Portuguese Real Estate Advisors

Lisbon Office Market Outlook

4th
Quarter
2013

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Lisbon Office Market Outlook

Research & Market Analysis Report

4th Quarter 2013

Outlook 2013

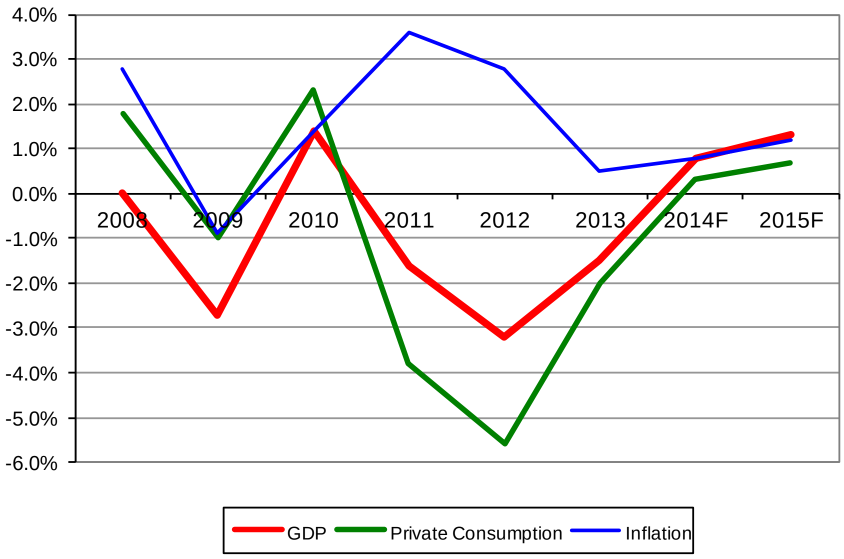
2013 economic performance was severely conditioned by financial assistance plan started in June 2011 and likely to be closed with success in May 2014. Although GDP decreased 1.5% on a yearly basis the last three quarters revealed a surprising GDP growth, although still very modest (below 1%).

The bailout plan is close to its end with recognized good results and positive evaluation by the "Troika" - EU-ECB-IMF. Nevertheless, the real economy suffered with vast austerity measures: major tax increases and major cuts in public expenditure. GDP fell more than 6.3% during the last 3 years.

In the context of economic adjustment demand (gross take-up) fell to 78,000 sq m in 2013 which is considered a record low and represents a severe decrease of 24% regarding prior year.

2014 is expected to be a turning point and economic indicators are now more positive: GDP is forecasted to grow around 1% in 2014, consumers' confidence index is consistently increasing, PSI20 stock exchange market index is rising for one year now, and even unemployment shows slightly better figures. Investment is forecasted to recover to positive growth in 2014.

Economy – Main Indicators



Average rents are still under pressure although prime rents are less volatile and commercial incentives are on players' minds. A very slow market is observed and substitution demand is dominant. Recover of demand is expected to be slow and progressive along with increasing economic performance.

Market main drivers are still risk avoidance and cost reduction although return on investment and equity is now gaining momentum. Lower interest rates for government bonds may open a new opportunity window in terms of future (sustainable) compression of interest rates and probably yields.

Summary:

"“2013 was conditioned by the bailout plan and severe tax increase”

“Main scenario is now a cautionary program or a clean exit from Troika Financial Assistance Plan to be set until May 2014”

“Economic indicators are now more positive although still fragile”

“Take-Up levels fall by 24% in 2013 and slight recovery is expected only for 2014”.

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

“Decrease of interest rates in long term government bonds may set the context for additional compression of yields”

The Economy

On the last three years a severe austerity with major tax increases and major cuts in public expenditure (including salaries and pensions) also reflected on real economy.

