



Portuguese Real Estate Advisors

Lisbon Office Market Outlook

4th
Quarter
2011

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Lisbon Office Market Outlook

Research & Market Analysis Report

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Outlook Fourth Quarter 2011

Strongly conditioned by economical context 2011 has been characterized by a very slow market. Demand (gross take-up) is at an historical low and rents are under pressure although decrease of new supply and pipeline managed to sustain increasing vacancy rates in most zones.

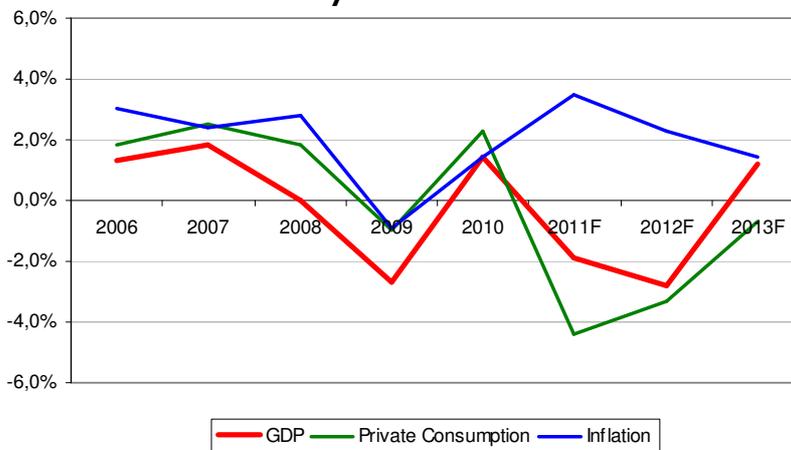
In the spring Portugal requested financial assistance from the EU and IMF and a major bailout plan for the next 2 years is been carried out with relative success. Negative economic growth until 2013 at least is now clearly assumed as an integrated result of vast austerity measures.

Despite the Portuguese financial program negotiated with the EU/IMF/ECB (troika) with clear short and medium term guidelines agreed by the 3 major parties, uncertainty is still on players mind as news on Greece (and also Italy, Spain, and even France) financial turmoil bring strain and unrest to the markets.

Relocation and downsizing is still the major driver for demand further enhancing a slow market, with significant impact on average rents and even on prime rents in most of office zones.

As to investment market transactions continues to be very scarce as risk adverse demand does not meet sellers' asking prices for most of properties potentially saleable. Perceived gross yields rose significantly. Difficulty in financing investment operations is now the major issue, along with risk perception. Nevertheless, occasional transactions may occur mostly between local players/funds and/or as a result of opportunity deals/prices.

Economy – Main Indicators



With very poor economic performance outlook for coming years global investment and confidence are now major factors for a potential retake of office space demand.

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“Market is strongly dependent on economic performance, at this point”

“In the spring Portugal signed for a 2 year bailout plan and economic recovery is forecasted only for 2013”

“Take-Up levels fall by 40% in 2011 during the first three quarters”

“Regain of confidence and investment will be slow and progressive”



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The Economy

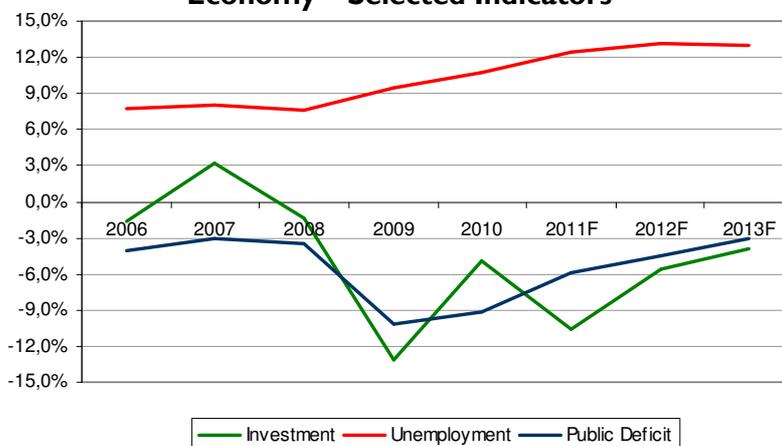
Former prime minister José Socrates resigned after the 78 billion 2 year bailout plan that was negotiated between the troika (EU/IMF/ECB) and the three major parties (representing 80% of voters). A new centre-right wing government was elected in June with a vast majority in parliament.

Second half of 2011 brought severe tax raises (including extra income tax of 3.5% for families) and cuts in public expenditure. Budget 2012 and 2013 will bring further severe cuts in public expenditure (including the removal of 2 salaries/pensions for public employees and retired people) along with major tax increases on consumption and income (with the exception of regular vat rate already at 23%).

