

Investment Market

October, 2008

Financial market uncertainty continues to impact upon real estate investment in Spain, Liquidity problems have led to a reduction in investment during the first nine months of the year, The market is responding through an upward shift in yields,

MARKET SUMMARY

The downturn in the real estate investment market intensified during Q3 as the global financial crisis took hold. Total investment volume reached 89.4 billion euros for the first 9 months of the year, a drop of 47% in respect to the same period a year earlier. The global crisis in financial markets has clearly restricted

Investment in Spain also experienced a significant slowdown. Excluding some large isolated deals, such as the Santander HQ deal, the drop in investment volume was similar to that seen in Europe,

A look at deals completed during the first 9 months of the year show a clear shift towards lower risk assets by investors. In addition, those assets that produce immediate income are most sought after. On the other hand, development projects are less desirable. Credit conditions have hardened considerably as banks scrutinise risk more closely. Even when considering relatively low volumes, financial entities require additional guarantees and increased margins.

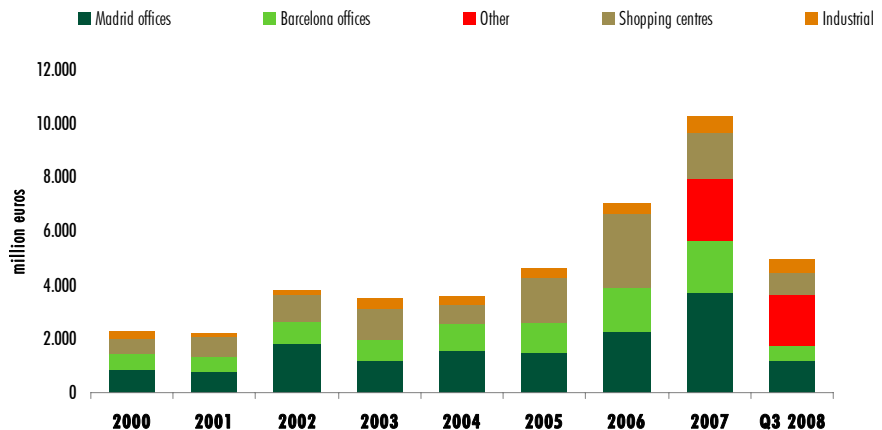
Highly leveraged investors have practically disappeared and equity investors now dominate demand. Approximately half of all investment was carried out by private

and institutional investors, chiefly insurance companies and property funds. On the supply side, the source of product is mainly from property companies in search of equity to comply with debt repayment obligations or companies seeking alternative ways to finance their business operations. Sale & leaseback deals provide this finance,

Despite a lack of comparable evidence, we estimate prime office yields in Madrid and Barcelona to have reached 5.5%. As such, the reference yield for the main office markets in Spain is above that for Ille de France in Paris (4.85%), the West-end of London (5.00%) and the German cities, However, it remains below the level in the City of London (6.00%). Indeed, there are signs that yield shifts in this market has begun to generate interest among equity investors, such as German open-ended funds,

Looking forward, current trends suggest that the market will continue to weaken towards year-end. Uncertainty remains and some investors are temporarily redirecting investments towards alternative assets in capital markets. Over the coming months, real estate debt may attract an increasing amount of capital,

REAL ESTATE COMMERCIAL INVESTMENT



Source: CB Richard Ellis

INVESTMENT ACTIVITY

Direct commercial property investment has weakened considerably in recent months. The rapidly deteriorating economic situation and the credit crunch have significantly reduced purchasing capacity. On a European level, the investment volume during the third quarter of the year was 60% less than Q3 2007. Following this trend, investment in Spain over the first 9 months of the year, excluding the Santander HQ deal, accounted for only 50% of investment for the same period a year ago.

