

RESEARCH



MADRID

OFFICE MARKET OUTLOOK
Q3 2014



OCCUPIER TRENDS

INVESTMENT TRENDS

MARKET OUTLOOK

KEY FINDINGS

The recovery in the Madrid office market is clearly underway

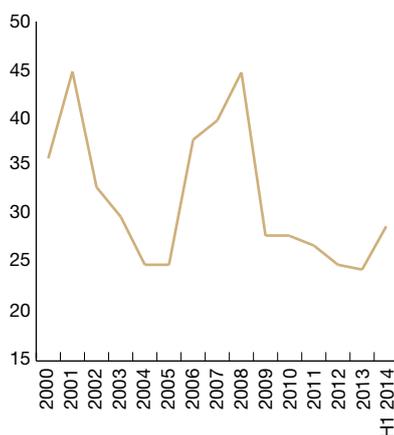
Prime rents reached their floor in 2013 and rose by 14% in H1 2014 to reach €28.00 per sq m per month

Madrid office investment activity has risen sharply, with volumes for H1 2014 amounting to €700 million, against €400 million for the whole of 2013

Limited development activity in recent years has helped to vacancy rate to stabilise at around 11.5%

With virtually no new development in the pipeline, a shortage of good quality stock is expected in the medium term which will lead to further rental growth

FIGURE 1
Prime office rents
€ per sq m per month



Source: Knight Frank Research

OFFICE OCCUPIER MARKET

Following several years of uncertainty, the Madrid office market is showing clear signs of recovery, with take-up for the first half of this year at its highest since 2008.

Indeed, this year's take-up is already above 200,000 sq m and it is expected that the long term average annual figure of 500,000 sq m will be achieved within the next 2-3 years. Tenant demand for offices is solid and has been aided by some very large lettings (such as the 14,000 sq m ICEX deal) and above all by the 130 small and medium sized deals below 1,000 sq m, which have helped to boost take-up volumes significantly.

Currently, the vacancy rate is in line with the long term average at around 11.5%. However, if obsolete buildings and unappealing locations are excluded from the analysis, the amount of vacant space falls by more than 40%. This is the main reason why experienced office developers have chosen to refurbish properties such as Castellana 278-280 (Repsol's old headquarters), Castellana 77 (the former Saint-Gobain headquarters), Hernani 59 (occupied by the courts) and Avenida de América 81 (previously occupied by Telefónica).

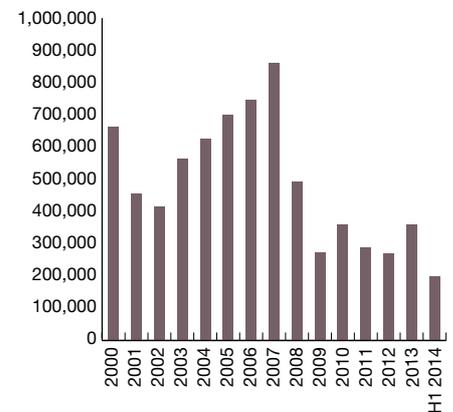
The end of 2013 was a clear turning point for the market, confirming that rents had finally reached their floor. Indeed, this year has seen rental growth for the first time since 2009, with rents in some high-quality and well-located properties increasing by up to 20%.

Prime CBD office rents now stand at €28.00 per sq m per month, up from

€24.50 at the end of last year. While there is unlikely to be an immediate general spike in rental values, a gradual ripple effect from the Castellana district to out-of-town locations is expected and rental growth should begin to re-emerge across the wider market.

The market remains favourable to tenants, with companies increasingly aware that the window of opportunity to secure a good deal may not last beyond 2016. This is forcing many firms to reassess their real estate needs, particularly in terms of optimising space in their longer term business plan.

FIGURE 2
Office take-up
sq m



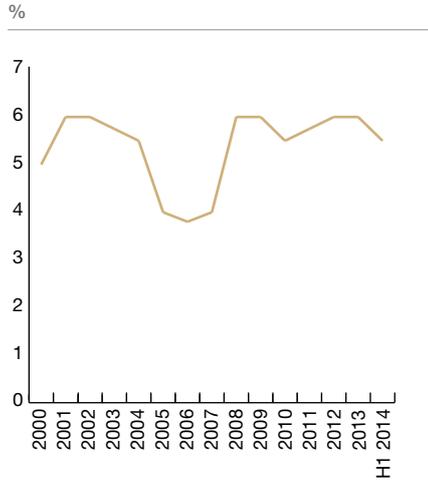
Source: Knight Frank Research

Key recent office leasing transactions

Address	Market	Submarket	Tenant	Size (sq m)
Pº Castellana 278	Secondary Centre	Plaza de Castilla	ICEX	14,023
Martínez Villergas 49, Ed. V. Baja, 3ª, 4ª, 5ª & 6ª	M-30 East	Avda. de America	Alstom	5,775
Alfonso XII, 62, 2ª Planta & Parte 1ª	Secondary Centre	Retiro - Jerónimos	BMN (Banco Mare Nostrum)	3,657
Vía de los Poblados, 3. Cristalia Ed. 9, 1ª, 2ª & 3ª Planta	M-40 North East	Vía de los Poblados	Bankia	2,597
Suero de Quiñones 34, 4ª, 5ª & 6ª Planta	Secondary Centre	Príncipe De Vergara Norte	Clarke Modet	2,097
Pº Castellana, 200	CBD	Paseo de la Castellana	Sony Music	2,047

