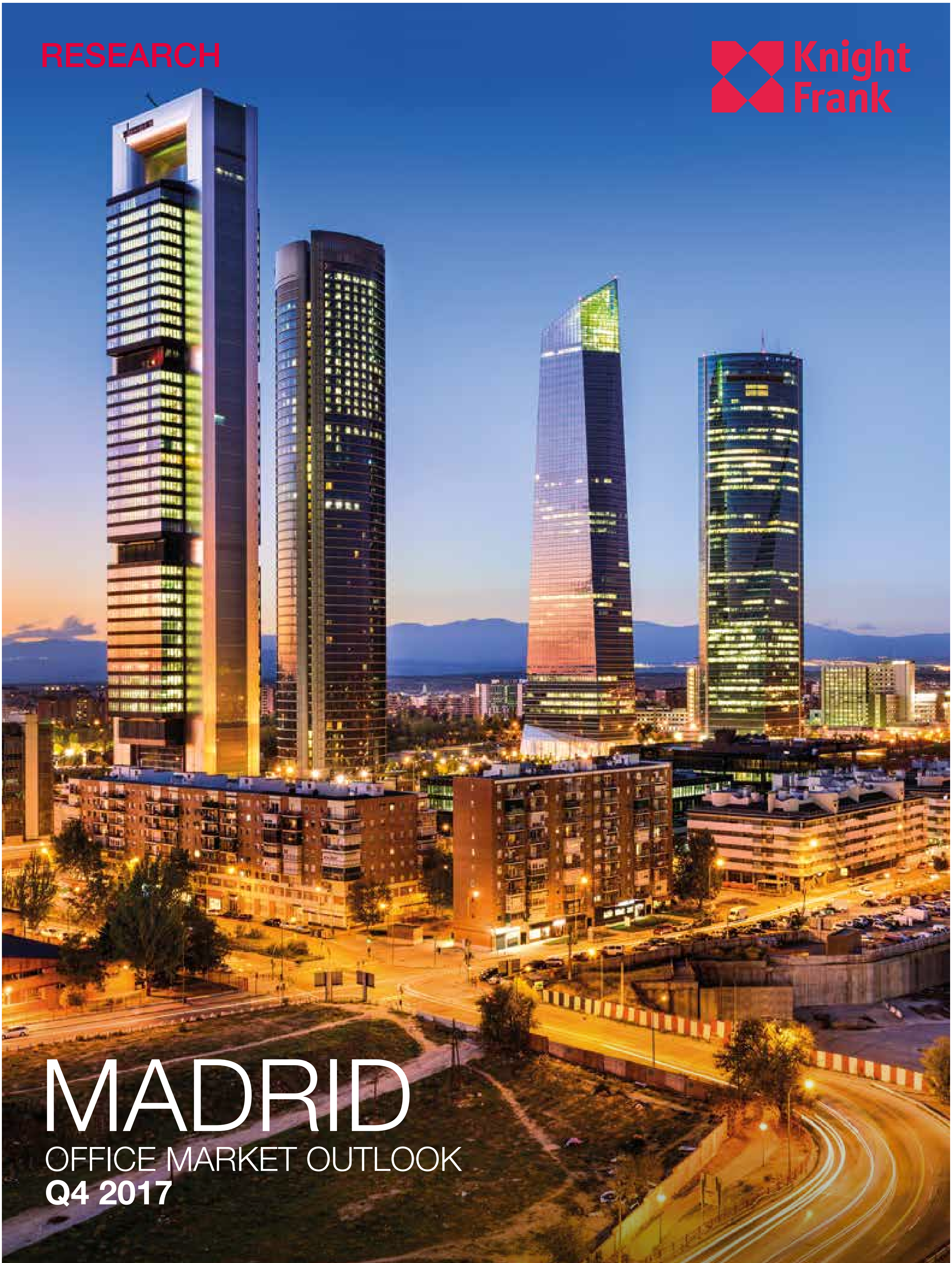
RESEARCH

Knight Frank



# MADRID

## OFFICE MARKET OUTLOOK

**Q4 2017**

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

# KEY FINDINGS

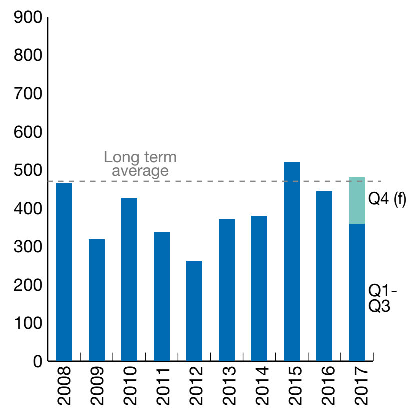
Spain's economy continues to outpace the eurozone, with GDP growth in 2017 forecast to move towards the pre-crisis peak.

