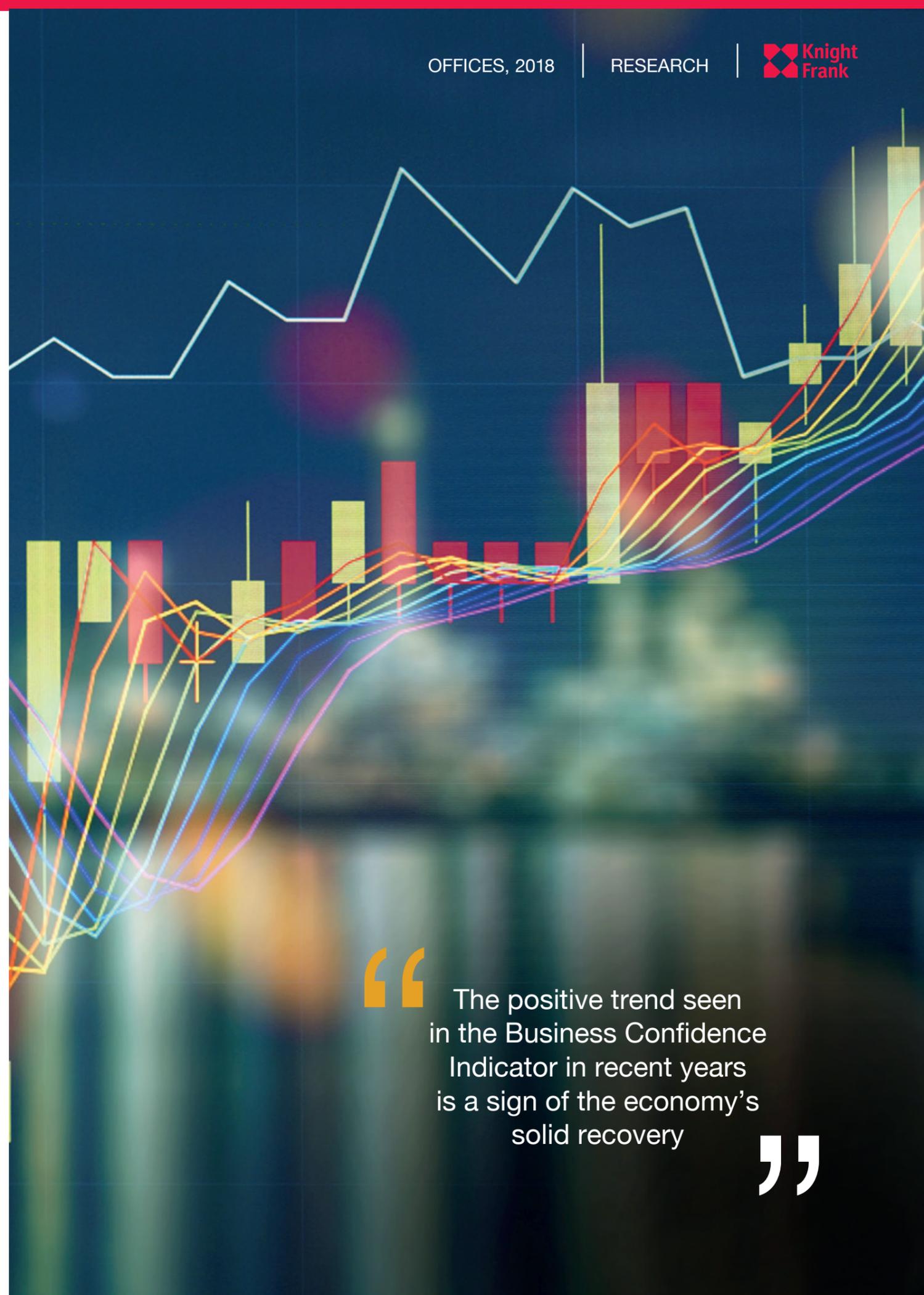


Source: INE

GRAPH 2
No. Social Security registrations
2016 January = 100



Source: Ministry of Employment and Social Security



“ The positive trend seen in the Business Confidence Indicator in recent years is a sign of the economy's solid recovery ”

OFFICES: A SPACE FOR LIVING, A SPACE IN WHICH TO GROW

For several years now, more and more companies have been incorporating new ways of working into their offices in order to increase employee satisfaction, improve their productivity and redefine their relationship with the workspace. These new ways of working are based on collaborative models involving: multi-disciplinary teams; more democratic decision-making processes; results-based performance assessments for employees; working from home; and greater flexibility.

When it comes to selecting a workspace, location is one of the most important factors for occupiers. Securing a particular location or area gives a company visibility and has become a key factor for retaining talented professionals. The trend is for people's workplaces, homes and where they spend their leisure time to all be within close proximity of one another. A central or excellently-connected location reduces the time that employees need to spend travelling

to and from work and therefore increases their level of satisfaction and their overall productivity; hence it is a must. Creating an environment in which employees want to spend time once they have finished their working day (areas with multiple leisure options, parks and green spaces) is a requirement for many occupiers.

Now, in what has become known as the Fourth Industrial Revolution, in which the development of robots, virtual and augmented reality and artificial intelligence are becoming ever more commonplace, work done by people must become increasingly innovative and capable of adapting, whilst workspaces must become far more inspiring places.

Employees have become the focal point, and their well-being the number one target. To achieve this, spaces must offer a wide variety of amenities to make employees' lives as easy as possible. Offices must offer spaces with var-

ious contrasting ambiances designed to motivate employees and offer a "look and feel" that drives their creativity. Other key characteristics include incorporating of recreational elements, features and furnishings that are more typically associated with homes than offices, as well as wide-ranging and customised food options.

Offering an office space that meets employees' current expectations and allows them to develop both on a professional and personal level will be key for improving employee productivity and attracting and retaining talented professionals. If companies want to offer their employees the ideal space, they will have to be prepared to pay a higher price per sqm, meaning their programmes for attracting and retaining talent must be closely aligned with their cost structures. One way of doing this is to ensure a more efficient use of space and adopt systems such as hot-desking.

Flexibility is the key

FLEXIBLE SPACE

Today, more and more companies need to be able to temporarily increase the amount of space they occupy in order to accommodate extra employees. This flexibility is vital in companies that are either commissioned on a project by project basis - especially if they are projects with very specific needs that require employing professionals on an ad-hoc basis - or that belong to rapidly growing sectors.

TECHNICAL AND TECHNOLOGICAL FLEXIBILITY

Technological progress is fast-moving and if companies want to remain competitive in an evermore digital world, they must be able to incorporate new technology into their processes, systems and offices as a whole. A good example is Colonial's building, Virto, located at Francisca Delgado 11, where artificial intelligence has been brought to life via a virtual assistant that not only learns occupiers' habits and preferences, but also helps to reduce the building's energy consumption.

FLEXIBLE TERMS

Changing the lease length or other terms and conditions is becoming increasingly important if companies are to adapt their office spaces to the new needs. Also, we will start to see shorter lease terms as a result of the new IFRS 16 accounting standards that will come into force in January 2019, and which will classify future term certain rental payments as part of a company's debt.

FLEXIBLE LAYOUT

Having a flexible space that allows an office's workstation and meeting room layout to be modified easily is now essential for ensuring efficient use of space. Open-plan areas that - depending on a company's needs at any one given time - can be divided into several work areas or simply used as one extensive open-plan space for large meetings are becoming ever more commonplace.

NEW TECHNICAL REQUIREMENTS

DIGITAL TRANSFORMATION

Technological progress is fast-moving, and offices today must be at the forefront of new developments both in terms of connectivity and communications. However, in the not too distant future this will no longer be enough. Within just a few years, we will not be talking about smart buildings capable of regulating overall energy and water consumption, but rather cognitive buildings that incorporate natural language and machine learning processing systems that collect data and analyse interaction between employees in a building. Data generated by sensors will be collected and analysed, natural language processing will allow occupiers to access all the building's services by merely speaking out loud, images and videos will be analysed and allow occupiers to see all the building's features and interact with them.

As well as the transformation of the property itself, buildings will also be fitted with apps that will be able to provide occupiers with useful information regarding the availability of different spaces in the building and the services and amenities offered in the area.

SUSTAINABILITY

Buildings designed to maximise the use of natural light and the sun's natural path, artificial lighting to be used solely in the absence of natural light, solar panels, rainwater collection systems, large windows that react to the weather in order to maintain an optimal temperature, by either minimising energy loss or even generating additional energy, reusable construction materials that do not affect people's health or the environment, as well as recycled and biodegradable products.

SURROUNDINGS AND ACCESSIBILITY

Buildings surrounded by natural and green spaces, and that encourage the use of a wide range of transport options by offering specific parking spaces and recharging points for electric vehicles and bicycle parking, even reducing the number of traditional car parking spaces available. Companies are starting to champion the cycling option by installing showers and paying employees who travel to and from work on their bicycles per kilometre cycled.

