

New Build Residential Market

Q1 2009

EXECUTIVE SUMMARY

- **The residential market continues to adjust**

In a scenario of general economic contraction, the residential property sector continues its particular and severe adjustment. The statistics confirm the slowdown in production, transactions, mortgage loans and, for the first time, property prices.

- **Slowdown in effective demand**

Property transactions in Spain have dropped noticeably. Residential demand is suffering from the economic crisis, unemployment and mortgage loan restrictions. The limited number of sales that are completed centre on discounted product.

- **Residential prices drop**

The current environment and extensive real estate inventory available for sale are pushing down prices. Public statistics and, to a greater extent, private statistics, evidence the property price cut in Spain; a trend that is expected to continue in the upcoming months.

- **The mortgage market contracts**

The number of new mortgages has dropped radically due, both to lower credit demand, and the hardening of loan concession criteria. Lack of financing continues to be one of the principal obstacles for the recovery of the residential market.

- **Financial entities have become the main players**

By swapping developer outstanding debt for property assets and by foreclosing on mortgages in arrears, banks and building societies are being positioned among the residential property holders in Spain.

- **The arrival of financial entities can revitalize the market**

The initial residential offer from banks has been relatively well accepted, suggesting the existence of potential residential demand given attractive prices and suitable financing. Financial entities can therefore provide a certain impulse to the Spanish residential market, increasing the pressure on some small and medium developers out of the market, unable to offer the same terms and conditions.

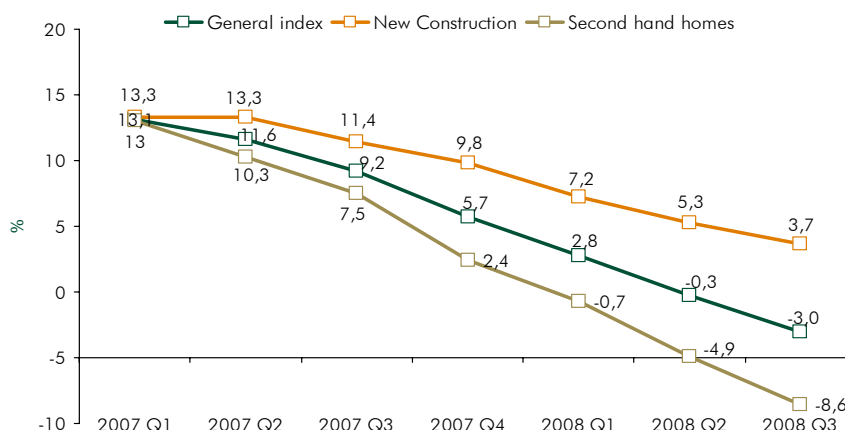
Current trends

Production	↓
Prices	↓
Accessibility	↑
Mortgage loans	↓
Transactions	↓

Trends for the upcoming quarters

Production	↓
Prices	↓
Accessibility	↑
Mortgage loans	↑
Transactions	↑

Evolution of the Annual Property Price Index



Source: INE

SUPPLY

New property developments in recent months have dropped in a rapid and significant manner: projects were approved from January to November 2008 to build 247,446 homes, 60% less than during the same period in 2007. This adjustment in residential development will to an extent help to correct excess supply in the medium term, but is also likely to negatively affect unemployment, consumer spending and the economy in general.

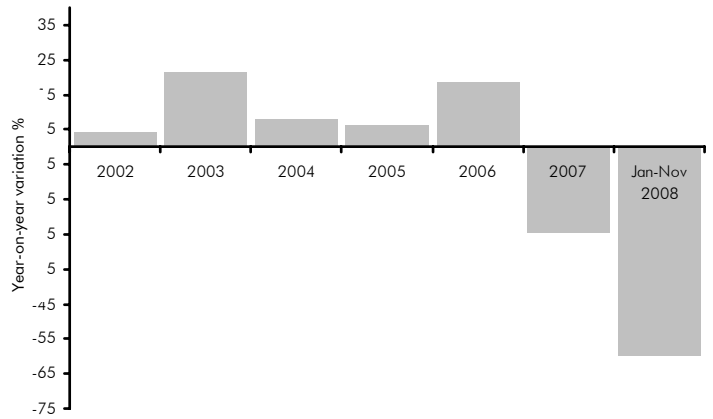
The volume of newly completed homes reached 570,930 units by November 2008, only 4.2% less than the total from the same period during 2007. Looking ahead, the amount of finished product will reduce to a greater extent, facilitating a slight improvement in the current supply/demand imbalances.

