RESEARCH

Knight Frank

SPAIN
Commercial Property Market Report **2014**

OFFICE MARKET | LOGISTICS AND INDUSTRIAL | SHOPPING CENTRES | INVESTMENT MARKET

ECONOMIC AND PROPERTY OVERVIEW

There has been a marked improvement in the Spanish economy over the last year and the end of the prolonged economic crisis now appears closer. Nonetheless, sentiment remains cautious, the drivers of a sustained recovery are still weak and downside risks remain.

The improvement in the Spanish economy has led to a revival of investor interest in the country's property market.

The change in the situation has come primarily off the back of improvements in the international economic climate and the perception of the Euro, which are helping Spain to emerge from the crisis of confidence that it has been through in recent times. According to forecasts from the Bank of Spain, GDP growth of 0.7% is expected in 2014.

Although the cost of financing for households, companies, credit institutions and public authorities continues to be high, the Spanish economy has been boosted by labour market improvements, as there has been a slight fall in unemployment, which is paving the way for a recovery in private consumption. The consolidation of debts in the private sector and tax consolidation are also underway, and will continue to aid demand and economic activity. Reduced uncertainty and improved results for credit institutions should create more favourable financial conditions across all business sectors.

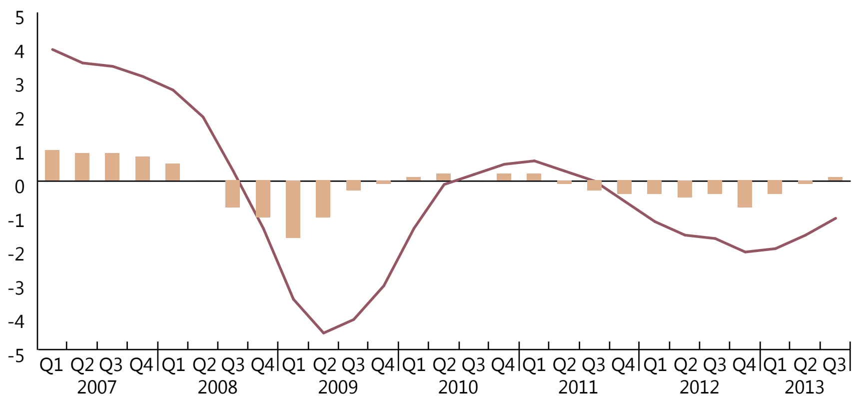
The real estate market benefitted from a recovery in business confidence over the second half of 2013 and investors' interest in acquiring commercial property increased significantly. Property owners who have been faster and more flexible in redefining their strategies have had the upper hand when putting new properties on the market.

In 2013, investment in non-residential real estate assets in Spain exceeded €3 billion, well above the investment volumes recorded in 2012. Property values are now coming close to their final corrections and subsequent stabilisation, and values in some sectors may begin to move upwards in 2014.

FIGURE 1

Spanish GDP growth

%



QUARTER-ON-QUARTER CHANGE ANNUAL CHANGE **Source:** Instituto Nacional de Estadística

MADRID CBD

MADRID OFFICE MARKET

After more than five years of crisis, uncertainty over the timing of a recovery in Spain's real estate sector appears to be receding. A general sense of optimism is beginning to be noted in the market, which is evident in the completion of a greater number of large-scale leasing transactions by both Spanish and international companies.

There remained a large degree of caution in the market in 2013 and the year was characterised by excess supply and fluctuating demand. Nonetheless, annual office take-up in Madrid increased to 362,788 sq m. The overall vacancy rate remained at a very stable level and a slight decrease was noted in new supply coming on to the market. Rental corrections have begun to bottom out.

