Modest take-up but little growth in supply

The persistence of the crisis and measures to reduce the public sector deficit continue to put pressure on commercial real estate markets. In the case of offices, the main markets within Spain, namely Barcelona and Madrid, have seen falls in transactions and new rises in available supply.

Madrid

• Take-up during the first quarter was 54,300 m², lower than the previous year for the same period (-27%) and the previous quarter (-45%)
• Transaction volumes fell in all zones. With scarcely 6,000 m² transacted, the Central Business District (CBD) was one of the worst affected
• In terms of the number of transactions, the fall on the previous year was less marked (-2.5%), indicating a severe contraction in the average floor space transacted
• Available space for immediate occupation increased, with a vacancy rate of 13.8%
• Lower levels of demand have led to new falls in average rents, now 9.5% lower than during Q1 of 2010 (due to a higher proportion of deals closed in decentralized areas)

Barcelona

• The take-up in Barcelona stood at 36,700 m², representing a decrease in both annual and quarterly terms
• The fall in prime rents began to slow down, reaching stability at around €18.50 /m²/month
• In response to the regrouping of office space, the vacancy rate exceeded 15% for the first time
• New-building starts remained paralysed

Investment

• Investment stagnated, reaching only €162 million
• The most active players were domestic investors, whereas international investors became ever more cautious
• There is upward pressure on yields for assets in secondary zones
• Yields on prime assets remained stable at around 5.5%
BNP Paribas Real Estate will build with you targeted and integrated real estate solutions for your every need: Valuation, Transaction, Consulting, Property Development, Investment Management, Property Management. With our international scope and on-the-ground presence, you’ll find the perfect partner that can ensure the success of your real estate project. With BNP Paribas Real Estate, all the pieces come together.

Your contact in Spain: +34 914 549 600
Zoning

The office market in Madrid

Key figures Q1 2012

<table>
<thead>
<tr>
<th></th>
<th>CBD</th>
<th>Centre</th>
<th>Decentralized</th>
<th>Outskirts</th>
<th>Total</th>
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<tbody>
<tr>
<td>Stock (m²)</td>
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<td>Take-up Q1 2012 (m²)*</td>
<td>5,700</td>
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<td>22,300</td>
<td>0</td>
<td>28,800</td>
</tr>
</tbody>
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* Data analysed and validated by BNP Paribas Real Estate that does not include renegotiations.
Mirroring the extension of the economic crisis, the demand for offices in Madrid remained below potential. The typical seasonal slowdown seen in the first quarter was accentuated, with take-up falling by 26% compared with the same period in 2011 and 45% in comparison with the previous quarter. The 54,300 m² transacted between January and March represented 40% of the long-run quarterly average and the lowest figure recorded throughout the last 10 quarters.

The reduction is, however, lower in terms of number of transactions which at 86, is below that for the same period in 2011. Following a trend that has become more accentuated throughout the recession, businesses are seeking less office space. A demonstration of this can be seen in the figure for average office space transacted (630 m²) that is the lowest seen since the second quarter of 2009.

Falls in space transacted were recorded in every zone. Most notable was the Central Business District (CBD), which saw a drop to almost half of the space transacted during the same quarter in 2011. The average annual reduction in the remaining zones is 23%. The Decentralised zone was noteworthy for an increase in transaction activity. Nevertheless, this was offset by a drop in the size of space transacted, going from 1500 m² per transaction in Q1 2011 to 750 m² in Q1 2012.

The lack of deals of over 5000 m² is notable in the breakdown of transactions by floor space. These amount to an average of 18% of the take-up since 2005 but represent a share of only 11% in this quarter. Only one transaction within this range was recorded during the first quarter of 2012, consisting of the engineering consultancy, Indra, in the Decentralised zone. Transactions representing less than 500 m² are conspicuous. With a share of 53%, these further illustrate the contraction in the demand for space because of the crisis.

Some 14% of transactions were closed for semi-industrial or high-tech spaces in the zones of Julián Camarillo and Fuencarral el Pardo (Decentralised). This share hovered between 5% and 10% from 2007 to 2011 so the current level highlights the willingness of companies to occupy alternative premises offering lower rents.

The forecast regarding the remainder of 2012 is for a continuance of modest demand levels. The employment and output forecasts for Madrid do not envisage expansion, despite the fact that better economic performance is anticipated here than in the majority of the regional capitals in Spain.
## Availability

Having grown by 0.4 percentage points during the quarter, the vacancy rate reached 13.8%. The main driver for this increase has been the freeing-up of second-hand office space. The stock of available offices increased only slightly, with the incorporation of 12,000 m² corresponding to the refurbishments of the buildings at Castellana 50 (6400 m² - CBD) and Gran Via 30 (5500 m² - Central).

