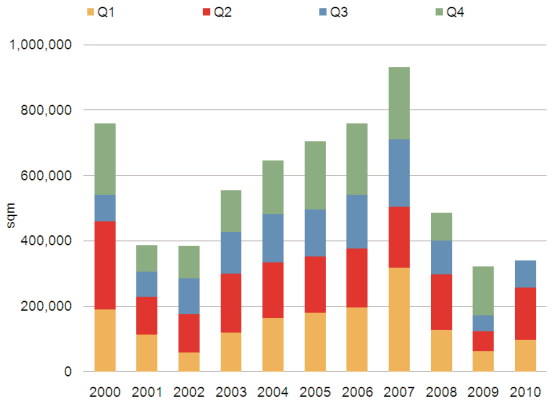
Madrid office market

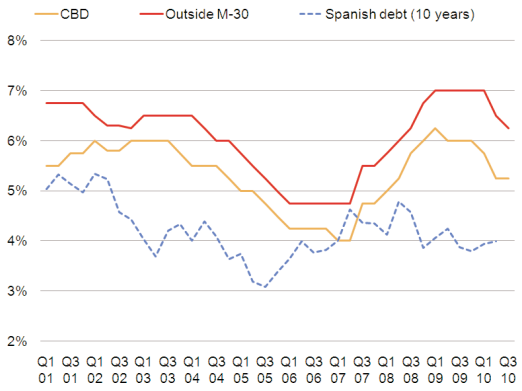
Autumn 2010

Annual take-up



Source: Savills Research

Prime yields vs Spanish Bond yield



Source: Savills Research, INE

"The good results in the occupier market have strengthened investor confidence. The CBD and the decentralised Prime areas will see the majority of investment activity in the coming months. It is worth remembering the words of Sir John Templeton: 'The time of maximum pessimism is the best time to buy'".

Gema de la Fuente - Head of Research

- The more than 80,000 sqm transacted in the office market over the third quarter represents a 72.5% increase, compared to the same figure and period the year before. Total take-up between January and September 2010 was double the 2009 figure and is already 6% more than the gross annual take-up registered for the whole of last year.

- The vacancy rate has continued to increase in the Madrid market. In September it was touching on 12% despite the lack of new build space coming on to the market over the summer months. However, not even the good take-up results managed to balance out the amount of space on the market.

- The combination of a high vacancy rate and the fact that there is still very little demand, can only mean one thing: that rents continue to fall. However, although this is the general situation, some specific submarkets are showing clear signs of stability or improvement. The prime areas within and outside of the M-30 have vacancy rates which are lower than the overall rate and have a continual stream of occupiers who are always interested in taking available space.

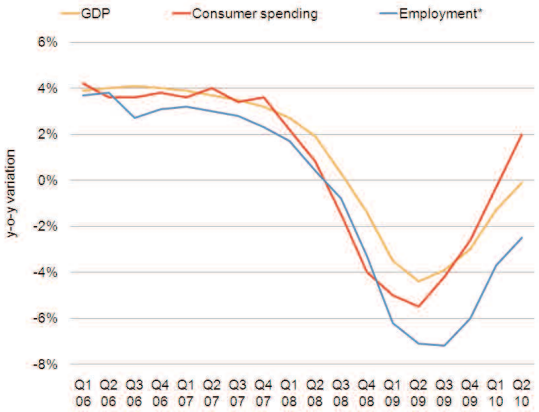
- The summer left its mark on the capital's investment market. Only one transaction was carried out: Metroinvest, which is part of Grupo Metrópolis, purchased one of Acciona's buildings in Julián Camarillo for €45.5 million.

