

EXECUTIVE SUMMARY

1. Current situation of the City of Madrid

1.1. Economic environment and outlook

Despite the progress made at the eurozone summit at the end of June, the lack of action by the ECB is keeping the markets tense. This, together with the global economic slowdown and signs that the eurozone recession is deepening in the second half of the year, is worsening the overall macroeconomic outlook. In Spain, the first quarter of 2012 ended with a 0.4% YoY fall in GDP, with a sharp contraction in investment spending (8.2% YoY), a moderation in the fall of the household spending (which can be interpreted as a pause rather than a turning point), a fall in public consumption (5.2% YoY) which, though important, is insufficient to achieve the required fiscal adjustment, and a significant reduction in the contribution of the external sector, due to the reduced dynamism of exports. In the case of the Madrid region, the falls of 5.3% in industrial GVA and 4.2% in construction weighed on GDP growth, which ended the first quarter at 0.6%.

CEPREDE has not changed the forecasts it made last May, which point to a 1.1% contraction in Spanish GDP in 2012 and 0.5% in 2013, driven by the strong reduction in public consumption (8.6% in 2012 and 8% in 2013), and by sharp falls in capital goods investment (7.2% in 2012 and 2.9% in 2013) and construction (10.2% and 4.1% respectively). The external sector is expected to contribute 3.8 percentage points to GDP growth in 2012 and 1.7 in 2013, without which it would otherwise fall by 4.9% in 2012 and 2.2% in 2013. The forecasts for the city of Madrid are also unchanged, at levels identical to those for Spain as a whole, with the largest falls being in the GVA of construction (4.1% in 2012 and 1.9% in 2013), followed by non-market services (1.5% in 2012 and 0.6% in 2013), as a result of public sector budgetary cuts.

1.2. Production activities

INDUSTRY

The fall in industrial production in Madrid is accelerating, ending April with an average annual decline of 6.8%, substantially worse than the Spanish average of 4.3%. Capital goods performed relatively well; although they suffered a serious fall, it is the only sector to show positive average growth (0.1%), 4.5 points above the national average. However, if we look at the YoY changes, they are increasingly negative, with falls of 21.1% and 21.6% in March and April respectively, and substantially more negative than the nationwide statistics (14.3% and 14.9% respectively).

Reflecting this deterioration in activity, 2012 began with a 5.8% fall in the industrial sector's Social security enrolments, with all sub-sectors declining except Energy supply and water distribution and treatment and Manufacturing of transport equipment, which saw its enrolment grow by 4.2% compared to a fall of 5.1% in the previous quarter.

CONSTRUCTION AND REAL ESTATE MARKET

Construction activity continues to grow steadily in terms of new building licenses, with cumulative average annual growth to May of 111.5%, with a clear rebalancing between subsidized and free-market housing, with greater growth in the former (88.8% versus 62.7% on a YoY basis). Activity was focused mainly in the Hortaleza district, which accounted for 65.6% of all licenses for subsidized housing and 53% of free-market housing in the city.

Non-residential construction is recovering (with cumulative average annual growth to May of 2.8% and a YoY rate of 80.6%, driven by strong growth in parking lots (up 170% YoY by surface area to May) and despite the sharp drop in industrial surface area (99.5%), which leaves cumulative annual growth at +44.4% and -97.0% respectively. Construction for tertiary uses, in turn, grew 67.7% YoY, taking the cumulative annual rate to 15.9%), while the weak growth in civic facilities (3.6%) does not compensate for the poor performance in earlier periods, leading to a cumulative annual fall of 44.4%.

SERVICES

Financial system

With the process of financial restructuring still ongoing, the number of bank branches in the city of Madrid continues to decline, though at a somewhat slower pace than in previous months (the fall of 7.6% YoY in the fourth quarter of 2011 compares with 5.5% in the first quarter of 2012), very similar to the reduction registered in Spain as a whole (5.4%) and less than that experienced in the Madrid region (6.9%).

On the other hand, the volume of deposits again declined in the first quarter of 2012 (0.6%), albeit to a lesser extent than in Spain as a whole (1.6%). With respect to the volume of credit to the private

sector, the fall appears to have slowed, with no change on an average annual basis, compared to a fall of 0.7% nationally. This is not the case of mortgage lending, that falls 46.7% YoY. This decline is due both to the reduction in mortgage originations (down 39.5% vs 33.3% in the fourth quarter of 2011) and to the average amount (down 11.1% versus 10.4% in the fourth quarter of 2011), a bigger fall than the Spanish average of 3.7%, reflecting the greater fall in prices experienced in Madrid's housing market.