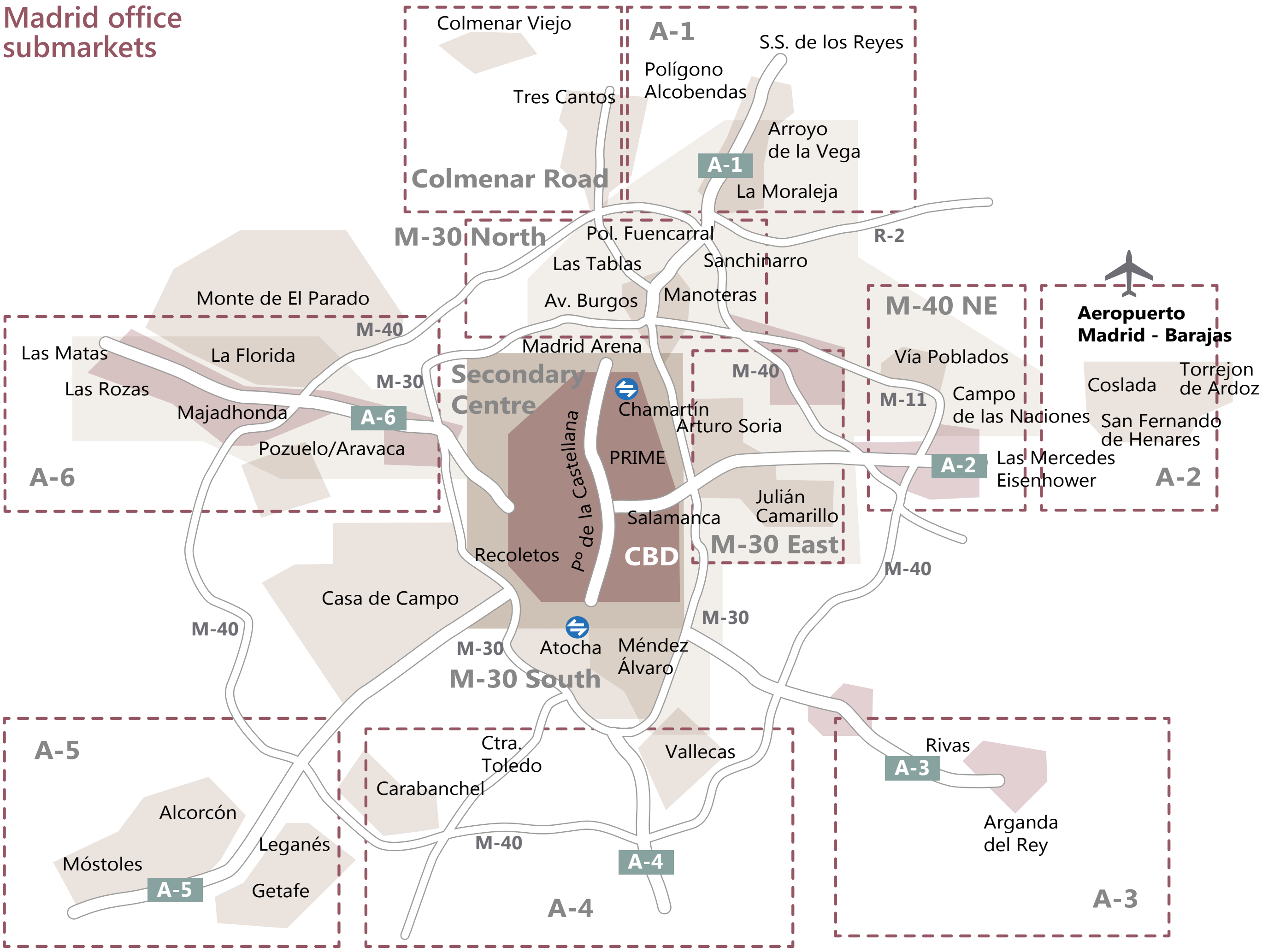
Supply

The overall vacancy rate remained fairly stable during 2013, at just over 11%. However, in some areas, such as out-of-town locations, high vacancy rates remain a cause for concern. The elevated availability levels in these areas have been caused by weak demand and the large number of projects that were developed before the economic crisis, but which still stand empty.

At present, the refurbishment of office space is a key factor when buildings are brought to the market. Attractively refurbished buildings with competitive rents are stimulating leasing activity and providing occupiers with a range of high quality alternatives. Large companies from a variety of different sectors have been taking advantage of opportunities to lease such properties.

Owners have adjusted to current market conditions and to the expectations of tenants, by becoming increasingly flexible when negotiating deals in their buildings. However, poor decisions by landlords when attempting to close lease agreements can

Madrid office submarkets




GRAN VÍA

result in tenants not signing for buildings or pursuing alternative options in order to take advantage of the current excess supply. The high levels of available supply are making the market ever more competitive, particularly in the 200-1,000 sq m space category.

Demand

During 2013, a total of 362,788 sq m of office space was leased in the Madrid market, representing a year-on-year increase of about 32%. On the face of it, this figure would suggest that demand for offices is on the rise, however a more detailed analysis of the data indicates that the situation is less clear.

The improved 2013 take-up figure was in large part due to several factors which are not necessarily indicative of the underlying strength of the market. There were a number of exceptional large-scale transactions, a variety of deals were closed by companies that had been searching for new locations for a long time and some companies amalgamated their offices under one roof.

The current economic climate has continued to affect demand, as many international companies are still cutting costs and monitoring the market. Most of the companies that are relocating offices are those that have a definite need to move, and demand for space remains highly dependent on these companies.

However, compared with the last five years, there has been a significant increase in the number of large companies making major occupational decisions. Over recent years, the weakening of business expectations led to a lack of movement by such companies, which in many cases renegotiated rents in their existing premises. However, 2013 saw the completion of the largest lease agreements to be signed since the beginning of the recession, and these have been key in encouraging other companies to pursue expansion plans and look for opportunities to relocate.