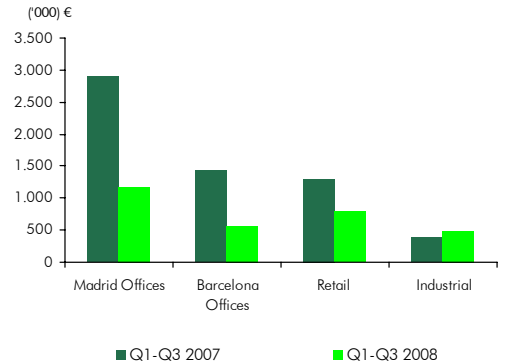
The performance of real estate recently in Spain differs greatly among sectors. A decrease in investor activity has been most evident in regard to shopping centres. This can be attributed not only to a weaker outlook for consumer spending growth but also to the fact that shopping centre lot sizes are larger and more difficult to finance in the current climate. Office investment has also been negatively affected. Total volume invested in offices in Madrid and Barcelona through to the end of Q3 was 40% down on investment during the same period in 2007. On the other hand, smaller deal volumes and less dependency on external finance for industrial premises may be a reason for a rise in activity in this market.

Not only has the current financial crisis affected total investment volume, but also the demand profile. Those investors with lower dependency on external finance, such as private and institutional investors accounted for 43% of investment in 2008 through to the end of September, up from 5% in 2007,

Available liquidity has become a major competitive advantage for private investors in search of representative assets and institutional investors seeking lower risk assets, Supply of assets mainly comes from property owners faced with debt repayment obligations. In this regard, some deals completed during the year have been completed as a form of payment in kind to cover outstanding liabilities. Sale & leaseback deals are also to the fore as companies investigate alternative ways to finance their core business. The Santander HQ deal and the sale of the Grupo Prisa portfolio are relevant examples,

INVESTMENT VOLUME

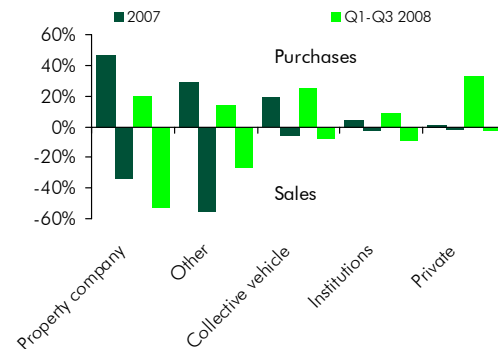
- Type of asset(*)