The Madrid Stock Exchange ended June with a 16.2% drop in the General Index since the start of the year, reflecting the high degree of uncertainty as to how the Spanish financial sector's solvency problems will finally be resolved, the tensions in the sovereign bond market and the confirmation of the deteriorating economic situation with the consequent impact on corporate profits.

Tourism

In the March-May period, the city's tourist figures have reversed the positive trend of the past two years. The number of visitors suffered a YoY decline of 1.7% and overnight stays fell by 2.7%. Unlike previous months, it was foreign tourism which experienced the greater decline (7.1% in the number of visitors and 6.8% in overnight stays), while domestic tourism grew 4.2% in terms of visitors and 3% in overnight stays.

The increase in capacity continues, although somewhat more slowly, with growth of 2.8%, 1.7% and 1.3% in the number of hotel beds in March, April and May respectively, and somewhat higher growth in the number of establishments (3.6%, 3.6% and 1.8% in the same months). This expansion, along with slowing demand, has led to a drop in occupancy levels, which fell by 8.1% compared with the same period in 2011. Employment in tourism, in turn, continues to show a slight downward trend, with a cumulative YoY fall of 0.8% in the January-May period.

Transport

The decline in traffic in Barajas airport, which started in 2011, has intensified. From January to May, passenger traffic recorded a cumulative YoY fall of 7.7%, with a sharp drop in domestic demand (16%), and, to a lesser extent, in international demand (3.1%). Freight was down by 9.1% to May on a YoY basis, weighed down by the sharp fall in national cargo (11.3%) and by international traffic, which has lost its dynamism and contracted 8.8%.

Urban transport declined by 1.7% on a YoY basis in the first quarter, despite the increases recorded in January and February (1.2% and 0.1% for bus passengers and 1.6% and 3.2% in the case of the Metro), due to the poor results in March, with declines of 8.5% in bus and 6.8% in Metro, though correcting for the fact that there was one working day less than in March 2011, these are reduced to 4.3% and 2.6%. Local train services, in turn, grew 3.2%.

1.3. Business dynamic

The first quarter of 2012 began with a YoY increase of 2.9% in the number of company start-ups, but a decrease of 0.4% compared with December 2011. With respect to closures, the average annual figures were similar to those of December 2011, but were down 1% in YoY terms, leaving the net increase in companies 0.5% below the December figure. With respect to Social Security enrolments, the accounts show YoY growth of 4.7%, due to the good performance of the services sector, the only one with positive growth, up by 5.9%, offsetting the contractions in construction (9.7%), industry (3.2%) and agriculture (2.5%).

Business confidence improved slightly in the second quarter of 2012, as reflected in the increase of one point in the Confidence Indicator to 26.6, though it lost 16 points compared with the first quarter of 2011. By sector, construction continued to present the lowest levels of business confidence (-50.7 points, 15.2 points worse than a year ago, although it is an improvement on the first quarter of 2012, when it stood at -53.6). The services sector suffered a further YoY deterioration, losing 17 points, though worsening by only 0.3 with respect to the confidence index in the first quarter of this year. In terms of the different business indicators, it is profits which show the greatest fall, with a score of -52 (ten points worse than in the first quarter and 32.3 worse than anticipated three months ago), followed by turnover (-48.5, 4.2 points worse than in the first quarter and 28.8 worse than expected) and employment (with a figure of -29 points, it improved 4.6 with regard to the first quarter but disappointed expectations by 6.4 points). The prospects for the third quarter of the year, although negative, offer some improvement over the second quarter, except in the case of sales prices. The largest improvement is in profits, where the negative score is expected to be reduced by 20.9 points, followed by turnover (18.5 points) and employment (10.6 points).

1.4. Demand

Retail sales in Madrid have continued to fall, although at a slower pace than in Spain as a whole, with an average annual decline of 5.4% in May, compared to 6% nationally. Furthermore, Madrid's consumer confidence index continues to deteriorate, standing at 24.2 points in the second quarter of 2012, 3.6 points below the figure for the first quarter. Employment in retailing also declined, though more slowly, with a YoY fall of 1.3% in May, compared with 2.3% in January and February.

Investment in capital goods has been slowing over the course of 2012, from an cumulative average annual growth rate of 5.5% in January to a decline of 2.7% in April, although this was lower than the national average (down 4.4%).

The good news is provided by exports, which are still on a rising trend, with a cumulative YoY increase of 10.5% in April; together with the stagnation of imports, this brought a substantial improvement in the balance of trade. By product type, it was exports of "other goods", "capital goods", "consumer manufactures" and "energy products" which showed above average growth, with cumulative YoY rates of 121.2%, 13.0%, 12.3% and 11.3%, respectively. On the other side of the scales were "motor vehicles", "consumer durables" and "foodstuffs", which declined by 9.2%, 5.7% and 3.4%, respectively.