COMFORT AND QUALITY

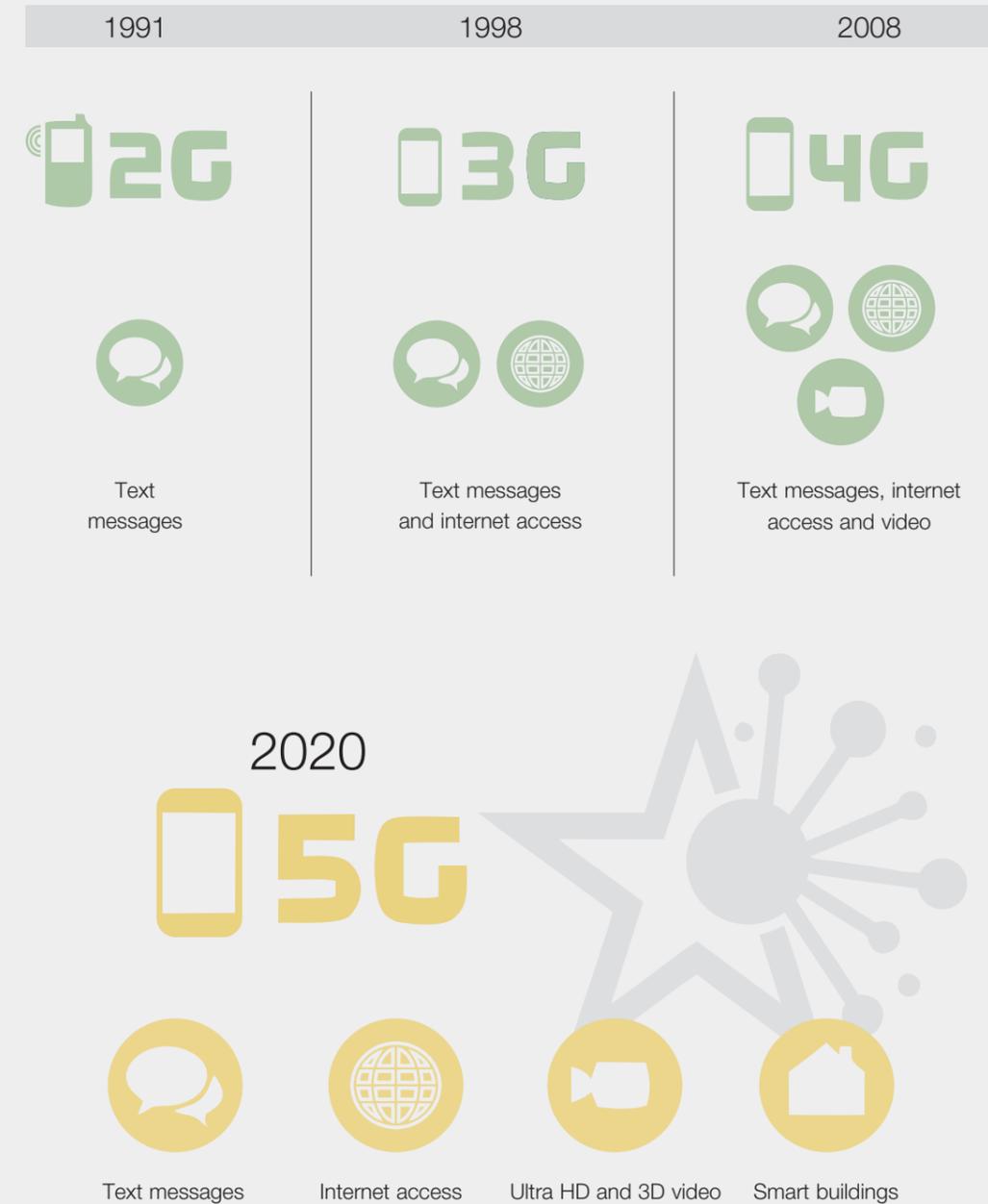
Flexible spaces that can be adapted to meet the needs of any given moment, lighting that can be controlled by each employee, climate control, all designed to maximise employees' well-being. Architecture and design are aligned to provide extensive and welcoming spaces. Furnishings that create a homely "look and feel" and workstation layouts that ensure each employee is at most 10 metres away from a window, no matter where they are working. Workspaces in which the materials (wood, wool, recyclable materials) and natural colours generate an ambience that drives productivity (biophilic design).

“

5G technology will be at the heart of the new economy. Incorporating 5G networks into the office market will lead to wireless buildings that no longer require raised flooring, and that boast much faster connections throughout the entire communications system.

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GRAPH 3
The communications network over time
1991-2020



Source: CNNMoney

CASE STUDIES

With flexibility being non-negotiable for occupiers, the most innovative companies are trying to reduce their fixed costs by turning fixed rent into a long-term variable cost. Co-working spaces offer an alternative occupier solution and can be found in buildings either used solely for this purpose or traditional multi-let and single-let office buildings which are partly occupied by co-working spaces that offer occupiers all the advantages associated with such spaces.

This method allows companies to adapt quickly when it comes to growing their business or changing their business strategy within very short timeframes. Moreover, companies are no longer just looking to rent a space, they are looking for an all-encompassing service that covers all their requirements in terms of workstation installations, meeting rooms, maintenance, security and concierge services amongst others.

These spaces, that were initially intended to be shared workspaces for people engaged in different types of work (particularly freelancers and entrepreneurs), have become occupier solutions for all types of companies. They are meeting points that provide the perfect setting for professionals of different sectors to network and increase their business opportunities. They are a product of the new ways of working and people's redefined work-life relationship.

In fact, two of the largest office building owners in Spain, Merlin and Colonial, have also started to invest in the co-working segment in a bid to diversify their rental portfolios. Colonial acquired Utopic_US and has become WeWork's landlord. It will also soon open a space administered by Utopic_Us at Príncipe de Vergara 112, where it will offer a service for both tenants and other occupiers. Merlin acquired a stake in the company Loom House and already has several spaces which it plans to open.

UTOPIC US - COLONIAL

Three workspaces that champion collaborative working among talented professionals in the centre of Madrid:

COLEGIATA | La Latina Technology and events

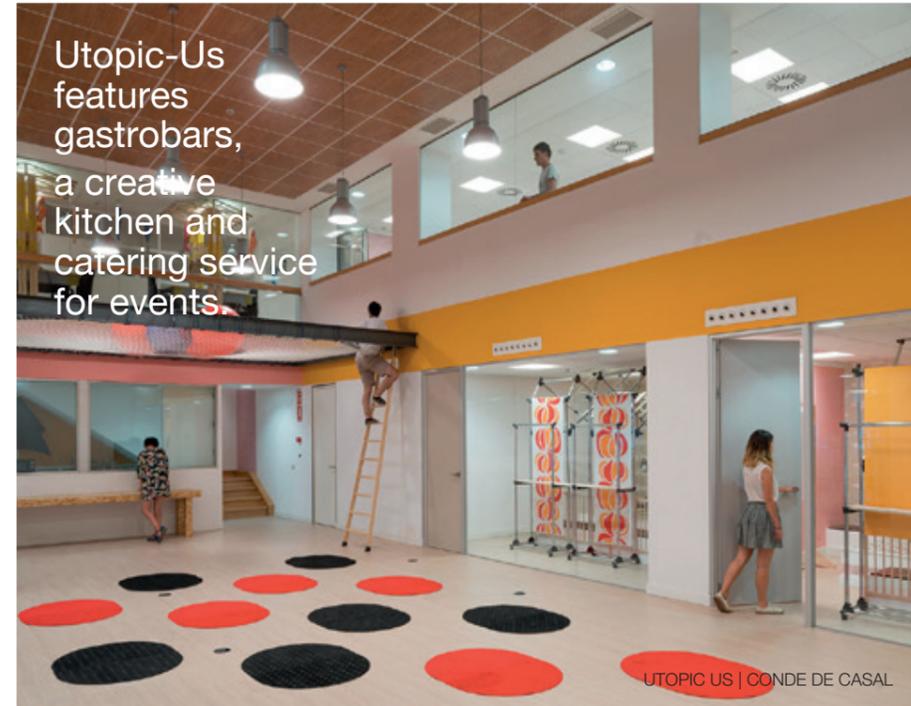
- A space designed for companies, SMEs and start-ups in La Latina in the heart of Madrid.
- **Services:** events and communication, co-learning, offices.
- **Specifications:** 1,000 sqm, 15 independent offices, 1 multi-use room, 1 central space for events.