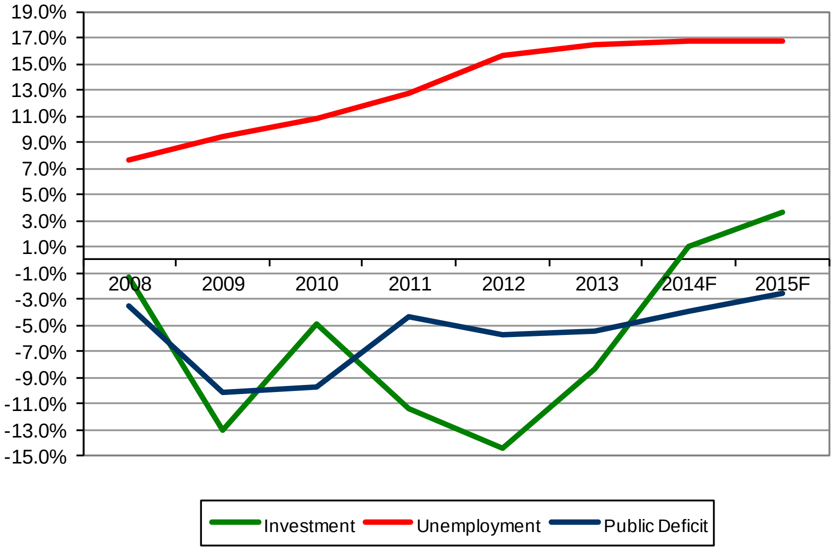
As a result decline in both public and private consumption was observed with GDP heavily falling throughout 2011, 2012 and first part of 2013. Private consumption fell considerably (-12% in accumulated figures) and employment rose to record levels.

Second quarter 2013 managed to halt previous recession and three consecutive quarters of shy growth were observed. Private consumption and unemployment latest figures show significant improvements although still very fragile and volatile.

Now being the major target the access to long term government bonds primary financing market in reasonable conditions (interest rates) along with control of fiscal deficit a slow and tight economy is still expected although some room for economic growth is likely. Inflation is likely to remain low and shortage of liquidity mostly amongst the small and medium sized companies continues to be an important issue.

Consumers' confidence and private consumption are slowly improving from record lows, exports continue to grow, and investment is forecasted to regain positive growth in 2014.

Economy – Selected Indicators



Economic upturn is forecasted for 2014, most likely mainly in second half. Also major reforms in labour laws, justice, lease laws and licensing are underway although its positive results are expected only in the medium term. Nevertheless, austerity measures should continue in order to reduce/consolidate public deficit leaving only room to a tight economy although more dynamic than in recent years.

GDP Growth:
2009: - 2.7%
2010: 1.4%
2011: -1.6%
2012: - 3.2%
2013F: -1.5%
2014F: 0.8%
2015F: 1.3%

YE Public Deficit (%GDP)
2009: - 10.2%
2010: - 9.8%
2011: -4.4%
2012: - 5.8%
2013F: -5.5%
2014F: -4%
2015F: - 2.5%

Inflation:
2011: 3.6%
2012: 2.8%
2013F: 0.5%
2014F: 0.8%
2015F: 1.2%

Investment:
2011: -11.4%
2012: -14.5%
2013F: -8.4%
2014F: 1.0%
2015F: 3.7%

Unemployment:
Avg 2011: 12.7%
Avg 2012: 15.7%
Avg 2013: 16.5% *
Avg 2014F: 16.8% *
Avg 2015F: 16.8%
* Official figures – troika reviews.

Private Consumption:
2011: -3.8%
2012: -5.6%
2013F: -2.0%
2014F: 0.3%
2015F: 0.7%

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Research & Market Analysis Report

4th Quarter 2013

Take-Up and Demand

A 24% decrease was observed in gross take-up for 2013 accumulated figures reaching only 78,000 sq m. Demand figures are considered very low when compared to average pre crisis data. However last three years average falls under 90,000 sqm/year and no major changes are likely for 2014.

Falling private consumption and investment along with rising of unemployment in previous quarters may be the main causes for a very weak demand. Cost cutting and shorter lease contracts in the context of a more flexible lease market also explain constant renegotiation of rental costs producing further pressure on rents and disabling further moving of companies.

