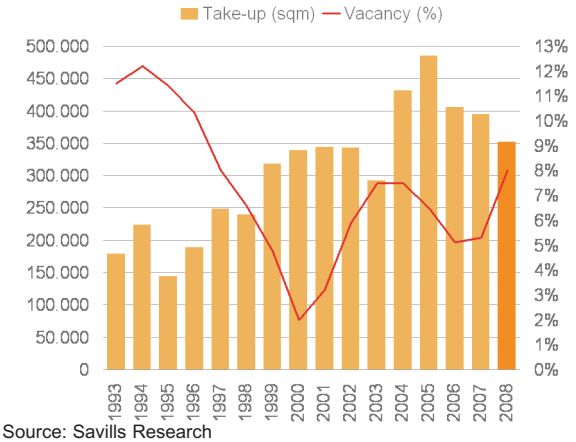
Barcelona office market

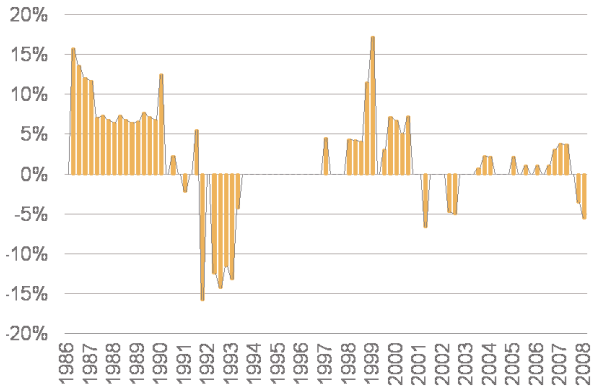
Spring 2009

Take-up and vacancy rates



Source: Savills Research

Quarterly rental growth



Source: Savills Research

"A difficult start for 2009 is characterised by deteriorating market fundamentals, with rising vacancy, weakening rental values and rising yields. The lack of attractive investment alternatives together with the fall in the Euribor has nonetheless contributed to a number of investment deals, which are based on quality assets, tenant strength and long lease term contracts".

Eusebi Carles - Director

■ After sixty quarters of continued growth, the Spanish economy has officially fallen into recession, experiencing two consecutive quarters of negative growth. The situation of the Spanish economy is likely to deteriorate in the next few quarters, and this will possibly continue through to 2011.

■ Despite the current economic situation, the letting market has maintained relative stability, mainly due to the completion of several owner-occupier purchase deals and large turn-key transactions.

■ The delivery of new projects has increased the city's office stock by 193,000 sqm, 80% of which has been incorporated into the market as available stock, mainly within the Decentralised areas and the 22@ district.

■ The 1.5 point rise in vacancy rate during the last quarter has not directly impacted on any given region, however large differences can still be observed between sub areas.

■ Until now, the decrease in rental values has been contained, experiencing an average 4.5% q-o-q decrease. The future fall in demand and the rise in office vacancy will put further downward pressure on rents.

■ In 2008 the total volume of investment reached 1,056 million euros, representing a 46% decrease with regards to 2007 figures. Lack of finance, negative growth forecasts for the Spanish economy and high seller expectations are preventing confidence growth and the completion of deals.

Economy

Spanish economic situation

The Spanish economy has experienced a 1.0% fall the last quarter of 2008 in terms of GDP. After two continuous quarters of negative growth Spain has now technically entered a recession. According to several economic reports, this economic contraction could last up to six consecutive quarters, representing the longest recession period since the return of democracy.

