



German Property Snapshot

The economy

Recent performance

The German economy showed a surprising upturn in Q2 2009, with growth of 0.3 % for the quarter, having suffered a rapid deterioration in the wake of global financial crisis last autumn. Leading the turnaround in the economy, has been a stabilisation of business investment, and a strong improvement in net exports as sales to Asia have risen. Consumer spending, an area of persistent weakness for almost a decade, rose a modest 1.2% on an annual basis in Q2, although this is still better than the US and the UK, where consumers cut back spending by 1.8 % and 3.2% respectively. Households have been supported by huge government fiscal support measures for new car sales and employment incentives, for those employers holding onto staff by placing them on part-time working hours.

Employment has held up well, showing only a 0.2 % drop in the year to Q2 2009. If it were not for government support however, unemployment is likely to have been significantly higher; possibly nearer a 10 % rate rather than the 7.7 % recorded in July. Consumer prices fell on an annual basis in July, the first fall recorded since 1987, when prices fell in the former West Germany. Deflation with largely driven by weaker oil and food prices. Underlying inflation has reduced, although is still positive, underpinned by relatively firm increases in wages, and rising cost pressures as corporate productivity has plunged.

Outlook

We expect German GDP to drop by 4.8 % in 2009, the largest fall in the post-war period, but then to rise by 1.6 % in 2010. Business confidence in August surged back to its long-run levels, indicating a marked upturn in demand. Germany's high dependence upon foreign trade led to an unprecedented drop in economic activity at the turn of the year, although will also help to drive an economic rebound.

The labour market is a potential area of weakness, as firms refrained from aggressively cutting employment. This can only be justified if demand conditions were to rebound to previous highs. We think this is unlikely, as some production will be permanently lost to more competitive locations in emerging Europe and Asia. The Government will also unwind its labour market support measures, and support for the car industry, reducing effective household disposable incomes. Exports and business investment are likely to resume their lead roles as the primary drivers of economic growth next year.

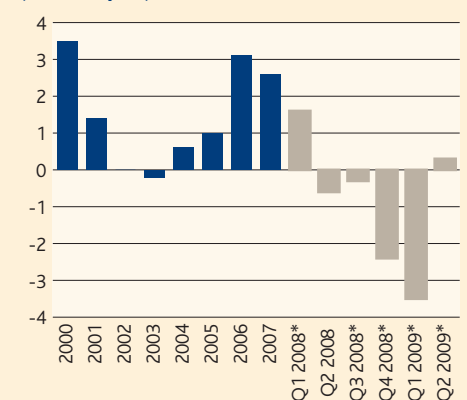
The economy's medium-term growth profile is likely to be volatile, as fiscal and monetary stimulus measures are withdrawn. As private demand conditions improve into late 2010 and early 2011, the risks are that interest rates are hiked swiftly to forestall inflation in the face of extraordinarily loose monetary policy, globally. To stabilise the German economy, household spending could plug a gap in demand. Low levels of household debts and a high savings rate put consumers in a good position to step-up spending, with a newly elected government possibly providing the catalyst for change, with a round of economic and labour market reforms.

Economic forecasts

	2008	2009	2010
Real GDP growth p.a. (%)			
Germany	1.0	-4.8	1.6
EU 27	0.7	-3.9	1.0
Inflation p.a. (%)			
Germany	2.7	0.2	0.5
EU 27	3.4	0.7	1.0
Consumer spending growth p.a. (%)			
Germany	-0.1	1.2	0.9
EU 27	0.6	-1.3	0.7
Unemployment rate (%)			
Germany	7.8	8.2	9.5
EU 27	7.2	9.5	10.5

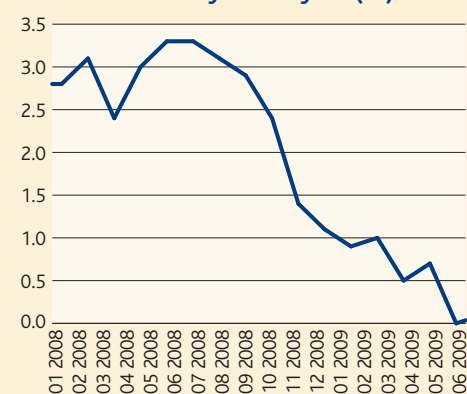
Source: Aberdeen Property Investors

German GDP growth 2000 – Q2 2009 (real, % p.a.)



Source: Aberdeen Property Investors, destatis
*quarterly change

German inflation year-on-year (%)



Source: destatis

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Recent property market trends

Office

The caution displayed within the office markets, already discernible at the 2008/2009 turn of the year, continued well into the first half of 2009, reflecting macro-economic developments in both the domestic and global markets. Instead of moving, tenants have tended to opt for extending their tenancy agreements by one or two more years.