As a result heavy decline in both public and private consumption is expected with GDP decreasing -2.8% in 2012 if not more. Private consumption is forecasted to fall by -4.4% in 2011 and -3.3% in 2012 as assumed by the government's fiscal strategic plan for 2011-2015. Unemployment will surely rise passing the 13% barrier and reaching an historical peak.

Major priorities are now the control of fiscal deficit and public debt. In 2012 deficit is forecasted to be -4.5%, and -3% target should be reached by 2013. Inflation is likely to increase although still not a major concern. Shortage of liquidity mostly amongst the small and medium sized companies continues to be an important issue. Local banks have proven resilient but will have to reinforce their capital after October euro summit decisions, probably recurring to public flows. In the troika memorandum 12 Billion euros are reserved to support the local banks at their individual request and are considered largely sufficient.

Economy – Selected Indicators



GDP Growth:

2006: 1.3%
2007: 1.8%
2008: 0.0%
2009: -2.7%
2010: 1.4%
2011F: -1.9%
2012F: -2.8%

YE Public Deficit (%GDP)

2006: -4.1%
2007: -3.1%
2008: -3.5%
2009: -10.1%
2010: -9.1%
2011F: -5.9%
2012F: -4.5%

Inflation:

2007: 2.4%
2008: 2.8%
2009: -0.9%
2010: 1.4%
2011F: 3.5%
2012F: 2.3%

Investment:

2007: 3.2%
2008: -1.3%
2009: -13.1%
2010: -4.9%
2011F: -10.6%
2012F: -5.6%

Unemployment:

Avg 2007: 8.0%
Avg 2008: 7.6%
Avg 2009: 9.4%
Avg 2010: 10.8%
Avg 2011F: 12.5%
Avg 2012F: 13.2%

Retake of economy is forecasted for 2013 with GDP growing about 1.2% with major driver on exports but international context may compromise that goal.

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Take-Up and Demand

Lisbon office market registered an historical low gross take-up of only approximately 45,000 sq m on the first three quarters of 2011 with forecasts for YE 2011 pointing to figures only between 60 and 80K sq m. Being so, a major fall in take-up levels is expected for 2011 and retake of confidence and demand is still uncertain in the short term.

Transactions were almost entirely lettings as sales represented less than 5% of total area transacted. Gross take-up levels falling in 2011 represent a very poor net take-up and most likely slightly negative.

Substitution demand (relocation/downsizing) is strongly dominant and that trend should remain in the near future. Relative weight of used space transactions remains high and represents more than 70% of total area transacted in the first three quarters. Although number of total transactions is similar to equal period in 2010 average are transacted diminished 38% to around 300 sqm per operation. Operations above 500 sqm are occasional and represent only 15% of transactions.

Globally the market can be considered in a strong downturn although relatively stable in overall trends, with extra volatility due to economical context and further pressure on continuously slowly declining average rents.

Gross Take-Up sq m:

2003: 140,000
2004: 165,000
2005: 149,000
2006: 161,000
2007: 201,000
2008: 233,000
2009: 116,000
2010: 105,000
2011: 60-80K

“Take-up levels fell 40% in 2011 when compared with equivalent period in 2010”

“Substitution demand via downsizing and operating cost cutting are main drivers”

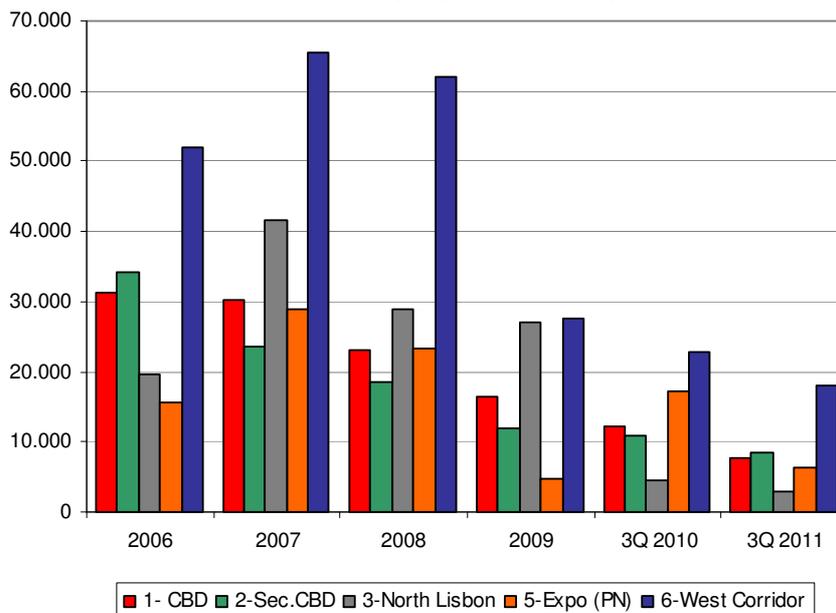
“Slowness of deals and volatility characterize the market”

“Average area transacted diminished by 38% to only 300 sq m per operation.