Previous recessions in Spain

Recession	Duration	Quarters	q-o-q change
1975	2 quarters	Q1 1975	-0.2%
		Q2 1975	-0.1%
1978 1979	2 quarters	Q4 1978	-0.1%
		Q1 1979	-0.5%
1992-1993	4 quarters	Q2 1992	-1.0%
		Q3 1992	0.0%
		Q4 1992	-0.4%
		Q1 1993	-1.1%
Now	?	Q3 2008	-0.3%
		Q4 2008	-1.0%

Source: INE

Several months of uncertain economic growth forecasts together with the economic difficulties exacerbated by the international financial crisis and the downturn in the building sector, have led the Government to re-adjust its economic forecasts. According to the 2008-2011 Spanish Stability Program approved by the Spanish Cabinet, GDP growth has been estimated at 1.2% for 2008, whilst in 2009 GDP it is expected to show a 1.6% decrease. Internal demand increased by a mere 0.7% in 2008 and is expected to register a 3.2% fall this year. This will be triggered by a 9.3% decrease in investment levels, and a 1.5% fall in private consumption, a level, uncompensated by the expected 2.1% increase in Government Administration expenditure.

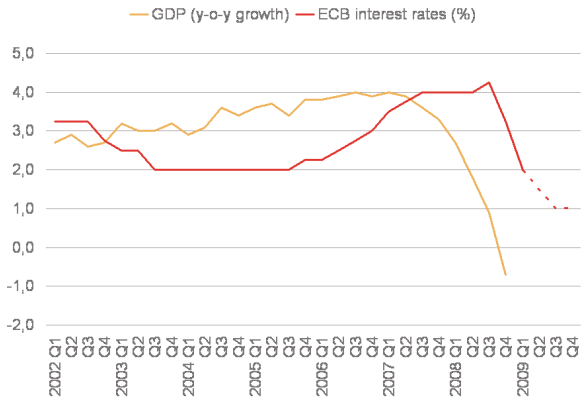
Whilst the export sector experienced a GDP gain of 0.6% last year, it is expected to show a 1.6 point increase this year. This increase however will not suffice to salvage the current economic recession, although it will considerably reduce balance of payments deficit.

Unemployment levels in 2008 reached a year high since 1987, with the number of unemployed reaching over 3 million, a figure which is expected to rise to 4 million by the end of 2009. The building sector has been amongst the worst affected, followed by the services and industry sectors. The rise in unemployment will force the Government to intensify public expenditure which will affect the balance of the treasury and will break for the first time the European Stability Pact reaching 6% in 2009, an unprecedented level since the early 90s. As a result of a fall in tax revenue, led by sharp tax falls on the real estate sector, Government savings will be particularly affected and experience a considerable decrease.

Most economic indicators which forecast the future of the economy are now showing negative results. However, in comparison to previous economic recessions, the speed and volume of the deterioration is now considerably higher.

On the other hand, inflation levels have levelled off and closed at 1.4% in 2008, representing a ten year low. This decrease represents the fifth consecutive decrease in the interannual rate since its record-high in July (5.3%), when the value of the Brent crude oil barrel reached $147. The fall in inflation has mainly been due to falling oil prices, and to a lesser extent, to a fall in other oil related products, such as transport. The value of the Brent crude oil barrel has decreased since August, reaching an average value of $43 in December, its lowest level since December 2004.

GDP growth and interest rates



Source: INE, European Comission

Faced with today's economic situation, measures have been taken to counteract the crisis, which include ECB tax cuts, adopted to limit the impact of the recession. In January, the ECB announced the fourth consecutive interest rate cut, a fall from 4.25% to 2% between October 2008 and January 2009. This represents a record low since the dot-com bubble burst. Further interest rate cuts are expected in March and June of this year, which would likely leave interest rates at 1%.

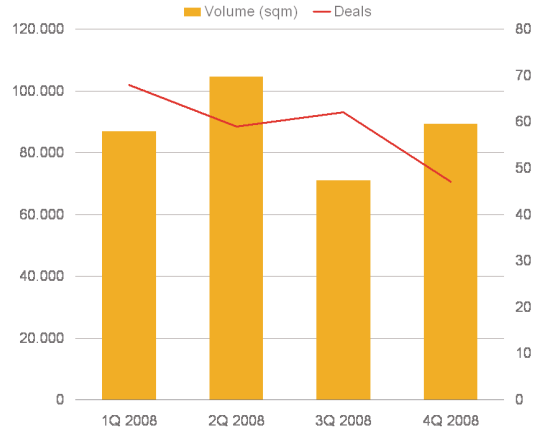
The economy will likely benefit from strong inflation contention and a fall in interest rates which will in turn deliver economic relief for families and companies.

