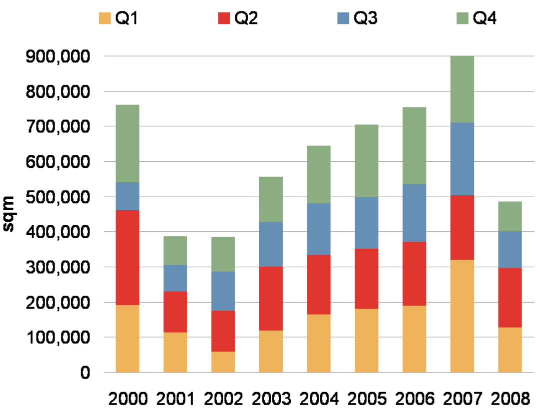
Madrid office market

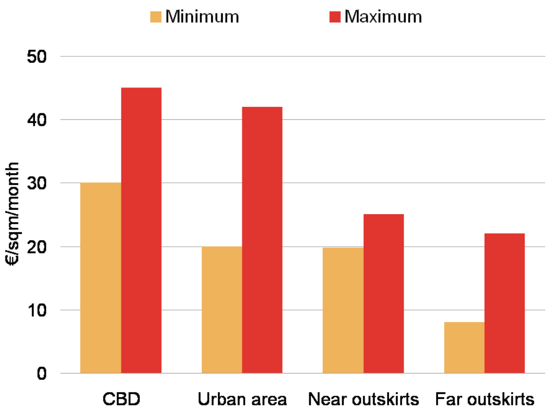
Winter 2008-2009

Annual take-up



Source: Savills Research

Asking rents for exclusive office buildings



Source: Savills Research

"The recovery of the activity in the market will depend on the banks being confident enough to provide access to credit. Price adjustments will continue to push up yields, which will attract again foreign funds that previously pulled out of the Spanish market back into the country".

Rafael Merry del Val - Head of Savills Spain

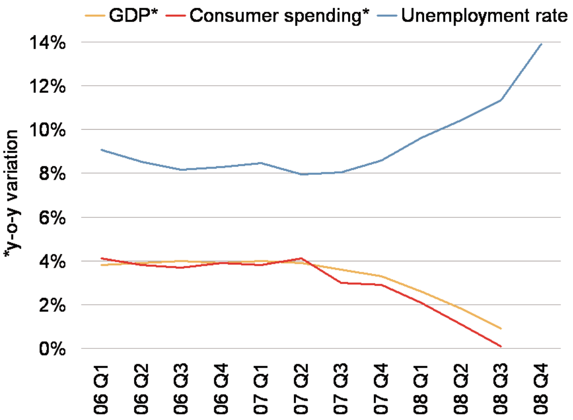
- Turbulence in the national economy: GDP suffered a quarterly decrease in the third quarter of 2008, stock markets are registering their worst results over the last few years and the unemployment index is one of the highest in the European Union.
- Annual take-up of office space did not reach expectations. Take-up has not passed 500,000 sqm, which represents a 46% decrease compared to take-up in 2007. The fourth quarter has been unusual, as it has been the poorest performing quarter of the year.
- Increasing vacancy rate. We are on the way to reaching one million sqm of empty office space.
- Up until now rents have remained stable, although they are beginning to show symptoms of falling in out of town areas. The lack of demand and the increase in available office space will favour a change in the rental cycle. Rental decreases will be more pronounced in areas furthest from the city centre, which have had large volumes of empty space on the market for several months now.
- 1,400 million euros processed in the capital's investment market, which is 47% less than the volume registered in 2007. The main players have been Spanish companies, both in terms of buyers and sellers. There are good investment opportunities in the market (although one has to look for them), but the lack of financing is becoming a widespread problem and is making it difficult to carry out some transactions.

Economy

Spanish economic situation

As 2009 begins we are embroiled in an international economic crisis which is expected to create a sharp decrease in the main macroeconomic levels in the large majority of western countries, including Spain. The serious financial roilings over the past year will then go on to culminate in a considerable contraction in the economy, which is now visible in the decrease in domestic products and in the rest of the supply and demand variables, as well as an increase in unemployment.