Economy

Spanish economic situation

Europe continues to come out of recession and this is happening at varying speeds depending on which country one looks at. The euro zone as a whole grew by 1% in the second quarter compared to the previous one and by 1.9% year-on-year. Various countries have comfortably exceeded this improvement (Denmark, Finland, Sweden...), especially the main European economy, Germany, who consolidated its recovery with quarter-on-quarter growth of 2.2% and 3.7% year-on-year growth. At the opposite end of the spectrum, countries such as Ireland and Greece have clearly deteriorated further. Spain seems to have suffered from a certain degree of sluggishness over the past few quarters, with the change in GDP growth over the past four quarters fluctuating between -0.3% to the latest 0.2%. In terms of year-on-year change, the second quarter only fell by a tenth.

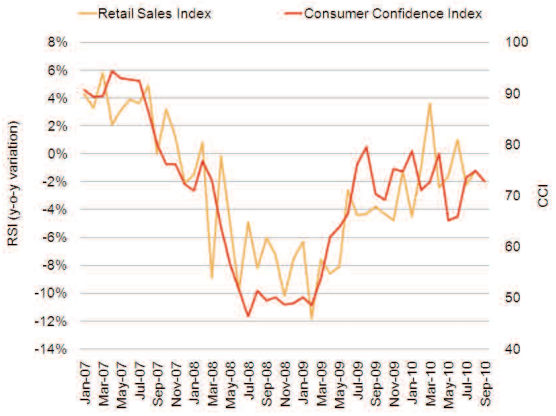
GDP, consumption and employment



Source: INE / *Full time employment

There are many uncertainties with regard to how the Spanish economy will perform in the short to medium term. It is expected that growth will slow at the beginning of the second half of the year, due to the increase in indirect taxes (VAT), the immediate effect of which would be a fall in private consumption. Consumer confidence has not really improved significantly and despite everything that has been said, it is household consumption which is growing most significantly (perhaps as a counter measure to the indirect tax increase). In view of household purchasing power not increasing and there being no improvement in access to credit, this has perhaps meant that greater consumption has led to a decrease in household saving, which reached its peak in Spain over the last period. The industrial sector has been the only one to register a significant improvement in terms of supply coming on to the market.

Retail sales and consumers' confidence

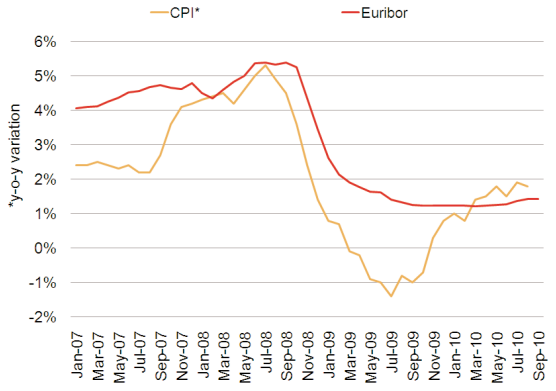


Source: INE, ICO

The Spanish Government's economic policies continue to be determined by international requirements, primarily focused on controlling the state deficit (11.2% of GDP in 2009), with the main priorities being cutting costs and public investment and the previously mentioned increase in indirect taxes. However, hurdles such as the high unemployment rate (above 20% of the active population in the last two quarters) weaken the state's capacity to balance out costs and income.

In terms of prices evolution, after significant recent fluctuations (maximum figures of above 5% in 2008 and minimums down to -1.4% in 2009), the annual change in CPI has been between 1.4% and 2.1% for the last seven consecutive months.

CPI and Euribor



Source: INE

Demand

Demand

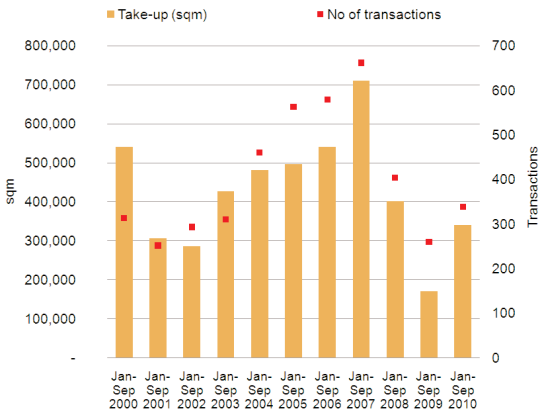
Expectations are surpassed, yet again

Yet again the Madrid office market does not fail to surprise us and for the fourth consecutive quarter has surpassed expectations. Previous quarters benefited from the chance timing of various «mega-transactions», which is something which has not happened in the third quarter of 2010, although we should point out that the over 1,000 sqm bracket is continually gaining more ground.

