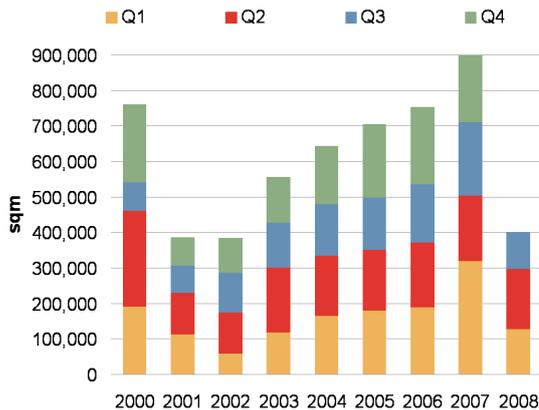


Madrid office market

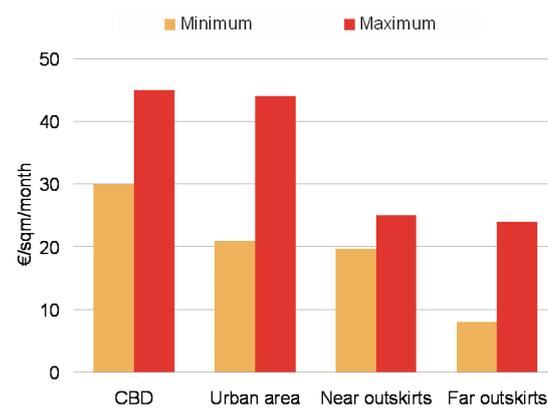
Autumn 2008

Annual take-up



Source: Savills Research

Asking rents for exclusive office buildings



Source: Savills Research

“The uncertainty in the financial markets and the inflexibility in the supply of credit are slowing down the investment market even more. The adjustment in yields continues and we expect them to reach levels that were unthinkable a few months ago”.



Rafael Merry del Val - Head of Savills Spain

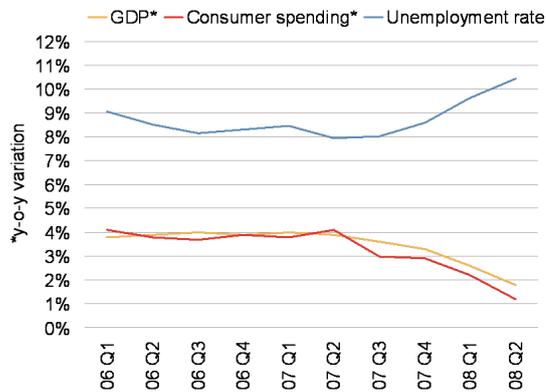
- The national economic indicators hardly paint an encouraging picture. The fall in household consumption, the reduction in the consumer confidence index and the continuing increase in unemployment levels are some of the most worrying aspects for the general public. On the plus side, the latest CPI figures are showing some moderation and we have seen the first signs of a reduction in the Euribor rate.
- The office occupier market continues to demonstrate signs of prudence and austerity. During the third quarter, take-up was just over 105,000 sqm, made up of around 100 transactions, similar to 2002 levels.
- Reduced demand dynamics have kept levels of supply stable. On the other hand, the reduction in take-up of vacant space has resulted in a slight increase in the vacancy rate, which now stands at 6.45%.
- The annual rental increase in Madrid was 3%, although we are starting to see differences in performance between Prime and peripheral zones.
- The investment market is blaming the lack of liquidity and the difficulty in obtaining credit for the falling transaction activity. The total transaction volume between January and September, excluding the BSCH transaction, is some 45% lower than for the same period last year.

Economy

Spanish economic situation

Far from letting up, international economic uncertainty has increased over recent months. The financial crisis, which started last summer in connection with the problems related to sub prime mortgages in the USA, has started to claim victims on both sides of the Atlantic. Such victims include large, symbolic companies (investment banks, insurers, mortgage companies), and as a result, unprecedented rescue packages have been approved in several countries (including Spain). Over the coming months we will be able to gauge the effectiveness of these measures and their impact on international macroeconomic data, which are themselves uncertain.

GDP, consumption and unemployment



Source: INE

In the meantime, the majority of economic indicators in Spain are still deteriorating. In the second quarter (Q2) of 2008, annual national GDP growth was 1.8%, eight decimal points less than in the previous quarter; inter-quartile growth was only 1 decimal point of a per cent, which is near enough stagnation. Nonetheless, these figures are better than for the remainder of the Eurozone, where annual growth is 1.4% and quarter-on-quarter growth is -0.2%.