GDP, consumption and unemployment



Source: INE

The outlook for the Spanish economy in 2009 is not promising, if one considers the predictions of the national and international independent experts, as well as Spain's own government who, in January, readjusted their estimations for GDP growth downwards to -1.6% and increased the unemployment rate to 15.9%. These are much more pessimistic figures compared to those provided a few months ago.

Data from the third quarter of 2008 registers a two tenths quarterly decrease in Spain's GDP, reaching an annual rate of 0.9%, nine tenths less than in the second quarter. The quarterly decrease was the same as the rest of the eurozone, which rose at an annual rate of 0.6%: leading to greater convergence.

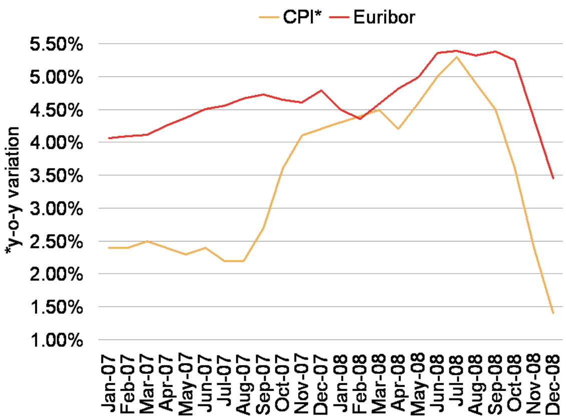
The contribution of the domestic demand was at only 0.1% compared to 1.5% in the previous quarter. Household spending continued to slow, rising by an annual rate of 0.1%, which implies a drop in growth of one percent compared to three months ago. If one agrees with the ICO confidence index, consumer expectations do not bode well for a quick turnaround. For its part, fixed gross capital creation particularly suffered, falling by an annual rate of 3.2%, mainly weighed down by the fall in investment in construction (-6.4%).

On the supply side there has been a general deterioration on all levels with the exception of non market services, even though general services grew six tenths less than in the second quarter. Again, the construction sector leads the way, with a 5% annual decrease; the residential real estate market continues to break records in terms of negative price variations, negative transaction volumes and negative numbers of new build projects.

The current situation is reflected in the hardships of the labour market: the unemployment rate at the end of the year reached 13.91%, continuing the marked increase seen at the end of 2008 and this is expected to continue over 2009. However, inflation figures have brought some light relief to this situation. Inflation saw considerable increases in the first half of 2008 reaching 5.3% in August, but finished the year at 1.4%.

Even though official data for the last quarter of 2008 has not been published, we can be sure that Spain is now in a recession which will go on to become worse in 2009; this will also be the case for other surrounding countries. Each states's quick and synchronised international monetary and fiscal policies have attempted and will continue to attempt to counteract the intensity, effects and duration of this intense economic crisis which has reared its head as a serious challenge after many years of international growth.

CPI and Euribor



Source: INE

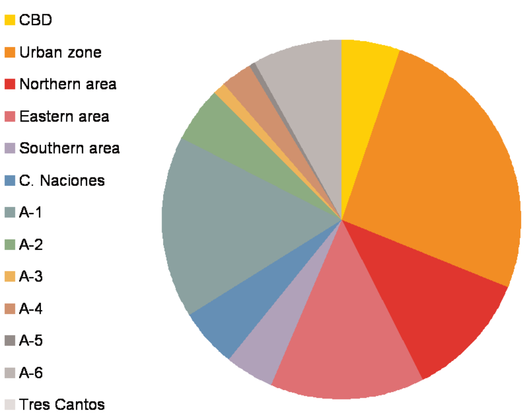
Demand

“Psychological barrier” of 500,000 sqm not reached

The registered annual results in the Madrid office market confirm the slowdown in the sector. The fourth quarter registered the lowest amount of take-up in 2008, touching around only 90,000 sqm (one has to go back to 2001–2002 to find a fourth quarter result below 100,000 sqm). Therefore, the annual total is at 490,000 sqm, which is a 46% reduction compared to levels reached the previous year. Demand has also fallen, although at lower levels than actual take-up, at 41% less than the almost 900 transactions signed in 2007.