In depth analysis of these transactions shows that between July and September the highest percentage of transactions (80%) were in the 1,000 to 3,000 sqm bracket, compared to 67% and 74% in the first and second quarter, respectively.

The total gross take-up in the Madrid market for the third quarter was 80,000 sqm; although this was a drop in activity compared to the previous quarter, this was expected as it was the summer holiday season and if one compares this figure with the same quarter in 2009, it represents a 70% increase in take-up. On the other hand, accumulated take-up between January and September 2010 doubles the figure reached in the first three quarters of 2009 and is almost 6% more than the total for last year.

Take-up and number of transactions



Source: Savills Research

Going back to looking at the size of space taken, space smaller than 500 sqm is not seeing its best of days. Since the start of the year small offices have fluctuated between 50% and 60% of all transactions in the market and the total up until September was at 55%, which is five percent below the figure registered the year before and four percent below the average figure for the past five years.

This size of space bracket could be considered to be one of the sounding boards of the market, as it is traditionally the size of space requested by small businesses (up to 49 employees). According to data from DIRCE, and not including businesses with no employees and micro-companies, small businesses make up 87% of SME's (up to 249 employees). These types of companies have been the ones that have been most affected by the recession and will play a key role in the recovery by contracting new personnel, which will be the point when they need more space to carry out their work.

In terms of the type of property requested, occupiers continue to clearly opt for exclusive office use buildings, with 75% of the sales transactions signed and 82% of take-up. However, a detailed study of the size of space taken shows that the best results have been in the medium range bracket (between 500 and 1,000 sqm) and large (> 1,000 sqm), with 81% and 82%, respectively. Offices smaller than 500 sqm in exclusive use properties only represent 70% of the total, followed by renovated space for professional use in mixed use properties.

High-tech buildings are a good alternative to exclusive use properties in the periphery areas closest to the city. Despite the fact that over the third quarter hardly any large operations have been registered in this type of property, the Julián Camarillo and Manoteras business areas were various of the major operations were carried out over the first half of the year.

The geographical spread of the different transactions has had a marked difference in terms of the M-30 ring road. 62% of transactions have been registered in the urban area, whilst 59% of space taken has been in periphery areas. The northern area of the city continues to be at the forefront of the most in demand areas. The PAU submarkets are of particular interest, as there is office space in new buildings, which are close to the city and are easily accessible via public transport.

The CBD continues to receive new occupiers. The ICBC will share its headquarters with Uralita at Paseo de Recoletos, 3 (transaction advised on by Savills); Paseo de Recoletos, 37-41 will now include Jones Day Reavis & Pogue as one of the tenants and the Korean Embassy will open its headquarters at Paseo de la Castellana, 15.

The owner occupier sales market made up 8% of all of the registered transactions. The average space taken for owner-occupier use has increased considerably compared to the previous quarter thanks to the sale of General Pardiñas, 73, which was one of Urbis's old headquarters. The China Cultural Centre will be the new owner of the building.