DUQUE DE RIVAS | La Latina Creative development

- A space designed for freelancers and start-ups. Also located in La Latina, where the creativity of new entrepreneurs is evident from just a short walk through the neighbourhood's streets.
- **Services:** therapeutic space, freelance area, an area with a homely "look and feel", designed to inspire.
- **Specifications:** 1,200 sqm, 120 workstations, 2 meeting rooms and 1 multi-use room.

CONDE DE CASAL | Retiro Innovation and international trends

- A space designed by the architect Izaskun Chinchilla and inspired by Tokyo and New York. Located in Calle Doctor Esquerdo.
- **Services:** a modern and ergonomically designed co-working space.
- **Specifications:** 1,200 sqm, 100 workstations, 8 individual offices, 2 meeting rooms, 1 multi-use room, 1 central space for events.



LOOM HOUSE - MERLIN PROPERTIES

THE ROYAL TAPESTRY FACTORY REAL FÁBRICA DE TAPICES | Atocha History and open-air spaces

A unique space featuring gardens and open-air workstations, located 10 minutes from Madrid's iconic Atocha mainline railway station.

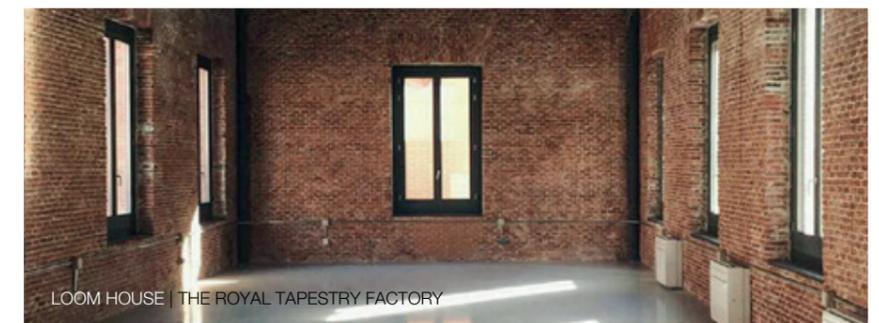
- A space comprising various buildings which are surrounded by landscaped gardens. People can also work in the gardens, an ideal space in which to hold meetings or let nature inspire their work. The complex comprises several warehouses offering co-working spaces, the area known as the Dryer offers permanent workstations and all their associated services, including a small age-old temple for special meetings and events.
- **Services:** collaborative innovation spaces, the Loom community (*comunidad Loom*), events.
- **Specifications:** over 1,000 sqm for workstations and 300 sqm for meeting rooms. 165 permanent workstations + 25 flexible workstations.

HUERTAS 9-11 | Centro In the representative Barrio de las Letras

- Building in the historic city centre. Opening in June 2018.
- **Services:** collaborative innovation spaces, the Loom community, events.
- **Specifications:** over 1,000 sqm for workstations and 300 sqm for meeting rooms. 165 permanent workstations.

PRINCESA 5 | Plaza de España Co-working in the heart of Madrid

- Twisttt co-working space next to Plaza de España. Opening in June 2018.
- **Services:** co-working, events.
- **Specifications:** 1,100 sqm for workstations, individual offices and meeting rooms. 111 permanent workstations + 35 flexible workstations.



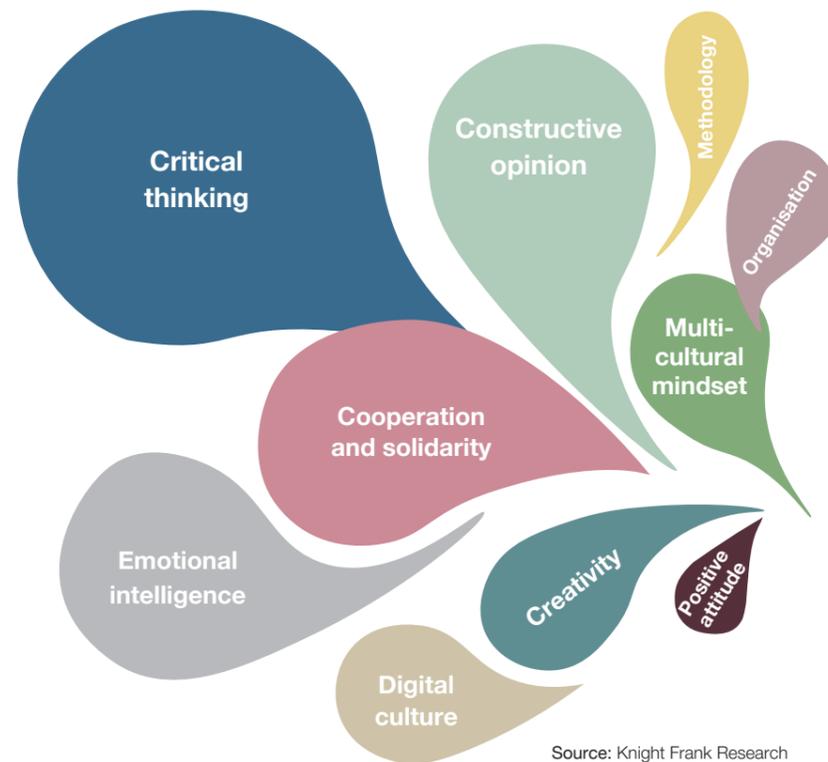
EMPLOYEES OF THE FUTURE

“Charm your employees and they will charm your clients”

As well as the workplace revolution, in which finding spaces capable of offering employees the best possible work environment has been companies' number one concern, the habits and expectations of employees are also changing. More so than ever before, employees now know what they want, they have a firmly fixed target and they want to feel motivated. Some of the positions that have emerged and that, a few years ago, did not even exist are testament to this change; roles such as Happiness Managers are becoming increasingly necessary if companies are to charm their employees and retain their workforce. Their aim is to attract and retain talented professionals by ensuring that employees feel happy and at one with their work environment. Various strategies are employed to achieve this goal; organising courses, reorganising spaces to create ones that are more user-friendly and comfortable, analysing each employee and associating their objectives with the company's, offering therapeutic services such as massages and sports activities are just some of the many initiatives.

Happy employees are the best allies of any company, as not only do they boost results, but they also positively impact the rest of the workforce, helping to constantly generate a stimulating work environment.

WHAT WILL EMPLOYEES OF THE FUTURE OFFER?



Source: Knight Frank Research

WHAT DO THEY WANT?



Source: Knight Frank Research

It is a well-known fact that motivated employees are priceless. They tend to be enthusiastic, proactive, analytical and creative, they know how to work as part of a team and are renowned for being open-minded, among many other qualities. All these factors shape the way in which they work and make them more productive, all in all resulting in a highly satisfactory “company-employee” relationship for both parties.

Employees are motivated via various channels; recognition and fair value for their work, a healthy work-life balance, flexible working conditions, independence... with their work

environment and workspace being one of the most important factors.

They no longer want to work in buildings that are impressive architectural feats, they prefer to work in an area that has character and that offers a wide range of services and amenities. They want to waste as little time as possible travelling to and from work and would even like the chance of being able to walk to work on a sunny day. They would like to have an open-air space where they can eat and enjoy the fresh air on their breaks. For them, it's all about sharing, and to share, they need collaborative spaces.



WHAT SHOULD THE IDEAL WORKSPACE BE LIKE?

LOCATION

In buildings and neighbourhoods that offer real character.

TRANSPORT LINKS

Good public transport links, well-connected by road, and accessible via alternative options, such as on bike or on foot.

ATTRACTIVE INTERIOR DESIGN

Different specialist areas boasting spacious collaborative areas that allow employees from various departments to interact, but that also offer other areas that are perfect for work requiring deep concentration and individual work.

SUSTAINABILITY

Committed to being environmental-friendly.

AIR AND LIGHT QUALITY

Natural light and good ventilation.

SERVICES

Adapted to employees' needs: restaurants offering healthy food options, gyms with wellness space etc.

Source: Knight Frank Research



MADRID

A NEW SUPER CITY

Spain's capital city has become a leading light in Europe, steadily moving up in the main city rankings year after year. However, gaining super city status is no mean feat, with cities required to meet a number of different criteria.

- Feature state-of-the-art infrastructure, considered to be some of the safest in the world
- Be a global magnet in terms of tourism, business and residential demand - a truly vibrant city
- Present economic growth and cultural depth
- Offer highly-recognised academic institutions
- Focus on specialist areas
- Its residents must be internationally recognised for their friendliness, warmth and vitality

All eyes are on Madrid, with 2018 set to be its year to shine as a genuine super city. Some of the main challenges facing the city are its transport options, its ability to adapt to and ensure the city benefits from the technological revolution, efficiency, access to housing and an office stock that makes the grade in terms of international demand.