The excess supply situation is one of the characteristic problems faced by the residential market today. In light of official purchase and new completion data, we estimate the number of unsold units in recent years to be around 825,000, not including supply acquired by investors; currently also for sale. It is estimated that the time required for demand to absorb the surplus is over three years.

Highlights

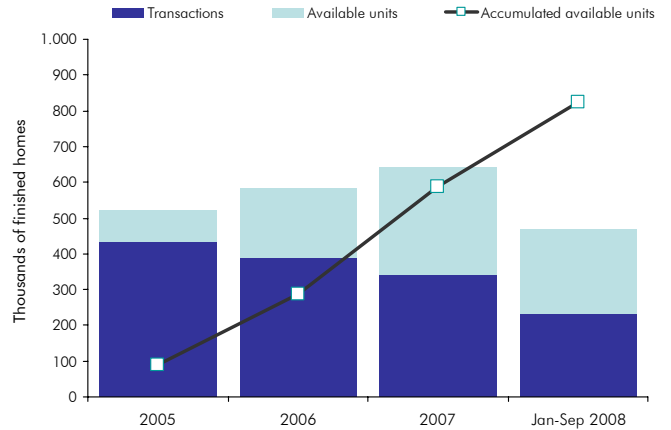
- Increased rental stock. Due to the slowdown in sales, there has been a certain migration of a part of the stock, initially destined for sales, to the rental market. This contributes, on one hand, to a reduction in unsold, available housing and, on the other, helps to establish a pool of houses to rent that the Spanish residential market lacks. This increase in number of properties on the rental market is what is causing rental prices to stagnate, or even drop in areas of greater supply.
- Financial entities gain relevance. During recent months, banks and building societies have accumulated residential product, mainly through exchanging developers outstanding debt for property assets, thus becoming one of the main suppliers of new property in Spain. Furthermore, mortgage foreclosures in the third quarter 2008 totalled 13,487, 146% more than during the same period the previous year.

New construction licenses



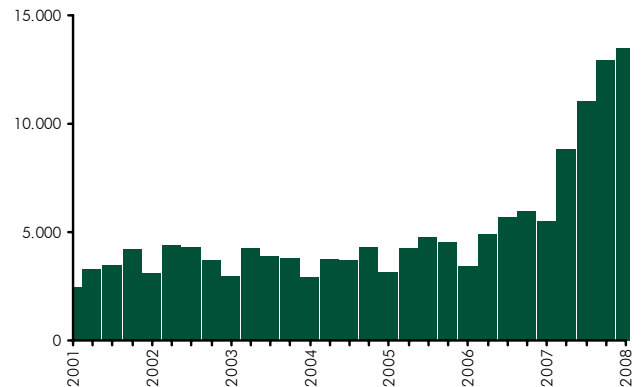
Source: MFOM

Available completed residential units



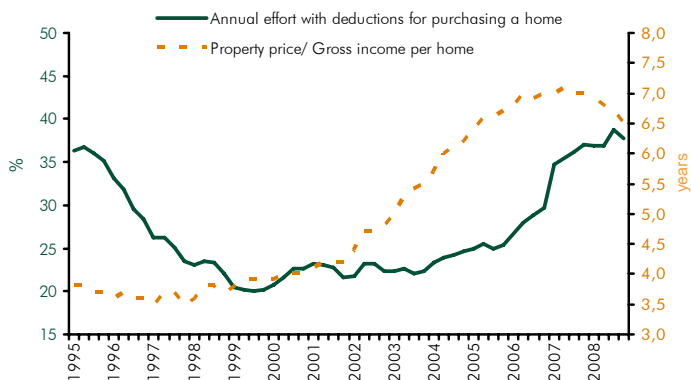
Source: School of Property Registers, MFOM

