

RESEARCH



# MADRID

OFFICE MARKET OUTLOOK  
Q4 2016

OCCUPIER TRENDS

INVESTMENT TRENDS

MARKET OUTLOOK

## KEY FINDINGS

The Spanish economy is forecast to outperform the rest of the EU in 2016, and according to Eurostat, will generate nearly one-quarter of the EU's new jobs in 2016 and 2017.

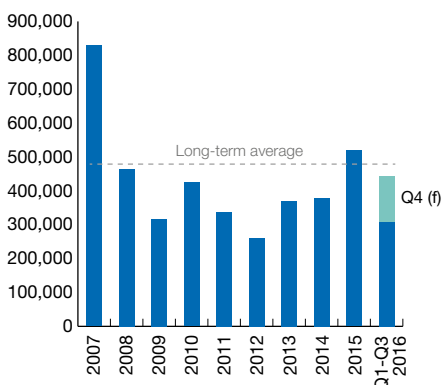
Madrid's development pipeline has increased, although as there are few speculative projects under construction, only a marginal increase in vacancy levels is expected.

Prime rents are showing upward movement and are underpinning the significant weight of capital being targeted at Madrid's real estate.

Strong capital flows have placed yields under further downward pressure, with prime office yields now at 3.9% and approaching their pre-credit crunch level.

FIGURE 1

### Office take-up sq m



Source: Knight Frank Research

## OCCUPIER MARKET

Even against a backdrop of political uncertainty, occupier demand in Madrid has remained robust throughout 2016.

Despite political headwinds surrounding the Spanish election in 2015 and 2016, Spain's economy has proven remarkably resilient. At a growth forecast of 3% for 2016, the Spanish economy is forecast to outperform the rest of the EU. The employment outlook also looks positive with unemployment falling consistently over the last few years. According to Eurostat, nearly one-quarter of jobs in the EU over the coming years will be generated in Spain.

These positive economic indicators have underpinned Madrid's strong occupational market fundamentals during 2016. H1 2016 was characterised by the strongest H1 occupier activity since 2010, with over 220,000 sq m of office space let, and several large-scale transactions concluding (Figure 1). In light of such solid activity, Q3 leasing volumes were unsurprisingly down, and although they reflect a 24% fall from the same quarter last year, there are signals of a strong finish to the year. There are a handful of deals over 10,000 sq m in the latter stage of negotiation and if they complete this year, full-year take-up will be in-line with the long-term average.

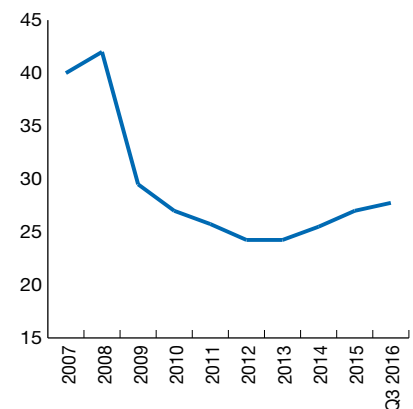
The CBD has been the main focus of demand but with quality space becoming restricted, some occupiers are widening their search and looking at peripheral areas to fulfill their space requirements. Madrid's development pipeline is however increasing. There is around 76,000 sq m of new office space under

construction and due for completion over the next two years. There are also considerably more refurbishment/redevelopment projects underway totalling over 220,000 sq m. Vacancy levels have remained relatively stable at 10.7% but may increase marginally as new supply enters the market.

Over the past year, prime office rents in Madrid have increased by 5% to €27.75 (Figure 2). Incentives have also been falling, with both rent-free periods and contributions to fit-out costs thinning. Prime rents in the CBD will continue to face upward pressure in 2017 and 2018, however in the periphery, only areas with low availability may see rental growth.

FIGURE 2

### Prime office rents € per sq m per month



Source: Knight Frank Research

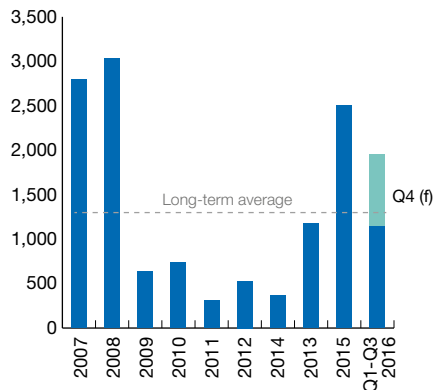
### Key office leasing transactions in 2016