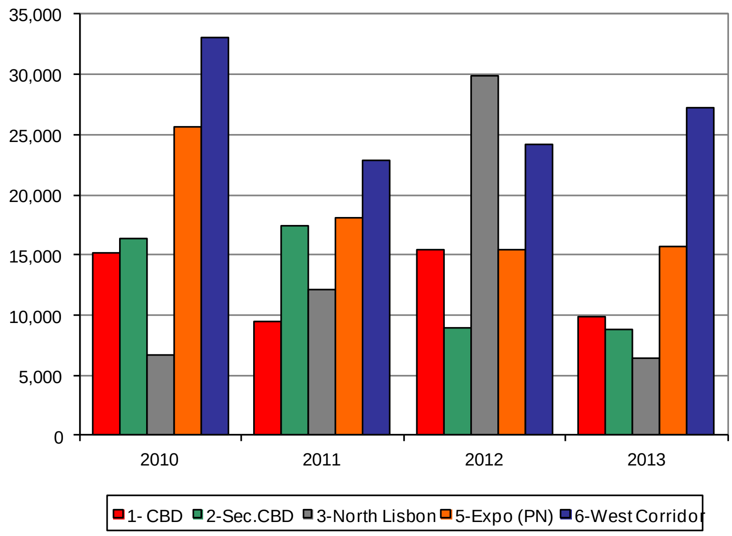
Excess of supply in most zones (mainly in zone 6) is also significant and may enhance rental pressure. Nevertheless, pipeline is now much lower than in recent years and developers are now very cautious.

Lease market is absolutely dominant and represented 97% of area transacted as sales were very scarce.

Number of transactions managed to match prior year (185) but average area transacted decreased 24% and average area leased decreased 17%, the latest to around 420 sq m. In fact, more than 65% of leases were below 300 sq m and 50% of total lease operations were below 200 sq m implying that take-up of smaller spaces might be a trend to be observed.

Also used space represented approximately 75% of total area leased illustrating substitution demand dominance. New space leases were mostly done in Parque das Nações (8000 sq m), Western Corridor (6700 sq m but only one operation) and Northern Lisbon zone 3 (3000 sq m)

Gross Take-Up by zones in Sq m



Most active zones were zones 6, 5 and 1 with respectively 35%, 18% and 13% of total leased area. As seen on the above chart zone 3 fell strongly and accounted for only 8% of leased area, explaining most of the 2013 fall in new occupancy.

Gross Take-Up sq m:
2009: 116,000
2010: 105,000
2011: 88,000
2012: 102,000
2013: 78,000

"Average area transacted on last three years is short of 90,000 sq m/year"

"Cost cutting and renegotiation are main drivers. Nevertheless, new companies and expansion of area deals are now more noticeable"

"Average area transacted decreased significantly to around 420 sq m per operation"

"Leases below 300 sq m are more than 50% of total lease operations"

"With some exceptions, lease operations of smaller spaces might be a trend to be observed"

"Slowness of deals and volatility characterize the market"

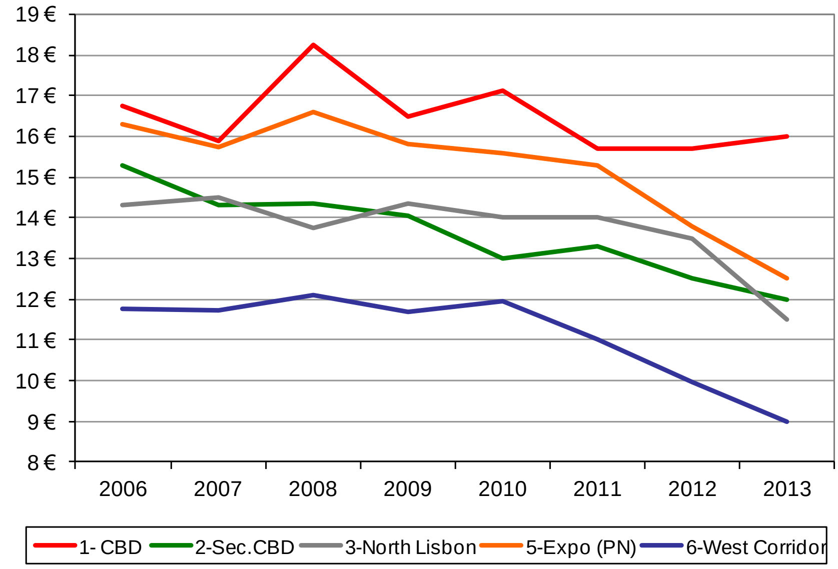
"Slow and progressive recovery of demand only in 2H 2014 is the mostly likely scenario at this point"