“Financing and risk are on players mind mainly on SMCs”

“Recovery only in 2013 is the mostly likely scenario at this point”

Gross Take-Up by zones in Sq m



Note: Excluding occasional deal of 62K sq m in zone 5 in 2008

Recovery is expected to be very slow and progressive probably only on 2013 and if as forecasted economic environment improves.

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Rental levels

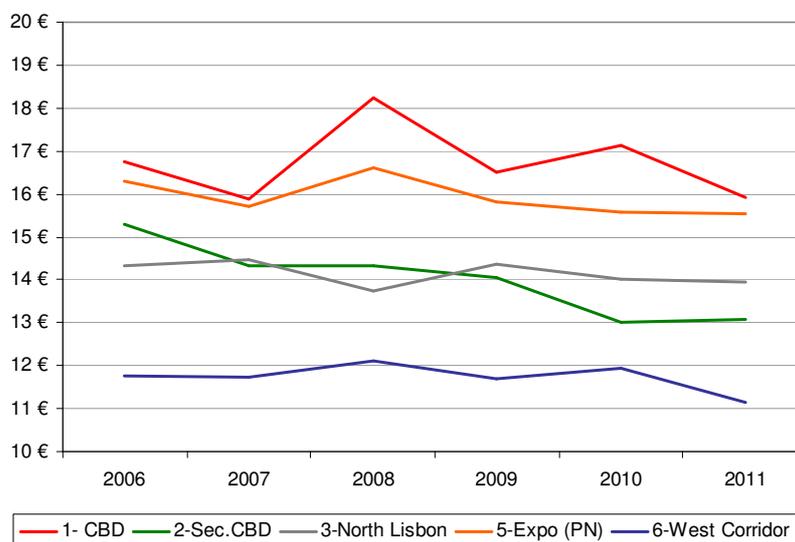
As a result of economic context and slowness of market pressure in rental levels is observed. In fact, average rents are still slightly declining. Moreover, prime rents have observed a significant decrease in recent quarters and further pressure can be felt.

Furthermore, a growing importance of major incentives as rent free periods or space fit outs financial contributions is observed, with the objective of allowing some stability on rental level.

Rental updates for existing contracts are set for 3.19% by decree-law during 2012 as a result of relative high inflation observed in 2011.

Despite the strong decrease in new supply and of forecasted pipeline conditions are met for a medium term pressure on average rents. That pressure will surely be enhanced on secondary locations and secondary buildings further increasing already strong market segmentation.

Average Rents estimative (rounded figures) Eur/Sq m/month



**Prime Rents CBD
Estimative
Eur/Sq m/Month**
2006: 20.2
2007: 20.5
2008: 20
2009: 19.5
2010: 18.5-19
2011: 18.5

**Prime Rents
Expo – Parque Nações
Eur/Sq m/Month**
2006: 17.75
2007: 17.5
2008: 17.5
2009: 16.5
2010: 16-16.5
2011: 15.75

**Prime Rents
Western Corridor
Eur/Sq m/Month**
2006: 14.5
2007: 14
2008: 14
2009: 13.5
2010: 13.5
2011: 13

Prime Rents:
“Some slight downward pressure.”

Average Rents:
“Globally slightly falling and analysis by zone is imperative”

Prime rents have been suffering a slow process of fine tuning due to poor demand. Prime rents now stand at around Eur 18.5 Sq m/ month on CBD and at around Eur 13 on Western Corridor for prime buildings. Suffering the effects of poor demand zone 5- Parque das Nações now presents prime rents slightly below 16 Eur/Sq m/month.

Analysis by zone is imperative as small fluctuations occur in different areas as a result of local market context.