Madrid's occupational market has been buoyant with the first nine months of 2017 registering the strongest occupier activity in a decade.

Strong occupational fundamentals are bolstering rental growth prospects which, in turn, is creating strong investor appetite for office product in the city.

Strong capital flows have placed further downward pressure on yields, with prime yields now approaching their pre-credit crunch level.

FIGURE 1
**Office take-up**
sq m (000s)




**Source:** Knight Frank Research

# OCCUPIER MARKET

## Take-up in the first nine months of 2017 was outstanding, making it the strongest period in a decade.

Now in its fourth year of expansion, Spain's economic climate continues to strengthen. The Spanish economy registered 3.1% growth year-on-year in Q3 2017 outpacing the eurozone. Consumer confidence has been lifting and labour market conditions have continued to improve. Unemployment has fallen from 27% in 2013 to 16.4% in Q3 2017, and despite remaining high, it is expected to continue its downward trajectory over the next two years. There are clear signs that the economic and occupational markets are in positive growth territory and the outlook is promising.

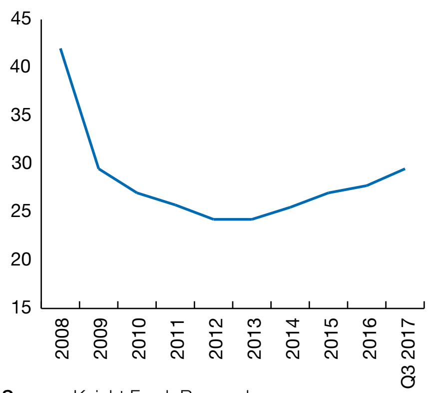
Strong job creation, especially in the services sector, has underpinned the increasing momentum witnessed in Madrid's occupational market. Office take-up in the first three quarters of 2017 reached 359,000 sq m – the strongest level since 2008 (Figure 1) and reflective of positive business sentiment. Take-up is projected to reach 500,000 sq m by year-end, making it one of the strongest years in a decade. Occupiers from a diverse mix of sectors have been active in Madrid.

Refurbishments and renovations have increased the availability of large high quality spaces in the CBD, so take-up inside the M-30 has increased in contrast to last year's trend. Compared to 2016, the proportion of take-up inside the M-30 ring increased from 47% to 56% over the first three quarters of the year.

In terms of supply dynamics, a muted development pipeline throughout 2017 has placed downward pressure on vacancy rates. Availability has fallen to 11.6% and the majority of new stock has been delivered through refurbishments and renovations. Pre-leasing activity has subsequently been high, with many buildings close to full occupancy even before they are completed. The development pipeline is however improving with around 325,000 sq m of office space planned for delivery in 2018-2019.

Prime rents continue to trend upwards in response to clear demand and supply imbalances. At Q3 2017, prime rents reached €29.50 per sq m per month (Figure 2).

FIGURE 2
**Prime office rents**
€ per sq m per month



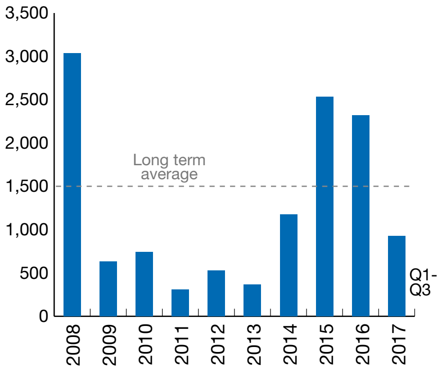

**Source:** Knight Frank Research

### Key office leasing transactions in 2017

| Address, Building | Tenant | Size (sq m) |
|---|---|---|
| Manoteras 20. Edificio C | La Caixa | 9,399 |
| Albarracín 34 | Grupo CTO | 7,049 |
| Sor Ángela de la Cruz 6 | Mapfre | 6,731 |
| Velázquez 130 | IE | 6,310 |
| Manuel de Falla 7 | Consejería de políticas sociales y familia de la Comunidad de Madrid | 6,252 |
| Santa Leonor 32 | Bankia | 5,746 |
| José Ortega y Gasset 29 | Baker & McKenzie | 5,562 |

