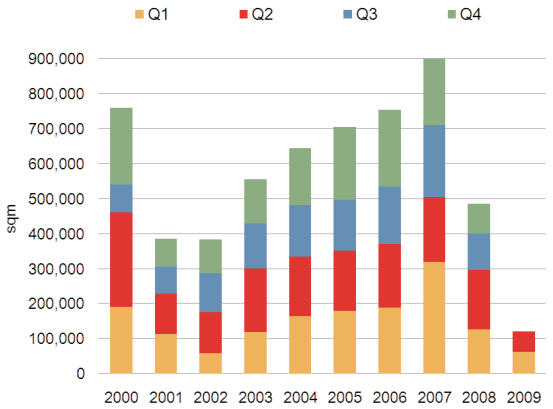
Madrid office market

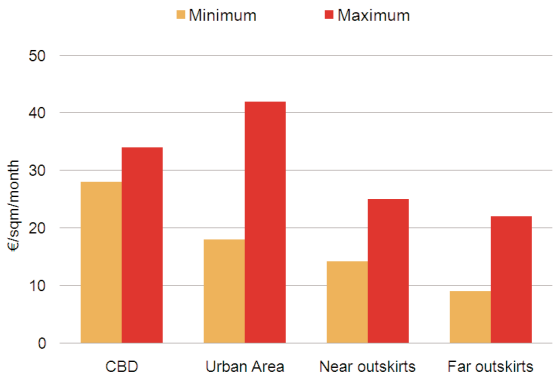
Summer 2009

Annual take-up



Source: Savills Research

Asking rents for exclusive office buildings



Source: Savills Research

"Growing investor demand in the central business district has created a slight decrease in prime yields. At the moment, capital values are not growing, as they are being held back by the drop in rents. Over the coming six months we could see price per sqm figures hit bottom".

Rafael Merry del Val - Head of Savills Spain

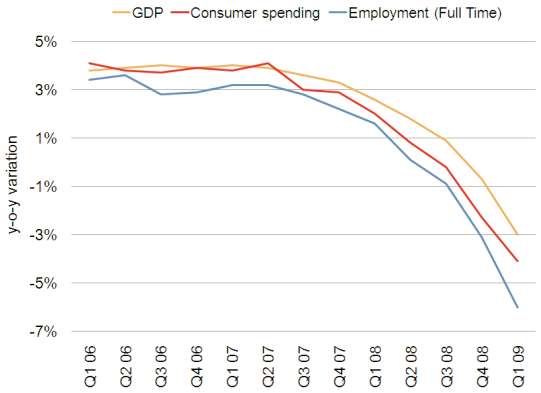
- After three quarters of recession, the economic indicators available in July point to a continued drop in economic activity, although the current decline is expected to be more moderate.
- The first half of the year closed with minimal levels of activity in the office market in Madrid. Take-up of office space was at its lowest levels seen over the last decade and investment volumes do not offer much better results. In both cases, comparing data from the same period of the previous year reflects a negative difference of nearly 60%.
- The vacancy rate continues to climb ever closer to 9%, albeit at a slower pace as the amount of available space increased by nearly 5% between April and June. Several of the most prestigious developments coming on to the market will significantly increase the vacancy rate.
- A drop in demand and an increasing amount of space on the market are sufficient conditions for a fall in rental prices. In December, we could reach a year on year difference of more than 25%. The drop in rents is preventing growth in capital values in the CBD, therefore yields are showing signs of recovery.

Economy

Spanish economic situation

Everything seems to point to the fact that Spain and the rest of world are in the middle of the crisis. If up until now all we have had is ever more dramatic drops in the majority of indicators, with figures reaching record negative levels, what one can now expect is a stabilisation of these poor figures, which will act as a prelude to a market recovery, which is still uncertain as to when it will happen and how strong it will be, as well as the impact it will have on each country. As with all crises, this will be an opportunity for those who know how to take advantage of this situation compared to their competitors and for them to have a better position in the international economic scenario.