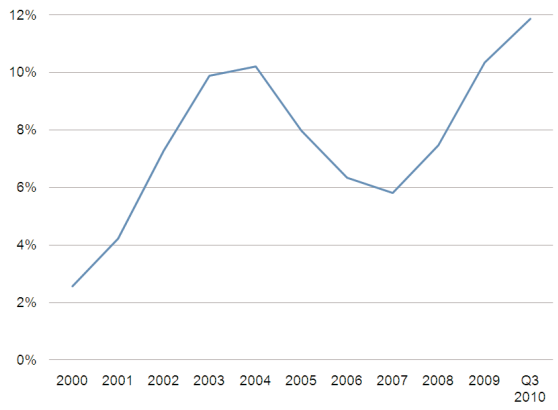
Supply

Supply

Vacancy continues to mount

There is not much new news to tell in terms of supply. The amount of vacant space is now above 1,500,000 square metres, which is making the vacancy rate move ever closer to 12%. With 70,000 sqm of new space in the office market, the Madrid office stock is now at 12.7 million square metres. There has been very little growth, with figures even growing little more than 1%. The largest developments came on to the market in the first half of the year. 70% of the volume expected to come on to the market in 2010 was delivered betwen January and June. Among the «mega-projects», were the two towers that completed the CTBA (Caja Madrid and Torre Cristal, with slightly more than 50,000 sqm in each) and the third phase of the Rivas Futura Business park, 45,000 sqm more, that can be added to the 80,000 sqm in the previous developments. Therefore, since the previous quarter the already battered A-3 submarket has one of the highest vacancy rates in Madrid.

Availability rate



Source: Savills Research

The business areas in the South came in to being with the intention of balancing out the exodus of the resident population southern towns to the business areas in the north. However, despite the fact that the southern area of the city has the highest percentage of inhabitants, everything suggests that it will be a long time until the periphery areas furthest from the city in the southern area of Madrid will be a serious market player. At the moment, the average size of transactions registered over the past few years it at approximately 550 sqm.

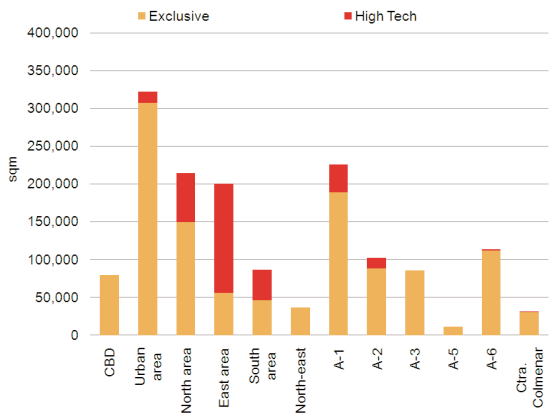
In terms of the four towers «micro-market», and considering that Caja Madrid will occupy Norman Foster's tower, despite the fact that they have not moved in, the vacancy rate would be at 45%. Torre Espacio had the advantage of the fact that it came on to the market first, but Torre Cristal now already has four tenants, although the average space contracted is only slightly above 1,000 sqm. There has been a great deal of talk about the effect that the towers would have on the capital's market, but if we assume that we are in the hypothetical situation of them being 100% occupied, this would only mean that the overall vacancy rate would drop by seven tenths of a percent.

Of all of the properties delivered in 2010, only 20% came on to the market in the third quarter, of which only 55,000 sqm were vacant, as the Vía Norte Business Park continues to receive new tenants. Little more than 33,000 sqm is expected to come on to the market up until the end of the year, of which 9,000 sqm are already pre-let. In the second quarter Diageo rented a property in El Plantío and LG Electronics will occupy the property in Las Rozas that it signed in the summer.

There is little change in the geographical layout of currently vacant space. Not much more than 28% of available space in exclusive use and high-tech properties is in the urban areas (CBD and the Urban Area). The periphery areas closest to the city have 32% and the periphery areas furthest from the city have 40%, which is spread throughout the business parks located on both sides of the main arterial roads running in and out of the city.

In terms of types of buildings, 79% correspond to exclusive use office buildings and the remaining 21% to high-tech properties. With regards to the latter, 45% of available technological space is in the Julián Camarillo area. The area is still in the process of regenerating and there are still many buildings which are pending being «up-dated». A positive point that should be made and generally speaking, is that it does not take long for new or renovated buildings to find occupiers when they are at market rents.