With regard to the office market, Madrid remains a firm fixture on international investors' radars, who still view the city as a hub of opportunity. Net take-up has been trending upwards for several years, whilst rental levels are still significantly lower than in the other main European markets.

PLANNING IN THE OFFICE MARKET

ZERO EMISSIONS IN THE CITY CENTRE

The APR (Residential Priority Area), due to be launched in mid-2018, will restrict daytime traffic in the city centre to residents, electric and hybrid vehicles, taxis, public transport and motorcycles (from 10 pm to 7 am). As a result, offices in the area will most likely start to attract companies that are committed to sustainability and respect the environment, or companies that champion innovative ideas, such as encouraging employees to cycle to work or use alternatives to driving.

SUSTAINABLE AND RESPECTFUL PLANNING

New refurbishment projects can not only breathe new life into a property built many years ago, but can also comply with legislation in force. This was the case with Castellana 81 (BBVA Tower); an icon on the Madrid skyline. Built in the 1970s, it is now one of the city's most cutting-edge properties following the refurbishment carried out by its owner, GMP. A pioneer in sustainability, having obtained the prestigious LEED Platinum Certification.

MADRID



GDP GROWTH IN 2017 (EST.) VERSUS TOTAL FIGURE FOR SPAIN (3.1%)



334 BASIS POINTS BELOW THE TOTAL FOR SPAIN



OF JOBS CREATED IN SPAIN SINCE 2014



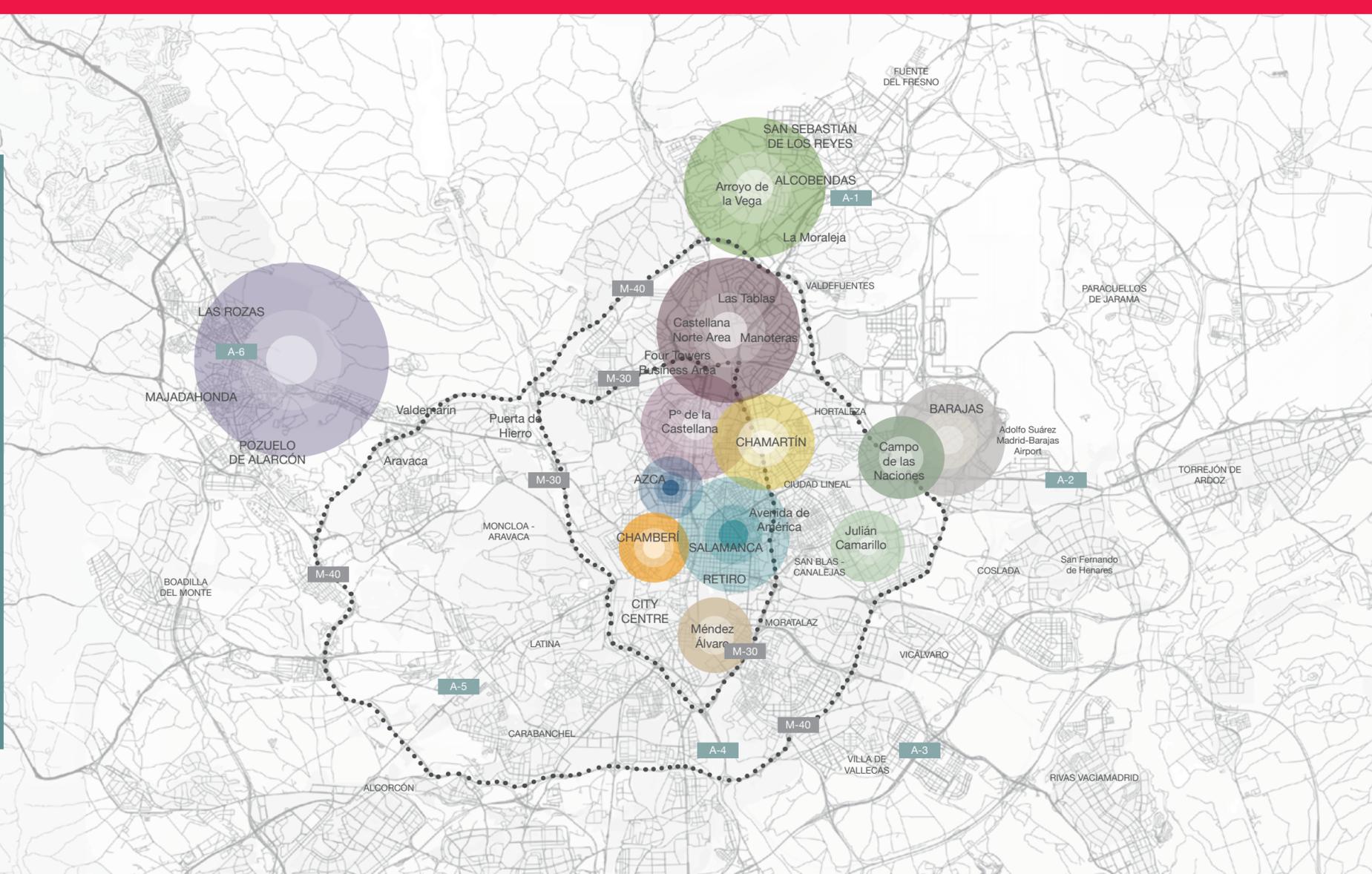
OF DIRECT FOREIGN INVESTMENT IN SPAIN IN 2017



IN 2017, +16% Y-O-Y

WHERE TO FIND THE OFFICE THAT WORKS BEST FOR YOU

Main office areas in Madrid



TOP COMPANIES LISTED BY AREA

CAST. NORTE FOUR TOWERS MANOTERAS <ul style="list-style-type: none"> · KPMG · CEPSA · PwC · BBVA · La Caixa · Evers 	PASEO DE CASTELLANA <ul style="list-style-type: none"> · Savills Aguirre Newman · WeWork · A&G Banca Privada · Freshfields 	AZCA <ul style="list-style-type: none"> · Deloitte · Ernst & Young · Ahorro Corporación · IATA 	SALAMANCA NEIGHBOURHOOD <ul style="list-style-type: none"> · Baker & McKenzie · Allen & Overy · Boston Consulting Group 	CHAMARTÍN <ul style="list-style-type: none"> · Uría Menéndez · General State Comptroller (IGAE) · CNMV · Knight Frank 	CHAMBERÍ ALMAGRO <ul style="list-style-type: none"> · WPP · Barclays Bank · Ministry of Finance · Cuatrecasas · HAVAS
MÉNDEZ ÁLVARO <ul style="list-style-type: none"> · Mahou · Amazon · Comunidad de Madrid · Sitel · Repsol 	JULIÁN CAMARILLO <ul style="list-style-type: none"> · Grupo CTO · Bankia · Indra Sistemas · Telefónica · El País 	CAMPO DE LAS NACIONES <ul style="list-style-type: none"> · Roche Farma · Publicis · Dentix · Sanitas · Coca-Cola 	A-1 HUB <ul style="list-style-type: none"> · Telefónica · Renault · Bankinter · Toyota · Indra 	A-2 HUB AV. AMÉRICA AIRPORT <ul style="list-style-type: none"> · Enaire · Vodafone · L'Oreal · Aena 	A-6 HUB <ul style="list-style-type: none"> · Orange · Volvo · Hewlett Packard · DIA

CASTELLANA NORTE | FOUR TOWERS | MANOTERAS

The most significant office project developed in Europe in recent years. The *Madrid, Nuevo Norte* project (previously Operación Chamartín) is having a major impact on this area's development. Auditors, consultants and a renowned oil company have all selected the area for their main headquarters.

MÉNDEZ ÁLVARO

An area with development potential thanks to its excellent provision of services, public transport and proximity to the city centre. Location sought after by large companies looking to develop new projects or carry out refurbishments in an area with strong growth potential.

Pº DE CASTELLANA

Primary business hub preferred by companies looking for a prestigious and emblematic area with stable rents. Companies in this area include financial firms, renowned consultants and value-add service companies.

JULIÁN CAMARILLO

Strategic hub, home to first-rate properties with competitive rents. This area is selected by tech firms looking for a property able to reflect the values of their brand.

AZCA

The primary office hub within the M-30 ring road, and the office area that boasts the best transport links and services in the whole of the city. A regenerated area, in which most properties and communal areas started to be refurbished in 2012. The area is home to service companies, tech firms, auditors and public authorities, among others.

CAMPO DE LAS NACIONES

One of the largest office developments in Madrid, with vast open spaces, good transport links and enough services to meet the needs of all of its occupiers. The headquarters of many top companies can be found here in large, high-quality properties.

SALAMANCA NEIGHBOURHOOD

Right in the heart of the capital, this area offers a high level of services and emblematic properties. This area is very popular among law firms and investment banks.