Demand and Take-up

Demand for office space in Barcelona has maintained relatively stable rates.

Gross office take-up rates reached 351,000 sqm in 2008. Despite the current economic situation, this only represents an 11% fall compared to 2007 (394,000 sqm), and a 27% fall compared to 2005, when Barcelona reached a record office take-up (485,000 sqm).These figures contrast with the significant fall in take-up rates in larger office markets, some of which have experienced up to a 50% fall in inter-annual take-up rates. The Barcelona market, given its wide range of sectors, has been relatively stable in comparison.

Take-up quarterly change



Source: Savills Research

In the second semester, take-up reached 160,000 sqm. These levels show a slight decrease from the first semester of the year, a yearly pattern not uncommon, given the usual reduction in take-up in the summer months. It is worth noting, however, that the number of deals closed during the last quarter of the year fell by approximately 26% compared to the average of the first two quarters, which shows a slowdown in underlying take-up rates.

In terms of areas, the City Fringe constitutes 51% of total take-up, thus confirming the continued tendency for demand to shift to areas such as the 22@ district. Supply within this area is mainly comprised of modern, state of the art buildings, offering competitive rental values and located in relative proximity to the CBD. Take-up in the Decentralised areas accounted for 23%. These areas attract demand driven by rental savings.

Rental deals represent almost 55% of total 2008 take-up, whilst owner-occupier purchases and turn-key operations have increased; representing 45% of the take-up with only 18 deals throughout the year and an average area per deal of 8,800 sqm.

Today's economy is experiencing a slow-down, following the end of economic growth in summer 2007. In this context, a number of companies present in the Barcelona market have chosen to consolidate their activities into one building, thus keeping corporate costs to a minimum.These shifts have mainly taken place between the CBD and the 22@ district. Cap Gemini, who moved to 22@ from the prime section of Diagonal Avenue, is a clear example of this shift. A further example includes Grifols, developer of plasma derivatives. In the midst of the real estate downturn, Grifols acquired an office complex in Sant Cugat in order to concentrate their corporate activities into one building and retain vacant office space for the future expansion of the company.

Main relocations

Company	Origin	Destination
CAP GEMINI	Diagonal-Prime	22@
GRIFOLS	Several locations	Sant Cugat del Vallès
ISDIN	Diagonal-Prime	22@
JOHNSON DIVERSEY	Esplugues	Cornellà
CTTI	Pº Gracia-Prime	Gran Via-Hospitalet

Source: Savills Research

Whilst companies were not previously drawn to such areas, these buildings are increasingly attracting attention, as they offer large surface areas at competitive prices, with modern specifications, providing an overall reduction in occupational costs.

These large deals (>3,000 sqm) accounted for 64% of the total take-up.

The demand for small areas continues to lead the Barcelona market, with 51% of the deals being for areas below 500 sqm. This demand is mainly concentrated in the CBD and the City Centre, where vacancy rates are consistently low and mainly in mixed use or obsolete buildings. The average surface area for deals in the CBD has been 460 sqm.

Public entities represent the principal occupier of space, accounting for 20% of the total take-up. Entities such as the Spanish Telecommunications Commission (CMT) and the Telecommunications and Information Technologies Centre (CTTI) have signed contracts for the purchase of turn-key buildings destined for their headquarters, in the 22@ district and in the Plaza Europa area, respectively.

Supply and Rents

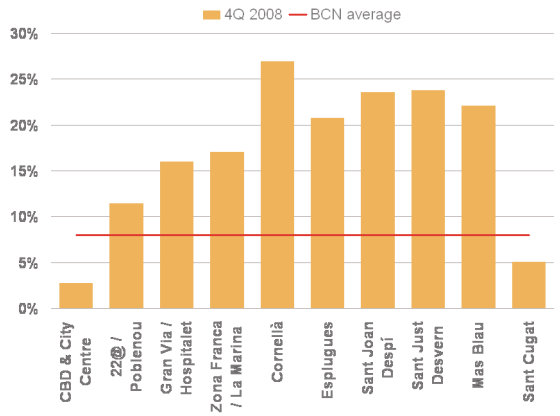
Supply and vacancy rate

At the end of 2008, 407,400 sqm of office space was available, representing an 8% vacancy rate for Catalonia's capital.