1.5. Prices and salaries

The loss of dynamism in consumption, together with the easing of tensions in energy and raw materials markets, has translated into a fall in inflation, from 3.1% in 2011 to 2% in the first five months of 2012. The continuing fall in consumption, arising from the economic recession and poor job expectations, along with some predictable declines in energy and raw materials prices as a result of the global economic slowdown, point to a decline in headline inflation to levels of 1.8% for the whole of 2012, and 1% in the underlying indicator, with additional falls in 2013, to 1.1% and 0.7% respectively.

Industrial prices in Madrid rose faster than at national level, with a YoY rise of 4.4% April versus 3.1%, although the increase has moderated from the figure of more than 6% recorded in 2011. With regard to the housing market, the fall in prices in the city continued, with declines of 12.3% in new housing and 10.9% in used dwellings, higher than those in the Madrid region (by 1.2 and 0.8 percentage points respectively), and the national average (by 3.1 points in both cases).

Finally, labour costs in the Madrid region picked by 3.5% in the first quarter of 2012, increasing the differential with Spain as a whole, where the rise was 1.1%, taking the differential to €483/month.

1.6. Labour market

During the first quarter of 2012, the Madrid labour market maintained the weakness seen in recent months, with a YoY decline of 4.4% in the number in employment. There was notable growth in employment among non-salaried workers, with a YoY rise of 4.7% compared to the double-digit declines recorded throughout 2011. This could be due to the adoption of self-employment by those losing their wage-employment (which fell by 5.5%), opting for entrepreneurship as an alternative employment. By sector, industry remains the only one with a positive YoY variation in the number employed, 11.1% in the first quarter of the year, 1.8 points better than

the increase recorded in the fourth quarter of 2011. On the other hand, the EPA (labour force survey) data for the first quarter of 2012 show a YoY increase of 3.9 points in unemployment, taking the jobless rate to 17.7%.

The Social Security enrolment data for June surprised on the upside. Whereas the forecast was for a contraction in enrolment of almost 1.3%, the outcome was only 0.3%. The reasons behind this lie partly in the new regime for domestic workers, which has led to the regularization of thousands of jobs. However, the economic recession leads us to forecast a fall of 0.8% in enrolment in the city for the third quarter, once this effect has run its course. The June data for registered unemployment have also surprised, with less growth than originally expected (10.5% versus the estimated 11.6%). However, behind these relatively good data lies the "discouragement" effect in the search for employment, the exhaustion of unemployment benefits (reducing the incentive to renew the registration as a job seeker), and even emigration in search of employment. Our forecasts for registered unemployment for the next three months show a slight increase from the 10.5% registered in June to 10.9% in September.

2. Monographic report

SPATIAL AND SOCIAL TRANSFORMATIONS IN THE URBAN REGION AND CITY OF MADRID AS A RESULT OF THE CHANGE IN PRODUCTIVE MODEL

During the past decade, Madrid has managed to position itself as the main link between the Spain and the global economy, concentrating a significant part of the activities of the senior management, administration, and technical and marketing services departments of the leading Spanish companies. At the same time, it has also experienced a profound spatial and social transformation.

In addition to the substantial creation of employment in the tertiary sector, highlights the dynamic and effective economic specialization in advanced services, characteristic of the new production model, creating the City of Madrid 140,942 net jobs linked to this sector between 2000 and 2007.

From a spatial point of view, the city has experienced a process of business decentralization toward the metropolitan periphery in search of better access by car, lower prices and greater availability of space, as well as the "corporate campus" phenomenon. Thus, only 12% of licenses granted for office use were for the city's central districts.

With regard to the retail sector, two phenomena should be highlighted. Firstly, the development of large shopping and leisure centres between 1995 and 2012 in out-of-town locations well communicated with the main highways or next to new residential developments. Secondly, the increase in commercial establishments in the city centre and the emergence of new areas (such as Triball, the area around Fuencarral Street). In conjunction with this reformulation of the traditional city centre, there has been a major expansion and renovation of the city's hotels and facilities for tourism, culture, leisure, and gastronomy¹.

With respect to trends in the residential sector, the real estate boom has given the lie to arguments that promised that housing prices would fall as the supply increased, and, especially, to the excessive classification of land through 'planning to the capacity limit' models. Moreover, "the current economic difficulties, particularly in relation to the new build sector, with medium-long term forecasts of economic activity very far removed from those of previous years,

¹ Ayuntamiento de Madrid (2011) "Evaluación del Plan General de 1997", p.225. http://www.madrid.es/UnidadWeb/Contenidos/Navegaciones/PGOU/Legislacion/EVALUACION_PG97_may12.pdf

raises an important question about future town planning with respect to the possibility of carrying out the 1997 General Plan for the south-eastern outskirts. This applies to the new build capacity in the districts of Villa de Vallecas and Vicalvaro, approximately 12,250,000 sq. m. for residential use (130,000 dwellings), 8,200,000 sq. m. for industrial use and 2,900,000 sq. m. for tertiary use".