Domestic demand once again reduced its contribution to GDP (1.5%, compared with 2.8% in Q1 2008). Once again, the main cause was the significant slowdown in household consumption, with annual growth of 1.2% - a reduction of one point compared to the same figure in Q1 2008. Even though consumer confidence improved in August, it dropped again in September (49.5 points), which leaves it only slightly higher than in July (a historic low at 46.3 points). The reduction in investment was more severe, especially in the construction sector (-2.4%). With regard to supply, the standard decrease in construction over the past few months (a reduction of 1.9% quarter-on-quarter) matches that of the industrial sector: added value within industry showed an annual decrease of 2.8%.

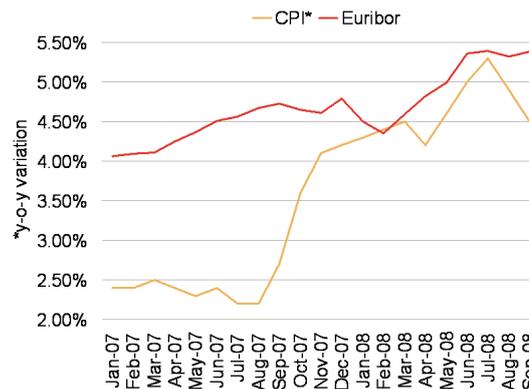
The service sector had better results, with an annual growth rate of 3.7% this quarter.

The unemployment figures are particularly negative: for years Spain seemed to be aligning itself with its European neighbours in the labour market, but it is once again moving further away with an unemployment rate of 10.4% in Q2 2008. The outlook is worse if we look at the latest monthly figures from Eurostat, which shows the unemployment rate in Spain at 11.3% in August, compared with just 7.5% in the Eurozone.

The inflation rate in Spain had a small respite in August, when the level dropped to 4.9%, down from 5.3% in July, mostly due to the drop in oil prices; the continuing trend of decreasing inflation continued into September, when the rate was 4.5%. The same cannot be said for the 12 month Euribor rate, with an average of 5.38% in September, one hundredth of a point off its historic high in July.

With its own problems and contributing factors, Spain finds itself in an international economic-financial crisis, more complex than ever seen before, the implications of which are hard to imagine. We will probably see further drastic measures such as those already taken (enormous injections of liquidity, state intervention, joint reductions in interest rates across the world), that aim to mitigate the adversity of the current situation.

CPI and Euribor



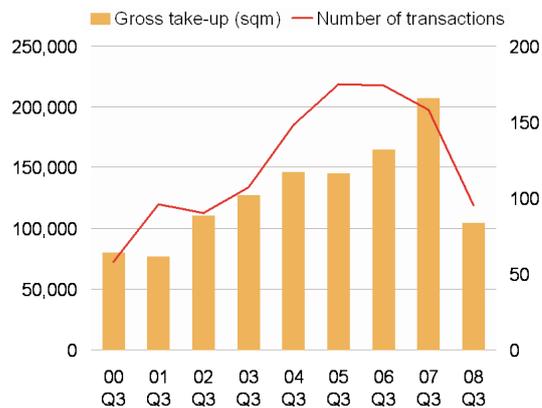
Source: INE

Demand

The holiday break has affected the office occupier market

Demand levels have slowed down over the summer months. But is this reduction really just down to the normal quiet holiday period? Or are companies now adapting to the new maxims of moderating expenses and optimising resources? Quarterly take-up was just over 105,000 sqm, nearly half the amount for the same period in 2007. Compared to historic data, the figures from the last two quarters are at 2003-2004 levels, the first years of recovery following the market shake up caused by the collapse of several technology companies, known as the “dot com crisis”. But to find figures comparable to current levels, we have to look back to 2002.

Take-up and number of transactions - 3rd quarters



Source: Savills Research

We can analyse the details of deals closed in order to test the market’s pulse. The fact that only one hundred transactions have been closed over the last three months gives a very strong indication of the cautious approach shown by the business world when facing moments of uncertainty. Recently we have been forced to look back to historic data from 2002 to find similar levels of transactional activity. An analysis of the floor space taken up in these transactions confirms the feeling of caution and austerity amongst SME’s – considered to be the market drivers – since the percentage of transactions below 500 sqm makes up just over 50% of the total, whereas we would normally expect this level to be around 60-65%.