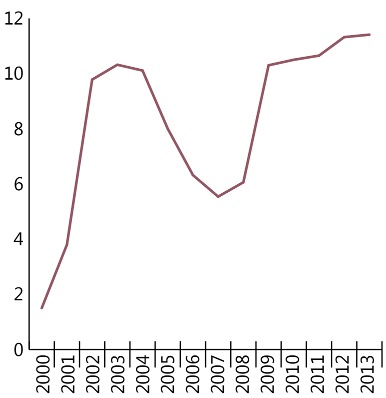
A wide variety of companies, such as Cepsa, Vodafone, Iberia, Agencia EFE and Amper, have made decisions to relocate to new offices, in line with the strategies of their parent companies and taking advantage of the opportunities available in the current market. The CBD has been the prime focus for service companies, consultancies and law firms. The amount of occupiers looking for large spaces in new office buildings is aiding the marketing of entire buildings, a number of which have been on the market for some time.

As with the restructuring of the banking

FIGURE 2

Madrid office vacancy rate

%

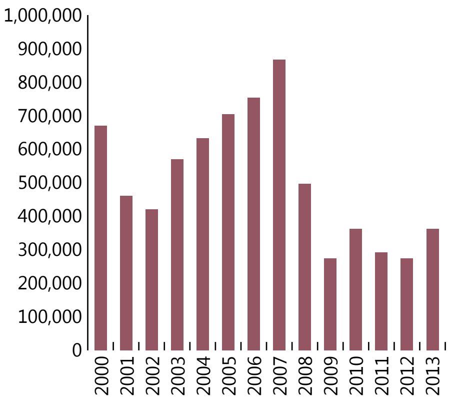


Source: Knight Frank

FIGURE 3

Madrid office take-up

sq m

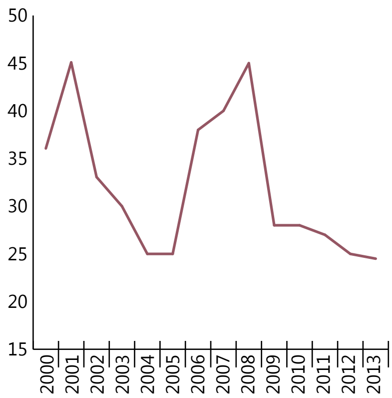


Source: Knight Frank

FIGURE 4

Madrid CBD prime office rents

€ per sq m per month

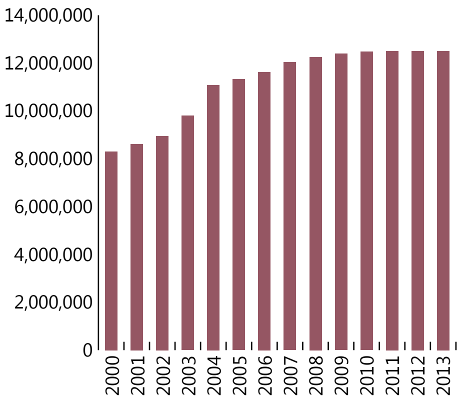


Source: Knight Frank

FIGURE 5

Madrid total office stock

sq m



Source: Knight Frank

sector, it is apparent that large companies are also having to restructure, with the aim of rationalising poorly performing parts of their businesses prior to taking office space for new projects, thereby gaining credibility before continuing with their investments.

Sustainability continues to be a key priority for companies and environmental concerns are now an important factor influencing decisions on the letting or purchasing of office space.

Rents

The decline in office take-up levels and the availability of large amounts of space have caused an imbalance between supply and demand since 2008, leading to significant falls in office rents.

The high availability levels have favoured tenants in their rental negotiations, while the owners of office buildings have continually needed to adjust their rental expectations to match the market. The downward negotiation of rents has become the norm, and there have been substantial disparities between asking rents and the actual rents achieved by completed deals.

At the end of 2013, prime rents for sole-use office buildings in the CBD stood at around €24.50 per sq m per month, a 2% decrease compared with a year earlier. However, towards the end of the year, some exceptional transactions in prime locations on the Paseo de la Castellana achieved rents of close to €29 per sq m per month. Outside of the CBD, it becomes more difficult to ascertain rental levels in different areas of Madrid due to the limited transactional evidence.

In the owner-occupier sales market, buyers are looking for opportunities, but it has become increasingly difficult to determine the value of individual buildings due to the lack of deals and the differences between properties.

Office rents are generally expected to remain stable in the short term, although there has been recent evidence that rents have started to increase in the very best prime buildings. Employment, which is one of the main demand indicators in the office sector, is forecast to increase in Spain by almost 1% over 2014. This should help to generate improved demand for office space and support rental levels over the coming months, before a fuller recovery in rental values is seen over the longer term.

Competition between landlords to lease their properties is expected to remain strong in 2014 and those who are unsuccessful may look to sell their properties.

While office rents have generally stabilised, there has been recent evidence of rental increases in the very best prime buildings.