Comparing take-up across the four quarters of 2008 one can see that there has been a notable reduction in the second half of the year (we must take in to consideration that the more than 300,000 sqm registered in March 2007 were an unusual phenomenon, given that several large transactions were finalised that had “dragged on” from the previous year). In the second quarter, although the amount of take-up was less than the previous year, the difference was only a fall of 8%. It could have been that worries surrounding general elections were calmed with the confirmation of the continuation of the current administration. But as more economic indicators came to light and national government’s and international organisation’s economic forecasts were revised downwards, a lack of confidence took hold in all areas of society.

Geographical distribution of the take-up - 2008



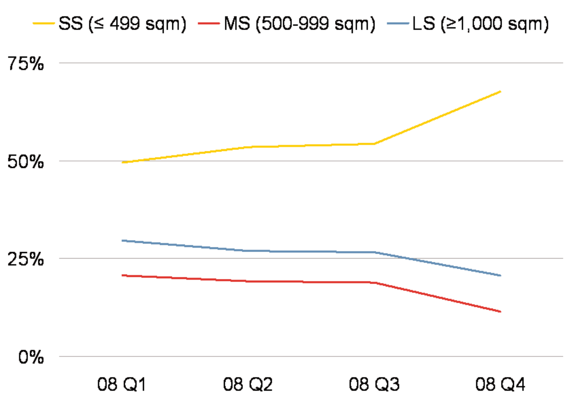
Source: Savills Research

The uncertainty about the economy, the hold up of expansion plans, reductions in personnel and cost cutting policies are some of the factors that are directly affecting the office occupier market. The question right now is: what will those companies that now see that they have too much space, do in the coming months?, and what will those who’s contract is about to finish do? Not long ago the reaction would have been to look for a new office, but now there is the option of renegotiating the rent with the landlord, although in many cases the first option works out as more expensive due to relocation costs. Obviously, not all companies take this option and if in previous studies we mentioned the continued fall in transactions signed in the small office space sector (<500 sqm), between October and December the percentage had nearly reached 70%. In boom years we have used this figure as an indicator of how healthy the business sector is, as these are generally the types of spaces required by small and medium enterprises, which are considered to be the economic drivers, and the first to detect and suffer from poor micro and macro economic results. Today, the sudden increase in the range of small office spaces on the market has come as a direct consequence of a fall in the other two categories, which we interpret as an adaptation to office space needs, particularly in those cases where there has been a considerable reduction in personnel.

Despite all of this, we do not want to be scaremongers. Large office space transactions have been signed, there are pre-lets in the market, although there are fewer than before and they tend to be in properties that will be delivered shortly. We have also detected that the time needed to make a decision has increased significantly.

There has been a strong reversal in the number of sales to occupiers. The year closed with only 8% of these types of sales transactions registered in the Madrid market, and the number of sales in the last quarter fell by 4%. Heavy restrictions imposed by banks on access to credit, make it difficult to find financing for these types of transactions. On the other hand, there are small users that, even when they are able to pay off credit, they still adopt a cautious approach and prefer to have liquidity in order to weather these uncertain times.