Another symptom that shows companies are cutting costs is the increase of deals signed in mixed-use buildings. Although buildings in exclusively office use account for the large majority of transactions both inside and outside the M-30, the proportion of office transactions for residential buildings within the ring road has increased by 15 percentage points, and is now at around 45%. If we focus our analysis on areas adjacent to prime spots, this percentage increases to 53%. Those companies opting to move headquarters

within the city have decided to prioritise lower rents above the enhanced corporate image or increased technical & technological services offered by exclusively office buildings, as the price differential is between 20-25%.

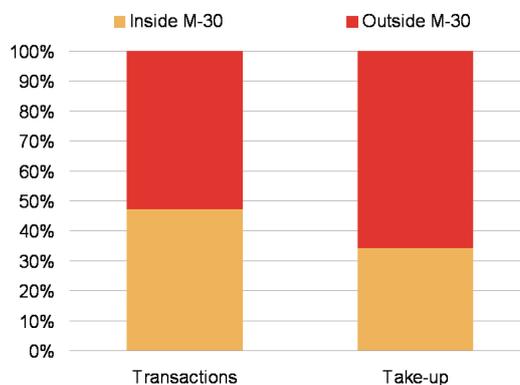
In the global market, sales to end-users have been particularly affected, since only 7% of all transactions were sales. Problems with gaining access to credit and the generally pessimistic market outlook have put paid to a large number of transactions.

A notable positive aspect is the number of pre-lets that have been signed in buildings that will come on to market within the next year.

There are no surprises when it comes to the geographical distribution of transactions. The city centre still boasts the highest number of transactions, whereas the areas outside the M-30 are still home to the largest transactions. A large amount of take-up has occurred in the north-eastern market segment, representing some 50% of total market transactions both in Q3 2008 and for the year to date from January to September.

Public bodies have shown very limited activity. Only the Regional Madrid Government has signed up space in one of the new buildings in the Polígono de Alcobendas estate, and two other entities associated with the state have just moved into offices in areas where they were originally based years ago (Orense and Julián Camarillo). Torre Espacio has been chosen as the headquarters for another embassy. In addition to the diplomatic offices of the United Kingdom and Australia, Canada will also be moving to the CTBA (Cuatro Torres Business Area).

Transactions and take-up in respect to the M-30 (accumulated 2008)



Source: Savills Research

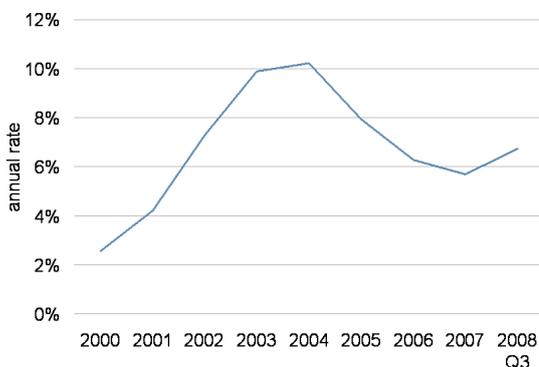
Supply

Vacancy rate stability

The almost 800,000 sqm of vacant office space on the market puts the vacancy rate in Madrid at 6.45%.

A rise of less than 1% compared to the amount of vacant space registered in July shows the lack of activity being carried out in the office market in the capital. The amount of new vacant office space that came on to the market did not even reach 17,000 m² and there has been little occupier movement.

Annual vacancy rate



Source: Savills Research

The addition of new developments has barely affected the total volume of office space. In addition to the afore-mentioned vacant space there are a further 22,000 sqm where tenants have recently signed agreements with landlords. That makes approximately 40,000 sqm more of space in the Madrid office market, which represents an increase in total stock of some 0.5%. Delays in the delivery of schemes under construction are becoming more commonplace, which will mean that changes in the vacancy rate will be slow and moderate.

We expect the year to close with some 300,000 sqm of new office space in the market, though we obviously have to wait until the end of the year to be sure of the exact figure.

Another important factor regarding the rapid change in the vacancy rate is the marketing of buildings due to come onto the market very shortly. The global economic and financial situation, as well as the office market, is tangibly different from that in recent years but, despite this, we are still seeing pre-lets and turnkey projects – albeit to a lesser extent.