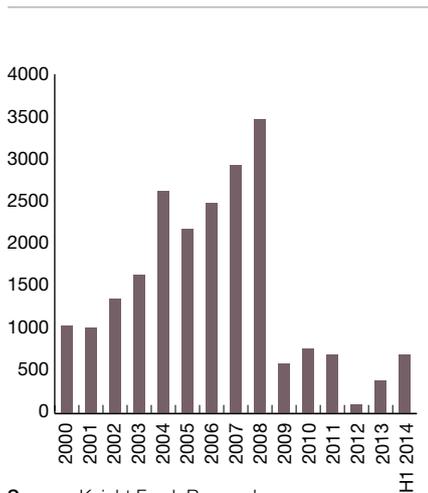
Source: Knight Frank

FIGURE 3
Prime office yields



Source: Knight Frank Research

FIGURE 4
Madrid office investment volumes



Source: Knight Frank Research

INVESTMENT MARKET

The office investment market has rebounded strongly. Transaction volumes for this year currently stand at €700 million and there has been strong competition for the best office stock which has prompted a hardening in Madrid prime yields from 6% to 5.5%. A significant amount of property debt has also been acquired. Perhaps the most noteworthy deal of this year is the sale of Castellana 200, which was acquired by the North American fund manager PSP and Drago Capital for €144 million.

Until last year, Spain was considered by many investors to be more of an opportunistic play, but this year's renewed activity demonstrates that the country is now back among the mainstream commercial property markets. Investors such as Baupost, KKR and Blackstone are just a few examples of large international funds that have made recent acquisitions.

Opportunistic investors, particularly those from the United States, remain active, having focused their efforts on peripheral countries in the early stages of their recoveries. In addition, opportunistic investors continue to seek assets which require more extensive management, with the aim of achieving double-digit returns. Currently, a number of Asian and Middle Eastern buyers are also studying major deals.

Other recent trends include a greater focus by the large fund managers on corporate acquisitions, as well as direct property purchases, while attractive yields have caught the attention of Latin American investors. Transaction volumes have also been boosted by improved access to finance, a number of portfolio disposals by SAREB and increased activity among the SOCIMIs (REITs).

Key recent office investment deals

Year	Address	Vendor	Purchaser	Price
Q2	Castellana, 200	Reyal Urbis	Drago Capital & PSP	€144,000,000
Q2	Edificio IBM	Morgan Stanley	Grupo Modelo (Fondo Finaccess)	€130,000,000
Q1	Av. de Europa 115	Solvía (Banco Sabadell)	London & Regional Properties	€117,000,000
Q2	Plaza de Chamberí, 8	Comunidad de Madrid	Línea Directa (Bankinter)	€40,226,000
Q2	Paseo de los Olmos, 19	KanAm	IBA Capital	€34,000,000
Q1	Edificio D - Albatros	Acciona	Confidential	€31,000,000
Q2	Paseo de la Castellana, 16	Private Investor	Familia Coto	€20,000,000

Source: Knight Frank



Castellana 200, acquired by PSP and Drago Capital for €144m

KNIGHT FRANK VIEW

The Madrid office market is staging a strong recovery and is expected to be one of the best performing property sectors in Europe over the next 1-2 years. This reflects a much improved economic backdrop which has given occupiers and investors renewed confidence and optimism.

Historically, Madrid's office market has correlated closely with corporate performance and employment levels. With economic forecasts continuing to improve, companies are employing more staff which, in many cases, will lead to additional requirements for office space.

A growing number of companies are also now looking at the possibility of relocating, having delayed their expansion plans during the recession, so the recent upturn in demand should lead to further growth in take-up in the coming months. As 2015 approaches, the combination of a more active occupier market, limited development pipeline and low rents offers a realistic prospect of strong rental growth. In turn, this will further increase Madrid's appeal to investors, leading to yield compression and enhanced growth in capital values. The investment case for Spanish property is compelling.



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EUROPEAN RESEARCH

Darren Yates, Partner
Head of Global Capital Markets Research
+44 20 7629 8171
darren.yates@knightfrank.com

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

Sam Berry, Analyst
International Research
+44 20 7629 8171
sam.berry@knightfrank.com

MADRID

Humphrey White,
Head of Commercial
+34 91 595 9000
humphrey.white@es.knightfrank.com

Raul Vicente,
Head of Office Agency
+34 91 595 9000
raul.vicente@es.knightfrank.com

José Antonio Lazúen,
Research Analyst
+34 91 595 9000
joseantonio.lazuen@es.knightfrank.com



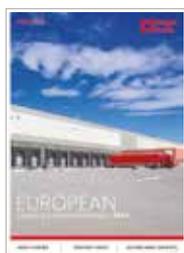
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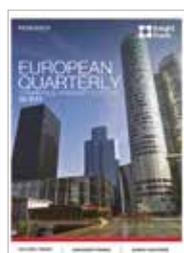
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