A-1 HUB

The main hub on the outskirts of the city, with large business parks. Location often chosen by major corporations, and that benefits from great visibility and a high amount of passing traffic.

CHAMARTÍN

Area with first-rate services and excellently served by public transport. It boasts strong development potential, given its proximity to Madrid, Nuevo Norte. Home to major companies, occupying highly emblematic properties.

A-2 HUB | AVENIDA DE AMÉRICA | AIRPORT

Unbeatable transport links with the airport. Home to the headquarters of top companies looking for visibility and quality properties at low rents. Demand for large office spaces near Madrid.

CHAMBERÍ | ALMAGRO

One of Madrid's real melting pots, filled with hotels, embassies, museums and iconic properties. A location popular among law firms, investment banks and companies looking for emblematic offices.

A-6 HUB

An area mostly comprising business parks, and a setting rich in green open spaces. The ideal location for large corporate headquarters, well-connected with the city centre.

“ For a city to attract companies, such as Google, that produce that all so important a wow-effect, they too must inspire and produce that very same effect ”



MADRID'S URBAN POWER

What makes Madrid a super city? If the ideal city were built from scratch, what would it be like?

Lifestyle. Who doesn't want to live in a city that has its own unique character? It is often said that Madrid stands out for both its skyline and its people. Its vast offering of leisure, shopping, dining and cultural options, alongside its historical neighbourhoods and new vibrant out-of-town areas - not to mention its attractive climate - make this city one of the top destinations for tourism, living, studying and working.

Super city, superbly connected. Madrid is incredibly well-connected. Whether by air, road or public transport, its infrastructure ensures quick access to any part of the city, and short journey times between other Spanish and international destinations.

Investor appetite, economic growth. Madrid is one of Europe's five most attractive cities for investors. National and international investors are drawn by both the city's strong economic growth and the attractive yields that can be found in various real estate markets, such as offices for example. As well as the full-scale refurbishments underway in many city centre properties, office development is also a safe investment option and a good alternative for building offices that offer the latest in market trends.

Period architecture and smart buildings, coupled with vast green spaces. Madrid boasts a wealth of real estate heritage that not only surrounds one of the city's main green spaces, the Retiro Park, but that is also just a short distance from the Parque del Oeste and from the city's natural green oasis, the Casa de Campo. Its smart buildings are also within striking distance of other unique green spaces, such as the Parque del Capricho in the A-2 area, and the El Pardo woodlands, a National Heritage site in the north-east of the city.

CHALLENGES FACING OWNERS

END-TO-END SOLUTIONS ARE THE KEY

INVESTMENT IN TECHNOLOGY AND HOW LONG IT WILL LAST

Owners must be able to adapt to the new sustainability and innovation requirements of today's occupiers. For many occupiers, a property must comply with a number of standards when it comes to sustainability. Obtaining certification to demonstrate that certain standards have been met in terms of sustainability and energy efficiency (BREEAM, LEED amongst others), as well as in terms of well-being and comfort (Well certification), will be a deal-breaker in the very near future.

Investment in new technology and building improvements reduces the time required to market a property and means that tenants will be more likely to pay for a particular space. However, such investment also requires in-depth analysis to identify what type of technology should be installed, how long it will be before the technology becomes obsolete, and the likelihood of achieving a return on the investment. Another aspect that technology undoubtedly improves is security, a key factor for both tenants and owners.

ADAPTING TO NEW DEMANDS

Today's work models, such as co-working, working from home and the gig economy (temporary employment based on individual skills) are becoming increasingly common on the market; systems that can adapt to the performance and personal circumstances of each individual. Owners are aware of just how quickly these new models are advancing and of the professional benefits that they provide for both employees and companies. This is why, in order to cater for a wider public, they are now incorporating co-working spaces into some of their traditional office-let properties, offering occupiers the opportunity to benefit from multipurpose rooms, where the services of external suppliers are at their fingertips.

OVERCOMING THE LACK OF AVAILABLE LAND

The lack of space in the centre of cities such as Madrid and Barcelona has driven up the number of refurbishments and spurred the development of new properties in outer periphery areas.

In Madrid, the latest major land transaction was Colonial's acquisition of two plots of land (Méndez Álvaro Campus). With construction set to begin later this year, this is the largest office-use land transaction to be completed in the city since the Four Towers plot of land was sold. Colonial, who acquired the land for €180 million, plans to build an office building that will come onto the market in either 2020 or 2021, and may designate part of the property as residential space. The area is already home to the offices of multinationals such as Amazon, Repsol and Ericsson, and Colonial has not ruled out the possibility of another top company headquarters occupying the larger of the two plots.

THE IMPORTANCE OF LOCATION

Location versus modern spaces. As we have already highlighted, location and transport links are musts for occupiers. In fact, many investors only consider a property accessible via metro if the nearest station is less than a ten-minute walk from its entrance.

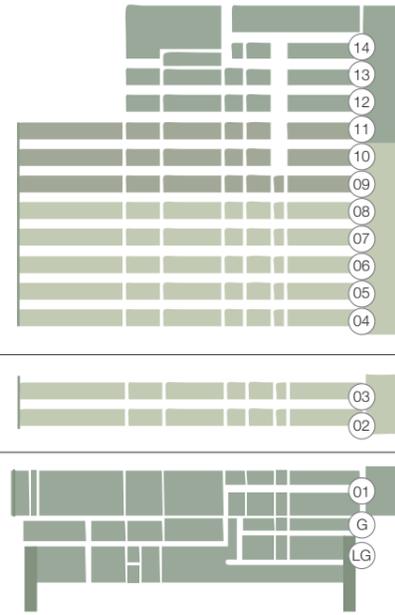
Mixed-use projects have become the perfect example of just how important location is. A mixed-use complex must be situated in an extremely well-connected location and receive enough footfall to make use of the on-site services offered (restaurants, accommodation, etc.). In contrast, office buildings located in considerably less-established areas must meet its occupier demand with the retail services available in the area, such as restaurants and pharmacies, among others.

ADMINISTRATIVE CHALLENGES

Owners must also tackle a number of administrative challenges. Regulations often have several grey areas and processes can be overcomplicated and outdated. Investors and owners are often faced with processes that are not streamlined across different town and city councils and that are sometimes extremely slow-moving.

There are also a number of new laws which must be taken into account, such as the aforementioned IFRS 16, which allows owners to enter leases on their balance sheets, except for low value properties or those with lease terms of less than a year.

In addition, meeting the requirements to obtain the above-mentioned sustainability and well-being certifications requires planning and preliminary studies, as well as sound resource management to ensure regulations are met and the desired results are achieved.



Example of an ideal flexible property

OWNER MANAGEMENT TRENDS



“ Owners will provide solutions for the various markets, offering their space as a service via apps, data analysis, insights and improvements ”

TRADITIONAL LETTINGS

FLEXIBLE SPACE

CO-WORKING SPACE OPERATED BY THIRD PARTIES

SERVICE PROVIDER

Same space, different marketing approaches



INTERVIEW WITH

JUAN MANUEL ORTEGA MORENO

CHIEF INVESTMENT OFFICER, GRUPO COLONIAL

“ Companies went from tenants to clients, and are now becoming guests ”



Real estate professional since 1997, and Chief Investment Officer of Colonial's Management Committee since December 2014.

He holds a Bachelors Degree in Business Management and Administration from the Universidad Autónoma de Madrid and is a member of the Royal Institution of Chartered Surveyors (MRICS).

INTERVIEW WITH JUAN MANUEL ORTEGA MORENO

Chief Investment Officer, Grupo Colonial



EDIFICIO CASTELLANA 43
The LEED GOLD certified WeWork Headquarters in Madrid

occupiers: floor size, space efficiency, free height, lighting, occupancy rates and sustainability, amongst others. If these specifications cannot be achieved via a full-scale refurbishment of the property, then we consider the demolition option.

The current portfolio that the company manages comprises properties in the prime markets of Madrid, Barcelona and Paris. What are the main competitive advantages of each of these markets? Does your Business Plan include expanding to other locations in the next few years?

Without doubt, the company boasts an exceptional prime portfolio in Paris, one which offers great stability and liquidity, with demand and rental values performing extremely positively in recent years, contrary to market forecasts. Equally, the prime and quality component of our property portfolios in Madrid and Barcelona is allowing us to take advantage of rising Grade-A property rents. With regard to a possible expansion beyond the above-mentioned markets, we are not limited to a strict or set policy. In this respect, any expansion would be assessed on the potential to create value for our shareholders and the risk-return reward.

In terms of Corporate Social Responsibility, your properties meet the very highest standards of quality and sustainability, with most of your portfolio LEED and BREEAM certified. What are your next targets in this area?