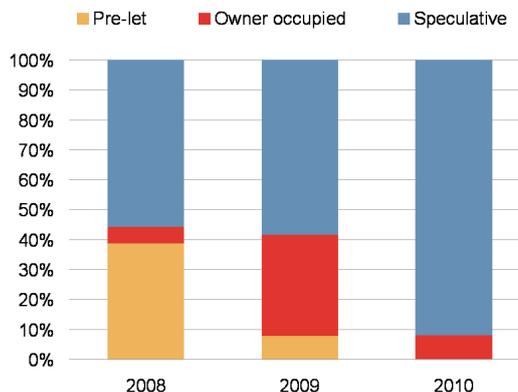
New developments

Delays in the completion of schemes under construction are becoming commonplace. The lack of liquidity to keep projects moving forwards is leading to delays in completion of some schemes. In addition, the current state of uncertainty is prevalent throughout the market, and is discouraging other developers from exposing themselves to further risk and undertaking new developments. The significant decrease in the number of pre-lets and the slowdown in take-up of completed schemes are two key factors when considering whether to embark on a new scheme. But although many developers have erred on the side of prudence and caution, others are aware of the cyclical nature of the market. Therefore those developers who are not in serious financial difficulty believe that the delivery of new schemes into the existing office stock will coincide with the last stage of this period of downturn and the beginning of the next phase of expansion.

Currently, some 450,000 sqm are expected to be delivered in 2009, of which 8% is already pre-let. This small percentage is in stark contrast to figures for recent years – 37% in 2008 and 52% in 2007. The total amount of new vacant space is balanced out by space that will be owner-occupied. Nearly one third of new space is being developed for owner-occupation.

The distribution of new space within and outside of the M-30 has been “altered” by the delay in delivery of two of the towers in the new business complex on la Castellana. The remaining city centre developments consist of comprehensive refurbishments to update and modernise the buildings’ technical specifications, thus making them more competitive when compared to other buildings in their catchment area. The Julián Camarillo district will contain a large amount of new space, some of which is already owner occupied or has pre-let agreements in place.

Future supply



Source: Savills Research.

Rents and transactions

Positive growth, but very modest

Overall, Madrid's office market is riding out the storm. Analysis of rents agreed between July and September is still positive, with an annual growth of 3%. However, each different business area has its own individual characteristics.

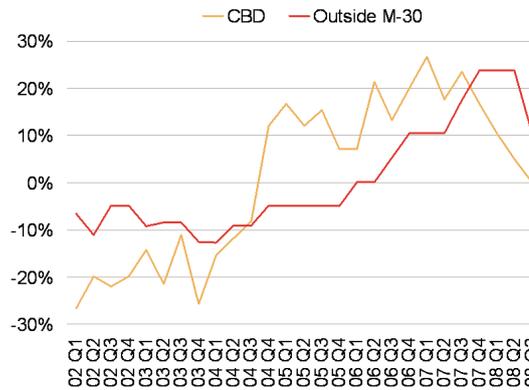
Broadly speaking, the prime office area and the highly consolidated business parks are able to deal with harder market conditions. The lack of available space and the sustained level of demand help to maintain market rental levels, although on many occasions these rents are compensated by other negotiations with the landlord, such as extended rent-free periods. In the near periphery, newly delivered buildings or those about to come onto the market have proven resistant to the current market difficulties. These buildings have become unique products thanks to modern design, incorporating the latest technical and technological advances, and in many cases using systems that optimise the use of natural resources. This means that the buildings are fully adapted to current office occupiers' requirements, therefore maximising the rents payable in those locations. It is a rather different story in areas further away from the city centre, which are far more sensitive to changes in the market cycle. There have been slight rental reductions in areas that tend to react directly to supply and demand constraints, but we are also witnessing rental adjustments in business districts whose rental levels have risen exponentially in the past, for no apparent reason.

It is a similar story for asking rents. The CBD and its surroundings, as well as some of the business parks within the most central part of the market, have revised their asking rents upwards. This is a simple marketing strategy by the landlords, aiming to gain a greater margin for negotiation, though we must wait and see whether rents reach these desired levels. There have been rental reductions in areas with vacant obsolete buildings, or with buildings that make it difficult for the occupier to optimise their use of the space.