(*) Excluding Santander Portfolio
Source: CB Richard Ellis

INVESTMENT VOLUME

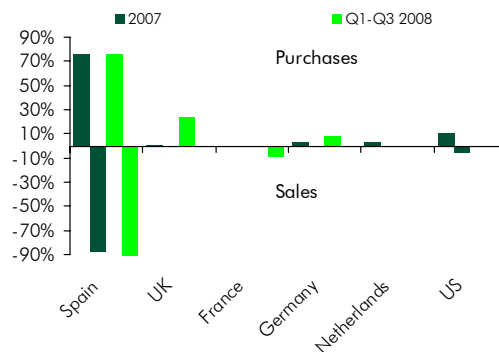
- Type of investor



(*) Excluding Santander Portfolio
Source: CB Richard Ellis

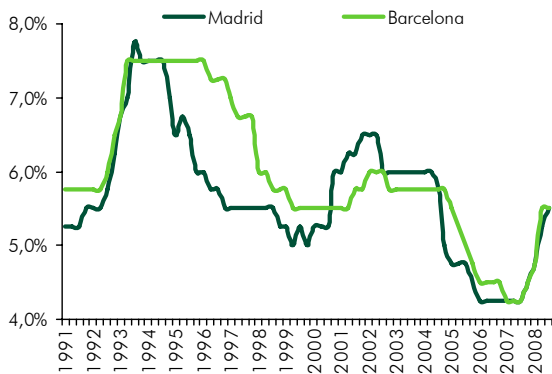
INVESTMENT VOLUME

- Investor origin



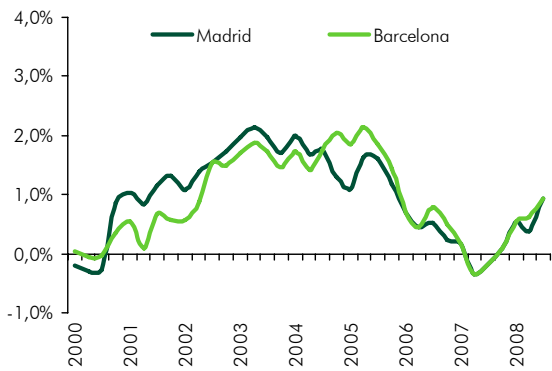
Source: CB Richard Ellis

PRIME OFFICE YIELDS



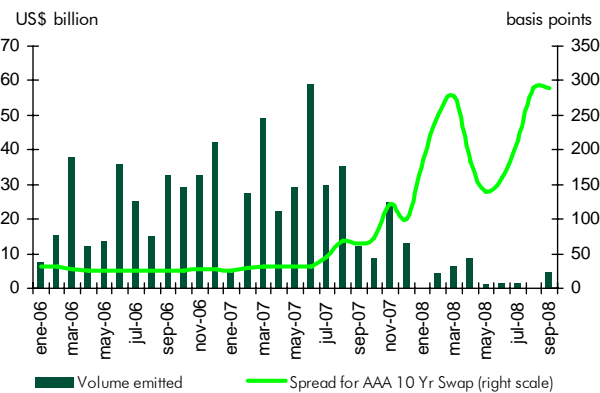
Source: CB Richard Ellis

RISK PREMIUM



Source: CB Richard Ellis

CMBS MARKET



Source: Morgan Stanley

Over the coming months we may see a renewed interest in offices from foreign capital, particularly from investors such as the German open-ended funds. However, investment volumes are not expected to reach those levels achieved in recent years.

YIELDS & FINANCIAL MARKETS

The upward trend in yields has intensified in the last six months. As such, prime office yields in Q3 ended the quarter at 5.5% in both Madrid and Barcelona. This represents an increase of 100 basis points since the start of the year as the property market has assumed the deterioration in economic growth. Moreover, yields between different asset types have diverged. Investors penalise secondary assets, short-term contracts and development projects in the risk appraisals.

Information from the financial sector indicates that prime rents may rise over the coming months. The risk premium for offices (the difference between the office yield and the yield on a 10 year government bond), while positive, is at historically low levels. When one considers the perceived country associated risk for the Spanish economy and the evolution of Spanish public debt, a further increase in office yields must be considered. If we accept that the office risk premium could return to 2%, in range of its maximum in recent years, prime office yields could rise a further 25-50 basis points, keeping bond yields stable in the short-medium term.

Global financial markets continue to suffer a shortage of liquidity. CMBS emissions are now almost inexistent and the cost of finance for banking institutions is causing real estate credit to slow to a standstill. Alternative methods of financing have yet to prove beneficial.

Since September, the failure of some financial institutions has aggravated the financial situation and the authorities and central banks in the US and Europe have responded to safeguard the international financial system. As a result, credit conditions have hardened further. Real estate deals of over 30 million euros with a LTV above 60% are now very difficult to finance.

OUTLOOK

Over the coming months, direct investment activity will continue to be dominated by small and medium sized deals for assets that produce an immediate income for the investor. Demand for development projects may not be so evident until the economic slowdown loses pace and signs of a medium term recovery can be seen. While debt repayment obligations influence disposal decisions, they are not expected to have a significant impact on pricing as a significant latent demand exists for representative buildings. The yield correction is in line with those seen in international markets. A further adjustment is possible before the end of the year.

MAIN OFFICE INVESTMENT DEALS 2008

PURCHASER	SELLER	CITY	ASSET	AREA (m ²)	VOLUME (€ million)
Drago	Grupo Prisa	Madrid y Barcelona	Cartera (3 Inmuebles)	85,000	315
Privado	AXA	Barcelona	L'illa Diagonal	18,000	90
La Caixa	Colonial	Madrid	Castellana 51	7,500	85
Union	BBVA	Barcelona	Josep Pla 2	18,500	84
ISDEFE	Iberdrola	Madrid	Beatriz de Bobadilla 3	16,000	70
Bami	Hansa	Madrid	Manoteras 2	12,000	58
GE	Landscape	Barcelona	Av, Meridiana	24,000	50
HNA	Metrovacesa	Madrid	Retama 7	10,800	43,5
Banco Santander	Fbex	Barcelona	Diagonal 458	5,000	30
NA	NA	Madrid	Castellana 40	3,000	NA
NA	BBVA	Madrid	Alfonso XII 30	3,800	24,5

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