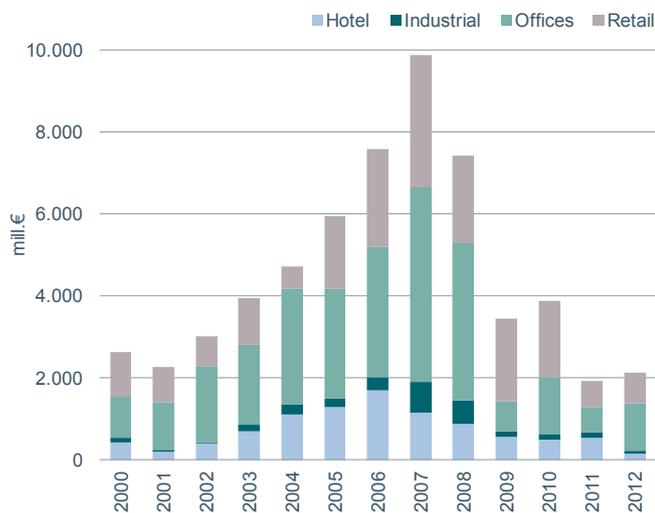


Market report Spain Investment

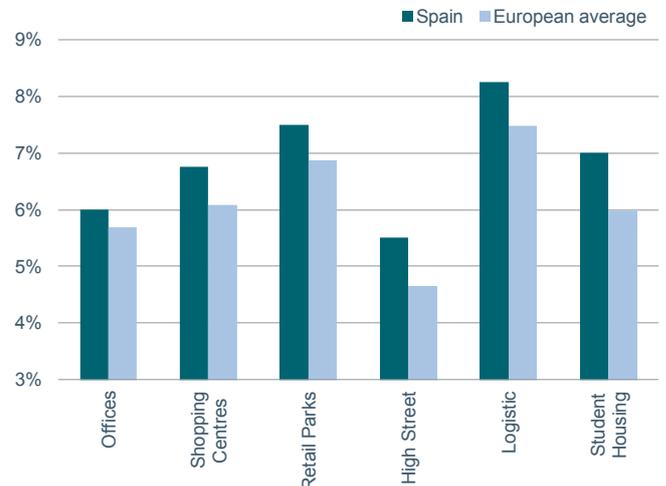
January 2013

GRAPH 1
Investment market by sector



Source: Savills

GRAPH 2
Prime yields Q4 2012



Source: Savills

SUMMARY

Overview

■ The shockwaves that have rippled through the economic and financial arena over the past year have had a swift and virtually blanket effect on international demand. Aversion to risk has meant they have fled the market, although this could be just temporary.

■ Despite subdued investment activity amongst international investors, many of those that have been involved with the market are fully up to speed with the area they are working in, because they already have several Spanish properties in their portfolios.

What is new is that South American investors are investing in Spain.

■ It is also worth highlighting that many international investors are waiting in the sidelines with bated breath to see how Spain's market indicators and economy are going to pan out. We should also point out that many of these investors are new to the market and have not had a presence in the country up until now - some of these are clearly opportunistic ones. Spain is one of the main markets in the European Union and investors are confident in its ability to

recover. They know that it has a while to go before stability returns to the market and it recovers the strength it had a few years ago.

■ The investment volume improved considerably in the final sprint up to year-end, increasing by 10% year-on-year to just over €2.1 bn. However, we should point out that half of this relates to three individual transactions: Torre Picasso, the sale & leaseback deal for 439 CaixaBank bank branches and the sale of the Canalejas complex.

Economic situation

GDP growth continues to decline, falling by 1.6% year-on-year in the third quarter, which means that it has now been negative for three consecutive quarters. The main economic indicators in the domestic economy are also continuing to decline. Average annual income in Spanish households fell by -1.9% year-on-year, which resulted in a 1% fall in average spending per household.

Retail sales recovered slightly in August (-1.9%), which was mainly the result of people making purchases before the VAT increase in September, after which the rates dropped again, with the latest figure published (November) standing at -7.8%.

Household budgets, purchasing power and consumption will largely depend on the blighted job market, although

forecasts for the short and medium-term do not bode well.

However, exports are offering a glimmer of hope - in Q3, exports of goods and services increased by 6.53% year-on-year. Expansion of business outside of Spain may mark the beginning of an economic recovery and job creation. In addition, the arrival of Europe's first tranche of bailout for the financial system should inject capital into the micro economy, which will have an effect on investment and growth in the business environment, resulting in an increase in consumption.

Investment volume

The investment volume registered in 2012 amounted to just over €2.1 bn, which is a 10% year-on-year increase.

At first glance, it looks promising; however, we must highlight that 50% of the total figure relates to three individual transactions, one of which was the first deal registered in 2012. Amancio Ortega's real estate vehicle kicked off the year by acquiring Torre Picasso, one of the most prominent properties in the Madrid office market, for €400 m. And just a few days before year-end, two sale & leaseback deals were signed. The Mexican property firm Carso, which is owned by Carlos Slim, who is considered to be the richest man in the world according to Forbes, paid around €430 m for a portfolio of 439 CaixaBank bank branches. This deal came at a time when it seemed as if there were no more of these types of properties left in the investment market, although the financial institution took two years to mull over the transaction before it signed on the dotted line.