The office stock in Madrid stands at 11.8 million square metres and no significant growth is foreseen due to the stagnation of development activity. Nonetheless, around 100,000 m² is pending delivery in 2012, located primarily within the decentralised zones.

In addition, the refurbishments in Paseo de la Castellana are anticipated for delivery at the close of 2012, providing the CBD of prime office space in one of the best locations in Madrid (in the area of the Plaza de Colón).

Unlike the figure for Madrid as a whole, the CBD saw a further fall in available products, returning to a vacancy rate of 3.7%. This is equivalent to around 130,000 m², with quality offices representing a share of 35%.

The Decentralised zone saw the lowest increase in availability, helped by the added transactions for semi-industrial spaces. As a consequence, the vacancy rate stood at around 21.5%, representing an increase of 0.3 percentage points on the previous quarter.

In the Central zone, 39,000 m² of second-hand office space was added during the first quarter of 2012. The main additions were:

- The Head Office of Mapfre in **Edificio Masters I** on Av. General Perón (10,600 m²)
- Delivery of the refurbished **Gran Vía 30** (5500 m²)

The growth in the vacancy rate in the centre amounted to one percentage point, reaching 15%.

Lastly, the Outskirts freed up 20,000 m², leading to an increase in the vacancy rate of 1.1 percentage points. Worth mentioning is the new availability of the former head office of BP (8850 m²) on the Arroyo de la Vega business park in the area of Alcobendas (Outskirts).

The scenario of weak business activity and reduced demand for offices gives a forecast of increased availability during the remainder of 2012. In addition, the persistence of regrouping and possible bank mergers plus divestments of publicly owned buildings may have a moderate impact on availability. This depends on whether these buildings can be refurbished to adapt them to efficiency standards and thus improve their financial potential.
**Rents**

The general trend on the Madrid market is a decline in rents. Nevertheless, prime rents have remained stable for the third consecutive quarter, at €27/m²/month. The most symbolic offices in the CBD are facing more active demand and landlords are showing greater patience in seeking rents which meet expectations. Despite the stability, the decrease in prime rents since 2007 amounts to 34%.

The average rent in Madrid in Q1 2012 was €14.50 €/m²/month, representing an annual mark-down of 9.5%. The annual reduction amounts to 34% on the highest level reached in Q4 2007 (€22 /m²/month).

The average rate in the Central zone showed greater resistance to quarterly reductions (-3% YoY), reaching €15.80 €/m²/month in Q1 2012. The average rent of the CBD saw a reduction of 7.4%, achieving a rent of €21.70 /m²/month during the same period. The level also fell by an average of 13.6% in the remaining zones.

Having increased by 5 percentage points compared with the previous year and representing 27% of transactions, the most significant segment continues to be that of €10 to €12.50 /m²/month. Around 59% of transactions were closed at below €15 /m²/month (average for the city) compared with 44% in 2011, implying that tenants value not only locations but also more affordable rents.

In real terms (discounting the effect of inflation), it may be seen that the current average rent lies below the levels seen in 2005. The difference between real and nominal rents grew between 2005 and 2007 with the increase in activity. As of 2007, this difference remained steady as a result of the lower inflation rate.

Landlords continue to offer incentives, attempting to increase occupancy and avoid the transfer of tenants to other zones of the city. These instruments include free rent periods, assistance with setup, staggered rents and short-term lease contracts. As a consequence, occupiers have greater flexibility to choose a location closer to the centre of Madrid at affordable rents.

The forecasts for 2012 indicate lower rents in various zones. As a result, it is foreseen that opportunities will continue to exist for companies willing to acquire office space.
Zoning

The Barcelona office market

Key figures Q1 2012

<table>
<thead>
<tr>
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<th>Outskirt</th>
<th>Total</th>
</tr>
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<tbody>
<tr>
<td>Stock (m²)</td>
<td>872,500</td>
<td>2,481,500</td>
<td>1,154,200</td>
<td>1,093,100</td>
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<td>260,500</td>
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<td>872,200</td>
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<td>Vacancy rate (%)</td>
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<td>9,7%</td>
<td>22,6%</td>
<td>27,0%</td>
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<td>Take-up Q1 2012 (m²)*</td>
<td>7,200</td>
<td>8,900</td>
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<td>36,900</td>
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<td>Prime rent Q1 (€/m²/year)</td>
<td>222,0</td>
<td>186,0</td>
<td>204,0</td>
<td>120,0</td>
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<tr>
<td>Avg. rent Q1 (€/m²/year)</td>
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<td>147,6</td>
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<td>150,1</td>
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<tr>
<td>New deliveries 2012 (m²)</td>
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<td>0</td>
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<td>Pipeline 2012 (m²)</td>
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<td>0</td>
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<tr>
<td>Pipeline 2013 (m²)</td>
<td>0</td>
<td>0</td>
<td>23,000</td>
<td>0</td>
<td>23,000</td>
</tr>
</tbody>
</table>

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Take-up during the first quarter was 36,900 m², representing annual and quarterly reductions of 33% and 37% respectively. The Barcelona office market reflects the greater uncertainty of the second phase of the crisis, with business people highly cautious when seeking office space.