The highest achieved rent was on the Paseo de la Castellana, in a building whose owner typically fixes rents above market values, so we have therefore excluded these transactions in our market analysis. As in the previous quarter, no transactions have been closed this quarter in the CBD, apart from the aforementioned transactions, but market feedback suggests that rents range between 40-42 €/sqm/month.

The maximum asking rent in prime areas, once again excluding isolated cases with clearly overvalued rents, has been set in the Standard Life building (Paseo de la Castellana, 55; CBD), reaching 45 €/sqm/month, which reflects a 10% increase on rents in recent months. Outside the CBD the maximum rent is in the tower owned by Mutua Madrileña in the CTBA. The asking rent on the upper floors is 45 €/sqm/month.

Prime rents evolution



Source: Savills Research

Major leasing transactions

Tenant	Area	Size (sqm)	Sector
Cheque Gourmet	Alcobendas	3,100	Business services
Confidential	CBD	3,500	Confidential
Orizonia	Arroyo de la Vega	6,000	Business services
Group M	A-6	7,000	Business services
Confidential	PAU's Norte	10,500	Energy
Confidential	East	12,500	Telecom.

Source: Savills Research

Major investment transactions

Buyer	Area	€m	Building
Grupo Rosales	Urban area	60	Banco Popular HQ
Inmobiliaria Alhambra	Urban area	44	Goya, 29
Familia Hinojosa	A-6	39 (*)	Ática
Confidential	CBD	25	Paseo de Recoletos, 22

Source: Savills Research (*) estimated investment volume

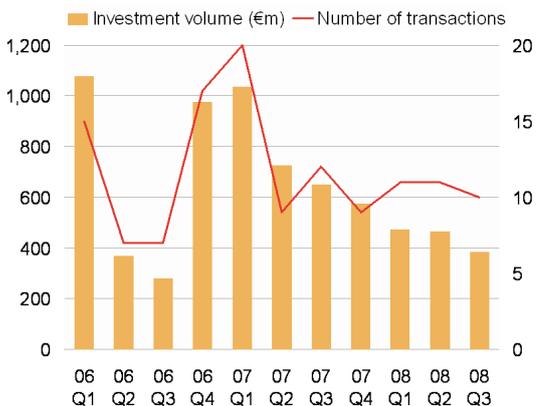
Investment market

Little news on the investor circuit

Some of the factors that have directly impacted Madrid's office investment market include the slowdown of the economic indicators, the downturn in the financial system and the lack of dynamism from end users.

There have been 10 transactions in Q3 2008, which is very similar to levels from this time last year, but we must point out that downward price adjustments are having an effect on the total amounts invested. Between January and September only around 1,300 million Euros were spent. However, we have excluded the transaction in the BSCH Ciudad Financiera, since the unique nature of the deal would distort the real estate of the market. Therefore the total investment volume for the first nine months of 2008 is 45% lower than for the same period last year. The sudden slowdown in investment expenditure is directly linked to the reduced availability of liquidity in the market, and the difficulty in gaining access to credit.

Investment volume and number of transactions



Source: Savills Research

The assets currently available in the market are still either outside the city centre, or are secondary buildings within the city. The market players taking on this type of transaction are therefore small investors or national developers who have reduced or totally stopped their activities in recent years owing to the high prices. Now, as these owners align the value of their assets to market values, investors with cash in the bank have been able to acquire well located properties in the city centre, with good quality tenants or with an imminent rent review before the downwards cycle starts.

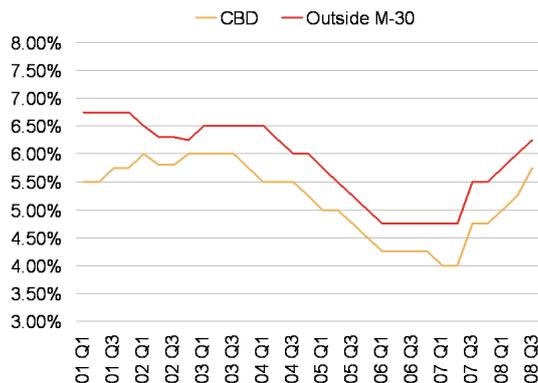
Foreign funds are still interested, and some agreements have already been reached on prime office buildings outside the city centre. There is a clear difference between institutional funds, who are displaying a state of alert and extreme caution, and the

opportunistic funds that, like national investors, are now analysing the properties at "sale" prices. Some of the German funds have been severely affected by recent events in the German finance markets. The lack of liquidity has stopped many from investing, but even those that are still active have drastically reduced their rate of purchases.