The other transaction relates to the sale of the Canalejas complex. After attempting to sell the complex on several occasions in the mid-2000s, it looks as if one of Banco Santander's most emblematic headquarters has been sold in Madrid. The new owner, the Villar Mir group, purchased the complex for €215 m and once Santander vacates the premises, it will start an ambitious renovation project to develop it as a mixed-use macro complex, comprising residential properties, a hotel and a retail area.

Excluding these three agreements from our analysis, as they are considered to be one-off transactions that do not reflect the current reality in the market, the estimated total investment volume figure for the end of 2012 stands at just over €1 bn, which is 44% below the figure registered just one year ago.

Market indicators are pointing towards an upswing in investment - price per sq m values have fallen by 60% compared to the top of the market and yields have increased by 200 basis points, so why are deals not being signed?

One of the main reasons for this decline in the number of transactions is economic uncertainty, which has had a significant effect on investor confidence in Spain, particularly international investors. Transactions have also been influenced by the difficulties in acquiring finance and the high cost if it is awarded and the shortage of good quality properties at market prices.

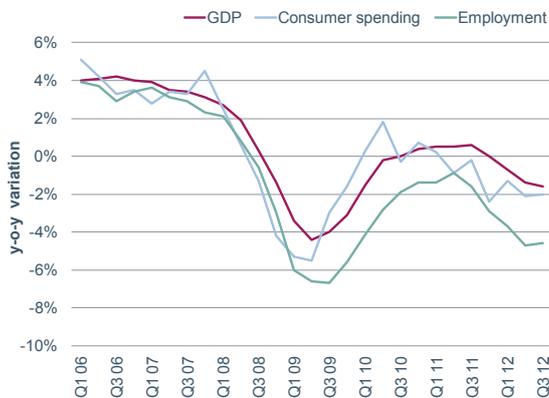
On top of this, the difference between buyer and vendor expectations of value is still significant, and this is scuppering the number of agreements being signed.

Market segments

Excluding the three aforementioned deals from the analysis, all segments of the real estate sector have suffered from a severe decline in absolute values compared to 2011, with the industrial/logistics sector being the most affected. However, in relative terms the sharpest declines were seen in the hotel market, despite the fact that, according to the latest figures published by the Institute of Tourism Studies (Instituto de Estudios Turísticos), the tourism sector performed well from January to November, with a 2.9% increase in tourist arrivals and a 6.0% increase in tourist spending. However, the market has not reached a standstill - investment transactions have given way to operators making hotel acquisitions.

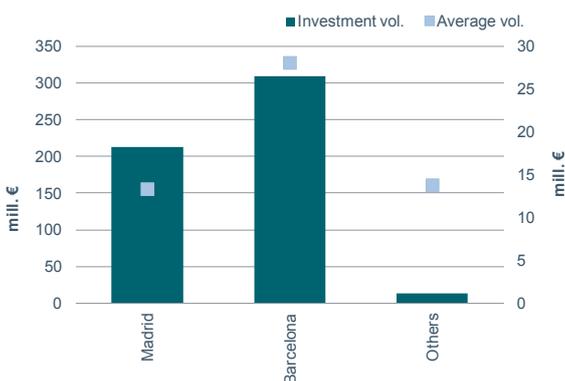
Around 79% of the total figure came from areas that have traditionally led the investment market - offices and retail. In terms of the office market, the difference between the number of transactions completed in Madrid and Barcelona is striking. Where in the

GRAPH 3
Economic indicators



Source: INE

GRAPH 4
Office* investment market 2012



Source: Savills / *excluding Torre Picasso and Santander's S&L

past, more transactions took place in Madrid, now over half of transactions took place in Barcelona, 38% of deals were signed in Madrid, and just 4% in other locations. The regional administration's decision to change its strategy to sell its properties as individual lots, instead of as a portfolio, attracted several investors, as they could bid for properties that were more in line with their specific requirements.

The retail market is not going through the finest of times. Just as in other segments, domestic investors are dominating the playing field, but their investment capacity means that they are limited in terms of the types of properties they have access to. The upswing in the retail unit submarket may be linked to this. Despite the latest data on private consumption, consumer confidence and retail sales being poor, retail units on prime retail high streets in the main cities are continuing to attract domestic investor interest.

Specialised retail properties, such as shopping centres, are still out of their reach, not just because of the high level of investment required, but also because it is a very specialised product that requires intensive management and experience, and prior knowledge of the sector. International institutional investors are the key investors in this type of property, but they are currently distancing themselves from the market. In some cases, this is because the management board has stopped any attempt to purchase properties, whenever their Spanish subsidiaries identify an opportunity, as the country risk is greater than the terms of the

deal. In other cases, (almost all), it has been due to market supply not being in line with their requirements, either in terms of the quality of the property or due to a disagreement in terms of the closing price and market data.