Distribution of the available space - Sept. 2010



Source: Savills Research

Rents and transactions

Rents and transactions

Rents continue to adjust slowly

The market continues to trend downwards and although adjustments are ever less marked, indicators suggest that rents will continue to decrease over the coming quarters.

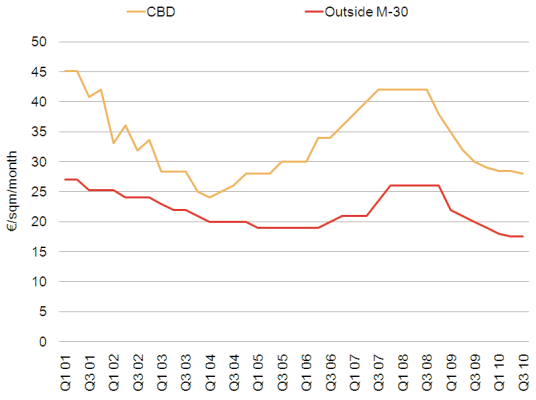
Despite the fact that the general overview reflects a fall in rents, it must be stressed that the Madrid office market is moving forwards at a quick march. Worth mentioning are the CBD and prime areas beyond the M-30 ring-road, which are well consolidated and whose vacancy rate is at lower levels than the overall market. The year-on-year difference in rental prices is at -7% in the city's main business district and at -10% in the areas beyond the M-30 ring-road. The quarter-on-quarter comparison of these two indicators reflects a certain amount of stability.

The incorporation of new projects would put downward pressure on rental prices, provided that the quality of the buildings which currently have available space were comparable. Unfortunately, properties in the city centre, including the Castellana area, are somewhat dated. When it comes to establishing a rental price adapted to the market situation, one must not only bear in mind the property's location, but also the services, quality and technical features on offer. It is not enough for a building to be located in the heart of the business district if that building is not improved to reach similar standards to recently constructed properties. Along these lines, it is expected that works carried out, on what for many years has been the only plot on the Paseo de la Castellana, will finish over 2011. This will increase the vacancy rate, which in turn could have a knock on effect on the rental levels of the best buildings in the best area. The AZCA area also awaits two new developments: one of which for many years was AXA Seguros' headquarters and the tower that which will replace the late Edificio Windsor. This will add an extra 30,000 sqm to the area, which is regarded by some as the heart of the city's financial area. However, these new square metres are not comparable to the vast majority of the existing buildings given that, despite the fact that some of them have carried out improvement and rehabilitation works, the average age of these buildings is over 20 years.

On the other side of the market are the secondary areas within and outside of the city. In these cases, rentals have also slowed the free fall in values. However and for the time being, year-on-year change continues to be above -10% in the urban area and over -20% in the secondary areas outside of the M-30 ring-road. There has been a fall of 4% and 8% respectively, compared to rents in the previous quarter.

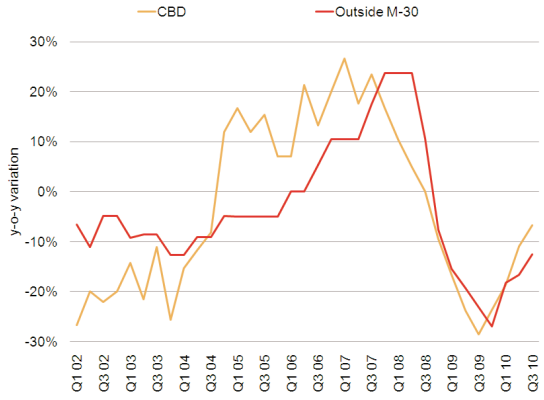
The periphery areas furthest from the city continue to be shot through. The high vacancy rates and a lack of demand have left rental prices at one-digit figures.