Collected mortgage executions



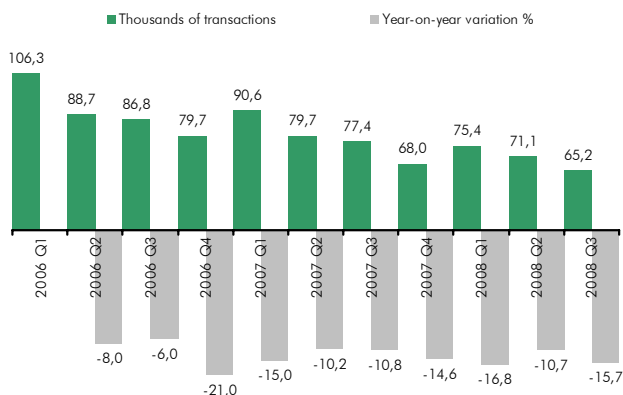
Source: CGPJ

Housing accessibility



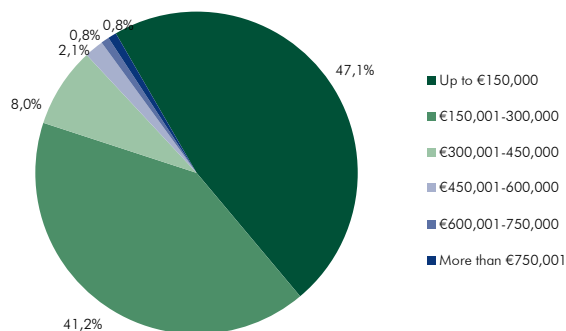
Source: BDE

New house sales



Source: Spanish School of Registrars

New house prices in 2008 (up to Q3) as per sale price



Source: MVIV

DEMAND

The expenditure necessary to purchase a house in Spain is equal to 6.5 times the estimated gross annual income of an average home in the fourth quarter 2008, five tenths less than during the same period of the previous year. The reduction of this variable is largely related to the drop in house prices which last year. This price correction is expected to continue through this year.

Furthermore, households need to dedicate 37.7% of their available income, including tax credits, to purchase an average home. This represents a drop of one percentage point on the previous quarter, which set the maximum level for recent years. The substantial drop in the euribor is also starting to have a positive effect on property accessibility.

The number of households in Spain continues to increase at a good rate. As at December 2008, there were 16.9 million homes in Spain, 448,000 more than at the end of the previous year. Latent demand for housing is apparent in the market but this is not being converted into effective demand. The year-on-year reduction in transactions up to September 2008 was 15.7%, in the case of new homes and 43.8% in the case of second hand homes. It is the latter that best evidences the market pulse as second hand home transactions are not affected by the time lag that generally occurs between private contract and public deed signing for newly completed product.

The year-on-year drop from January to November 2008 of mortgage loans for purchasing homes reached 45.8%. This is due, both to lower credit demand and the toughening of conditions for mortgage concessions, which continues to be one of the main obstacles for the recovery of the residential market.

Highlights

- The limited effective residential demand focuses on more affordable homes. Of the 395,344 private residential transactions executed from January to September 2008, 47% corresponded to prices less than €150,000, 41% to transactions between €150,000 and €300,000, and only 11.7% were for transactions involving prices above €300,000. Prices in many cases remain relatively high and, together with a lack of financing, this is stifling demand. In 2009 we can expect financial entities to offer residential properties at more attractive prices and with improved access to finance.