Quarter	Address, Building	Tenant	Size (sq m)
Q2	Ulises 16	Bancopopular-e	8,091
Q3	Santa Leonor 32	Centro de Servicios Operativos e Ingeniería de Procesos	5,746
Q2	Av. Industria 51	CAF Signalling	5,615
Q1	Retama 7	SITEL	5,469
Q1	Emisora 20	AVINTIA	5,377
Q2	Ferraz 21	Universidad Juan Carlos	5,300
Q3	Av. Fuente de la Mora 1	Everis Spain	5,243

Source: Knight Frank Research

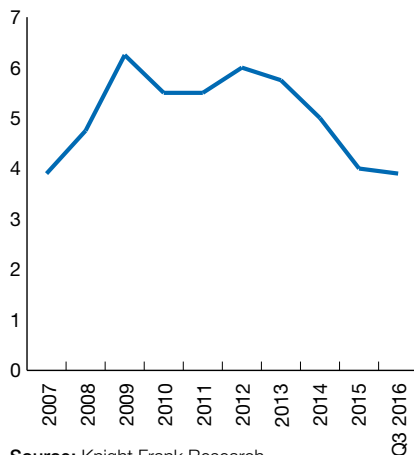


FIGURE 3  
Madrid office investment volumes  
€ million



Source: Knight Frank Research

FIGURE 4  
Prime office yields  
%



Source: Knight Frank Research



Torre Cepsa purchased by Pontegadea

## INVESTMENT MARKET

Buoyant rental growth forecasts in Madrid have encouraged investors to deploy capital in the market. This is against a backdrop of slowing transaction volumes in most other European markets. Notably, of the top five most active European markets in 2016, Madrid has been the only one to record growth. More than €3.5 billion of capital has been invested into commercial real estate in the first nine months of 2016, with the majority in Madrid's office sector, where a forecast of double-digit rental growth has been prompting a scramble for assets.

Though investment volumes were muted in Q1 and signalled a sluggish start to the year, they have rebounded over the last two quarters to reach historically high levels. A total of €1.14 billion was invested in Madrid's office

market in the first three quarters of 2016 (Figure 3).

Domestic investors have been the most dynamic accounting for 60% of the total volume. This makes Madrid one of the most domestically-oriented markets in Europe. It represents a marked turnaround from 2013-14 when the market was characterised by an influx of foreign, opportunistic capital. The US has been the largest source of cross-border capital at 23% of the total office volume.

The market is suffering from a lack of quality space. Yields have continued to come under downward pressure and at 3.9%, they are approaching their pre-credit crunch level (Figure 4). As competition intensifies, the best-positioned assets will likely see further yield compression.

### Key office investment transactions in 2016

Quarter	Property	Seller	Buyer	Approximate price (€ million)
Q3	Castellana 259	Bankia	Pontegadea	490
Q2	Santa Hortensia 26-28	Finaccess	Colonial	156
Q2	Campezo 1	Standard Life	Greenoak	140
Q1	Espronceda 32-34	BBVA	Eurostone	51
Q2	Serrano 73	Finaccess	Colonial	47
Q1	Manoteras 48*	Lonestar	Trejano Iberia Socimi	44
Q2	José Abascal 45	San José/Parquesol	Colonial	35
Q3	José Abascal 41	Credit Suisse	Mutua Madrileña	31

Source: Knight Frank Research

## KNIGHT FRANK VIEW

Despite strong economic growth, occupiers have been exercising caution throughout 2016. However, development activity is lifting, suggesting occupier and developer confidence is improving in the market.

Madrid is riding a wave of capital as investors are in pursuit of strong rental growth prospects, and compared to other European markets, Madrid's

rental growth outlook is compelling. Full-year office investment volumes are expected to reach over €2 billion, boosted by a handful of major deals including the sale of Adequa business park (up to €380 million) being advised by Knight Frank. The pressure to invest will continue to intensify throughout 2017 leading to further hardening of yields.



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### EUROPEAN RESEARCH

**Matthew Colbourne**, Associate  
International Research  
+44 20 7629 8171  
[matthew.colbourne@knightfrank.com](mailto:matthew.colbourne@knightfrank.com)

**Vivienne Bolla**, Senior Analyst  
International Research  
+44 20 7629 8171  
[vivienne.bolla@knightfrank.com](mailto:vivienne.bolla@knightfrank.com)

### SPAIN

**Humphrey White**,  
Partner  
Head of Commercial  
+34 600 919 012  
[humphrey.white@es.knightfrank.com](mailto:humphrey.white@es.knightfrank.com)

**Raúl Vicente**,  
Associate  
Head of Office Agency  
+34 600 919 023  
[raul.vicente@es.knightfrank.com](mailto:raul.vicente@es.knightfrank.com)

**Ignacio Buendia**,  
Commercial Research Manager  
+34 600 919 103  
[ignacio.buendia@es.knightfrank.com](mailto:ignacio.buendia@es.knightfrank.com)



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