We are extremely proud of the progress we have made in this area, one in which we are head and shoulders above the market average. Even so, we are concerned with more than just being able to display the certificates in our properties. We are currently working towards minimising our energy costs, with our goal being zero emissions.

One of your properties, Castellana 43, has become the Madrid headquarters of WeWork, specialists in creating collaborative workspaces. In addition, by purchasing

co-working firm Utopic_Us, Colonial has established itself as a pioneer of this business model in Spain. In your view, what is the main advantages offered by this way of working compared to the traditional method?

We are fully aware of the rapid transformation taking place in how businesses occupy workspaces. Flexibility has become a must for companies and is a trend that we cannot ignore, especially when the so-called traditional method often does not make the grade. Our core business is based on offering occupiers spaces that work for them, hence, our portfolio will continually adapt to meet different occupier strategies.

Do you plan to implement this work model in any of your office properties? If so, how will you go about it?

Definitely. In fact, we are already rolling this out. Our project at Príncipe de Vergara 112, due to open very soon, is set to include a space managed by Utopic_Us that will serve both the property's clients and third parties. And this is obviously not the only project of this nature in our property portfolio.

Your tried and tested track record in the sector allows you to detect shifts in demand. What are the main differences between occupiers now and a few years ago? How have their priorities changed?

Companies have gone from tenants to clients and are now becoming guests. Nowadays, companies no longer base their letting decisions solely on costs as they did several years ago. In many cases, companies now understand that their cultural transformation is very closely linked to the workspace that they offer their employees. There is an underlying concern about retaining talent and creating spaces that boost creativity, corporate responsibility is now taken firmly into account, and the degree to which disruptive technology could alter the way in which the work environments are used is constantly under review.

“ Flexibility has become a must for companies and this is a trend that we cannot ignore ”

Colonial recently made the largest office-use land acquisition seen in Madrid in recent years (in the Méndez Álvaro area); the first land transaction that the Group has completed in the city. Do you think that its merger with Axiare could lead it to specialise further in this type of transaction?

In recent years, Colonial's investment policy has been clearly driven by the goal to generate value-add. Our acquisition of Axiare meets that objective both in terms of organic and in-organic growth. Prior to the deal, Colonial's

projects under development comprised a total buildable area of more than 180,000 sqm in Spain alone. This year we are due to complete the Príncipe de Vergara building and the 22@ Tower, comprising 24,500 sqm, and we have also just completed the Discovery Building, located in Madrid's Castellana North hub.

EDITING AND WRITING:
KNIGHT FRANK RESEARCH



DISCOVERY BUILDING MADRID



SIMULATION OF THE FUTURE MÉNDEZ ÁLVARO CAMPUS | MADRID
Computer generated image

“ Year-end figures for 2017 suggest the market is on course for a record 2018 ”

OCCUPIER MARKET

TRANSACTIONS H2 2017

During H2 2017, office take-up exceeded 320,000 sqm, up 43.5% y-o-y. This increase is mainly due to the increase in the average deal size as opposed to deal count.

At YE 2017, gross take-up in Madrid stood at 570,000 sqm, up 23% y-o-y, and above the historical average of 500,000 sqm. The renewal of Madrid's office stock, mainly thanks to the investments and refurbishments completed, has largely contributed to these record take-up levels.

Whilst technology firms have taken the lion's share of office space in previous years, in

2017 it was Finance and Insurance companies that signed the most, with Government Bodies/Public Authorities topping the table in H2. However, all sectors are currently fully engaged in a digital transformation and in incorporating ICT into their production processes, a shift that is changing business models and opening the door to new ways of working.

With regard to the distribution of take-up and the number of transactions per space bracket, the number of deals signed for offices comprising <500 sqm and between 500 sqm and 1,000 sqm remained on a par with 2016. However, the number of deals for office space comprising over 5,000 sqm gained pace and increased their weighting in terms of total take-up to over 30%.

Lettings between 1,000 and 5,000 sqm accounted for the highest percentage of take-up; 42.6% of the total area let.

In 2016 more office space was taken in areas outside of the M-30, given the lack of availability of good quality large-scale offices in more central areas. In 2017, take-up for space located within the M-30 ring road continued to gradually trend upwards, with office space located in this area accounting for 55% of the year's total take-up figure and for circa 60% of the H2 figure.

In the second half of the year, 13 deals were signed for office space > 5,000 sqm, seven of which were located in the CBD, two in the Secondary Centre sub-market and just four outside of the M-30 ring road. The co-working firm WeWork let two office buildings in the CBD - Castellana 43 (5,500 sqm) and Castellana 77 (6,500 sqm). Both buildings have been refurbished and are LEED certified (Castellana 77 has been pre-certified).

Savills' acquisition of the consultancy firm Aguirre Newman led to another of the year's major deals; the letting of over 6,000 sqm at refurbished Castellana 81.

Baker & McKenzie's relocation to Edificio Beatriz from Castellana 92 freed up space for A&G Private Bank to move into the Azca area and accommodate its expanding workforce that had begun to outgrow its property on Joaquín Costa.

IE Business School will add more than 6,300 sqm to its technology campus at Campus Velázquez (Calle Velázquez 130), where they have access to cutting edge technology and plan to develop technological immersion programmes for digital transformation training. MAPFRE will also take up 6,500 sqm in its newly refurbished property at Calle Sor Angela de la Cruz 6.

The standout players, however, were the Public Authorities, who let more than 80,000 sqm in H2 2017.

The Ministry of Finance's lettings at Calle Manuel Cortina 2 (recently purchased by GMP) and Calle Mateo Inurria 15 particularly stand out. Elsewhere in the Secondary Centre, the Region of Madrid let almost 15,000 sqm at Calle Ramírez de Prado 5, in the Méndez Álvaro area. The largest transaction in terms of floor space was signed outside of the M-30 ring road in the Julián Camarillo area, at Calle Albarracín 31 (owned by Acciona), where the Region of Madrid plans to house its Criminal Courts. Enaire, a subsidiary of the Spanish Development Ministry, let over 7,500 sqm in the Las Mercedes Business Park (Campezo 1), in the A-2 area.

In addition to the aforementioned transactions, we would also highlight that outside of the M-30, Banco Sabadell's insurance firm relocated its head offices from Sant Cugat del Vallés in Barcelona to the Castellana Norte building at Isabel Colbrand 22 in Las Tablas and Publicis to Partenon 12, where they let over 10,000 sqm of office space.

GRAPH 6
Take-up by sector
2017



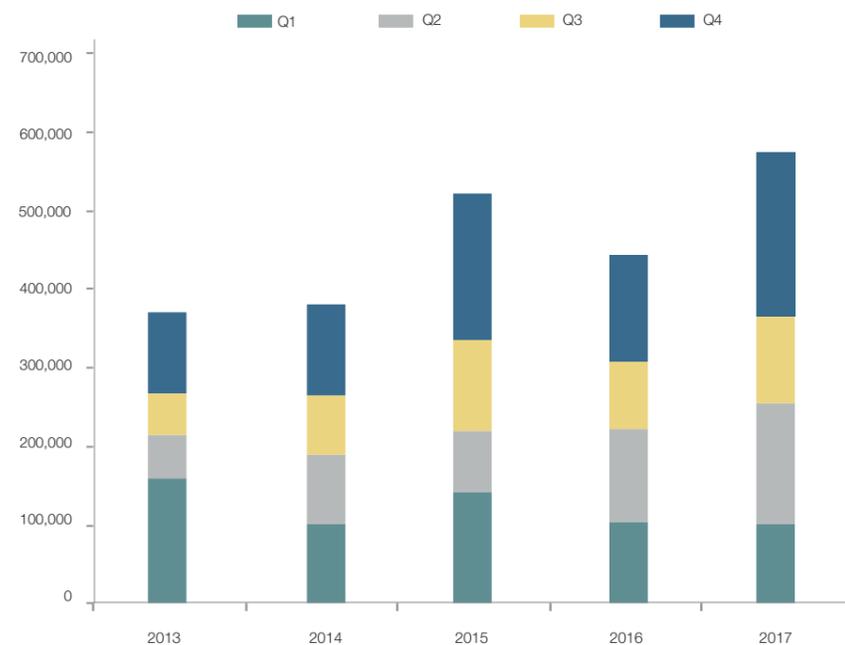
Source: Knight Frank Research

GRAPH 7
Take-up by area
H2 2017



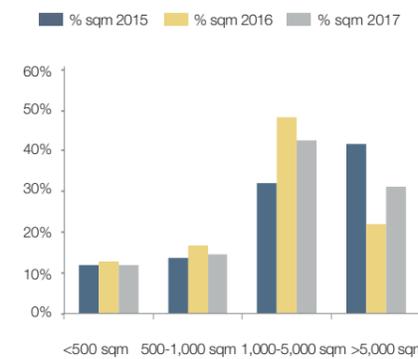
Source: Knight Frank Research

GRAPH 4
Quarterly take-up performance
2013-2017 (sqm)



Source: Knight Frank Research

GRAPH 5
Take-up by size of lettings
2015-2017 (%)



Source: Knight Frank Research



“ Rising demand and increasingly less available quality space are expected to continue driving up prime rents in 2018 ”

SUPPLY Q4 2017

Availability in the CBD fell sharply in H2 2017, dropping to 6.2%.