Metrovacesa has played a significant role as a vendor. The Phoenix plan (plan Fénix), with which it aims to disinvest its non-core assets, is continuing to reduce the company's debt. Metrovacesa started the year with the sale of a building in the Moncloa district, and its most recent sale related to a building on Paseo de Recoletos. Grupo Banco Pastor has also put several of its assets on the market, albeit with the intention of securing funds to construct its new headquarters at the start of the A-2. As of very recently, the bank's corporate headquarters at the junction of Velázquez and Goya, and the headquarters of Banco Popular Hipotecario, in the Fuencarral business district, have new owners. The bank will occupy the buildings for approximately four years, which will guarantee income during the years when the market is in recession.

A cross-sectional look at the market shows that, unlike in recent years, many buildings are now up for sale. The number of potential buyers has reduced considerably, since the restrictive conditions of the credit market or, in some cases, the blocking of finance, have taken some of the real estate giants off the field of play. So why are deals not being closed? The problem revolves around buyers' and sellers' expectations still being a long way apart. These differences are decreasing, and yields are improving in the buyers' favour.

Prime yields



Source: Savills Research

Yields and outlook

Yields continue to rise

The summer break has not stopped yields from increasing. In previous analyses, the quarterly yield shift in the CBD was around 25 basis points, but the increase between June and September was some 50 basis points, i.e. prime office yields on the Castellana are now at 5.75%. This figure is not based on any specific deal, but our analysis of market sentiment leads us to this estimate.

Worsening economic expectations for Spain in 2009

In their September forecasts, the economic and financial entities, studied every month by Consensus Economics, have taken into account the bad results for investment in fixed assets and industrial output from Q2 2008, substantially reducing their estimates for these two variables. They forecast an annual fall of 0.5% and 2.5% for investment in fixed assets in 2008 and 2009 respectively, and falls of 2.6% and 1.5% for industrial output in the same years. Forecasts for GDP growth and domestic consumption have also been reduced for 2009, with growth of 0.5% and 0.3% respectively. Forecasts for 2008 remain similar to those of the previous Consensus (in August), with GDP growth of 1.4% and household consumption growth of 1.0%.

Spain - Economic forecast (y-o-y variation)

	2006	2007	2008	2009
GDP	3.9%	3.8%	1.4%	0.5%
Consumer spending	3.7%	3.1%	1.0%	0.3%
CPI	3.5%	2.8%	4.5%	3.2%

Source: Consensus Economics

It is believed that the small inter-quartile growth of the national economy in Q2 2008 is mostly due to the increase in public spending and export figures, which should decline as export demand in the current international climate reduces. In turn, domestic demand will be impeded by the halt in real estate and poor household consumption, resulting in a prediction that inter-quartile GDP growth will become negative in Q3 2008 (-0.3%).

With regard to the consumer price index, expectations are still for a gradual moderation (growth of 4.5% and 3.2% in 2008 and 2009 respectively), though these levels are still high when compared to the remainder of the Eurozone.

Clear reduction in annual take up rate

The end of the expansion phase is getting closer, which will result in a reduction of take up rates, an increase in vacancy rates and a rental adjustment that will be most severe in unconsolidated zones and those furthest away from the centre of the market.

Bearing in mind that the market is usually more active in Q2 and Q4, we will keep to our estimated transaction volume of approximately 550,000 sqm for 2008, with corresponding upwards adjustments as and when further large deals come to light over the next few months. This represents a reduction of 35-40% compared with 2007 levels. It seems that both the current state of the economy and the blows delivered by the global financial system will affect some companies' expansion plans, since many have already decided to scrap their search for a new headquarters, or at least put it on hold. On the other hand, many of the large space requirements that were in place at the start of the year are still active in the market, given the difficulty of finding space suited to the company's requirements.

Yields on the increase

The significant differences in price expectations between buyer and seller that existed at the beginning of the year are slowly being reduced. The more shrewd owners have signed deals before prices drop further. Those that rejected offers now face reductions of up to 40%.