Prime rents



Source: Savills Research

Prime rents variation



Source: Savills Research

Major leasing transactions - Q3 2010

Tenant	Area	Size (sqm)	Activity
Banco Santander	A-6	6,000	Bank
LG Electronics	A-6	5,500	IT
Infoglobal	North	3,600	IT
Oracle Sun Microsystems	A-6	3,000	IT
Huawei	North	3,000	IT
Atento	North	2,700	Professional services

Source: Savills Research

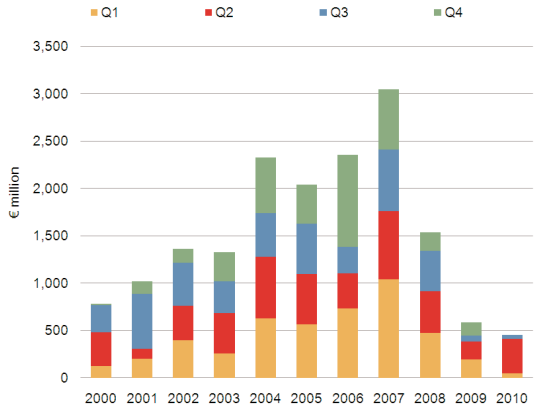
Investment

Investment market

Closed for holidays

The summer break left its mark on the Madrid investment market, given that throughout the summer months only one transaction was registered: Metroinvest, which is part of Grupo Metrópolis, purchased one of Acciona's buildings in the Julián Camarillo area for €45 million. The accumulated figure between January and September provides a more encouraging picture. In comparison to the previous year's data, the investment volume corresponding to the first nine months is at a similar level, i.e. ca. €470 million. However, one must point out that 46% of the total was still concentrated in two transactions over €100 million (Caja Madrid's headquarters in Las Rozas and the Master's II building, both of which were signed in the first half of the year). The average transaction volume has increased by more than 30% on 2009 figures, from €26 million to €33 million.

Investment volume



Source: Savills Research

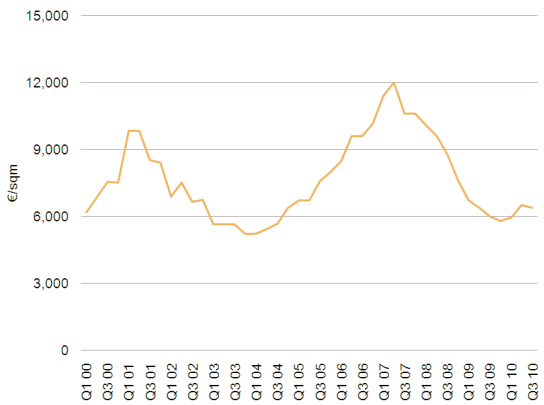
Investment activity is still being driven by national investors, both in terms of the buyer and the seller. All transactions featured a national seller, 41% of the investment volume comes from real estate companies who are disinvesting properties, 52% from real estate funds in finance companies or insurance companies and only 7% corresponded to private investors. As far as buyers are concerned, both national and international investors have been on the playing field, although their profiles and their investment pattern are completely different.

Among local buyers, private investors and family offices have been responsible for 60% of the acquisitions, although the percentage of investment volume lies at a discreet 28%. The average investment volume average is hovering at around €14 million, whereas it is normally at €20-40 million. National investment funds aim for larger volume properties. These are namely mutual insurance companies, insurance companies and the real estate divisions of banking institutions, which have a larger buying capacity and are therefore capable of acquiring properties over €50 million.

Up until now all of these followed the same pattern of property acquisition. Properties were located in the CBD area and the surrounding area, but the lack of product for sale and the fierce competition for properties with “for sale” signs, have led national investors to look at other alternatives in decentralised areas. However, potential sacrificing with regard to location has not meant that there have been any concessions on other investment parameters.

International investors came in to the picture towards the second quarter of the year and since then no new signings have been registered. The high yields requested by the parent companies have meant that they have had to look outside of the M-30 ring-road, in consolidated areas such as Campo de las Naciones, the first stretch of the A-2 Madrid-Barcelona motorway or within the Las Rozas Business Park.