The natural turnover of properties due to the expiry of contracts and space rationalisation have been the main drivers for transactions. As a result, demand has been low and in line with domestic economic activity.

Within this context, the zones seeing a reduction in transactions have been Central and Outskirts. The former saw 8800 m² transacted, representing a quarterly reduction of 47%. Around 4600 m² were transacted in the latter, representing 25% of the long-run quarterly average and 20,000 m² less than in the fourth quarter of 2011. Nevertheless, the CBD (with 7200 m²) and Decentralised zone (with 16,100 m²), saw an increase on the figures recorded for the fourth quarter of 2011.

Despite the low levels of activity, the demand for offices in the areas of Plaza de Europa and 22@ were sustained, attracting 35% of contracted floor space. High building specifications, recent construction and affordable rents represent the foundations for this good performance.

Another factor behind the reduction was the absence of large-scale transactions. Despite the fact that the number of transactions saw a rise of 17 compared with the previous quarter, the space transacted fell by more than 33% during the same period. As a consequence, the average floor space per transaction fell to 540 m², the lowest for the last six years. Mirroring this, 54% of the transactions represented a take-up of below 300 m² and 86% amounted to less than 1000 m².

In terms of the outlook for the remainder of 2012, modest take-up will continue as per 2011.
Supply

The main effect of low levels of activity has been an increase in the vacancy rate. New additions of floor space to the existing vacancies have not been offset by increased transaction activity. As a result, the vacancy rate reached 15.6%, representing a new record for the last 5 years. It should be pointed out that the greater part of these additions originated from second-hand offices rather than new-build as new office development remains almost paralysed within Barcelona.

The highest vacancy rate corresponds to the Outskirts, where some 27% of the stock is empty. This has remained relatively stable since the close of 2011 and indicates the amount of available products in districts such as Sant Cugat del Vallés, Cornellá and Prat de Llobregat.

This followed by the Decentralised zone, with a vacancy rate of 22.6%. Despite the impact of demand, availability has increased by around 20,000 m² due to the existence of new vacant buildings in the areas of Plaza Cerdá and 22@.

Resulting from the freeing up of other properties, the Central zone added 1.8 percentage points to its vacancy rate, reaching 9.7%. This zone contributed most to the growth of the overall vacancy rate.

The CBD saw a slight increase, although available space was lower. The vacancy rate here stood at 8.6%.

The reaction of developers to these difficulties has been to cancel the commencement of works for new-buildings since 2010. Within this context, only one project under construction has been identified, for delivery in 2013 in the area of Plaza Europa and amounting to 23,000 m².

The take-up rate over the last year would enable supply to be absorbed within 4.7 years. This indicator has grown from 4 years in 2011 and 2.7 years in 2010. The lowest timescale is for the CBD, where 3.1 years would be necessary to absorb supply, followed by the Central zone, which would require 4.4. The greatest progress within this context corresponds to the Outskirts, going from 12 to 5 years over the last 12 months.

The outlook for the year end is for slight increases in availability in areas which are less central and outside of the new business districts of Plaza Europa and 22@. As an upsurge in new-build is not envisaged, stock will remain stable up to 2013.
Prime rents in Barcelona stood at €18.50 /m²/month during the first quarter of 2012, representing a fall of 5% on the year and an aggregate reduction of 33% since the historic peak in 2008. For its part, the average rent in Barcelona showed an annual decrease of 2%, reaching €12.50/m²/month. This is a reflection of a market with scarce demand and growing availability of product.

The Central zone was the only area which increased rent levels, up to €12/m²/month from €11.60/m²/month one year ago. The CBD continues to give the highest average rent, at €15.50/m²/month, despite having fallen by 7% compared with Q1 2011.

Rents also fell by 3.3% in the Outskirts, reaching €8.30/m²/month. This zone has shown the greatest resistance in terms of rent reductions, associated with a current level which is already fairly low.

Faced with the difficulties of bringing properties to market, landlords remain willing to provide incentives such as free rent periods, staggered rents and costs not charged to rental. An additional strategy is to offer shorter term lease contracts in order to give more flexibility to tenants.

Rents in the Decentralised zone are getting ever closer to the levels of the CBD. The positioning and quality of the properties is incentivising the transfer of tenants located in the centre towards 22@ and Plaza Europa. This zone may become an extension of the Barcelona CBD within the near future.

Real rents (discounting the effect of inflation) show that current rent levels lie below those seen in 2006. In fact, since Q1 2010 the average rent has remained consistently below that of 2006. In addition, the gap between nominal and real rents remains steady, indicating controlled inflation levels which scarcely effect nominal rents.

