Portuguese Real Estate Advisors

Lisbon Office Market Outlook

1st
Quarter
2009

(data on 1Q 2009)

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Outlook First Quarter 2009

Scarcity of data and drastically diminished number of transactions is what best characterizes the first quarter of 2009. In fact, after the international financial turmoil on last months of 2008 a slowdown in demand on first months of 2009 was expected. With the available data at this point figures show a severe retraction in gross take-up (demand), perhaps more sharp than previously foreseen.

At the same time, due to the context of economic recession and financial instability both locally and in Europe, investment transactions were almost absent, gross yields (perceivably) rose and prime rents declined smoothly.

In fact, economic recession and its uncertain duration will affect strongly the performance of commercial real estate in the coming trimesters. Enhancing the previous trends relocation, resizing and renegotiation will be the major drivers for private demand. A determinant public demand is also possible as the role of the state in the economy is now increasing.

Summary:

The Economy

Recent financial turbulence and uncertain economic performance of countries in euro area forced several consecutive revisions of previous economical forecasts. Recent Bank of Portugal projections point now to a strong recession with GDP figures of -3.5% in 2009 and -0.6% in 2010.

Major concerns are now both the shortage of liquidity mostly amongst the small and medium sized companies and the rising unemployment (even more pronounced in the northern more industrialized region). Major measures and interventions on behalf of the state are now in place and more may be underway. Slightly negative inflation is foreseen although with no real risk of generalized deflation.

Another major issue is the severe increase in real spreads over Euribor interest rates for both public and private entities financing, although the fast and pronounced decline of Euribor reference interest rate in last months softened the impact of climbing spreads for both families and companies.

Major drivers are now expected to be public investment and consumption along with exports – as euro area performance improves - as private investment and consumption are expected to contract. However all of these variables are under strong pressure as a result of international context, public deficit and public debt. No major tax cuts are expected.

GDP Growth:
2005: 0.5%
2006: 1.3%
2007: 1.8%
2008E: 0.0%
2009F: - 3.5%
2010F: - 0.6%

YE Public Deficit (%GDP)
2005: - 6%
2006: - 3.9%
2007: - 2.6%
2008E: - 2.2%
2009F: - 6%

Inflation:
2007: 2.4%
2008E: 2.8%
2009F: - 0.5%

Investment:
2007: 3.2%
2008E: - 1.3%
2009F: - 14.3%

Unemployment:
Avg 2007: 8.0%
Avg 2008E: 7.6%
Avg 2009F: 8.5 – 9%

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Take-Up and Demand

Lisbon office market registered a gross take-up of only approximately 20,000 sq m in 1Q2009 (according to LPI) almost entirely lettings as sales were almost inexistent. In 2008 almost 35,000 sq m where accounted in similar period which enhances the poor performance of early 2009. Gross take-up levels are likely to fall in 2009 and net take-up will surely be poor if not negative.

On a now more "slow" and more volatile market - as characterized by players - substitution demand is strongly dominant and those trends should remain in the near future. Relative weight of used space transactions will surely remain high and in first quarter reached 70% of total area transacted.

Globally the market can be considered as slightly depressed although relatively stable in terms of rents and overall trends, but with extra volatility and less confidence due to economical context. Postponement of investment decisions may lead to lower private demand on coming months with special emphasis on first half of 2009.

Gross Take-Up sq m:

2003: 140,000
2004: 165,000
2005: 149,000
2006: 161,000
2007: 201,000
2008: 233,000
2009: 120K-180K

"Slowness of deals characterize the market"

"Substitution demand via downsizing and operating cost cutting are on players agenda"

Rental Level

Globally speaking average rents are slightly declining as shortage of demand is being felt by players. Furthermore prime rents have observed a significant decline. Analysis by zone is nevertheless imperative as fluctuations in market are being differently felt in different zones.

Despite the relative decrease in new supply and slowness of forecasted pipeline conditions are met for a medium term pressure on average rents. That pressure will surely be enhanced on secondary locations/buildings.

Being so, an increasing discrepancy between prime rents and minimum values observed will be further enhanced as a result of increasing market segmentation.