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Supply

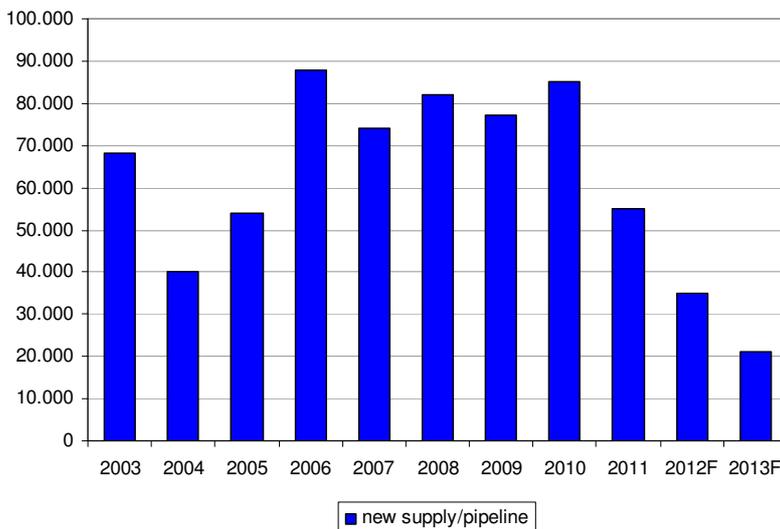
During 2011 about 55.000 sq m of new built was completed and put on the market following the 85,000 sqm of new built supply concluded in 2010. Construction is now much lower than in the past but still very significant when compared to low demand figures.

Current situation can be described as relative excess of supply in the market with some pinpoint exceptions (in CBD for instance). Development of new schemes is now much lower than in the past and developers act with extra caution betting on pre-letting and custom-tailored projects.

For the next 2 years, available data shows only 55K sq m of stock pipeline. Nevertheless, major delays in completions are also feasible. Most actives zones in terms of new supply will be zones 2 – Secondary CBD, and 3 – North Lisbon/Inner Circle where a significant amount of new built stock in forecasted for the next one to two years.

After the strong level of recent completions no significant projects are registered for zone 6 – western Corridor, at this point. Also only 1000 sq m of new built/rehabilitation is being designed for CBD, which can be considered purely incipient.

New Built Supply and Pipeline – Estimative in Sq m



New Supply sq m:

2003: 68,000
2004: 40,000
2005: 54,000
2006: 88,000
2007: 74,000
2008: 82,000
2009: 77,000
2010: 85,000
2011: 55,000
2012/2013F: 55,000

“Pipeline for the next two years is about 55K sq m although some delays in completion are likely”

“The pipeline for CBD is almost zero”

“After recent new stock put on the market pipeline for zone 6 – Western Corridor is now incipient”

The importance and weigh of used space in the market is also growing strongly now accounting for about 57% of available space. That trend further enhances the pressure on landlords’ commercial conditions offered to new occupiers.

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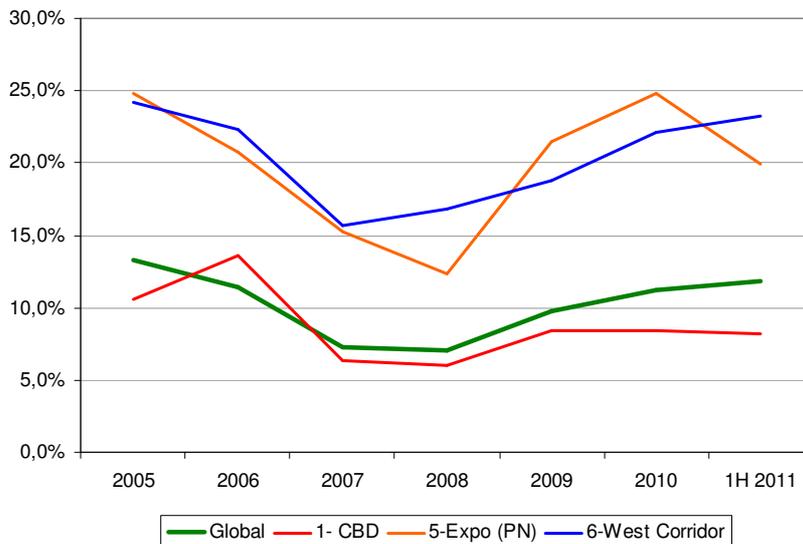
Vacancy Rates

Vacancy rates observed significant (although moderate) increase in recent quarters with global rate now in excess of 12%. Major rates are structurally observed in expanding zones of Parque das Nações (now around 20%) and Western Corridor (23%).

On the short term vacancy rates are likely to continue to slowly increase as a result of both poor demand and new built being put on the market. Vacant space left by moving tenants will also contribute for supply volume as average area demanded by new occupiers has been falling sharply.

On the medium term vacancy rates can stabilize if as expected new built drastically diminishes and take-up recovers along with economic performance.