Unlike 2017, when large-scale refurbishments in Azca accounted for most of the market's new supply, new-build projects in other areas will start to emerge this year. More than 70,000 sqm is expected to come onto the market in 2018. Almost 50,000 sqm of this will be new-build, whilst the remainder will comprise refurbishments and renovations.

One of the projects due to come onto the market inside the M-30 is the 1,827 sqm property at Calle Francisco Gervás 13 in the Cuzco area, which the Socimi Saint Croix decided to refurbish following its acquisition back at the start of 2017. Additionally, Q3 is also expected to see construction completed on Colonial's 11,300 sqm property at Calle Príncipe de Vergara, 112, which is already being marketed.

However, the real revival in the next few years is due to take place in the northern area. Half of the 70,000 sqm due to come onto the market in 2018 is located in the M-30 North area, the natural extension of the city's office market. Additional office space in the pipeline for 2018 includes the following: 14,000 sqm in the Oxexo building, 17,000 sqm within Isla Chamartin and 6,000 sqm at the newly refurbished Costa Brava 12 building.

By year-end, Colonial will have completed the refurbishment of VIRTO, which will add an additional 14,500 sqm of available space to the Arroyo de la Vega area. Colonial will also have finished building 8,652 sqm of space located at Josefa Valcarcel 40 Bis, in the M-30 East area.

RENTS

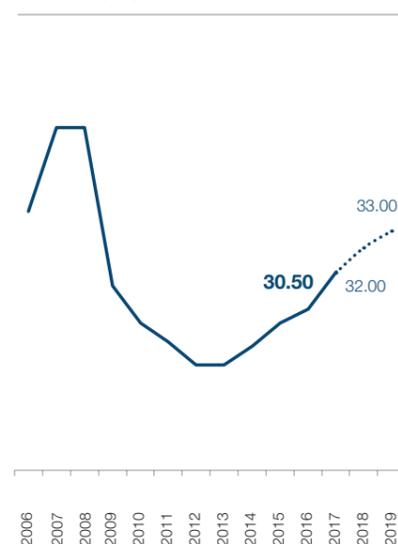
The spike in demand for large-scale office space and the fact that good quality offices in the most sought-after areas have now come

back onto the market after undergoing refurbishment works continued to put upward pressure on prime rents, which rose to €30.50 per sqm/month by YE 2017.

The highest rental price achieved in the second half of the year was signed for a space comprising less than 350 sqm at Castellana 41 (€38 per sqm/month). Castellana 31, owned by Mutua Madrileña, and Torre Serrano, owned by Infinorsa, also achieved some of the highest rents seen in H2 2017, at around the €36 per sqm/month mark.

Office rents also increased somewhat in the Secondary Centre sub-market, where the very best buildings achieved rents of around €19 per sqm/month. Outside of the M-30, closing rents in the very best buildings remained close to the €15 per sqm/month registered in the first half of the year. In quality buildings slightly further afield, rents also edged marginally upwards, reaching €11.5 per sqm/month.

GRAPH 8
Variation in prime rents
2006-2019 (€/sqm/month)



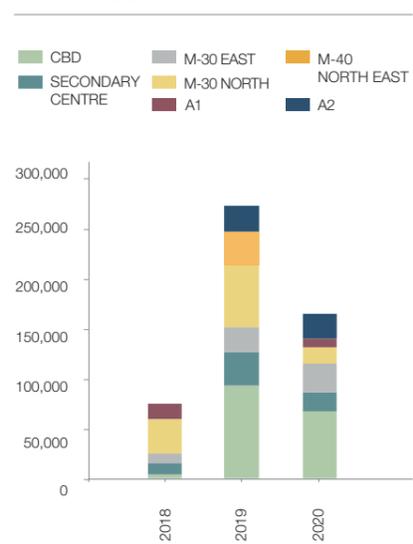
Source: Knight Frank Research

GRAPH 9
Vacancy rate
2017



Source: Knight Frank Research

GRAPH 10
New supply by property location
2018-2020 (sqm)

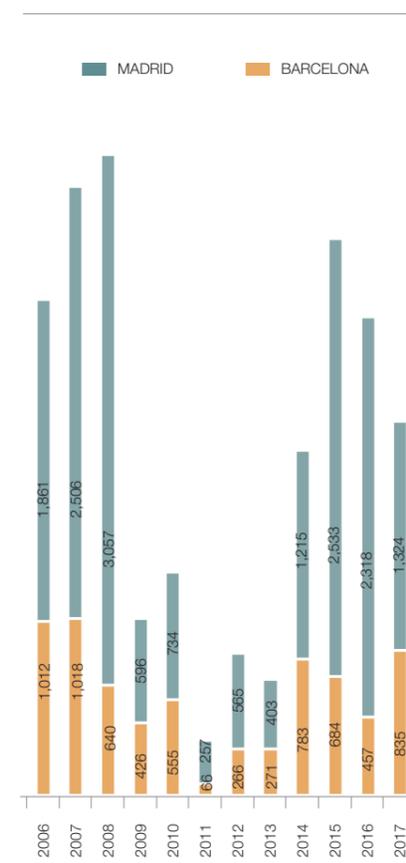


Source: Knight Frank Research

INVESTMENT MARKET

Despite an exceptional first half of the year, the YE 2017 investment volume in Madrid and Barcelona came in at circa €2,160 million, 22% down y-o-y. The political instability generated by the Catalan independence process caused several players to put some investment decisions on hold, whilst the lack of mega-deals involving the acquisition of properties such as Torre Espacio, Torre Cepsa or Adequa Business Park – all sold over the last two years – prevented the forecast investment figure being reached in 2017.

GRAPH 11
Investment volume
2006-2017 (€ million)



Source: Knight Frank Research

DEMAND AND TRANSACTIONS

In 2017, investment funds were the most active players in both the Madrid and Barcelona office investment markets. In Madrid they accounted for over 40% of the year's office investment total and, along with Socimis, stole the limelight from other investors during the second half of the year. In Barcelona, investment funds accounted for circa 37% of the 2017 investment figure and were particularly active in the second half of the year, accounting for almost half of the office investment total.

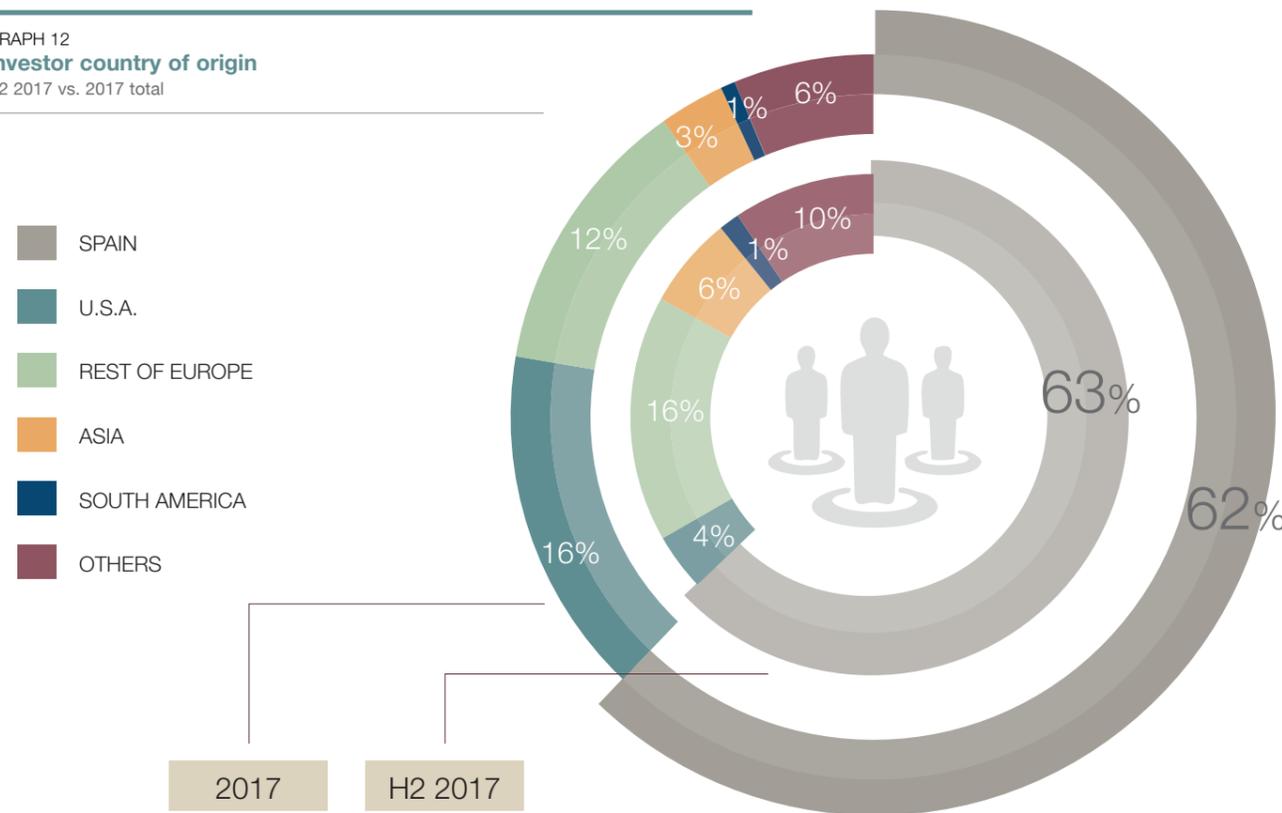
In terms of deals completed by investment funds in Madrid, of particular note are: Remer Investment's acquisition of the Palacio de Miraflores at Carrera de San Jerónimo, 15 for €60 million; the Los Cubos building that Henderson Park and Therus Invest acquired for €52 million; the €30 million that LaSalle Investment Management paid for Acanto