Another trend is the growing importance of major incentives as rent free periods or space fit outs financial contributions, allowing some stability on rental level.

Prime Rents:
"Some slight downward fine tuning."

Average Rents:
"Globally slightly falling although analysis by zone is imperative"

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Supply

Development of new schemes is now much slower than in the past and developers act with extra caution. Pre-letting and custom-tailored projects are major bets for players. Only 82.000 sq m of new built were put on the market in 2008 allowing some downward pressure on vacancy rates on most zones in YE2008. 2008 was also marked by the completion and occupancy of 62.000 sq m of the pre-let Office Parque Expo scheme by Ministry of Justice wich distorted the overall gross take-up figures.

Available data point to new built supply to be completed in 2009 totalizing 120 K sq m with about 25% already pre-let. Of total schemes in pipeline surely a big part will be postponed (in terms of completion) causing the new supply in 2009 to be significantly lower (estimated between 80 and 95K sq m). First Torre Colombo 29.000 sq m office tower will significantly affect zone 3 and all of the market but news of about 50% of pre-letting deals have assured some stability. Most actives zones in terms of new supply will be zone 5, 6 and 3 (Torres do Colombo).

Vacancy Rates

As a result of lower supply being put on the market vacancy rates observed moderate decrease in 2008 with exception of zone 6.

Players expect a short rise in vacancy rates as a result of poor demand although slowness of new supply may soften the impact of poor take-up.

Prime Yields

Investment market strongly felt the shortage of liquidity and the new (more restrict) criteria in bank financing causing a major slowdown in investment transactions. Furthermore, investors further enhance the focus on low risk prime location products mismatching the (perceived) available supply.

Strong scarcity of transactions and also lack of available data in the first quarter disable an accurate estimative on prime (gross) yields. Available data accounts as a fact that prime gross yields rose from previous peak of 5.75% to 6.5% in second half of 2008. Besides those facts players and analysts now believe that theoretically prime gross yields can be placed between 7.25% and 7.5% or even above. Nevertheless only future (real) transactions can validate (or not) those figures. For the time being demand is not meeting the supply asking prices. Moreover, risk premiums over prime yields currently observed on more central locations as Madrid, Barcelona or even London and Paris have to be put into the equation.

New Supply sq m:
2003: 68,000
2004: 40,000
2005: 54,000
2006: 88,000
2007: 74,000
2008: 82.000
2009F: 95-120K
Mostly pre-let

Vacancy Rates:
2003: 7.3%
2004: 12.9%
2005: 13,3%
2006: 11.5%
2007: 8.4% (+)
2008: 7.05% (+)
2009: 8%-10%

Prime Gross Yields Estimative:
2000: 7.5%
2004: 7.25%
2005: 6.25%
2006: 6%
2007: 5.75%
2008 (YE): 6.5%
2009: not available

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Zone 1 – Prime CBD – Central Business District

Av. da Liberdade, Marquês do Pombal and Av. Fontes Pereira de Melo

Portfolio: 573,000 sq m **Vacancy:** approx 6%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	22,200
2005	8,500
2006	31,300
2007	30,100
2008	23.000

Quarters	sq m
1Q 2005	1.600
1Q 2006	10.600
1Q 2007	13.000
1Q 2008	6.500
1Q 2009	2.000

Estimated New Supply 2009 : 0 sq m

Rental Level (€ / sq m / month) : Prime € 20,00 ; Average: 16 to 17.00

Zone 1 showed a very poor performance in terms of gross take-up in early 2009.

Available supply breakdown shows prominence of used space (+/- 70%).