GDP, Consumer spending and Employment rate



Source: INE

The Spanish economy contracted in the first quarter of 2009 by an annual rate of 3% and 1.9% compared to the end of 2008, which has meant three consecutive inter-quarter reductions in GDP. Even though in annual terms we have gone from a 0.7% decrease in the last quarter of last year to the aforementioned -3% of the first quarter of 2009, it is possible that we are very near the turning point where the domestic product does not continue to deteriorate quarter on quarter. Comparing the Spanish GDP with the whole of the euro zone, one can see that the European figures are even worse: Inter-quarter fall of 2.5% and an annual drop of 4.9% in the first quarter.

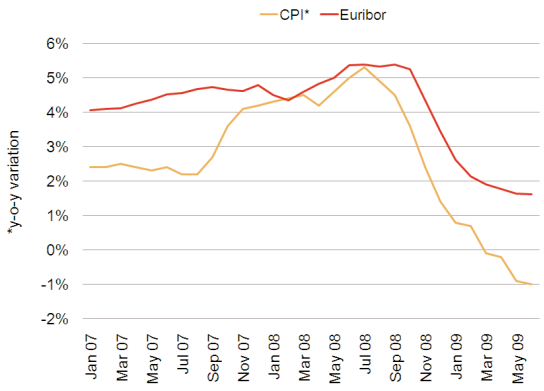
The national demand contribution to GDP growth in the first quarter of the year decreased by 5.3% (it decreased 3% in the previous quarter), which is mainly explained by the drop, once again, in household consumption (-4.1%). Both variables have been negative over the last three quarters, as well as deteriorating considerably. Although consumer confidence has not stopped improving since March; and even though it is at very low levels, there is still some optimism for growth in the near future.

With regard to supply, the only sector that did not decline, compared to the previous quarter was construction, which decreased by 8% again. The poor performance of the services sector, which was negative for the first time (-0.6%), even affected non-market services, which even though were growing, did not grow as positively as over the past few months.

Unemployment in Spain continues to be the most evident consequence of these bad economic times. The Labour Force Survey (LFS) drawn up by the INE (Spanish National Statistical Institute) showed an unemployment rate at the end of the second quarter of 17.92%, 56 basis points above that of the first quarter. Between these two periods the number of unemployed increased by 126,000 people to reach 4,137,500. Eurostat declared that, as at May, Spain was the country with the highest rate of unemployment not only in the eurozone, but also of all the twenty-seven countries within the European Union, with a rate of 18.7%, much higher than the 9.5% of the euro zone and the 8.9% of the Union.

The drop in the ECB interest rate halfway through last year, from 4.5% to the current 1% in May 2009, has caused a continuous fall in the value of the Euribor since the end of last summer, which has meant that over the last few months it has continually been reaching record lows; in June it was at 1.6%. The same has happened to the CPI levels in Spain that, after negative year on year variations over the last four months, was situated at -1% in June, with a decrease compared to the previous month of 0.4%. The underlying inflation (general rate - not including non-processed foods or energy products) has also fallen over the past few months, but less markedly. In June it grew 0.8% compared with the same month in the previous year.

CPI and Euribor



Source: INE

Demand

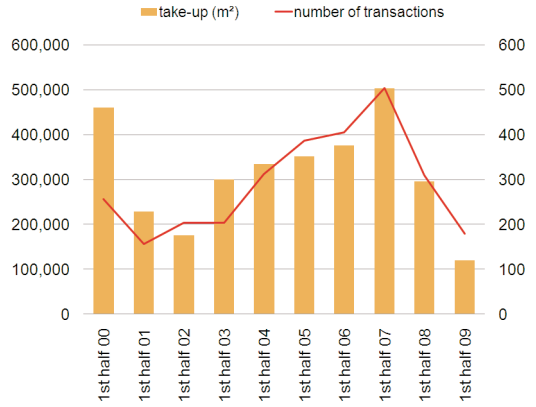
Take-up over the first half of the year: lowest level on the decade

The seasonality of the market used to make the even quarters the ones that offered better results, but in this case, take-up has been slightly lower than reached in the first quarter although demand has increased by a modest 8.5%.