Rental levels

During the last years a strong pressure on rental levels was felt, as observed in the chart below. With some resilience on prime CBD zone I average rents have decreased between 15 to 25% in most zones in the last five years.

Prime rents have managed to sustain higher levels and avoid sharper declines due to specific location and better quality or more differentiation on buildings/spaces. Also commercial incentives like rental free periods and space fit outs financial contributions are now common in order to sustain rental levels for investment funds and institutional investors.

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



Main reasons as previously said are weak demand, excess of supply in some zones, renegotiation and cost cutting drivers, all in the context of a tight economy.

Prime rents now stand at around Eur 18.5 Sq m/ month in CBD and at around Eur 11 on Western Corridor for prime buildings. Zone 5- Parque das Nações now presents prime rents at around 15 Eur/Sq m/month

Mainly in periphery zones and non prime buildings average rents have been suffering significant downward adjustments. Current levels now stand at around 16 eur/sq m/month in CBD, around 12.5 Eur/Sq m/month in Parque das Nações and around 9 eur/sq m /month in Western Corridor.

Despite the decrease in new supply and forecasted pipeline conditions are met for a medium term pressure on average rents mainly on secondary locations/buildings.

Analysis by zone is imperative as small fluctuations occur in different areas as a result of local market context, mainly on zones I and 5.

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
2012: 18.5
2013: 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
2012: 16
2013: 15

Prime Rents Western Corridor Eur/Sq m/Month
2006: 14.5
2007: 14
2008: 14
2009: 13.5
2010: 13.5
2011: 12.5-13
2012: 12
2013: 11

Average Rents:
"Strong pressure on average rents and major commercial incentives"

Average Rents on CBD – zone I:
"Sustained resilience"

Prime Rents:
"Slight downward pressure."

Supply

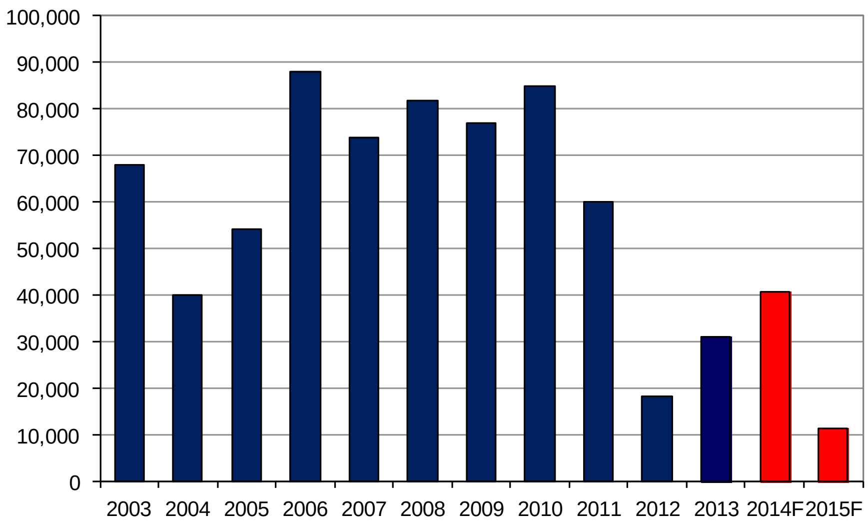
Due to poor demand market is considered in relative excess of supply with overweight of used space. With some exceptions (in CBD for instance) available space is abundant mostly in zones 6 Western Corridor (240,000 sq m) and 2 secondary CBD (120,000 sq m).