The forecasts for 2012 point towards stability of prime rents. Nevertheless, warnings remain with regard to a possible reduction in rents for properties located in more peripheral areas which are less marketable.
Investor activity in commercial property has fallen drastically during the first quarter. Caution has climbed ever higher due to the persistence of the crisis and new austerity measures. Within this scenario, investment volumes in Spain amounted to €162 million, far below the level of €738.5 million one year ago. By segment, offices represented three quarters of the volume, followed in turn by hotels and retail space.

Two office transactions were noteworthy in Barcelona: an acquisition by Pontegadea in the CBD (Paseo de Gracia 56) for €53.5 million, the first in this zone since the third quarter of 2010, and the sale by the Regional Authority of the Headquarters of the Consejería del Territorio y Sostenibilidad for €52 million. No transaction exceeded €100 million during the quarter.

In response to current levels of uncertainty, international investors remained aloof from the market. In all cases, the buyers in the transactions recorded were domestic investors.

With regard to returns, stability is still found within the prime office segment, remaining at the same level since the close of 2010. This points towards divergence between the expectations of vendors and buyers, reflected in the scarcity of transactions. For their part, returns on secondary assets have begun to take a more positive path, thus encouraging transactions regarding assets which are riskier than prime but attractive for risk profiles which are more lax.

Reduced activity is anticipated for the remainder of 2012 and it is possible that investment volumes will remain below those of 2011. Nevertheless, and as seen during recent quarters, discounted offers for quality assets may appear in the near future. In addition, the sale by the Regional Authority this quarter may be the starting point for the release of properties one-by-one, the strategy of large-scale sales through portfolios having been abandoned.
GLOSSARY

BNP Paribas Real Estate Research aims, to the extent possible, to produce comparable and homogeneous indicators. We try to contribute to market transparency by entering the definitions of concepts and indicators used in our reports, so that readers can clearly understand each one of them.

**Calculation of surface area:** Data on take-up, vacancies, stock and future supply (pipeline), are expressed in gross area in square meters. For internationally comparable figures, BNP Paribas Real Estate multiplies Spanish figures by 0.82.

**CBD:** This is the most active businesses area for the tertiary sector in the city. For this reason it is considered as the most interesting real estate.

**Take-up:** This represents the total surface area rented, pre-let, sold or pre-sold during the analysis period.
- It does not include surface are available for rent.
- An area is considered ‘taken-up’ when the contract is signed or a binding agreement has been reached.
- A pre-let is considered as take-up executed off-plan or during the construction period.
- Deals are the number of transactions where the contract was signed in the period of analysis.
- Take-up figures are subject to change.

The breakdown of take-up by sector is compatible with European NACE activity codes.

**Supply:** Total office space, which at the date of preparation of the report are:
- Physically unoccupied.
- Ready for immediate occupancy.
- Actively marketed.

Includes sub-let area and is mentioned separately when possible.

- Vacancy rate: Total area available divided by stock at the date of preparation of the report.

**New deliveries:** Amount of office space having reached technical completion in the period of analysis. They can be pre-let or available for occupancy.

**Pipeline:** Surface area of properties for which works have started on a new development or significant reforms at the date of preparation of the report. Includes projects for occupancy by the owner (turnkey). Excluding land adaptation works.

**Stock:** Total amount of surface area for office use, whether occupied or available, at the close of the report.

**Average rent:** The average rent charged during the last quarter, weighted by the surface area of each rental contract during period, either, new or used.

**Gross Yield:** Annual gross income (before property costs and expenses) on the purchase price, excluding transfer costs.

**Net Yield:** Net income on the purchase price plus all costs of purchase.

**Prime Rent/Yield:** Represents the highest rent/yield on the the dates of the report, in one unit:
- Standard size proportional to demand in each location.
- High quality and specifications.
- In the best office locations in the market.

The transactions executed during the period are used to determine the prime rent and yield. In the absence prime transactions during the period of analysis, a hypothetical rent/yield is based on expert opinion and market conditions.

**Pipeline:** Total surface of all projects under construction. Includes reforms of buildings undergoing conversion to offices.

**Investment volume:** The sum of the selling prices of all non-residential real estate assets in which BNP Paribas Real Estate has identified a change of ownership. Includes office buildings, Retail, Industrial and logistics, and hotels. The levels reported in the reports are not final and are subject to change.

**Types of investors:**
- Insurance
- Private Investors and Family Office - Corporations
- Property Companies
- Consorcia
- Shareholders
- Others

**Opportunistic investment vehicles:** Investors seeking a yield of over 17% with leverage levels of over 60% of the gross value of the asset.

**Value-added Investment Vehicles:** Investors seeking a yield of between 11.5% and 17% with leverage levels of between 30% and 70% of the gross value of the asset.