TABLE 1

Key Madrid office occupier deals, H2 2013

Market	Submarket	Tenant	Address	Size (sq m)
CBD	Cuatro Torres Area	CEPSA	Torre Bankia, Paseo de la Castellana, 259	47,975
M-30 North	Polígono Fuencarral	Banco Sabadell	Isabel de Colbrand, 22 - Edificio C	10,032
M-30 North	Las Tablas	Ferroser	Parque Vía Norte - Edificio V	6,500
A6	La Florida	Volvo España	Basauri, 7-9	5,919
CBD	Paseo de la Castellana	Hogan Lovells	Paseo de la Castellana, 36-38	4,608
Carretera de Colmenar	Tres Cantos	Carl Zeiss Vision	Ronda de Poniente 5	2,825
M-30 East	Julián Camarillo	Konecta	Parque Empresarial Avalon - Edificio D, Santa Leonor, 65	2,196
A6	Las Rozas	ING	Vicente Alexandre, 3	1,516

Source: Knight Frank

SPANISH OFFICE INVESTMENT MARKET

The Spanish real estate investment market is gradually becoming more attractive to international investors. The general stabilisation of the Eurozone, signs of improvement in the economy and accumulated price adjustments since 2008 have all been key factors encouraging investors to reconsider Spain as a place in which to invest.

After an extended period of uncertainty, there is now increased optimism among investors.

After an extended period of uncertainty as to when the market would recover, there is increased optimism among investors, which resulted in the completion of more than €3 billion of commercial investment transactions in 2013.

The launch of the "bad bank" SAREB in 2012 seems to have had a domino effect, and the completion of some of its high profile transactions has encouraged further market activity. While it is primarily focused on the residential property market, SAREB has now sold in the region of 6,400 properties and divested properties and loans with a book value of €2 billion.

There has been a notable change in the investor profile. The perception of the Spanish property market has improved among international funds, and it is no longer solely of interest to hedge funds looking for heavily discounted transactions, as was the case in recent years when several portfolios were bought to the market.

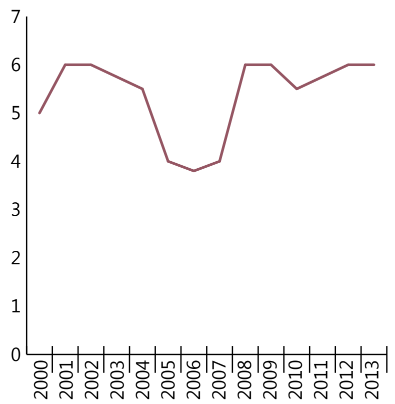
International investors are now actively looking for opportunities to buy income-producing properties. They are not only looking at buildings in prime locations and established business districts with market rents and highly solvent tenants, but are now also considering acquisitions of properties

CUATRO TORRES BUSINESS AREA

FIGURE 6

Madrid prime office yields

%

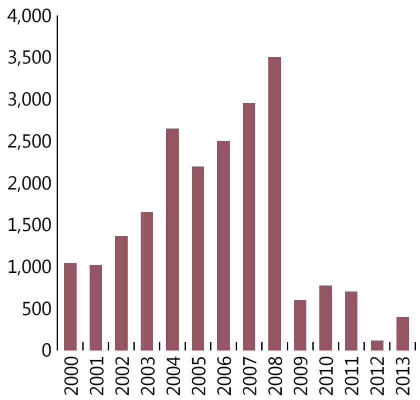


Source: Knight Frank

FIGURE 7

Madrid office investment volumes

€ million



Source: Knight Frank

that are in need of refurbishment or not fully let. Other investor groups such as institutional investors, family offices and rental portfolio property funds are also investigating opportunities to buy properties in the main Spanish cities.

Among the investment firms and groups that have been most active in Spain, it is worth highlighting Apollo, Cerberus, Kennedy Wilson, Värde Partners, TPG, Goldman Sachs and Blackstone, who have all invested heavily in property and real estate companies. In addition, there has been a wave of transactions involving investors from emerging countries in Latin America, driven by the growing wealth of this region of the world. Another sign of the improved

PASEO DE LA CASTELLANA

optimism in Spain is that wealthy overseas private investors have taken stakes in well-known Spanish construction companies.

With price corrections of close to 60% since 2008, Madrid has seen some of the most substantial adjustments in Europe, contrasting with other capital cities such as London and Paris, where prices are significantly higher. Despite the improved demand, it is not expected that significant price increases will be seen for some time. However, as long as there is no change to the improving economic outlook, the first signs of growth should be seen in the medium-to-long term.

With yields on 10-year Spanish government bonds falling below 4% at the start of 2014 and bank deposits yielding around 1%, the real estate sector can generate attractive annual returns of 5.50-6.00% for prime assets. Moreover, the appreciation that an asset can gain over time must also be considered and, as the Spanish market appears to at the lowest point of the cycle, most assets have an upside potential.

There is a limited supply of prime buildings available on the investment market. This is expected to continue throughout 2014, and may prevent some investors from implementing their plans to invest in Spain. In the current market, any building that is placed on the market seems to attract competitive bidding and sells within a relatively short period of time.