New supply and pipeline are now lower. Developers act with extra caution: Some pipeline and new built is already pre-let and most of operations in centre of the city are refurbishments and rehabilitation of buildings.

For 2014 a total amount of 40,000 sq m is in pipeline but 35% of it is the new EDP (electrical distributor) headquarters in zone 4 historical zone. The rest will occur in CBD – Central Business District with 2 refurbished buildings and zone 2 secondary CBD with a new building in Nova Amoreiras.

For 2015 only 2 refurbishments in zone 1and 2 are accounted as pipeline at this point adding up to +11,000 sqm in city centre stock.

New Built Supply and Pipeline – Estimative in Sq m



Data available points to 55.000 sq m of pipeline for the next two years although some delays are feasible.

Most actives zones in terms of new supply will be zones 1- CBD mostly refurbishments and zone 2 – Secondary CBD. Out of town and Parque das Nações registered pipeline is null at this point.

New Supply sq m:
2009: 77.000
2010: 85.000
2011: 60,000
2012: 18.000
2013: 31.000
2014F: 40.000
2015F: 11.000

"The pipeline for out-of town is null"

"No registered pipeline for Parque das Nações at this point"

"Most active zones in terms of pipeline are CBD (mostly refurbishments), and secondary CBD - zone 2"

Vacancy Rates

In the context of greater Lisbon market 13.2% is now the global official vacancy rate on YE2013. Vacancy rates rose moderately in recent quarters as a result of low demand for existing supply. Moreover, new companies and new installments were short leading to a market with substitution/moving as main driver.

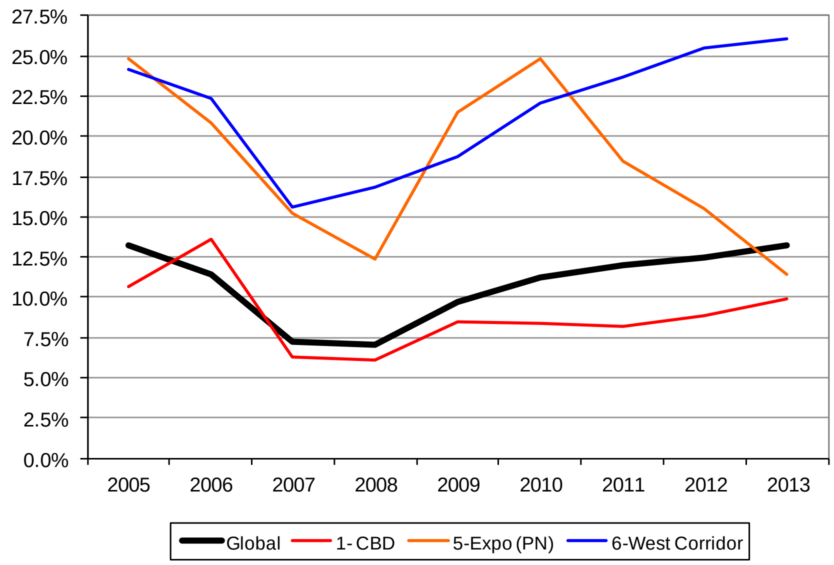
Major rates are structurally observed in zone 6 - Western Corridor (26%) where available (new and mainly used) space is now very abundant.

Zone 5 – Parque das Nações with its small dimension and huge sensitivity managed to reduce its vacancy rate down to 11.4% due to reduction of new built and specific/occasional large dimension lease deals.

CBD – Central Business District vacancy is still below two digits (9.9%) due to less available space and enhanced atractivness.

Due to its large dimension zone 2 – Secondary CBD registers low figures (currently around 11.5%) but available space is considerable high (close to 120K sq m).