The city's social space is undergoing an intense process of reorganization as a result of various circumstances, such as ageing, population loss, the replacement of the Spanish population by immigrants, the migration of young middle class people to new urban developments on the outskirts or to existing urban areas undergoing renewal, the expulsion of poorer populations to other spaces, etc. The ultimate significance of these processes is not clear, because in many cases they are occurring simultaneously within districts or neighbourhoods, offsetting each other and making it difficult to extract conclusions from the resulting figures at district level.

In any case, several processes can be confirmed. First, the increased complexity of the social map; such complexity is in general unstructured and very segmented even at local level, since the very different income levels tend to constitute separate and relatively impermeable realities, maintaining distances through prices or even physical barriers such as infrastructure, inaccessibility, urban introversion or defensive architecture. Second, the progressive trend towards segregation at the top end of the real estate market, which then cascades down, as reflected, for example, in the increase in new housing prices in lower income areas. Third, the absence of proper mechanisms to regulate a housing market which has shown, in addition to its inefficiency in meeting the population's real housing needs, its perversion as an instrument for dispossessing non-owners and the lowest income sectors in favour of the financial and real estate sectors, and in the end its fall has brought down the whole economy.

IS THERE A MARKET IN INDUSTRIAL REAL ESTATE IN A SERVICES CITY LIKE MADRID?

The city of Madrid has been able to maintain important productive activities anchored in the "real" economy, especially in a good part of the services sector, and has maintained an economic structure in which technology-intensive activities with strong demand still play an important role, in addition to a diverse productive sector based on a constellation of small and medium-sized businesses with proven capacity to survive

One of the best ways to appreciate this facet of the urban economy is by studying the local industrial real estate market on different spatial scales of analysis. The key conclusions of this article are the following:

1. Despite the crisis, Madrid's industrial real estate market maintains a significant position in the European context. This fact partly contradicts the tendency of many local actors to view productive activities in the city as an annoyance, destined to disappear in the medium to long term.
2. Economic cycles, which largely determine the demand for land for productive activities, are not harmonized with those of town planning, with its capacity to put new land on the market. Thus, in the midst of the recession, there are many new facilities for industrial use in an advanced stage of design, planning and administrative approval, but their real possibilities of final execution remain uncertain. Spaces as "La Atalayuela" with 73 Has., or "Los Cerros" in Vicalvaro with 24 Has., are left dormant, awaiting a new period of economic growth to unlock the development of buildings housing some kind of productive or logistical activity on their land.
3. Industrial real estate products - land and buildings - in the city of Madrid as a whole are no more expensive than in the other municipalities of the metropolitan area. For this reason, it would be necessary to revisit the simplistic interpretation that the price of land is the fundamental factor behind the expulsion of productive business activities from the city.
4. Among the industrial zones most valued by investors as a safe haven in times of crisis are the districts with the strongest industrial tradition such as San Blas, Villaverde, Vicalvaro and Puente de Vallecas, though investor interest is not so focused on the occupation and development of construction projects on these holdings in the short term.
5. There is some over-supply of medium and small industrial buildings which, although better suited to the demand arising from the leading role of SMEs in Madrid's economic structure, cannot be acquired due to the lack of access to credit. In contrast, thanks to the ample availability of land prepared for productive activities and logistics in the outlying districts of the south-eastern arc, there may be an increase the supply of large industrial spaces appropriate to the

requirements of large companies and investment funds looking to take advantage of the capital's excellent communications at very low prices.

6. The territorial complexity of large cities requires a precise analysis to identify enclaves with a seemingly contradictory spatial role (peripheries in central spaces and new centralities in peripheral spaces). This complexity, together with the redefinition of many economic activities as a result of a more knowledge-intensive orientation, makes it necessary to revise the meaning of the relationship between many of the economic establishments and the urban space in which they are based. This implies a new industrial environment, highly integrated with the provision of advanced services and globally interdependent, both for inputs and for markets¹. This new scenario, combined with the scarcity of credit for new developments, by and large signals the end of spatial localization strategies based mainly on price. On the contrary, it provides us with a new opportunity to allow the principles of rationality to take precedence in spatial location, taking into account the medium and long-term profitability and the viability of projects to develop spaces dedicated to productive activities.

¹ Castells, M. y Hall, P. (1994): *Tecnópolis del mundo: la formación de los complejos industriales del siglo XXI*. Alianza Editorial, Madrid