PRICES

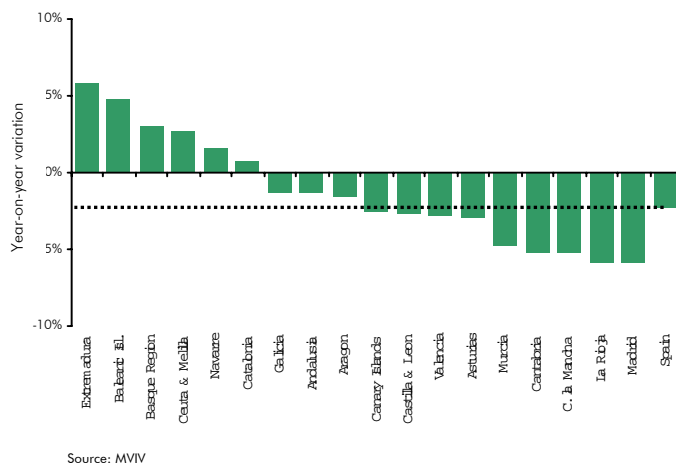
As at the end of 2008, the official statistics already slowed a general slowdown in property prices, with an average variation around -2.3% and -3.7% for new and second hand homes respectively. On the other hand, the majority of private sources indicated greater discount rates, setting the year-on-year average variation at around -10%.

The average value of new private residential transactions in Spain reached a record maximum in December 2007 - €197,912 - and moderated since then to around €190,150 in September 2008. The regional variation is notable: in Extremadura and Galicia the average price is under €140,000 while it exceeds €275,000 in Madrid or the Basque Region.

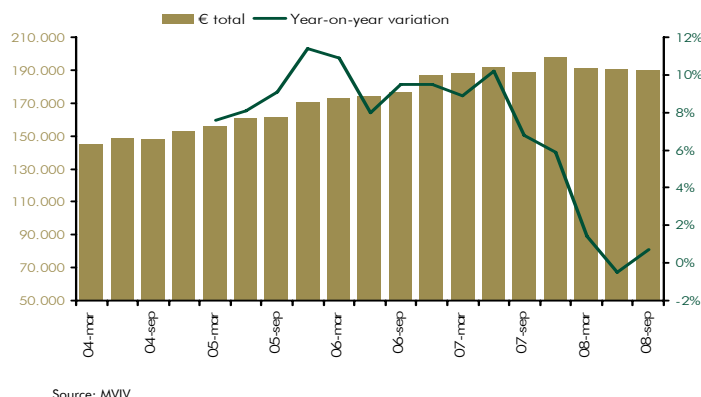
Highlights

- The reduced number of transactions closed in recent months in the residential market do so at around 20% under the initial asking price. Looking ahead, we expect asking prices to continue to trend downwards.