The 1.5 point rise in the vacancy rate compared to the first semester has had no direct impact on any one particular area, however large differences can still be observed between sub-areas.

The CBD continues to experience undersupply, which may be slightly eased following the relocation of some large companies to other areas. Despite the hand over of several buildings in the area, Sant Cugat continues to show a lower vacancy rate with regard to Barcelona's average rate. An expected 90,000 sqm of new projects, however, will be delivered in the area in 2009. Office submarkets in Baix Llobregat continue to show signs of oversupply, with vacancy rates reaching over 20%. Cornellà, for example, saw the completion of buildings 6 and 7 of the WTC Almeda Park office complex at the beginning of 2008. This increased its vacancy rate from 12% to 27%. We anticipate however that this vacancy could be reduced with competitive pricing, given the quality and accessibility of the buildings.

Vacancy rate by sub areas



Source: Savills Research

Delays in completion will affect many projects.

The strong office market of recent years had triggered frenzied development activity, in particular areas such as 22@ district. Given the current uncertainty, several developers are opting to delay initiation of projects and await an improvement in the lending markets, and /or the possible sale of the project.

A total of 333,000 sqm of office space is expected to be delivered until the end of 2009, 75% will be speculative, 23% will be owner occupier and a low 2% will represent pre-leased areas. Three of the towers in the new Plaza Europa 'New Business Area' (Realia, Zenit and Inbisa) will be delivered this year. These account for 27% of total development expected in 2009. Sant Cugat will represent 40% of new developments, 42% of which will be owner occupied. The 22@ district will see the incorporation of 70,000 sqm of new office space, 70% speculative. The majority of new developments will be located in the City Fringe and in the Decentralised areas. In the next few months, these areas will see a rise in vacancy rates and rents will suffer further pressure.

Rents

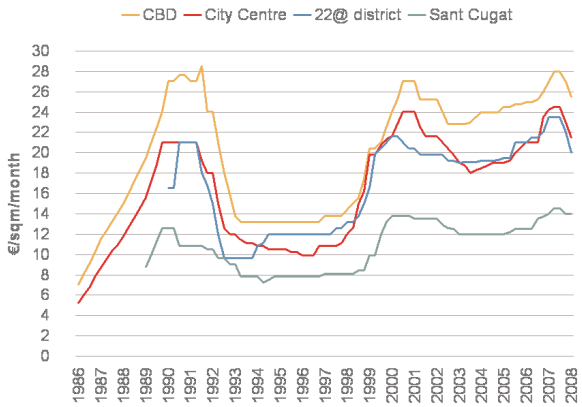
In general terms, rents in Barcelona experienced a small decrease in the last quarter of the year. The current economic situation has increased caution. This, in conjunction with increasing supply, is leading to downward pressure on rents. The extent varies according to the different sub-areas.

The 22@ district has been the most affected in terms of rental values with a quarterly fall of 9%. This may be due to buildings, initially entering the market at relatively high prices for the area, decreasing their rental value due to the economic climate, a necessary measure in order to increase the building's competitiveness in order to attract demand.

The CBD experienced a significant increase in rents since the mid of 2006, however it has now also readjusted its rents, lowering them by 5.6% with regards to the third quarter. This has situated prime rents at 25.50 €/sqm/month, a strong contrast to the 32.00€/sqm/month asking price in the area at the beginning of the year.

Due to competitive rents and good quality stock, rents in Sant Cugat have not yet been overtly affected by this price correction and have maintained levels similar to those of the previous quarter.