Rents are under pressure on zone 1 despite the relatively low vacancy rates

Zone 2 – Prime Office Location

Amoreiras, Castilho, Av. da Republica, Av. 5 de Outubro, and Campo Grande

Portfolio: 1,040,000 sq m **Vacancy:** approx 4,5%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	21,100
2005	33,200
2006	34,200
2007	23,600
2008	18.000

Quarters	sq m
1Q 2005	2.200
1Q 2006	5.100
1Q 2007	2.800
1Q 2008	8.000
1Q 2009	3.500

Estimated New Supply: 2009 : 9,000 sq m

Rental Level (€ / sq m / month) : Prime € 17,00 ; Average: 14.5

Take-up levels show relative lower performance in this zone in early 2009

Low vacancy rates allowed to relatively sustain average rents despite the poor demand

New projects are scarce and global area in pipeline might be considered low

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Zone 3 – Inner Circle

Praça de Espanha, Av. José Malhoa, Av. Columbano Bordalo Pinheiro, 2ª Circular





Portfolio: 405,000 sq m **Vacancy:** approx 4,5%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	13,000
2005	16,100
2006	19,700
2007	41,600
2008	29.000

Quarters	sq m
1Q 2005	3.000
1Q 2006	3.000
1Q 2007	1.100
1Q 2008	900
1Q 2009	3.000

Estimated New Supply 2009 : 29,000 sq m (Torres do Colombo) – 50% pre-let

Rental Level (€ / sq m / month) : Prime € 17,00 ; Average: 13,50

Zone 3 showed relatively high level of activity in 1Q 2009 when compared to other zones.

Low vacancy rates are observed but soon coming Torres do Colombo office above shopping centre (although partially pre-let) will cause significant impact on supply (and possibly on rents) in 2008/2009.

Zone 4 – Historical Areas

Baixa, Chiado, Av. Almirante Reis and surrounding areas




Portfolio: 446,000 sq m **Vacancy:** approx 4%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	11,800
2005	3,900
2006	1,900
2007	7,800
2008	13.000

Quarters	sq m
1Q 2005	1.400
1Q 2006	200
1Q 2007	900
1Q 2008	700
1Q 2009	2.300

Estimated New Supply: 2009: 15.000 sq m (1 scheme already pre-let)

Rental Level (€ / sq m / month) : Prime € 15,00-16.00+; Average: 11.00 to 13.00

The historical zone has some particular characteristics within the greater Lisbon office market.

It is composed by a mix of old, refurbished and even adapted residential buildings

Both new building for EU maritime security agency and recent refurbishments in prime buildings have artificially pulled up prime rents.

Figures have to be analyzed with caution

Zone 5 – Parque das Nações

Parque das Nações, former Expo 98 area.

Portfolio: 294,000 sq m **Vacancy:** approx 13%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	29,000
2005	5,000
2006	15,800
2007	28,800
2008	85.000

(occasional)

Quarters	sq m
1Q 2005	100
1Q 2006	500
1Q 2007	3.200
1Q 2008	6.700
1Q 2009	2.000

Estimated New Supply 2009 : 30,000 sq m (of which a part may be postponed)

Rental Level (€ / sq m / month) : Prime € 16,50 ; Average: 15,50

Zone 5 is a small zone and although within Lisbon city is considered alternative to more centre locations. Each new scheme or transaction has major impact on statistics

Very Low take-up in early 2009 with rents under pressure

New schemes are in pipeline for 2009/2010

Zone 6 – Western Corridor

A5 motorway, Miraflores and Carnaxide

Portfolio: 856,000 sq m **Vacancy:** approx 17%

Gross Take-Up (Rounded Figures):

YE	sq m
2004	40.900
2005	46,600
2006	52,000
2007	65,600
2008	62.000

Quarters	sq m
1Q 2005	4.000
1Q 2006	17.500
1Q 2007	20.000
1Q 2008	10.700
1Q 2009	6.000

Estimated New Supply: 2009 : 25, 000 sq m (of which a part may be postponed)

Rental Level (€ / sq m / month) : Prime € 15,00 ; Average: 12.00

With more than 850 K sq m zone 6 is now the second largest area in Lisbon Market.

It has confirmed a consistent level of activity with approximately 50 K – 60 K sq m being taken in the last three years.

Early 2009 showed lower performance than in previous years in terms of gross take-up

Rental levels remain stable at around € 12 / month although under pressure

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Appendix I – ZONE DEFINITION

Data Source: PREA, LPI provisional data for 2009; INE, BdP, GEP/MEI,

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