Vacancy Rates Estimative (%)



Different zones observe different performances as local markets have specific characteristics. Due to its small dimension zone 5 – Parque das Nações normally observes more volatility in vacancy rates. On the other hand, due to its large dimension zone 2 – Secondary CBD registers low figures (currently around 7.2%) but available space is considerable high being close to 75K sq m.

Notable exception on high vacancy rates is CBD that currently observes figures of around 8.5%. Structural context of this zone means lack of new built supply and relatively high potential demand implying one digit figures for vacancy rate.

As restrain on pipeline volume is now clearly assumed by players on the medium term levels of vacancy rates are strongly linked to regain of confidence and regain of take-up levels.

Vacancy Rates (global) :
 2005: 13,3%
 2006: 11.5%
 2007: 8.4% (+)
 2008: 7.05% (+)
 2009: 9.7% (+)
 2010: 11.5% (+)
 1H 2011: around 12%

“Vacancy rates rose in recent quarters with some occasional exceptions “zone 1 and 6) due to local market specific characteristics and dimension”

“Conditions are met for a strong medium term pressure on vacancy rates with probable exception of CBD”.

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Investment

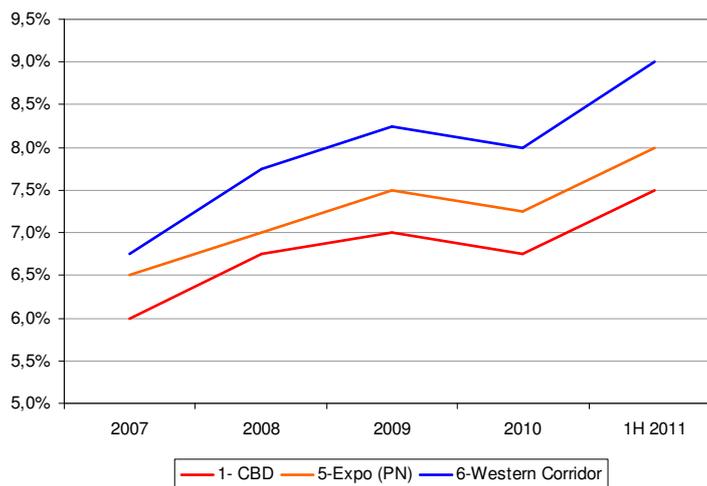
Investment market was strongly affected by the negative economic performance involving shortage of liquidity. New and much more restrict criteria in bank financing caused a major slowdown in investment transactions. Furthermore, investors further enhance the focus on low risk prime location products mismatching the (perceived) available supply.

Being so transactions are very scarce and only few operations occurred and mainly between local investment funds. After the strong downgrading of Portuguese debt rating (that also implied the decrease of public companies and commercial banks rating) international investors are not particularly willing to invest in Portuguese property in the current context. Moreover, due to risk avoidance potential demand is now even more focused on prime property on prime locations like CBD.

Available data show that prime gross yields rose to current level of around 7.5% (estimative) in 1H 2011 for prime buildings in CBD. In the periphery – Western Corridor perceived gross prime yield rose to figures close 9% for prime buildings.

These figures have yet to be proven by real transactions as current market strongly lacks liquidity meaning that transactions are only occasional.

Gross Prime Yields by Zone – Estimative (%)



Prime Gross Yields Estimative:

2004: 7.25%
2005: 6.25%
2006: 6%
2007: 5.75%
2008 (YE): 6.5%
2009: 7.0%/7.5%
2010E: 6.75%-7%
1H 2011E: 7.5%

“In the investment market volume of transactions diminished drastically when compared to prior to 2009 period”

“(Perceived) Prime Gross yields rose drastically”

“Globally, demand is not meeting the supply asking prices”

“Risk avoidance and financing of operations are now the main keys”

“On the medium term opportunity some opportunity deals may occur”

For the time being, globally speaking, demand is not meeting the supply asking prices. Moreover, risk premiums over prime yields currently observed on more central locations as Madrid, London and Paris have to be put into the equation. Nevertheless, as gross yields rise some investors and funds with liquidity may seek some opportunity deals. On the other hand, on the medium term some owners may be pressured to sell due to specific financial constraints resulting in more volume of transactions.



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Appendix I – ZONE DEFINITION



Data Source: PREA based on LPI; INE, BdP, and Min.Finance for Economics

- Zone 1: CBD Central Business District
- Zone 2: Secondary CBD
- Zone 3: North Lisbon/Inner Circle
- Zone 4: Historical Areas
- Zone 5: Parque das Nações (former expo 98)
- Zone 6: Western Corridor (out-of town)

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