Prime rental values by sub areas



Source: Savills Research

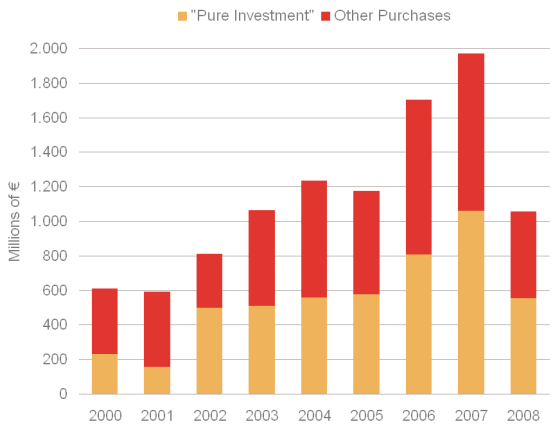
In the current climate, tenants hold greater negotiating power, and landlords are being forced to offer more incentives to attract demand. These incentives will be most attractive for tenants who can offer solid guarantees and accept lease terms.

The investment market

The total volume of investment for 2008 reached 1,056 million euros in 36 transactions, representing a 46% decrease with regard to the record high 2007 end of year figures, led by a particularly strong first semester, prior to the US sub prime crisis.

Investment volume was 486 million euros during the second semester of the year, representing a 30.3% decrease compared with the same period in 2007. These results reflect the deterioration of the investment market, as a result of increasing lack of available finance, the negative economic forecasts for the Spanish economy and the increasing market uncertainty.

Investment volume



Source: Savills Research

On the more positive side the central banks' downward correction in interest rates following the bankruptcy of Lehman Brothers has reduced the cost of finance. This in conjunction with the sharp increase in yields has increased the spreads for investors. Notwithstanding, the overall scarcity of finance and increased spreads from lending institutions for investments with higher risk profiles, remain the key problems. Banks are attempting to reduce risk which has led to a fall in the number of players in the investment markets. Those with high levels of liquidity and reduced debt, fairing best.

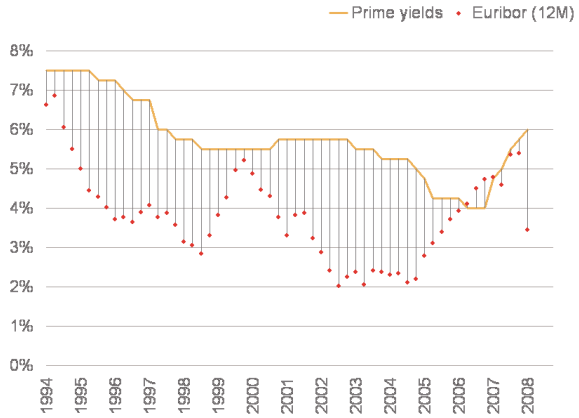
In this economic scenario, opportunity funds, some international core and core plus funds and family offices are once again active in the market and are involved in the principal deals currently taking place. National funds, remain generally inactive. Spanish fund Santander Banif Inmobiliario recently announced that it was putting a two year hold on redemptions and is currently looking to sell assets rather than buy.

The Catalan Government has become a leader in property acquisitions and has been involved in the purchase of various buildings it occupies. This reflects the current Local Government's call to reduce rental exposure and purchase certain properties, which previously occupied as tenant.

Investors have become rigorously selective buyers, with a focus on assets which guarantee long term income and long lease terms. Sale and leaseback operations are leading the market, pushed by the need to obtain higher liquidity from owner occupiers and due to the guarantees which long term lease contracts offer investors. Notwithstanding, each sale & leaseback deal is different and owner solvency, their business plan, bank guarantees, agreed rental levels and reviews, repurchase agreements and other contractual conditions should be carefully observed as they can inevitably affect the final value of the property.

Recent sale and lease back deals include the 20 million euro sale of Barclays Bank main branch at Passeig de Gràcia 45 to the Vila-Casas Foundation, and the Plaça Catalunya 5 sale, part of the BBVA portfolio, to the German fund Deka for 82.5 million euros.