11-13; AEW Europe's purchase of Francisco Sivila 106 for a similar sum; and the sale of the Isla Chamartin business park to Tristan Capital and Zaphir Asset Management for €103 million, a deal that was brokered by Knight Frank. In Barcelona, the following deals stand out: the sale&leaseback of Mango's offices and design centre in Palau de Plegamans for €100 million; the acquisition of the former Government of Catalonia's headquarters at Fontanella 8 by a Korean investor via CBRE Global Investors for €64.7 million; and the private equity manager AKM's acquisition of Joan d'Austria, 39.

SOCIMIs also accounted for a considerable share of Madrid and Barcelona's investment activity, although they were far more active in the former than the latter. Of particular note in H2 2017 were: the more than €100 million that Zambal SOCIMI invested in Albarraçin 25, Santiago de Compostela 96 and Lérida 44; the €32.5 million invested by Colonial in acquiring Arturo Soria 336 and the Josefa Valcarcel 40 project from Metrovacesa; and Onix



GRAPH 12
Investor country of origin
H2 2017 vs. 2017 total



Source: Knight Frank Research

Capital Partners' acquisition of Manoteras 12, a deal brokered by Knight Frank.

Whilst institutional investors kept a lower profile in Madrid's office market in H2 2017, they accounted for almost 23% of Barcelona's total investment volume thanks to Catalana Occidente's €90 million acquisition of the Luxa complex, home to Amazon's headquarters.

The top two deals completed by real estate companies during the second half of the year were Inforinsa's acquisition of 40% of Torre Serrano in Madrid, and Grupo Metropolis' acquisition of the Can Ametller Business Park in Sant Cugat del Vallés, representing

10% of Madrid and Barcelona's total investment figure in H2.

Private investors were fairly inactive in 2017. This said, during the second half of the year, in Madrid we would highlight José Lladó's acquisition of Fernando el Santo 15, home to the Argentinean Embassy, whilst in Barcelona we would note Emilio Cuatrecasas' purchase of numbers 444 and 632 on Avenida Diagonal, along with the 31,000 sqm acquired as part of Project Finestrelles.

After companies headquartered in the US injected the most capital into the market during the first half of the year, Spanish investors moved back to the top of the leader board

during the second half of the year (accounting for over 60% the investment total in H2) owing to the political uncertainty.

SUPPLY

Institutional players were joined by corporate owners as the market leaders in terms of supply, together accounting for more than 45% of the total sales volume.

These were followed by developers and real estate companies who accounted for a total of 15%, and who came in marginally ahead of private owners and family offices (14%) and investment funds (13.5%).

SOCIMIs, who have previously barely featured in the supply analysis, are expected to be one of the most active players in 2018 due to both the property rotation criteria which they are legally obliged to fulfil and the trend to further specialise expected over the coming years.

A supply analysis by country of origin at YE 2017 highlights that Spain accounted for more than 75% of the total volume, followed by the UK (8%) and the US (6.75%).

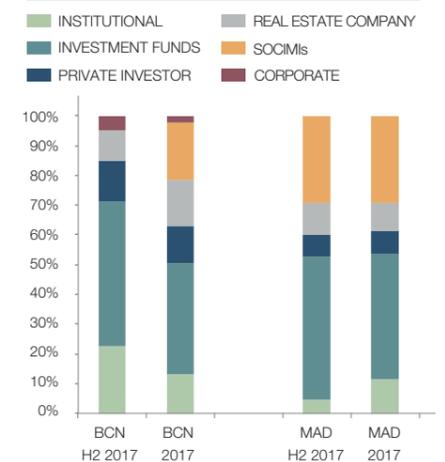
PRICES AND YIELDS

Average prices in Madrid and Barcelona's CBDs continues to trend upwards as in recent years. Prices broke above the €8,000 per sqm barrier in Madrid, whilst in Barcelona the €6,900 per sqm mark was reached.

In the second half of the year, two deals closed at over €10,000 per sqm particularly stand out: in Barcelona the acquisition of Diagonal 444 by Emesa and in Madrid, Inforinsa's acquisition of Torre Serrano. However, neither of these two equalled the year's highest average price per sqm, which was signed in Madrid in H1 in the Barclays headquarters at Colón 1, which CBRE GI acquired from Barclays for €14,000 per sqm.

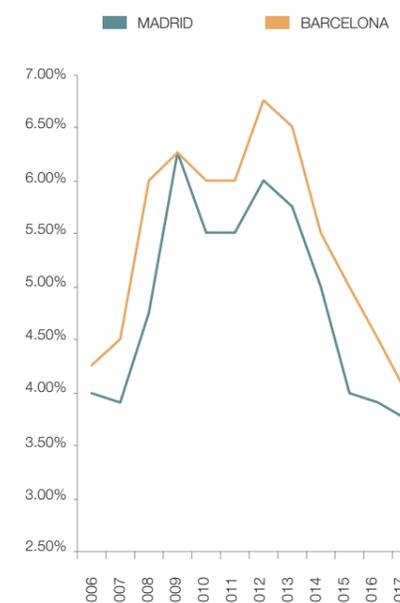
Yields remain tight in the region of 3.75% in Madrid and 4% in Barcelona. In Madrid, this can be attributed to three main factors: the low yields on financial and alternative investments; the increasing trend for rents that are sustainable in the medium term; and the lack of investment product. The Catalan markets, which had been registering solid performances, will stabilise as soon as the political situation stabilises.

GRAPH 14
Type of investor
H2 2017 vs 2017



Source: Knight Frank Research

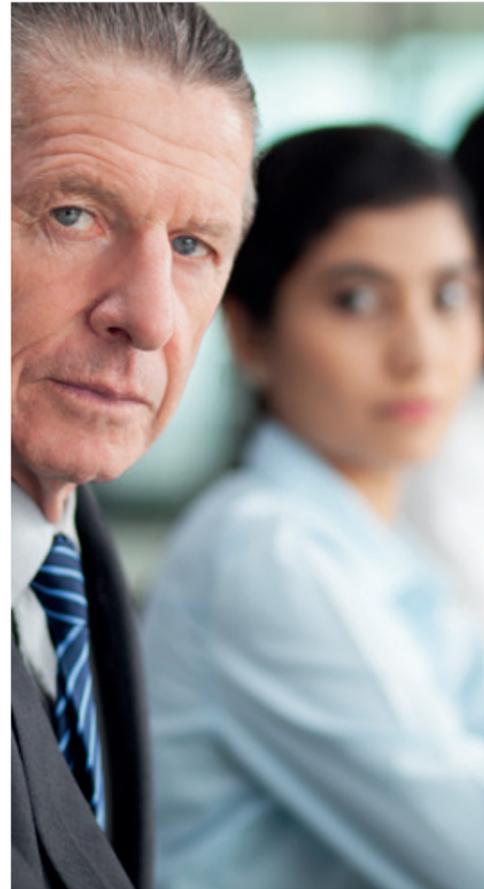
GRAPH 13
Prime yields
2006-2017



Source: Knight Frank Research



THE TRANSFORMATION IN IMAGES



“

As people change, so too does their work philosophy, the way in which they work, and the tools needed to successfully adapt to these changes.

Understanding this shift is key to achieving professional success across all levels.

”





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