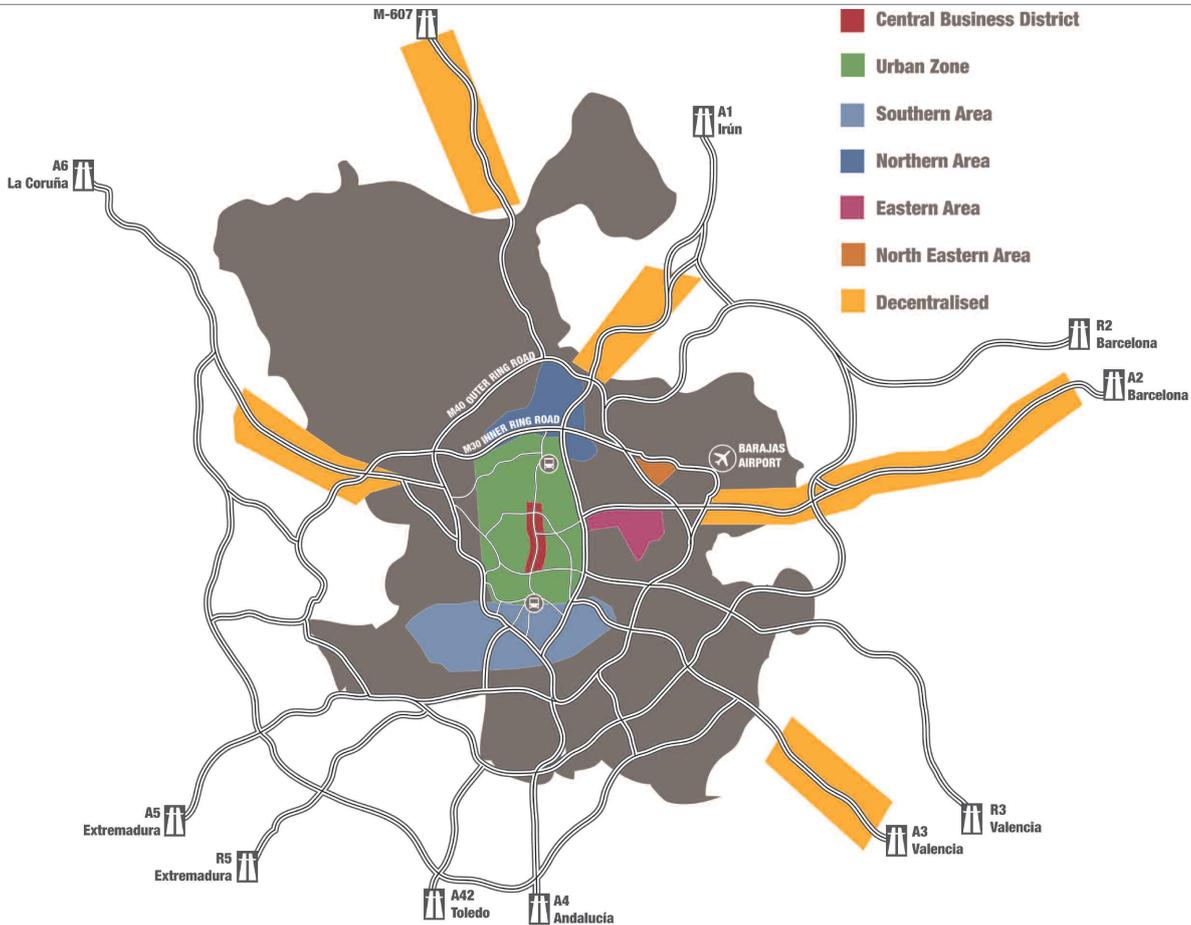
The arrival onto the market of the "jewel in the crown" of some key national investors, which up until now have been safely locked away, could increase the annual sales volumes, since prime buildings in prime areas at current market prices provide a more than attractive opportunity for the foreign funds that have kept their sights firmly set on Madrid.

Yields are continuing their upward trend. The readjustment of prices will be evident in the final months of this year and will continue into early 2009 until the market reaches equilibrium.

We will reach levels that were unthinkable only months ago. The market is moving firmly towards 6%, which is expected to be seen on the Castellana before year end, when the international investors will come flocking. In the first few months of 2009 there will be deals closing at 6.5% in the CBD.

Madrid office market map

Survey map



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