Gross take-up data for the first half of the year confirms the weakening situation of the office market in Madrid. Between January and June just over 120,000 sqm were transacted, the lowest level of the decade. Comparing it with the volume registered in the same period of last year, the results show a 59% decrease. The first half of the year is also an extremely long way off the average take-up of the last five and ten years, at 64% and 62% lower. In terms of the number of transactions carried out, the data is less negative, but one would have to go back as far as 2001 to find a lower amount than the 180 transactions carried out up to June.

The average size of space contracted was lower than 700 sqm, due to the drastic shortage of large office space contracts being signed. Only four spaces above 3,000 sqm have been let and none has exceeded 5,000 sqm. Obviously, we have not included the building that the CAM acquired and that it occupied as a tenant for many years in the Chamberi neighbourhood, in the previous take-up data.

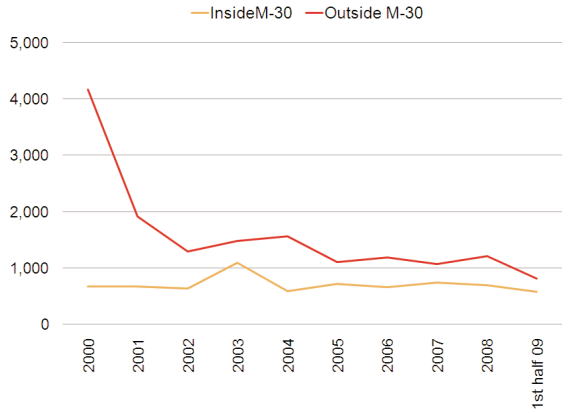
Take-up and number of transactions



Source: Savills Research

The increase in properties becoming vacant and lower rents have not been sufficient stimuli to encourage occupiers to move their headquarters. The privileged position that tenants currently have is encouraging them to renegotiate rents with the owners, even before their rental contracts expire. In exchange for a rental reduction, they offer an extended period to their term certain. Those that have taken the opportunity to change location in order to reduce costs are finding a wider scope of options than those available to them several years ago. More than 40% of the transactions were carried out in the city centre (CBD and urban area), which was an unthinkable figure in previous years. By also including the decentralised sub-markets adjacent to the M-30, that percentage then reaches 49%.

Average transacted area respect to the M-30



Source: Savills Research

The sales market to owner-occupiers is in a dire state. The percentage of signed transactions and floor space acquired for owner-occupier use is less than 10% of the total number of transactions. There are few companies that can afford to acquire premises due to the large outlay this represents, even though since the beginning of the year, the Euribor rate has reached historic lows. Caution prevails as we are facing a crisis with no specific end in sight.

By type of building, those properties used specifically for offices remain at the forefront, both in terms of the number of transactions and in terms of space absorbed, but we should highlight that the largest average area transacted over the past six months corresponds to high tech buildings. Within this category, the Julian Camarillo market easily tops the list of transactions, both by number of transactions as well as by volume of take-up. Good access by public transport (as practically all the areas that have semi-industrial premises are located very near or in residential areas) and above all the good price/quality ratio manages to attract occupiers that look for the benefits provided by an exclusive office only building with lower rents.

In terms of the sectors that are most active, Professional services and New Technologies are still very active in the market. Several government bodies are still active and accounted 6% of the take-up over the last six months. Ineco continues to increase the amount of space it has taken in the original area of Campo de las Naciones and Tragsa is doing the same in Julian Camarillo. The Pedro Churruca business park, will house a total of 4,000 sqm of offices of three government bodies linked to the Spanish Ministry of Foreign Affairs.