Transactions by surface size - 2008



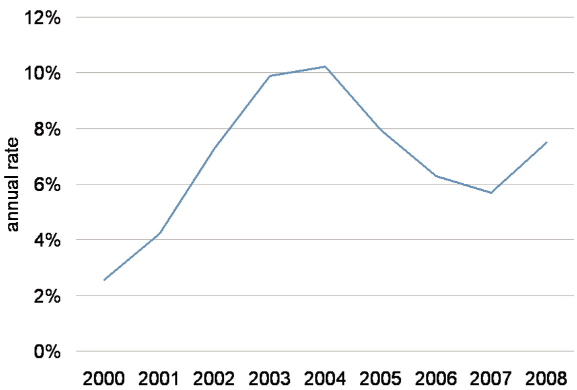
Source: Savills Research

Supply

Ever more space on the market

After starting to rise after the summer of 2007, the vacancy rate in Madrid's office market continues to increase. December's figure closed at 900,000 sqm of space on the market, which puts the vacancy rate at 7.50%. In the last quarter of the year, hardly any new stock came on to the market, the total was a little more than 57,000 sqm, of which more than a third of the office space corresponds to Sacyr-Vallehermoso's tower in the CTBA. Of the new space that came on to the market in the fourth quarter, only 5% has been owner occupied or occupied by tenants who signed a pre-let agreement. It has been some time since we last saw this situation, given that between January and September 55% of projects have been to "pre-let tenants". This factor, along with the postponement of various developments expected to come on to the market in 2008, has contributed to "containing" the growth in the vacancy rate.

Annual vacancy rate



Source: Savills Research

New developments

Over 2008 close to 265,000 sqm was delivered and in 2009 more than 450,000 sqm is expected to be delivered. Torre Cristal and Torre Caja Madrid are two of the most emblematic projects that, for differing reasons, have delayed their entry on to the market, but there are various projects on the outskirts of the city that have postponed their incorporation on to the market. In total, almost 190,000 sqm of office space has delayed its entry on to the market for approximately a year. On the other hand, and as happened in previous years, we will readjust this figure over the coming months, as these speculative projects may well push back their delivery dates or even indefinitely postpone them due to a lack of financing.

If the most relevant data in previous years was new pre-let space (52% in 2007 and 43% in 2008), 2009's key figure will be that a quarter of space will be owner occupied. 25% of the amount of space being developed will be used as their owner's headquarters. The largest examples are Torre Caja Madrid, the turn-key project that AMA acquired from Bouygues in Cristalia Business Park and the property that Carlyle is developing for Registradores de la Propiedad at Calle Alcalá, 510.

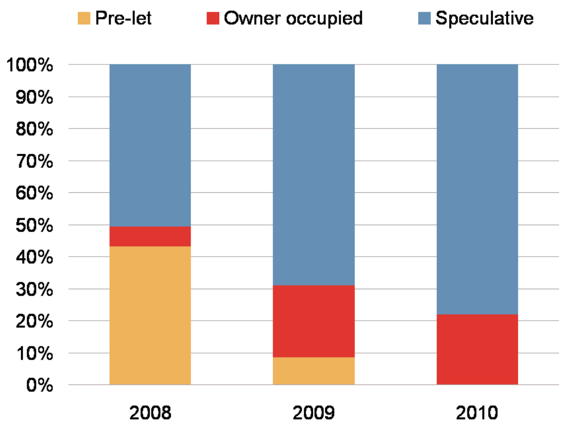
Studying new stock in the M-30 area also shows a different outlook than what we are normally used to. A third of the space will be incorporated in the city centre area. The two towers that will complete the CTBA surface are the main reason for this increase in this area. One must go back to 2007 to find a similar situation, which was the year when the first tower came on to the market at the end of Paseo de la Castellana.

The difficulty of starting new developments in the city centre means that, aside from exceptional cases such as the CTBA complex, new stock in the city is limited to comprehensive renovation projects. Over the coming months, 24,000 sqm of refurbished and adapted space for users will come back on to the market.

In terms of the geographical location of developments in 2009 the area Julián Camarillo stands out. Excluding the 100,000 sqm of Torre Caja Madrid and Torre Cristal from the annual total, the area will make up a third of the expected new stock to come on to the market. The Parque Empresarial Avalon is of particular significance, with 45,000 sqm spread over nine buildings, where OESIA pre-let 12,500 sqm after the summer. The process of regenerating the area for business use continues at a good pace and the excellent quality/price, easy access via public transport, and the provision of complementary services for business activity, are the perfect incentive for attracting demand.

The area surrounding the A-6 is ranked second in terms of the highest amount of office space to come on to the market, with more than 60,000 sqm, but a third of the space will have already been occupied when it comes on to the market.

Future supply



Source: Savills Research.

Rents and transactions

Madrid office market rents remain the same... For a year?