Prime capital values in CBD



Source: Savills Research

Yield adjustments across the whole market

Investment supply in the prime area is coming on to the market bit by bit and there is also strond demand from investors, which has been pushing yields down since the beginning of the year. With yields theoretically at between 5.25% - 5.50% and prime rents at between 28€/sqm/month and 29€/sqm/month, capital values now exceed 6,000 €/sqm and present a positive year-on-year change for the second consecutive quarter.

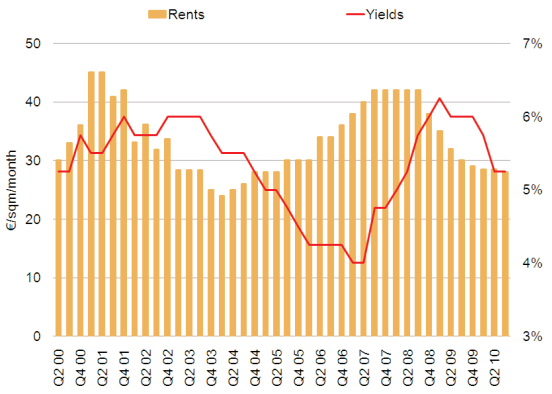
There was a difference of slightly more than 50% between the figures registered at the top of the market and the very lowest value so far, although it is difficult

Yields and outlook

to suggest that the market will go back to the real estate «bubble», it is clear that the office market has made its first steps towards recovery and the CBD is in an advantageous position.

The prime areas outside of the M-30 are in a similar position. Yield levels would be at between 6.25% and 6.50%. New or renovated properties, which are 100% occupied or with a high level of occupation, solvent tenants and medium to long term lease agreements, will be the properties in investor's sights.

Prime rents and yields in CBD



Source: Savills Research

Outlook

Economic forecasts

Everything seems to point to the fact that, aside from some potential relapses of a few tenths of a percent, the Spanish economy is in a phase of very slow and virtually no growth, after the free fall of all of the main macro-economic indicators over the duration of the recession.

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

	2009	2010	2011
GDP	-3.7%	-0.4%	0.6%
Consumer spending	-4.3%	1.0%	0.4%
CPI	-0.2%	1.6%	1.4%

Source: Consensus Forecast (October)

The potential for financial collapse in the banking system, renewed peaks of massive employment destruction and foreign investor's anxiety with regard to Spain's solvency, seems ever less likely. As is the likelihood of an immediate and significant recovery in GDP, consumption, investment and the national manufacturing sectors. We will not be seeing any clear signs of a new recovery cycle, which could lead to an improvement in the unemployment rate and to a significant increase in GDP and the remainder of the aforementioned variables, until well in to 2011.

Market forecasts

At this stage of the year and given the good take-up results registered between January and September it seems clear that the year's total take-up figure will exceed 400,000 sqm and it seems likely that it will reach 450,000 sqm, as various large requests that are in the process of being negotiated could be signed before the end of the year.

New developments which are expected to come on to the market, will hardly increase the stock by more than 35,000 sqm, although only 24,000 sqm will be added to the vacancy rate as two of the buildings are already let.