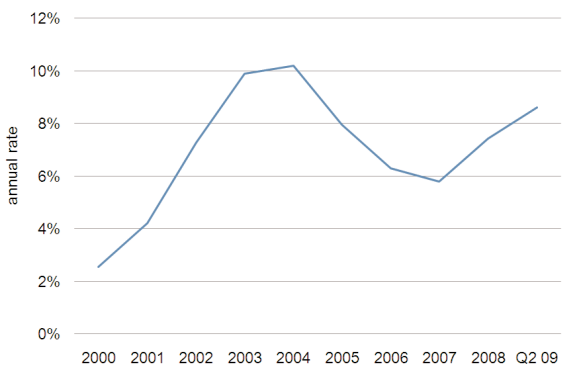
Supply

Availability, over 500,000 sqm

The vacancy rate in June was close to 9%, which represented just over 1 million square metres available in buildings for exclusive office use.

The delay in the delivery of developments is holding back the increase of empty office space and properties are still being handed over, which were pre-let over last year. Therefore, between April and June, nearly 45,000 sqm came on to the market, of which only a quarter were not pre-let. The handover of the Torre Cristal (Crystal Tower), with 100% of its space still on the market, will be a milestone, which will drastically increase the vacancy rate in the city centre and affect the global market quota.

Vacancy rate



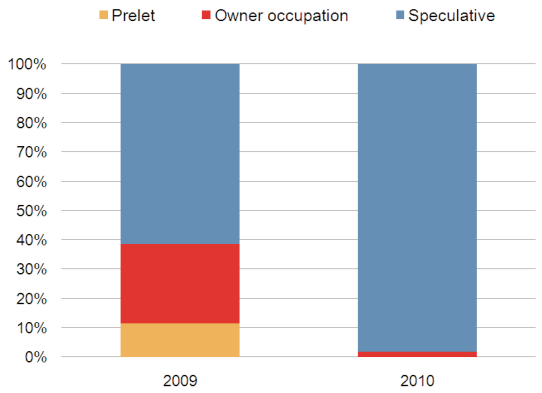
Source: Savills Research

According to initial forecasts, over the second half of the year more than 300,000 sqm should come on to the market, 73% of the predicted total, but the final amount will continue to readjust itself as time goes by, as it appears more than likely that several properties will postpone finishing construction works until the end of 2010. Assuming the current data, approximately 215,000 sqm will come on to the market vacant, which will increase the vacancy rate up to 10%.

By volume, among the developments pending handover and which are to be let in their entirety, we would highlight, the “Mutua Madrileña” tower in the CTBA complex with more than 50,000 sqm of office space and the “Parque Avalon” in the Julian Camarillo area, with 45,000 sqm set over nine buildings, of which three are already confirmed to be let to two new technology companies (Oesia and IBM).

Also, in the coming months works will finish on the future headquarters of several companies that acquired them some years ago for their own use. The most relevant is the tower that will complete the business complex at the north end of the Paseo de la Castellana. Caja Madrid will begin to move in to the property at the end of this year. A new building will also be opened in the Parque Cristalia, in the extension of the Campo de las Naciones, which will be the company headquarters of “Agrupación Mutual Aseguradora” and the Property Registry will take-up space at the very end of Calle Alcalá, on the edge of the Julián Camarillo area.

Future supply



Source: Savills Research

The micro-market which is made up of the four buildings that have changed the skyline of Madrid will exceed 30% of the space on the market at the end of the year. Currently, only the ‘Torre Espacio’ and the ‘Torre Sacyr’ are available for immediate occupation and the average vacancy rate is at approximately 20%. The latest end of construction date for ‘Torre Cristal' is September. When this happens, and if no new tenant appears, the vacancy rate will exceed 50%. The Caja Madrid Tower will reduce this level, dropping it to levels of 30%, as it will be fully let when it comes on to the market.

What does 2010 hold in store with regard to new space? It is still too early to answer this question, but it seems inevitable that the projects that have already started to be constructed will extend their delivery dates. On the other hand, according to several developers, having a tenant interested in a property will accelerate the handover of the building.