At the very least this is the question that we could pose after calculating the average closing rents registered across the market. The honest truth is that year on year growth has been 0%. But as we always point out, studying specific results is misleading. In general terms, rental movement within the M-30 has been positive and in areas outside the ring road there has been negative growth. Again we must point out that that the business park submarkets have been developed differently, as factors which determine the final price are very different, and this includes some business parks that are in the same area.

Also, year on year growth in the CBD reached 15%, but overall the city registered a 10% drop. In peripheral areas closer to the city (the surrounding area closest to the M-30) has generally been more stable. The drop of 19% in Campo de las Naciones also caught our eye. Looking at historic data, this confirms that over the last months of 2007 the only transactions carried out were in the “heart” of the business park, whilst in October and December 2008, the lack of available space in the area diverted transactions towards Vía de los Poblados (the second extension of the area), where rental levels are significantly lower. The areas that are located further from the city are the ones that have begun to be affected by falls in final signed rents.

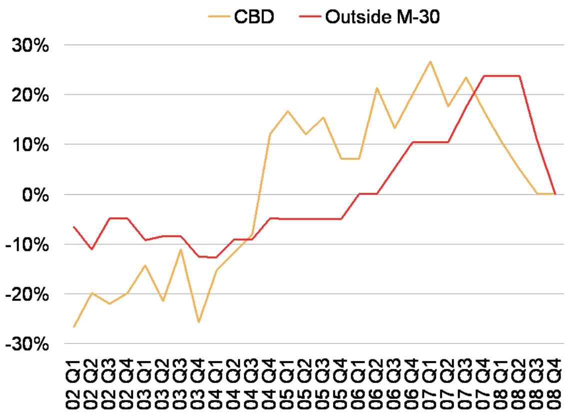
The results on a quarterly basis are very similar. The overall result has been a fall of -1%, noting that the type and quality of the properties where transactions have been carried out have been different and located in several different areas, hence said rents are not objective.

When studying asking rents the overall view is very similar: there have been hardly any drastic changes in the rents required. It is worth pointing out that, although at the beginning of the year, landlords were reluctant to admit the coming change in cycle, they are now coming around to the fact that they need to adapt to the current situation providing rental or other incentives in the contract.

The highest asking rent in the CBD, not including very specific one off properties which are clearly above market, remains at 45 €/sqm/month. The rents for office space in the towers in the CTBA are scaled depending on the floor that the office is located on, but the maximum starting rent has gone from 44 €/sqm/month in the previous quarter to 42 €/sqm/month registered in December. Outside of the M-30 the highest rents are located at the start of the A-1, in the new business developments located in the PAUS, where rents have remained the same as in the previous market report at 24 €/sqm/month and in the Parque Empresarial Cristalia, in the Campo de las Naciones area, at 23 €/sqm/month of built area.

On the outskirts of the city rents are also above 20 €/sqm/month in newly developed consolidated areas; such as the A-6. We refer to a property that is about to come on to the market which fronts on to the M-40 and the A-6.

Prime rents evolution



Source: Savills Research

Major leasing transactions - Q4

Tenant	Area	Size (sqm)	Sector
Mº Ciencia e Innovación	East	7,500	Public Administration
Grupo Adecco	A-6	6,000	Professional services
EDP	North	4,000	Energy
MTV	CBD	2,500	Audiovisual
RH&GR	CBD	2,100	Law office

Source: Savills Research

Major investment transactions - Q4

Buyer	Area	€m	Building
Union Investment	Campo de las Naciones	115	Pórtico
Real, I.S.	Julián Camarillo	25 (1)	Atos Origin HQ
Grasset	Campo de las Naciones	23 (2)	Cristalia - Build. 9

Source: Savills Research

(1) Estimated investment volume (2) Advised by Savills

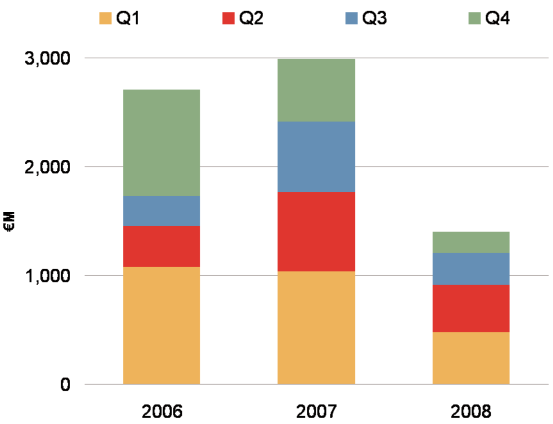
Investment market

The end of a turbulent year

The poor results in the international financial markets have affected the economy and, although some sectors have been more affected than others, the fact is that the general effect has been very negative.