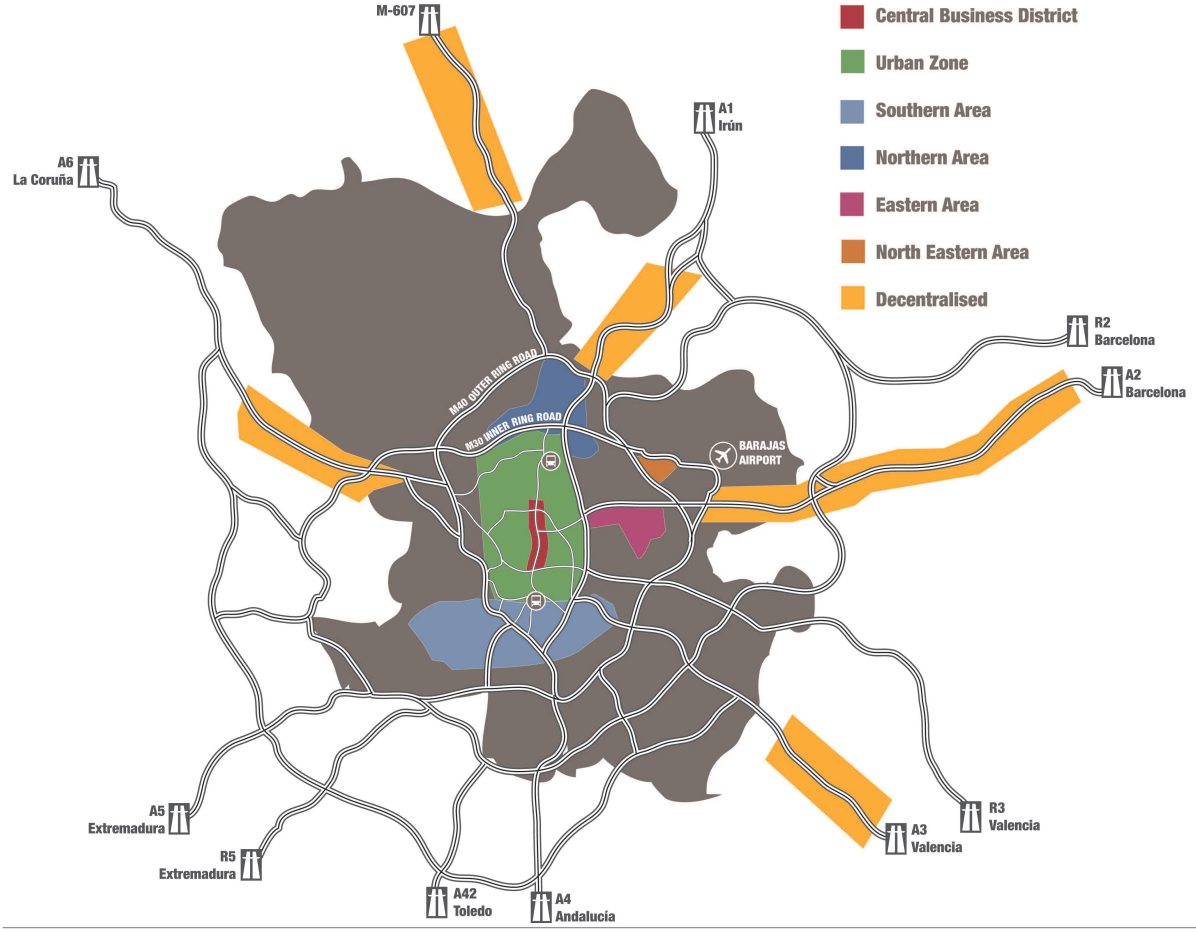
Only slightly more than 160,000 sqm is expected to come on to the market in 2011, which is 52% less than the amount of new space that came on to the market in 2010. It seems that at last developers have slowed their activity, but we should point out that two thirds of the space corresponds to three large projects whose delivery were on hold, therefore, if we exclude this space, the expected volume for 2011 would be 27% more than was delivered in 2010.

Rents will continue to fall; or at least everything suggests this will be the case. Demand is playing hard to get and supply is growing slowly, this fundamental therefore suggests that there will continue to be adjustments in the market. A recovery is still a long way off, but the CBD is one step closer to stabilising.

Without a doubt, the large amount of gross take-up in the occupier market will put investors on alert. Apart from the CBD, the capital has many submarkets with vacancy rates which are below the market average, with recurring demand which is triggering investor interest. Yields will continue to fall at a moderate pace as they have since the beginning of 2010. Various transactions are in an advanced stage of negotiations, therefore the total annual investment volume could be at around €750 million.

Madrid office market

Survey map



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