Regarding availability of properties that are already part of the office market, it seems inevitable that the number of premises on the market will continue to grow, due on the one hand to companies vacating in order to redefine their structure and others that have gone in to liquidation. According to the latest Informa Company Movements Report, published by D&B, between January and May, 10,800 companies went in to liquidation, with Madrid top of the list with nearly 18% of these companies.

Rents and transactions

Negative growth of prime rents for the third consecutive quarter

Rents are still in a downward cycle. The supply and demand model is making its mark. An increase in available space and a decrease in demand are the key factors causing a fall in rents.

All market areas have been affected to a lesser or greater extent by a fall in closing rents. Only very few sub-markets have escaped being affected by lower rents, when comparing annual and quarterly rents, although it is linked more to specific properties, than the positive or neutral performance of specific areas.

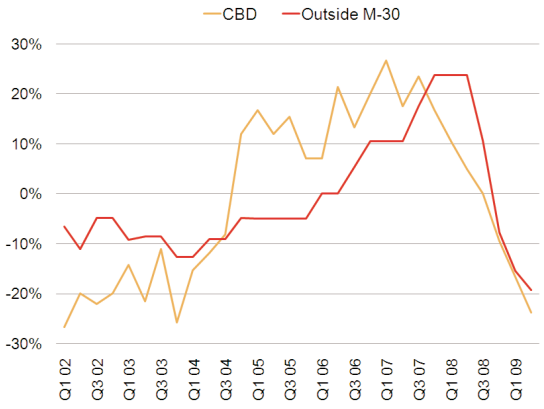
Within the M-30 area, the most noticeable drop in rents has been in the CBD. The 32 €/sqm/month in June represented a 9% decrease compared to the closing rent in April. The year on year difference is touching on 24%. In secondary areas the drop has been approximately 13%, compared to the same period the year before. Outside of the ring road rental levels in highly consolidated areas (prime) and secondary areas have been very similar, with both areas reaching 19%.

Regarding initial asking rents, the level of variation has been felt most when looking at rents on an year on year basis, when rents were at very high levels despite the fact that the tentacles of the financial and economical crisis were closing in on the property market. The stance which many owners are still adopting is that of not reflecting a drop in initial rents, which they then compensate later with another set of incentives, such as a larger rent-free period or by contributing to fit-out or set-up costs, which will equally lead to a drop in net rents. Aside from these contributions, we are also aware that some owners are willing to reduce the asking rent by 25% and 30% if a long-term contract can be signed by a specific tenant for a large office space.

The towers located on the old Real Madrid Training Grounds are the tallest properties in Madrid and have the highest rents in the Madrid office market. The highest office rents in the city are between 40 and 42 €/sqm/month, which are much higher than the 34 – 36 €/sqm/month registered for prime buildings on the Paseo de la Castellana. The current market will not put up for long with a difference of 15% between this modern complex within the city and the best locations in the city.

We will continue to see spiralling decreases. Each sub-market will evolve independently, and will be subject to demand and its vacancy rate, which will increase significantly when the developments which are about to be finished, come on to the market.

Prime rents evolution



Source: Savills Research

Main leasing transactions - Q2

Tenant	Area	Size (sqm)	Sector
PLETTAC	A-2	4,750	Business services
IBM	East	3,800	ICT
Línea directa	A-6	2,500	Insurance
Herbert Smith	CBD	1,500	Business services
Rotchschild	CBD	1,400	Bank-Finances
AECI	Urban area	1,200	Public Administration

Source: Savills Research

Main investment transactions - Q2

Buyer	Area	€m	Building
Pryconsa	Urban area	20.00	Pradillo, 42
M.Abogacía	CBD	35.00	Pº de Recoletos, 14
Vía Celere	CBD	16.00	Pº de Recoletos, 15
COBILAC	CBD	52.00	Pº de Recoletos, 19
Private investor	Urban area	35.15	Serrano, 73