Euribor rate - prime office yield gap



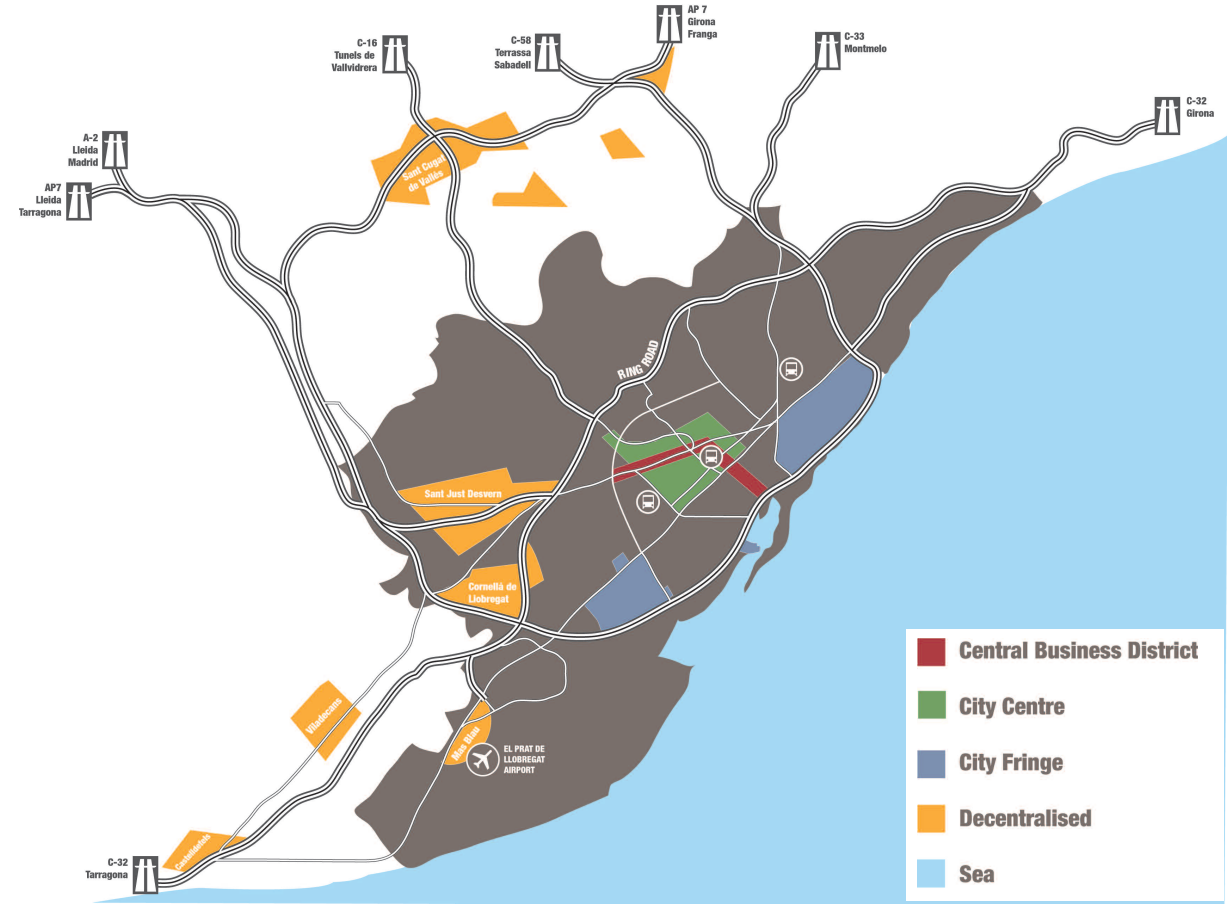
Source: Banco de España, Savills Research

The general downward correction in capital values has affected, to a lesser extent, assets which offer buyers peace of mind, through long leases to solid covenants.

Yields continue to rise, prime yields reaching 6.0%-6.25% , with an inter-annual correction of 125 basis points (a 200 point increase since summer 2007). Secondary locations have been the more affected by this rise, with a 225 basis point increase as compared to the levels experienced before the sub-prime crisis.

Barcelona office market

Barcelona office market map



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