The seven major office centres in Germany saw overall turnover decline (letting and transactions with owner-occupiers) by an average of approximately 30 % on an annual comparison, although with disparate quarterly results across these cities. Frankfurt for example, performed well due to the German Railways deal (72,000 square metres) in the year's first quarter, Munich recorded two balanced quarters and achieved the highest half-year turnover in Germany (approximately 265,000 square metres).

Due to less demand, coupled with an increased number of building completions, the vacancy volume in Germany's office centres rose during the year's first half, by around 6% compared to the preceding year's equivalent period. New speculative projects are being postponed for the time being.

Rental values for the major German office centres peaked at the 2008/2009 turn of the year, with the first six months of this year seeing average falls in rents of 3.5% due to the economic situation.

Retail

Despite the currently strained cyclical situation, in a less-than-easy financial market environment, demand for retail properties in prime locations of the German centres remains high. In contrast to the office markets, these highly-frequented shopping high streets have not yet experienced lower prime rents during the course of 2009, as supply lags far behind demand. The highest rents are being paid in Munich. Inner-city shopping centres are also in demand.

By contrast, in the B and C locations, and in the 1A locations of the smaller towns with inadequate purchasing power and retailing centrality, demand for retail space continued to fall, resulting in an increased supply of retail space and falling rents.

Currently, the main type of property causing problems is the traditional department store, which is running into increasing difficulties. These difficulties are as a result of a business model concept that is no longer viable; a full-range provider in a competitive environment, plus the lack of a harmonised concept for the varying locations and size structures involved.

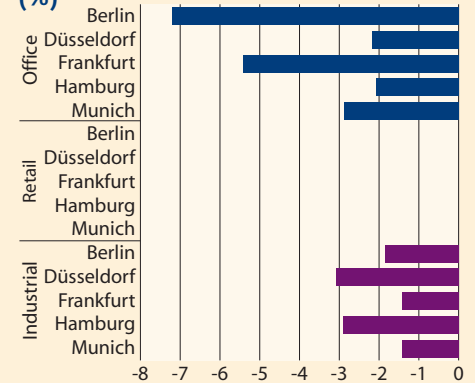
Industrial

The industrial storage and warehouse markets too, exhibited reduced demand in 2009 (down approximately 15%), although not to the same extent as the office property market. New buildings, in particular, with owner-occupiers from the retail sector, dominated transaction turnover, whereas portfolio buildings were less in demand.

In the five major business centres, the total fall in overall turnover was approximately 20%, although turnover was, in fact, up for units measuring more than 5,000 square metres.

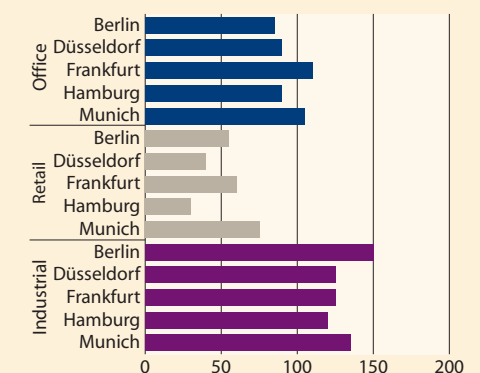
Rents fell in the first half of the year, with prime rents continuing at a high level: €5.80 per square metre in Frankfurt, for example.

Prime rental change Q4 2008 - Q2 2009 (%)



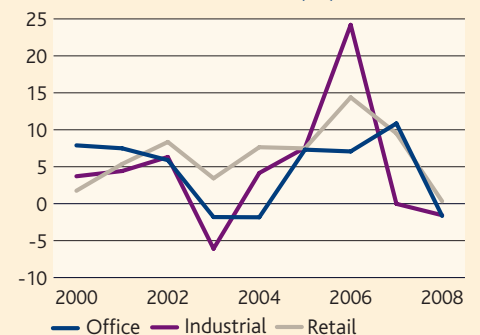
Source: Aberdeen Property Investors

Prime yield shift from peak to Q2 2009 (basis points)



Source: Aberdeen Property Investors

Prime total return Germany office, retail and industrial 2000-2008 (%)



Source: Aberdeen Property Investors

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Recent property market trends

Investment market

It is the investment market that is still suffering most severely from the macro-economic environment. Following an unsustainably high volume of investment in commercial properties during the boom years of 2006 and 2007, the decline observed in 2008 continued. During the first half of 2009, properties worth approximately €4 billion changed hands, which corresponds to a fall of 77 %, compared with the preceding year. The seven major investment centres accounted for around 50% of all transactions.

The largest proportion of deals involved office and retail properties, whereas industrial properties played a subordinate role. In contrast to the boom years, market activity was dominated by individual deals, with portfolio transactions featuring hardly at all. The market was also dominated by domestic investors with solid equity capital behind them, and no longer by their opportunistic foreign counterparts. The average transaction volume fell to between €13 and €15 million per deal, with the major focus on security-oriented core products.