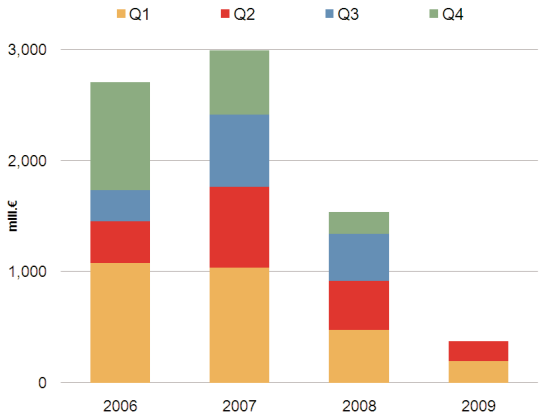
Source: Savills Research

Investment market

Investment market at an all time low

After a modest first quarter, both in terms of the number of transactions and the volume of investment carried out, the second quarter of the year is looking like it will follow the same path. The quarterly volume reached just over 185 million euros, which means that the volume for the first half of the year is at nearly 380 million, which is the fruit of twelve transactions. We should point out that the properties that several banking entities swapped to alleviate debts with some specific real estate companies are not included in this figure, as we do not consider them to be 'open market' transactions. The market continues to move forwards, albeit slowly. Comparing historic transactions over the past few years leaves no room for doubt, one has go back to 2000 and 2001 to find figures lower than these. Compared to the first half of 2008 there has been a decrease of 58% in the volume of investment and compared to 2007, a difference of 78%.

Investment volume by quarter



Source: Savills Research

The average investment volume continues to nose-dive. If we make a quarterly, six-monthly or annual analysis, the trendline is ever falling. The calculation for the first two quarters of 2009 has been 32 and 31 million euros respectively and the six-monthly total is set at 31.5. This investment volume fits perfectly with the standard investor that has been most active and dominates the market: i.e a small national investor interested in prime, well located properties, with a maximum value of approximately 40 million euros. Of the twelve registered transactions, only two exceed this figure.

Analysing buyers again shows the keen interest of national investors, mainly headed up by private and family offices: 54% of the transactions signed up to now and 50% of the investment volume registered between January and June has been signed by this type of company.

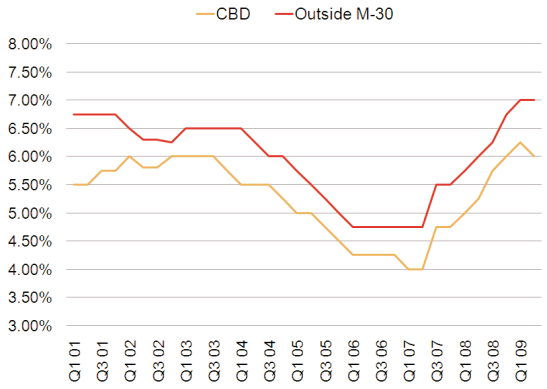
International investors are not excluded from the market out of choice. They, along with national investors, are also interested in properties located in the central business district, which have solvent tenants and long-term contracts, but the "aggressiveness" of Spanish buyers, who are offering initial yields some 50 basic points lower than their asking prices, are not allowing international investors to enter the market.

Interest in the CBD and the surrounding area is undeniable. 90% of investment volume has been concentrated on the Castellana and the surrounding area. One of the transactions carried out outside of the M-30 was the building that BANIF sold in Las Rozas as a package deal together with the Plenilunio shopping centre.

There are currently offers on the table for properties located in decentralised areas. Interest in these products is based on the type of tenant and on the length of the lease contract. Where the majority of contracts in the market are for 5 years, those that have longer contracts are of interest to national and international investors, despite not coming anywhere near to the contracts exceeding ten years which are so common in European markets.