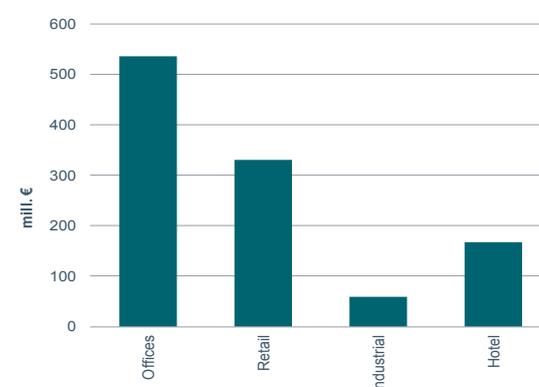
Who is buying?

Over the past twelve months, just over two thirds of the total figure registered (once again excluding the three aforementioned deals) related to local investors. They have been leading transactions in all sectors. The predominance of domestic investors in the office market is also staggering - with 75% of the total figure.

Pontegadea, the Inditex Group's real estate vehicle, has continued to make major investments over the year, adding several properties to its portfolio. In addition to the aforementioned Torre Picasso, it also bought the office building at Paseo de Gracia 56 in Barcelona, as well as the retail unit that houses Apple's flagship store on Paseo de Gracia 1. One of the last deals of the year was also carried out by Pontegadea: BBVA's headquarters on Paseo de Gracia 5. Interestingly, all of the agreements that they signed in the three markets were the highest transactions registered in each market segment.

Despite subdued investment activity from international investors, it is worth pointing out that many of those that have engaged in the Spanish market in 2012 are well aware of the area they are working in, because they already have several Spanish properties in their portfolios. In other words, they know the market, the country and its traits,

GRAPH 5
Investment 2012* by sector



Source: Savills / * excluding Torre Picasso and CaixaBank's and Santander's S&L

and despite the negative indicators, they believe that Spain can achieve an economic recovery.

In line with the saying 'Buy low, sell high', others continue to hold off for the moment and are waiting in the sidelines to see how the economy performs and keeping a keen eye out for opportunities to appear.

Alternative properties

For several years now, the student-housing sector has been positioning itself as a sound alternative in the Spanish real estate market. Traditionally, the majority of private university student housing was in the hands of religious institutions or publicly speaking, the universities themselves. However, gradually, private capital has reached the sector, either via private firms acquiring or managing properties, or via long-term concessions to manage public student halls.

TABLE 1
Largest commercial investment deals 2012

Market	Asset	City	Inv. vol. (mill.€)	Vendor	Purchaser
bank branches	439 bank branches	several locations	428.2	CaixaBank	Inmobiliaria Carso
offices	Torre Picasso	Madrid	400	FCC	Pontegadea
offices	Canalejas Complex	Madrid	215	Santander	Grupo Villar Mir
hotel	Luchana palace and Almagro palace	Madrid	100	na	Private investor
offices	Copérnico portfolio	Madrid and Barcelona	95	Hypothekebank	Anchorage and Värde (Madrid) Private investor (Barcelona)

Source: Savills

Spain is starting to look like an attractive option for operators from other European countries with strong and mature markets. One of the first operators to establish itself in the market was Victoria Hall, when it acquired the Galileo Galilei student hall in 2007. The latest operator to enter the market is Knightsbridge, which has purchased the Galdós university student hall in Madrid, with the support of Oaktree Capital Management. Unnim, a domestic player, purchased several properties in Barcelona a few years ago. In 2008, EBM purchased Metrovacesa's stake in the Campus Patrimonial group and Lazora has controlled Resa, the leading operator in the market since 2011, which currently manages around 7,000 rooms in Spain's main university cities.

Yields

The economic climate and its direct impact on the property market are causing yields to continue to move out. This is mainly linked to rental adjustments, which are likely to continue throughout 2013.

Prime yields in different segments of the market are currently above the European averages, and this may attract investments from international funds. The principal potential stumbling block for international investors to come back to the market is focused on the economic recovery and credit

beginning to flow again. This should be resolved thanks to Europe's cash injection in to the financial system, which would help the financial sector start lending again, and could mark the beginning of a recovery. Consequently, companies would be able to access credit to invest in expanding their businesses, which would include job creation. It would also encourage an increase in private consumption, which is the current cornerstone of the financial system.

In any event, different financial institutions continue to forecast negative growth in 2013, which will delay growth to 2014-2015. ■

OUTLOOK

2013

- International investors are keeping a close eye on the Spanish market. Despite the current circumstances in the economy, they are confident in Spain's ability to recover. The time to buy is getting ever closer. In addition, international funds, which up until now have not participated in the market, are showing interest, the majority of them are opportunistic investors.
- The fact that domestic investors are much more flexible, is giving them the upper hand in the market. They have purchasing power, and they want to buy properties. They are looking for properties that match their investment profile (both in terms of the type of property and investment volume).
- Access to finance and changes in the economic climate will continue to affect performance in the investment market.
- Investment activity is expected to be similar to that of 2012 (excluding the three aforementioned deals), although if a portfolio is purchased, this could considerably inflate the annual figure.
- The retail and logistics sectors will be the most affected, given that they are closely linked to consumption. The spotlight will remain on offices and high street retail units, which will be particularly attractive for domestic investors.

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