The second half of 2013 saw some significant office transactions in Madrid, including the sale of the Reyal Urbis building on Avenida de San Luis to IBA Capital Partners and the deals completed via public auction for two buildings on Gran Vía, which attracted strong interest from several investors. Also notable was the re-sale of Castellana 18, which had been bought by the private Indian investor Ram Bhavnani earlier in the year, before being sold on to a Catalan family office.

LOGISTICS AND INDUSTRIAL MARKET

The logistics and industrial market continued to be affected by the wider economic situation in 2013, although demand for space has been boosted by rising online sales, meaning that there is an increased need for large warehouses. Madrid, Barcelona and Valencia are the most important locations in Spain for such properties.

Investor confidence in the sector has improved and Spain is back on the agenda for investors interested in purchasing individual properties or good portfolios, as long as the pricing is correct.

Supply

There are high levels of available supply in all major logistics locations. In order to achieve lettings and sales, the owners of warehouses have needed to adapt their properties to suit their locations and meet the limited demand in the current market.

The Madrid industrial vacancy rate is still high at approximately 13.8%, equating to a total of 850,000 sq m of space available for occupation. Even so, there are shortages of available large warehouses in locations where there is demand for such properties. It will remain a long time before a balance between supply and demand is achieved.

In prime areas, vacancy rates have generally stabilised, however, availability has continued to increase in secondary locations as second-hand warehouses have been vacated and come back on to the market.

Madrid logistics areas

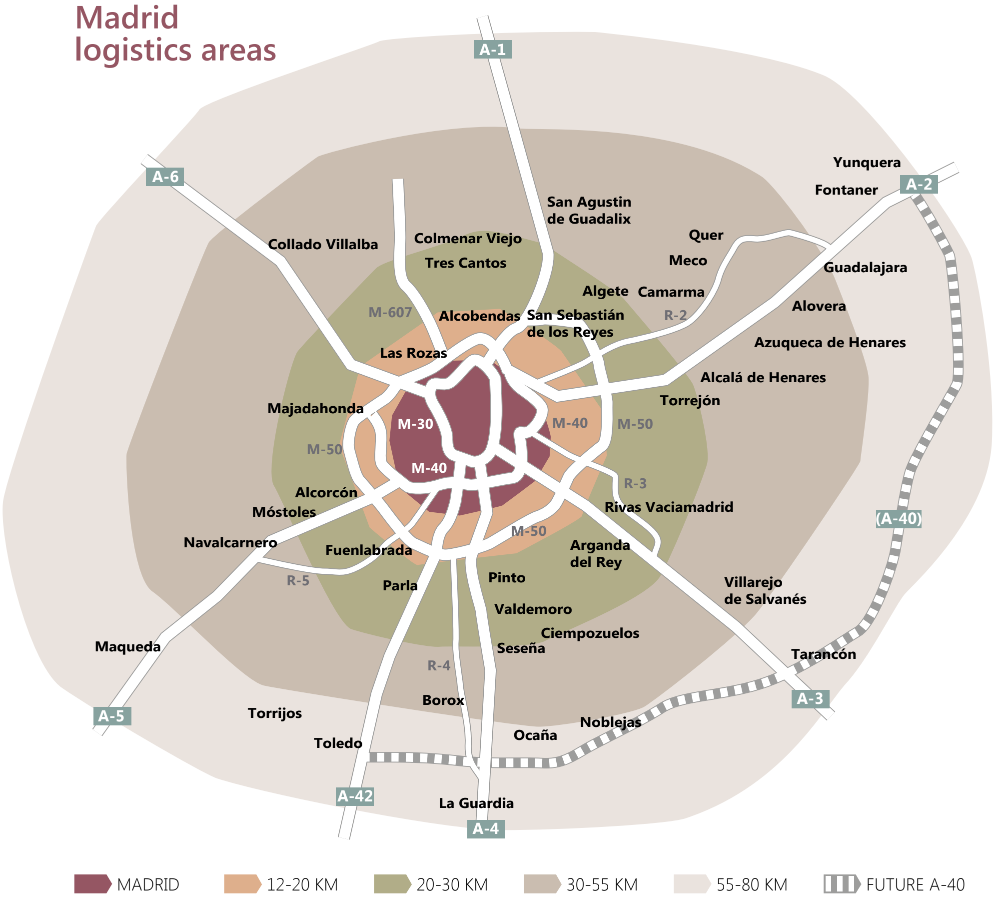
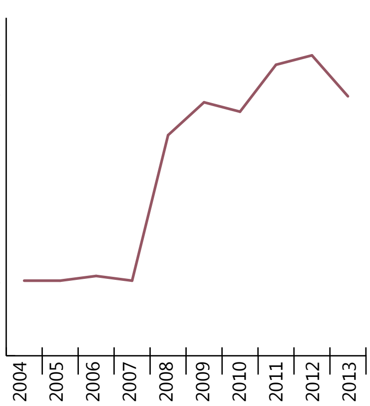


FIGURE 8
Madrid logistics vacancy rate
%



Source: Knight Frank

Demand

Occupier demand remains strongest for high quality, well located and efficiently configured industrial properties, while there is little interest in older obsolete stock. Logistics operators continue to look to reduce their costs and rents, signing long-term lease agreements, but with short compulsory fixed terms.