On top of the economic crisis, Spain has also seen its real estate bubble "burst", which has lead to the collapse of several real estate giants, above all they were those companies that had a large majority of their business in the residential sector. Some of these companies had various business lines, so in an attempt to eliminate debt and obtain liquidity they put some of their properties up for sale. At first, it was non-strategic product, that was not very emblematic or was in outer areas of the city, but as the year has gone on, we have seen more interesting transactions. However, there are still many properties available, which are waiting to change hands, which in many cases, are being made to wait too long. Buyer and seller's expectations have reduced considerably over the past few months, but this still remains an obstacle to the signing of transactions.

Investment volume by quarter



Source: Savills Research

The total investment volume registered up to December reached 1,400 million euros, which is a drop of 47% compared to the previous year (as in previous studies, we have not included the Banco Santander "Ciudad Financiera" transaction so as not to distort the current market situation).

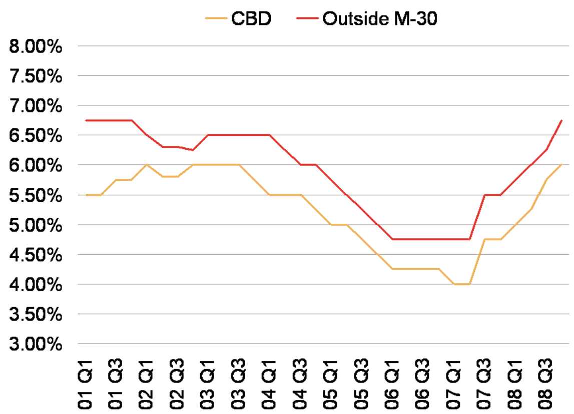
The main players in the market continue to be national companies. As previously indicated, sellers tend to be real estate companies and developers. In terms of buyers, although the largest group tend to be Spanish companies, various foreign funds, the majority of which are German, have begun to re-enter the market. The market is still changing, hence we hope that these foreign funds will hark the return of foreign capital. We can say that in general, buyers have returned to the basic fundamentals of investment: they are very selective with properties and focus their interest on prime products, and the foreign buyers especially are shying away from risk. It is also important to point out that the number of potential buyers has reduced considerably, as some company's high levels of debt and the ever more strict conditions when trying to obtain credit have left almost all of the "usual" players out of the equation. Looking in depth at Spanish companies which are currently acquiring properties, one finds small companies that have remained relatively inactive over the last few years, which therefore have a great deal of liquidity or a small amount of financing.

Quarterly analysis of investment volumes indicates that, although each quarter has seen a considerable drop compared to 2007, the second half of the year has suffered more from the general slowdown in the market. The string of scandals in financial entities, investments constructed on false promises, along with the discouraging economic indicators and the continual lowering of expectations for the coming year, have favoured a reduction in investment activity in the real estate sector.

Yields climb ever higher

Yields continue to soar up to levels that were unthinkable just one year ago. The year on year increase in the CBD has reached 100 basis points. Compared to the first half of 2007, where the "credit crunch" was meant to have started, the difference is as much as 175 basis points. The prime areas outside of the M-30 have seen a similar story. Compared to yields in December 2007 yields are now 75 basis points higher and 200 basis points higher than in July of the same year.

Prime yields



Source: Savills Research

Outlook

Pessimism with regard to the Spanish economy in 2009 continues to grow

Consensus Economics's January monthly report does not indicate any form of break away from the continued month on month deterioration in expectations and indicates a decrease in the Spanish economy of 1.5% in 2009 and a slight growth of 0.4% in 2010, which now sets the national economic growth below the majority of the Eurozone (-1.4% in 2009, 0.8% in 2010).