National investors currently have limited investment capacity. They dominate the small volume market of up to 50 million euros, and, as previously indicated, they are very aggressive with regard to prime properties. Outside of this area is where the international funds have more opportunities, as they will not meet 'competition' from the locals because the buildings do not meet the criteria they are looking for, even though prices are lower. The need for liquidity will be a determining factor, but the seller's knowledge of the market will also have an influence, as in some cases a strict approach can result in losing a good transaction.

Prime yields



Source: Savills Research

On the other hand, a sense of confidence in the Madrid market is returning. Despite the fact that economic forecasts are still negative, it seems that credit activity is returning. Banks are granting financing, although it comes with cast iron conditions and takes into account

Yields and outlook

the solvency of the borrower, its past relations with the entity, etc.

Yields, end of the climb

It seems that prime yields have ended their frenetic upward climb, which started halfway through 2007. Overall results in the Madrid market do not differ much from figures registered in other European cities, but as of March it seems that there has been more active investment demand for prime buildings in the central business district (CBD), which has caused a drop in yields on the Castellana and its surrounding area to 6%, 25 basis points lower than the figure registered in March.

In the decentralised and periphery areas, we could see a period of stability with some indications of a rise in yields, as the difference between yields offered by buyers and those expected by sellers is still very different. Currently we estimate that the yield in consolidated (prime) areas outside of the M-30 is at 7%.

Less of a deterioration in economic forecasts for Spain

Although the monthly survey carried out by Consensus Economics in July showed some pessimistic forecasts in terms of growth for the Spanish economy in 2009 and the coming year, for the first time in months figures did not significantly deteriorate compared to the previous month, and even improved to some extent for 2010, which if one always takes a realistic viewpoint, could be considered to be the start of some form of potential change in prospects.

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

	2008	2009	2010
GDP	1.2%	-3.8%	-0.7%
Consumer spending	0.1%	-4.0%	-0.7%
CPI	4.1%	-0.1%	1.4%

Source: Consensus Economics (July)

Hence, the GDP is expected to reduce by 3.8% in 2009 and 0.7% in 2010, which compared to June forecasts is a drop of 30 and 10 basis points, respectively. The forecast for household consumption in 2009 only fell by one tenth compared to the previous month, and for 2010 it has improved from a 0.8% drop calculated in June to a rate of -0.7%. As in the previous study, inflation in 2009 is negative (-0.1%).

Market forecasts

With unemployment figures constantly growing, one cannot be optimistic about the coming months. The results of the “Informa Company Movements” study, published by D&B Informa also do not offer a promising outlook: between January and April the number of companies created fell by 36% compared to the same period in 2008. 4% fewer companies closed down, but Madrid tops the ranking with nearly 1,600 companies that have gone in to liquidation. Both variables have a direct influence on the office market, because the space vacated by companies that have closed or are reconfiguring and optimising their space will continue to increase the amount of vacant space on the market. Likewise, the 215,000 sqm of new empty space that will come on to market, should also be added to this data. In terms of take-up, the estimated annual volume is expected to be between 200,000 sqm and 250,000 sqm, as some of the large requests for space currently in the market could close before the end of the year. Rental growth will continue to be negative, at least until the end of the year. Prime rents in the city could be in the range of between 27 – 28 €/sqm /month.