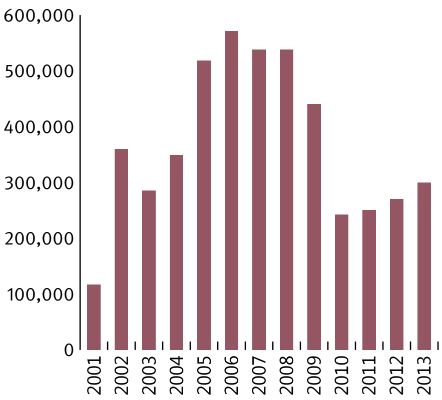
Madrid logistics take-up reached approximately 300,000 sq m in 2013, which was the highest figure in the last four years. However, take-up volumes remain low in an historical context, reflecting the dependence of the sector on consumption, and there is still a long way to go before take-up returns to the levels seen pre-2009.

Among the relatively few deals that were completed in 2013, many resulted from occupiers seeking to lower their rents, rationalise space and improve locations. These are likely to remain major motivations for occupiers, especially small and medium enterprises (SMEs) who are finding it extremely difficult to keep attracting new business. In many cases, such companies have been forced to either close or vacate parts of their premises. The proximity of warehouses to major urban centres is a key factor in many occupiers' relocation decisions, as they seek to reduce delivery times.

FIGURE 9

Madrid logistics take-up

sq m

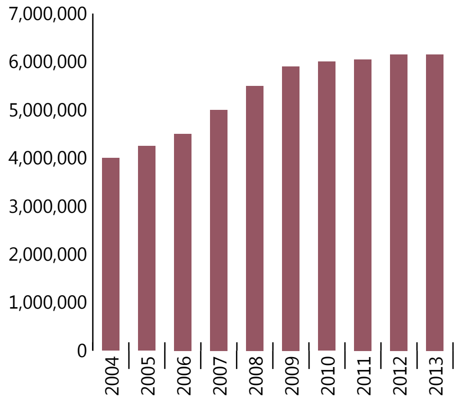


Source: Knight Frank

FIGURE 10

Madrid logistics total stock

sq m

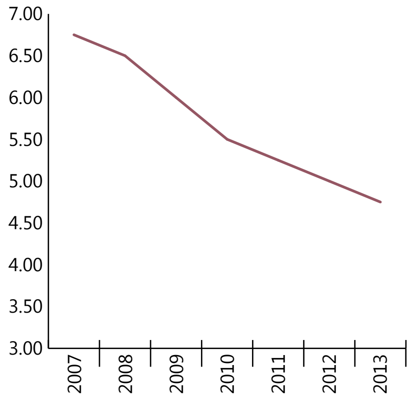


Source: Knight Frank

FIGURE 11

Madrid logistics prime rents

€ per sq m per month

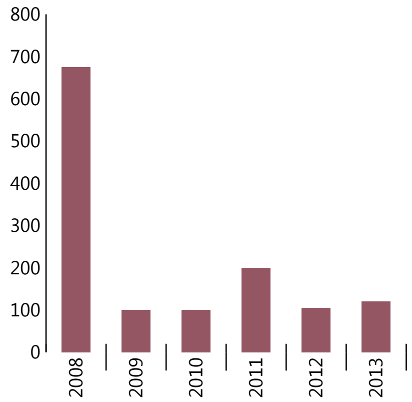


Source: Knight Frank

FIGURE 12

Madrid logistics investment volumes

€ million



Source: Knight Frank

Since the crisis began, there has been a lack of new warehouse space being made available for rent. Many occupiers are waiting for warehouse owners to help stimulate a recovery in market activity by refurbishing vacant properties, thus increasing the availability of high quality warehouse space.

There continues to be an absence of turnkey transactions, as occupiers are able to choose from the large amount of space available at rents which are much lower than the rental levels that would be required by the developers of new projects. However, in the absence of new stock, occupiers will often negotiate with owners to ensure that properties are refurbished or restructured before they move into them.

The average size of the warehouses leased in 2013 was relatively small, at just under 5,620 sq m. Only four deals of over 30,000 sq m were closed. The largest deals of the year included Cerezuela's acquisition of a 34,500 sq m plot in the Coslada CTC and Docout's letting of a 43,531 sq m warehouse in Tarancón.

Despite the economic recovery remaining uncertain, there will continue to be opportunities in 2014 for logistics and industrial occupiers looking to expand their operations and to take advantage of the current availability of space in the market.

Rents

In common with other commercial sectors,

FONTANAR INDUSTRIAL ESTATE

prime rents are beginning to stabilise in the Madrid logistics market, standing at €4.75 per sq m per month at the end of 2013. However, rents in secondary areas remain under downward pressure and the lack of transactions makes it hard to determine market rents for specific properties in such locations.