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

	2007	2008	2009	2010
GDP	3.7%	1.2%	-1.5%	0.4%
Consumer spending	3.4%	0.7%	-1.6%	0.0%
CPI	2.8%	4.1%	1.5%	2.2%

Source: Consensus Economics

Aside from the variables detailed in the table attached, the poor results forecast extend to fixed capital investments (-7,5% in 2009 and -1.6% in 2010) and to industrial production (-6.5% in 2009, -0.2% in 2010). The record falls over the last few months of 2008 in this latter sector, the quarterly contraction in GDP by two tenths of a point in the third quarter, the crisis in the residential real estate market and the restictions on credit appear to have led to this drop in the economy in 2009, with the hope of a slight recuperation in the economy from 2010 onwards.

2009 is expected to see a moderation in price increases (annual average of 1.5%). Taking in to consideration that growth in the index in December 2008, published after this study, is now set at 1.4% and new decreases are expected, it is possible that in the coming months this estimation will be lowered still further.

What does 2009 hold in store?

Difficult times are ahead for everyone, and the office sector continues to attempt to ride the wave. The lack of annual take-up in 2008 will not be the only poor figure. According to the INE, over the year we will see more than 300,000 companies go bankrupt in Spain, which is an increase of 24% compared to the previous year and the highest increase registered in a decade. The number of businesses that have closed has not been balanced out by the number of new business started, as the year closed with a fall of close to 4% in company start ups. The economic recession is showing it's worst side in the continual increase in unemployment data, with forecasts expected to increase considerably over the coming months.

Faced with this outlook, companies will continue to be frugal and cautious, attempting to cut down costs as much as possible, putting expansion plans on hold, etc. This situation will directly affect the volume of take-up. If it was not possible to reach the psychological barrier of 500,000 sqm in 2008, are we prepared for 400,000 or 350,000 sqm? As the year goes on we can comment more on this figure; again it very much depends on the large volume transactions that are still trawling the market.

In terms of availability, the vacancy rate will continue to rise. On top of the "new space" that is coming on to the market, one must also add the offices that are becoming available due to companies folding or reducing their space allocation. We are on the way to reaching a total of one million sqm of office space on the market. Of the space expected to come on to the market in 2009, nearly 25% will be owner occupied, which will stop a very sharp increase.

A fall in demand and a rise in supply: results in a fall in rental prices. But, will this be in all areas? And at the same pace? Without a doubt the CBD and the more consolidated areas of the M-30 will feel this less than in areas further outside of the city, where availability has already been very high for several months. On the other hand, those properties that have recently come on to the market or are about to, will continue to achieve top rents in the areas that, despite the difference in value compared to their "competition" in terms of location, are particularly of interest to occupiers.