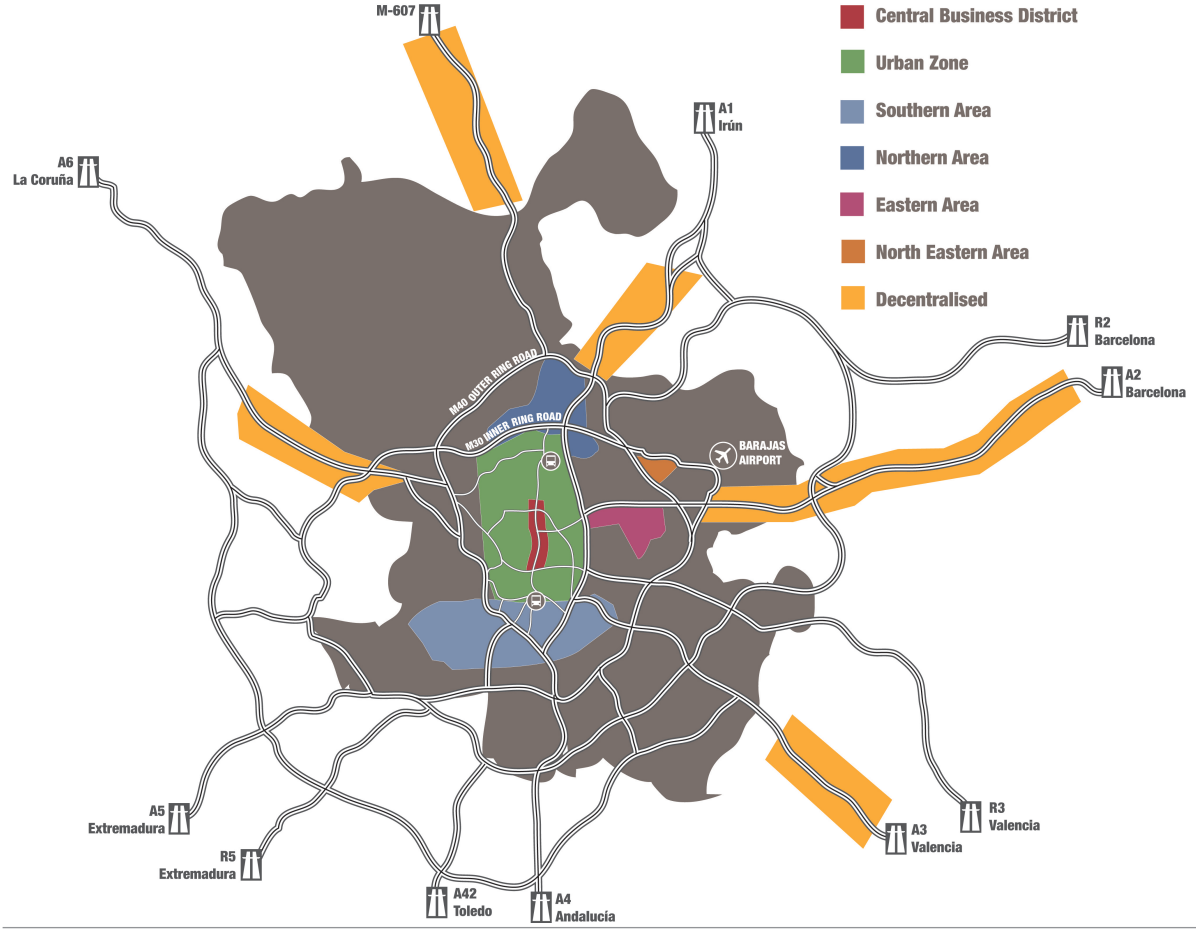
In the investment market, national investors, headed up by family offices, will continue to be the main players. These investors focus on rental properties and have a long-term investment strategy, they trust in the local prime property market, which allows them to move quickly and therefore they are buying at a price per sqm, which they already consider to reflect a strong correction.

The growing interest in the prime area will allow yields to remain stable. This does not mean that capital values have started to grow. The continued fall in rents will mean that price per sq prices will continue to fall. What we can confirm is that the change in the price of prime properties has slowed and in our opinion, could hit bottom in the next six months with prices per sqm at approximately 6,000 €/sqm - 6,500 €/sqm. It is important to point out that we are referring to a specific sub-market: the best buildings located on the best streets.

In terms of “secondary” investments, the dynamics are very different. The lack of demand for these buildings, demonstrated by the lack of transactions signed outside of the M-30, shows that the price of these assets should drop even further to find a balance or wait for demand from the CBD to move to the more consolidated periphery areas in search of more prestigious buildings with medium to long-term contracts. For less prestigious buildings and areas, which are finding it difficult to locate occupiers, the future is very complicated.

Madrid office market

Survey map



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