Within the Madrid market, Coslada and Getafe are the locations where the largest number of logistics operators are concentrated, and these continue to be the most sought-after areas. As a result, they have seen the least severe falls in rents.

Land prices continue to fall and stand at between €90-150 per sq m in the most popular logistics locations.

Investment market

Investment volumes in the logistics sector were particularly low in 2013, but, nonetheless, there was interest from investors such as Blackstone, who purchased logistics centres following their acquisitions of assets in other sectors.

Other investors are adopting opportunistic strategies and studying options in the logistics market. However, the limited supply of prime assets in the best locations with long-term lease agreements is a major obstacle to investment activity.

The most important investment deals of 2013 included Blackstone's acquisitions of two assets in Alovera, Madrid, totalling approximately 77,000 sq m, and a portfolio comprising two properties in Madrid and one in Barcelona which Blackstone purchased from AXA for c.€50 million. There are several ongoing deals which may be closed in the first few months of 2014. Prime logistics yields have stabilised and currently stand at 8.50%.

Retail floor space density GLA (sq m)/1,000 inhabitants

< 200 | 200 TO 300 | 300 TO 400 | > 400

Source: AECC/Knight Frank

SPANISH SHOPPING CENTRE MARKET

The outlook for the Spanish shopping centre sector has improved, with significant increases noted in the CIS Consumer Confidence Index for Spain towards the end of 2013. This was aided by improvements in employment and household incomes.

PARQUE CEUTA SHOPPING CENTRE

As has happened in the office sector, there has been a slowdown in development activity in the shopping centre market. In 2012, Spain saw a record amount of new retail space delivered to the market, but there have since been very few openings and no significant shopping centre developments are in the pipeline for the next few years. Only those projects that have already begun construction will continue to see development, but some may have difficulties finding retail occupiers of a high enough standard to attract customers.

At the end of 2013, total shopping centre floor space in Spain amounted to 15 million sq m (GLA) within 530 schemes.

It is increasingly important that new and existing shopping centres are tailored to changing consumer habits and lifestyles. Transforming centres by achieving the right mix of leisure and restaurant facilities alongside retail space can be crucial to increasing footfall and improving the performance of shopping centres.

As in the rest of Europe, online retail sales are growing rapidly in Spain, which is encouraging retailers and investors to seek locations that complement both high street retail activity and the in-store collection of purchases made online.

Shopping centres with high environmental standards are able to attract better tenants than those than have not been refurbished and are not environmentally sound, and are thus of most interest to investors. The best performing shopping centres are generally those with a strong mix of top-tier supermarkets, retail stores, leisure facilities and restaurants.

Shopping centre investment

Sentiment in the retail investment market has improved in recent months, and investment funds have returned to the market. Although consumption continues to show signs of weakness and a full economic recovery is still a long way off, the retail sector is seeing definite interest from investor groups and shopping centres on the market have received multiple bids from a range of investors.

The current pricing of retail property is a major attraction to investors, as prices have become much more expensive in other European markets. However, the lack of product on the Spanish market continues to restrict activity and investors seeking prime retail properties currently have very few alternatives available. Current demand for retail property is encouraging more secondary assets on to the market, but this has created a mismatch between the quality of product that is on the market and the product that investors are actually seeking.

With regards to financing, which is a key factor when purchasing shopping centres, banks remain cautious and at most offer between 45-60% LTV. This suggests that investors may need to consider alternative sources of financing in 2014, such as insurance companies or pension funds.

Yields for prime shopping centres stand at between 7.00-7.50%. These yields are among the highest in Western Europe and are indicative of the lack of investment demand in Spain in recent years. With consumer activity still weak, there are not yet any signs of yield compression and prime yields are currently stable.

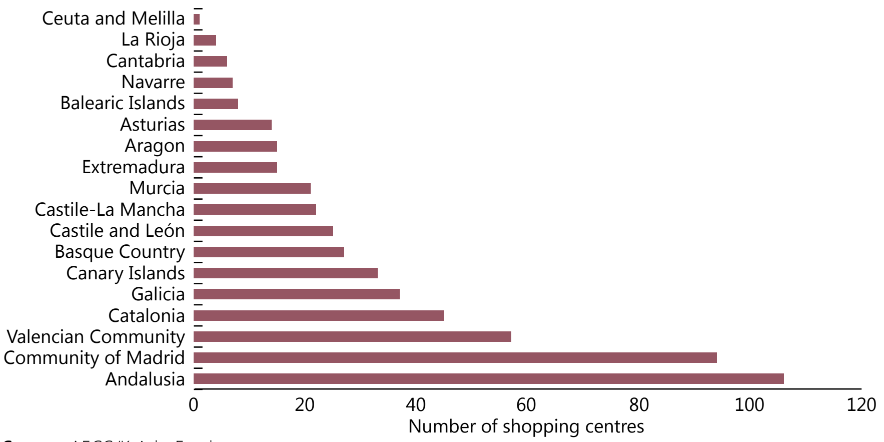
A different story is evident when looking at secondary centres, of which there are more than prime centres. Difficulties such as falling rents, vacant units and temporary rental discounts have resulted in yields for secondary centres rising close to 8.50%.