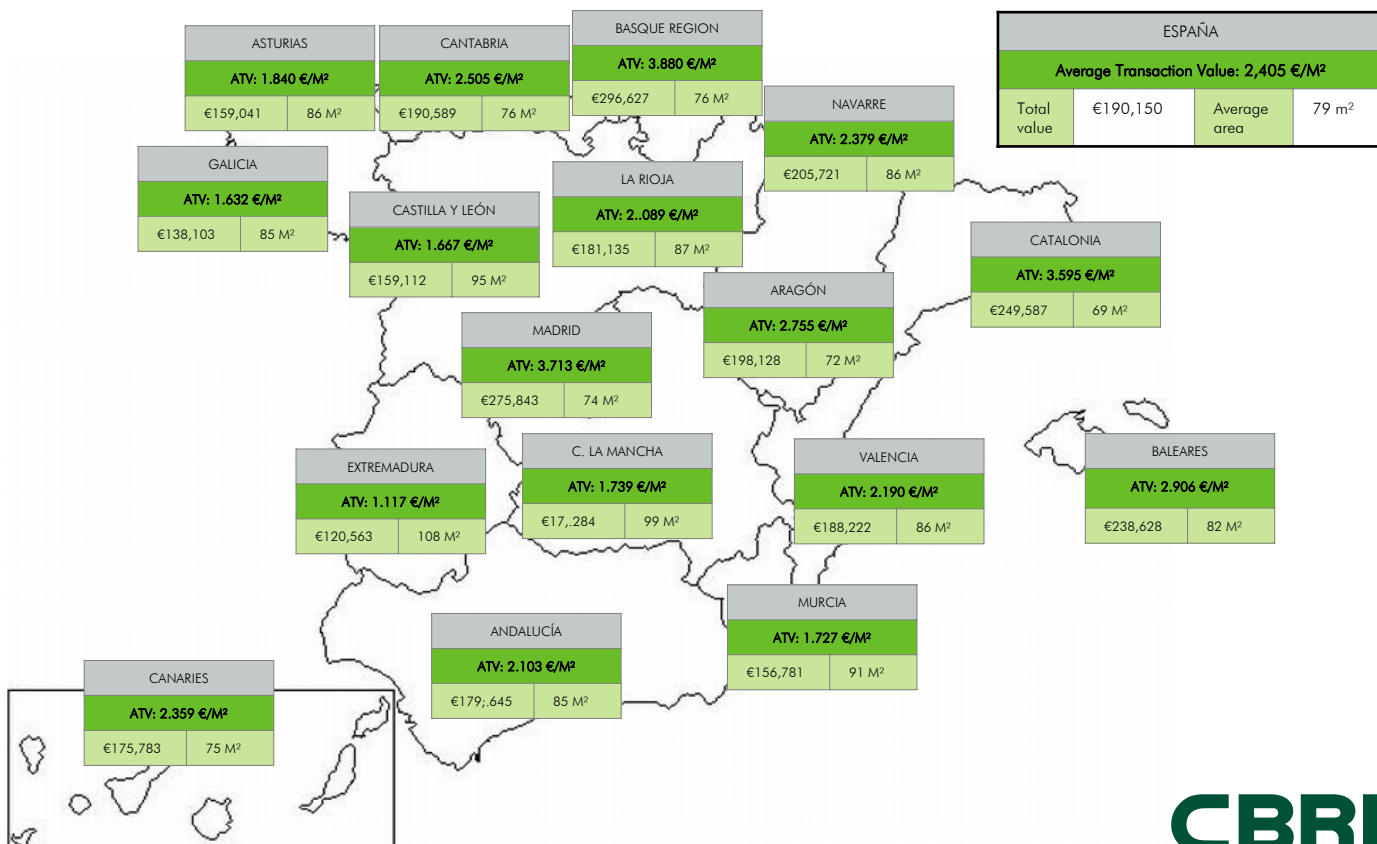
Average price of new private houses in Spain Q4 2008.



Average price of new private houses in Spain



Average price of new private houses in Spain (Q3 08)



Sources: CBRE, School of property registers, Ministry of Homes

INTERVIEW

YOLANDA LOZANO
Country Manager CBRE Residential Division

How do you see the current situation of the residential market?

The parameters of the residential market are changing and will continue to do so in the coming years. The traditional residential development margins, above 20%, should be cut back in two ways: reduction of the basic cost, land, in order to move on to a reasonable weighting of around 25-30%, and a considerable increase in end product quality, including after sales services on where applicable, for the benefit of the purchaser.

What are the solutions to the current situation?

The key is flexibility. It is necessary to consider of price adjustments, rental opportunities and new marketing channels. These approaches bring supply closer to demand, which has been largely forgotten in recent years.

Will the arrival of REITs affect the residential market?

I think the key for REITs to work will be in the handling of initial tax and administrative legislation - streamlining evictions, etc. After that, it will become a plausible option if the product is properly selected and managed, because of the rental potential in Spain. With the good backing of brands such as our own managing these vehicles, and based on the aforementioned premises, they could be a viable alternative.

On the other hand, the main national real estate developers will find it very difficult to convert to a REIT structure because:

- 1) The transfer of assets from a developer (equity or finished product) to a REIT is taxed like a normal purchase (VAT or ITP, and AJD). A transitional regime should be applied to allow such transfer of property to the new REIT at a reduced tax.
- 2) The maximum gearing of a REIT is calculated to be at 60% of its assets value. This will limit its growth and development in the medium and long term.
- 3) The hold period before selling an asset, seven years for property whose origin is self-development, is excessive. Developers would require highly flexible and advantageous finance conditions, which seems complicated in the current scenario.

What are your estimates for 2009?

There already is an increasing demand interested in purchasing and/or renting at reasonable prices. These prices represent an average reduction of 30% on maximum prices reached in early 2008, which means returning to price levels from five years ago. However, much depends on geographic location, use as first or second home, type, area, etc.

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