Vacancy Rates Estimative (%)



Vacancy rates are now strongly linked to regain of take-up levels as restrain on pipeline volume is now clearly assumed by players.

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

Vacancy Rates (global) :

2009: 9.7% (+)
2010: 11.5% (+)
2011: 12.0% (+)
2012: 12.5% (+)
2013: 13.2%

"Vacancy rates rose in recent quarters in most zones "

"Some occasional exceptions to increased vacancy rates are zone 5 and 1 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

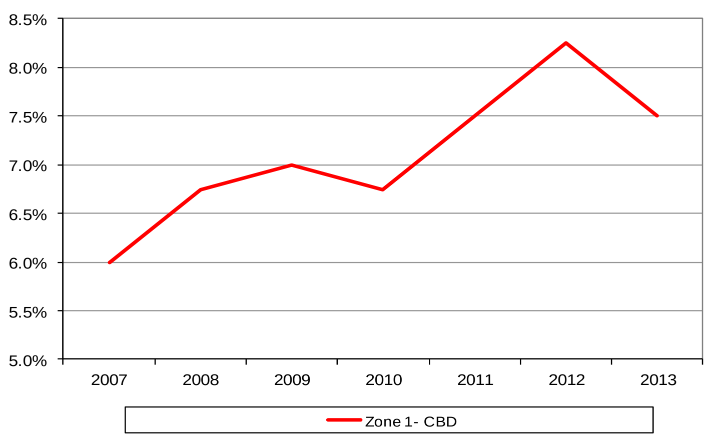
In a recent period where international investors were not particularly willing to invest in Portuguese property (after the strong downgrading of Portuguese debt rating) investment market suffered a strong downturn mostly felt in 2012.

2013 already saw a more dynamic market with international players acquiring prime buildings with a long term approach. Most active zone was Parque das Nações where Báltico building was acquired by Deka Imobilien by 43 M euros and Espace and Explorer buildings were also acquired by AFIAA – Swiss foundation for International Real Estate Investments by 30 M euros according to the published news. CBD was also active with major transactions between local players. Refurbishment of Avenida da Liberdade buildings is on players' agenda.

Agencies report more than 300 million euros in transactions in investment market in 2013, of which a significant part relates to office segment. However, due to risk avoidance potential demand is now even more focused on prime property on prime locations. Therefore, transactions are still scarce but noticeable stronger in number and volume than in recent past.

After consecutive quarters of rising prime gross yields data shows that they have already started to compress in recent quarters. Available data reports that prime gross yields now stands at around 7.5% after peaking at 8,25% (estimative) in 2012 for prime buildings in CBD. In the periphery – out of town - perceived gross prime yields normally imply a premium of 1 to 2% relatively to CBD. Perceived gross yields seem now more sustainable.

Gross Prime Yields – Estimative (%)*



Demand is still not meeting the supply asking prices disallowing increased number of transactions. However, recent deals have proven confidence on behalf of foreign investors. Some investors and funds with liquidity may seek good opportunities leading to opportunity deals. More important, on the medium term some owners may be pressured to sell due to specific financial constraints.

Increased confidence may lead to regain of investment market, mainly with a long term approach, although volatility is still present and rental returns are still weak.

Prime Gross Yields Estimative:
2009: 7.0%
2010: 6.75%
2011: 7.5%
2012: 8.25%
2013YE : 7.5%

"Prime Gross yields managed to decrease in recent quarters in CBD".

" Some major deals brought back confidence and long term perspective"

"Globally, demand is still not meeting the supply asking prices but that can change with regain in confidence"

"Shortage of financing and liquidity is still globally felt, although some foreign players seem now more comfortable".

"On the medium term some opportunity deals may occur"

"Clean exit or cautionary program may lead to better market access leading to significant decrease of opportunity cost"

"Improvement of ratings is likely on the medium term. Some local banks have now favourable outlook by rating agencies".

Appendix I – ZONE DEFINITION

Data Source: PREA based on LPI; INE, Bank of Portugal, 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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