The most significant retail transactions of H2 2013 included the acquisition of the Parque Principado shopping centre in Oviedo by a joint partnership between Intu Properties and Canada Pension Plan Investment Board, for €162 million. Noteworthy deals within the Madrid region included IBA Capital Partners' purchase of ABC Serrano for €60 million and Temprano Capital Partners' acquisition of Cuadernillos retail and leisure park, for an amount believed to be close to €12 million.

Retail deals elsewhere in Spain included Zaphir Group's purchase of San Vicente Outlet Park in Alicante for €8 million. Meanwhile, the French retail group Carrefour has agreed to buy a portfolio of 127 shopping centres in France, Spain and Italy from Klepierre for €2 billion. This transaction, which remains subject to a final agreement between the parties and the approval of regulatory authorities, is expected to be closed in the first half of 2014.

FIGURE 13

Geographical distribution of Spanish shopping centres

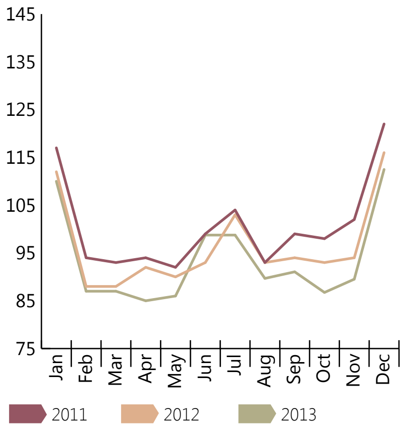


Source: AECC/Knight Frank

FIGURE 14

Retail traffic footfall national index

Index

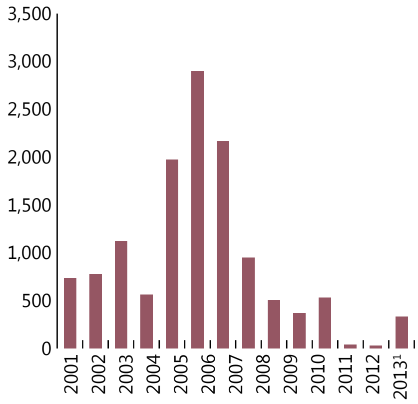


Source: Experian

FIGURE 15

Spanish shopping centre investment volumes

€ million



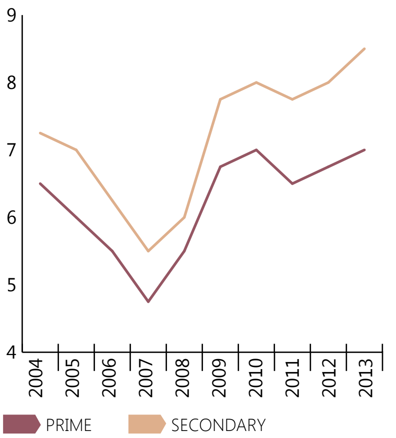
Source: Knight Frank

¹ Does not include the pending Carrefour/Klepierre transaction

FIGURE 16

Spanish shopping centre yields

%



Source: Knight Frank

FIGURE 17

Spanish consumer confidence index

Index

Source: Centro de Investigaciones Sociológicas (CIS)

RESEARCH

AMERICAS
USA
Canada
Caribbean

AUSTRALASIA
Australia
New Zealand

EUROPE
UK
Austria
Belgium
Czech Republic
France
Germany
Ireland
Italy
Monaco
Poland
Portugal
Romania
Russia
Spain
Switzerland
The Netherlands
Ukraine

AFRICA
Botswana
Kenya
Malawi
Nigeria
South Africa
Tanzania
Uganda
Zambia
Zimbabwe

ASIA
Cambodia
China
Hong Kong
India
Indonesia
Macau
Malaysia
Singapore
South Korea
Thailand
Vietnam

THE GULF
Bahrain
Qatar
UAE

Newmark Knight Frank Global

MADRID

Humphrey White
Head of Commercial
+34 91 595 90 00
humphrey.white@es.knightfrank.com

Raul Vicente
Head of Office Agency
+34 91 595 90 00
raul.vicente@es.knightfrank.com

Alejandro Galán
Head of Industrial & Logistics
+34 91 595 90 00
alejandro.galan@es.knightfrank.com

Daniel Díaz García
Research Analyst
+34 91 595 90 00
daniel.diaz@es.knightfrank.com

LONDON

Chris Bell
Managing Director, Europe
+44 (0) 207 629 8171
chris.bell@knightfrank.com

Darren Yates
Partner, Head of Global Capital Markets Research
+44 (0) 207 629 8171
darren.yates@knightfrank.com

Matthew Colbourne
Associate, International Research
+44 (0) 207 629 8171
matthew.colbourne@knightfrank.com

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.

Knight Frank Reports are also available at www.knightfrank.com