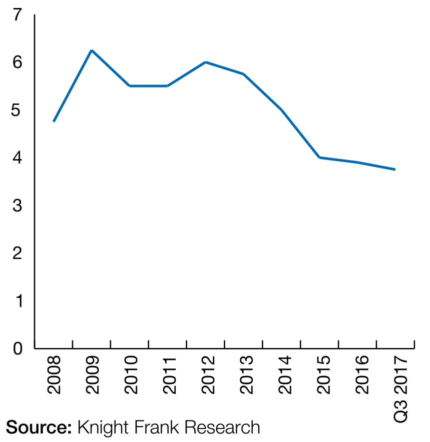
**Source:** Knight Frank Research

FIGURE 3
**Madrid office investment volumes**
€ million




**Source:** Knight Frank Research

FIGURE 4
**Prime office yields**
%




**Source:** Knight Frank Research

Cuatro Torres Business Area

# INVESTMENT MARKET

Growing confidence in the Spanish economy, combined with upbeat rental forecasts, have encouraged investors to deploy capital into Madrid's commercial real estate. Office investment volumes totalled €928 million in the first nine months of the year (Figure 3). Although volumes were down from the same period last year (-26%), several large-scale deals are expected to close in the final quarter, and are expected to bring full-year volumes in ahead of the long-term average.

Investment funds have emerged as the most dynamic purchasers, accounting for 42% of the total office investment volume. This heightened activity from investment funds has led to a change in the origin of the buyer with domestic capital falling as a share of the total transactional volume. 65% of the investment volume were by companies headquartered in Spain compared to 80% in 2016, as US and UK investors increased their presence.

Institutional investors continue to be the largest disposers of office assets. While Spanish REITs (SOCIMIs) have kept a fairly low profile, they are expected to be one of the most active group of sellers by the end of the year.

The heightened pressure to buy and lack of product on the market has inevitably compressed yields with prime yields falling to 3.75% in Q3 2017 (figure 4). A further hardening of yields is likely, with top prime properties already seeing yields of 3.5%.

## Key office investment transactions in 2017

| Property | Seller | Buyer | Approximate price (€ million) |
|---|---|---|---|
| Portfolio BBVA | BBVA | Oaktree Y Freo | 180 |
| Isla Chamartín* | Lone Star | Tristan Capital Y Zaphir Asset Management | 103 |
| Manuel Cortina 2 | Mapfre | GMP | 72 |
| Carrera de San Jerónimo 15 | Mutua Madrileña | Remer Investment | 60 |
| Sede Barclays (Plaza Colón 1) | Barclays | CBRE Global Investors | 55 |
| Calle Miguel Ángel 23 | Lico Inmuebles, Particular Y Sgae | Axiare (Axia Real Estate Socimi) | 53.4 |
| Serrano 47 | El Corte Ingles | Infinorsa | 50 |

**Source:** Knight Frank Research
* Deal completed by KF

# KNIGHT FRANK VIEW

Increased business confidence and an improving labour market are supporting Madrid's occupational market dynamics. Due to political uncertainty, economic growth momentum may ebb. Nonetheless, the positive trend in occupier demand will continue into 2018 and will lead to further rental increases.

A positive economic outlook and the availability of financing has boosted investor confidence and encouraged investors to deploy capital into commercial real estate. Madrid's rental growth prospects are compelling and will continue to underpin investor appetite, resulting in the further hardening of yields in 2018.

## EUROPEAN RESEARCH

**Matthew Colbourne,** Associate
International Research
+44 20 7629 8171
matthew.colbourne@knightfrank.com

**Vivienne Bolla,** Senior Analyst
International Research
+44 20 7629 8171
vivienne.bolla@knightfrank.com

## SPAIN

**Humphrey White,**
Partner
Managing Director
+34 600 919 012
humphrey.white@es.knightfrank.com

**Raúl Vicente,**
Associate
Head of Office Agency
+34 600 919 023
raul.vicente@es.knightfrank.com

**Rosa Uriol,**
Head of Research
+34 915 959 000
rosa.uriol@es.knightfrank.com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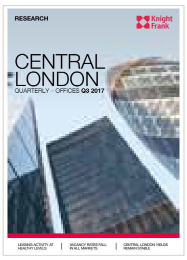
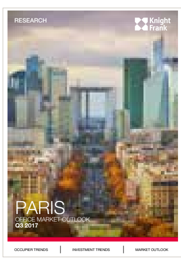



Central London Quarterly - Q3 2017

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