Corresponding to the fall in demand, the level of yields on Germany's commercial property market has risen steadily since 2007. Industrial and office properties recorded the highest increase in prime net initial yields, until Q2 of 2009, with up to 150 basis points in Berlin and 110 basis points in Frankfurt. It should be remembered, however, that yields vary widely depending on the rental level involved, the remaining term of the tenancy agreements, the tenant structure and the quality of the building concerned. Currently, dependant upon the over or under rent for agreement-to-market-rental, we calculate a range of 4.7% - 7.6% for prime yields in the German centres.

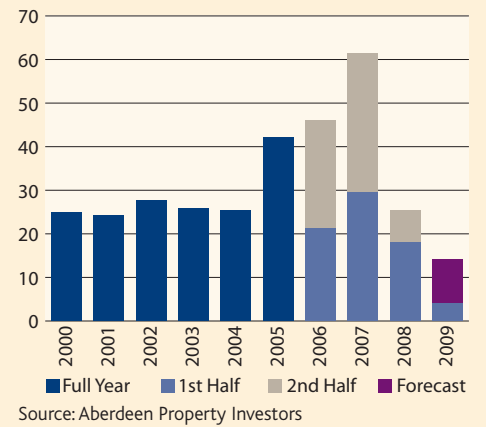
Outlook

The current mood of gloom, reflecting the ongoing situation in the business and financial markets, coupled with an anticipated increase in unemployment, continues to dampen demand on the property markets, even though initial signals, such as the unexpected economic growth in Q2 2009, have fuelled hopes of a genuine turnaround.

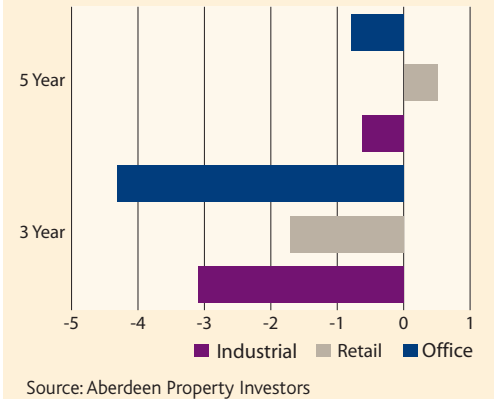
With a time-lag compared to the anticipated economic growth, prime rents are expected to fall before the end of this year and into 2010, so that by 2011 at the latest, rental levels can be expected to rise again. On an annual average, retail properties show the smallest decline in rental values.

The three and five year forecasts for total returns (prime) indicate that performance will stabilise or even grow, with the cash-flow return being the driver for total return, particularly in the next few years, whilst the principal focus is restored to properties and active asset management.

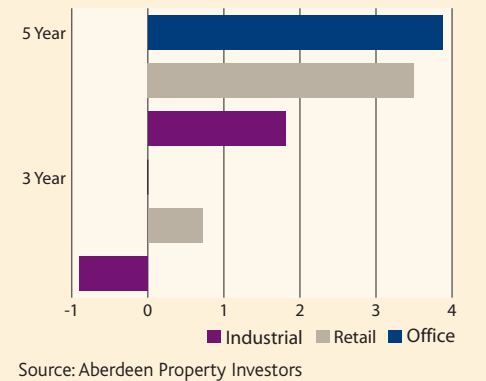
Commercial investment volume Germany (€ billion)



German prime rental forecasts from 2009 (% p.a.)



German total return forecasts from 2009 (% p.a.)



German Property Snapshot

Aberdeen market view

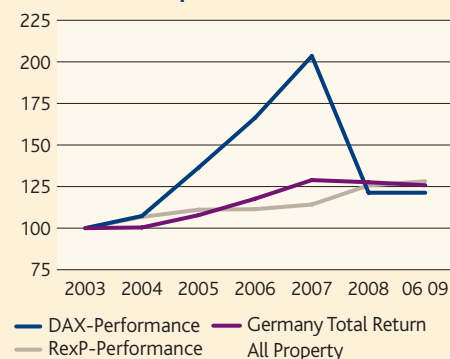
The table below, shows Aberdeen’s recommended positions on the German commercial property market, relative to a prime property benchmark (Germany Total Return All Property), in order to achieve outperformance over a five-year period.

Sector	
Germany office	Neutral
Germany retail	Neutral
Germany industrial	Underweight

Source: Aberdeen Property Investors

Note: Sector weightings reflect annualised prime five year return forecasts from 2010: "all property" 6.8%, offices 7.1%, retail 6.5% and industrial 5.6%. The underweighting to industrial property can be achieved by a marginal overweighting to the much larger office sector.

Asset classes – performance since 2003



Source: Aberdeen Property Investors, Deutsche Börse

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