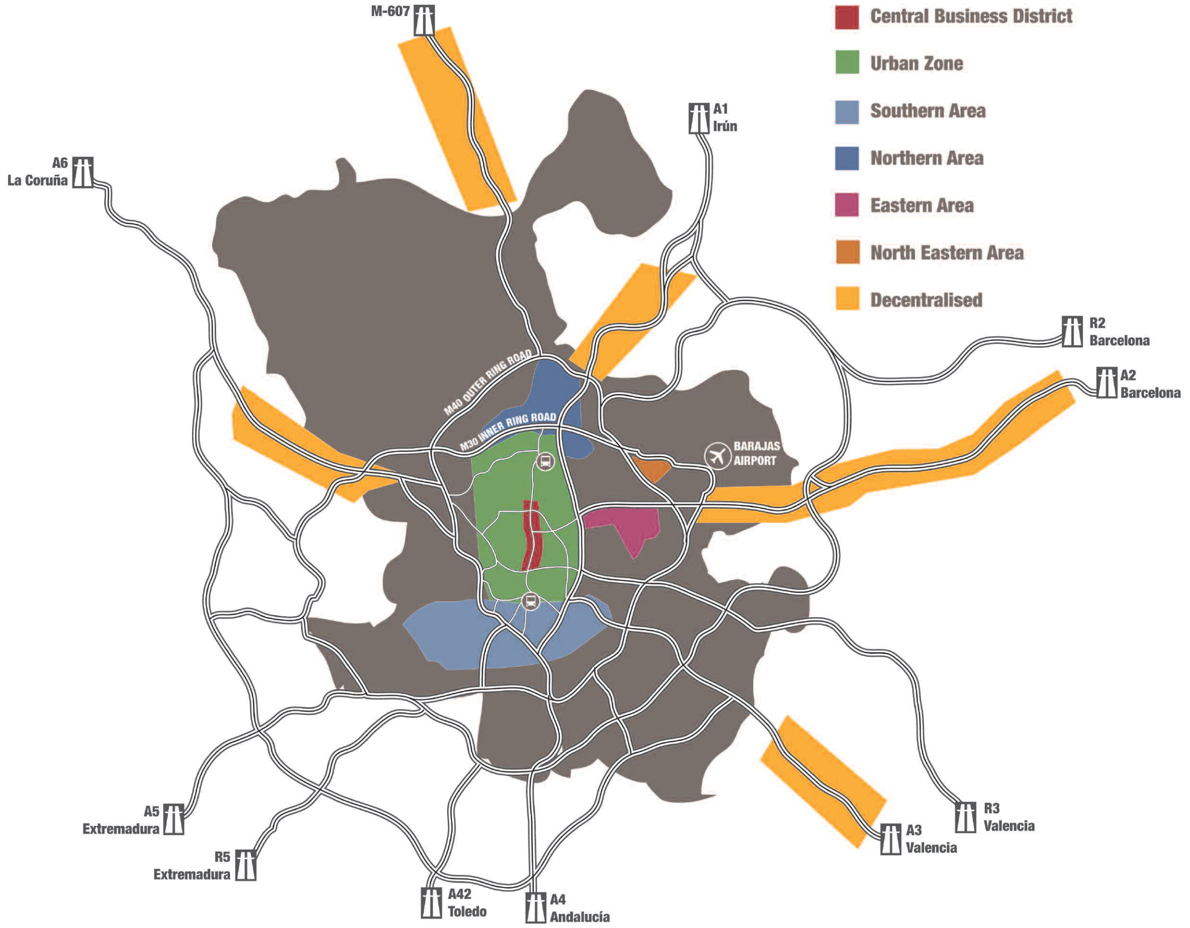
Poor stock market results and the scarcity or lack of "equity" have made some investor's portfolios very top heavy. Because of this a large amount of product will come on to the market for sale.

The investment market will remain active, if not at a more relaxed pace, but slowing down does not imply stopping. On one side of the playing field there will be international investors, the majority of which will be opportunistic investors, that are studying the Spanish market with interest, in search of "bargains" and on the other, private investors or small national funds. All of which are in search of quality assets, that are well located and have solvent tenants. The average investment volume will be less than usual, at around 30 million euros.

There continues to be a difference of opinion of value between buyers and sellers, although Spanish investors are already accepting that yield adjustments are realigning prices to realistic figures. Yields will continue to rise, which could attract more foreign capital, although investors will be suspicious, due to the country's fragile economic situation.

Madrid office market

Survey map



For further information please contact




Rafael Merry del Val
Head of office
+34 913101016
rmerry@savills.es

José Navarro
Head Cap. Markets
+34 913101016
jnavarro@savills.es

Alberto Gómez
Office Agency
+34 913101016
agomez@savills.es

Gema de la Fuente
Research Madrid
+34 913101016
gfuente@savills.es

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 180 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East. A unique combination of sector knowledge and entrepreneurial flair give clients access to real estate expertise of the highest calibre. We are regarded as an innovative-thinking backed up with excellent negotiating skills. Savills chooses to focus on a defined set of clients, therefore offering a premium service to organisations with whom we share a common goal. Savills takes a long-term view to real estate and works hard to invest in long term and strategic relationships and is synonymous with a high quality service offering and a premium brand.

Savills
Research

savills.com/research

savills