



Nordic Quarterly Property Snapshot

Aberdeen

Economy

Recent performance

- The global economic recovery has gathered pace in recent months. World GDP rose in Q2, the first positive outturn in a year, albeit at half the average pace for the last decade. Very aggressive monetary and fiscal policy loosening since last autumn has successfully put a floor under the world economy. Economic forecasts in all major regions are now being consistently revised upwards for this year and the next. Asset prices have partly retrenched losses sustained in the aftermath of Lehman Brothers failure, with share prices rallying by more than 50% from their March lows. At the same time, confidence in the financial system, more generally, has strengthened considerably.
- Total real GDP for the Nordic region is expected to fall by 3.4% in 2009, although the extent to which each country is affected will differ significantly. With inflation falling sharply and labour markets still weakening, interest rates in the Nordics are also likely to stay low in the coming 12 months.
- Weak domestic demand and still falling housing prices remain key obstacles against a recovery for the Danish economy. Falling investments, combined with further weakening in exports and private consumption, resulted in a 2.6% contraction of the Danish economy in Q2. The Danish unemployment rate is still well below Nordic and European averages.
- The export oriented Finnish economy also contracted sharply in the first half of 2009, with Finnish exports being reduced by one third, compared to the same period one year earlier. Being the only eurozone country in the Nordics, Finnish exports have been losing competitiveness as the euro has been strong against other major currencies.
- The global economic crisis has curbed Norwegian economic growth, although the impact has been less severe than for most other countries. The stabilising effects of a sizeable petroleum industry and a large public sector, combined with significant fiscal boosts and no immediate threat of tightening, has kept the economy relatively healthy, with an unemployment rate still 3.2% as at August 2009. Norwegian authorities have already started unwinding the unconventional measures undertaken and the Central Bank increased the key policy rate by 25 basis points in October.
- The large, cyclical export industry in Sweden has suffered from weak global demand, with Swedish industrial production contracting by approximately 20% since August 2008. However, the very low repo rate, the measures undertaken to increase liquidity in the banking sector and the effects of the weak currency have started working. After contracting for four quarters in a row, the Swedish economy exited the recession in Q2 by reporting a quarterly GDP growth of 0.2%.

Economic outlook

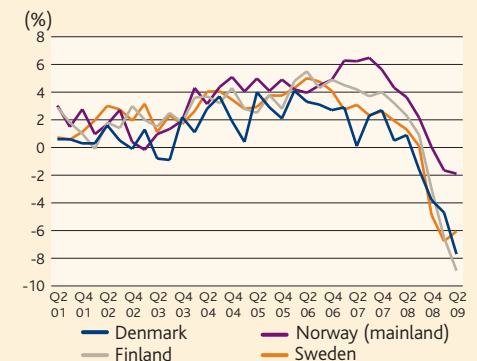
- The availability of credit has improved, relative to the standstill of last autumn, and has been a key factor behind better financial market conditions. An inventory led revival in global manufacturing production has gathered pace, underpinned by government fiscal support measures, and should lead to a strong rise in activity in late 2009 or early 2010. Due to high levels of private debt in the US and parts of Europe, we expect households in mature economies to raise saving rates, amid rising unemployment into mid to late 2010.
- A pick up in global economic activity will be the key for a sustainable recovery in the Nordic countries. As inventories have been cut sharply, increasing demand should feed directly into manufacturing activity.
- In general, Nordic public finances were sound before the financial crisis. Hence, fiscal measures undertaken to counteract the slowdown do not necessarily call for a sharp fiscal tightening, once the economic recovery kicks in. The potential of a more gradual and careful tightening of fiscal policies makes us more positive for the Nordics in the medium term than for countries heavily burned with debt and significant current account deficits. As a result, economic growth in the Nordic region is forecast to be higher than for the eurozone in the coming five years.

Economic forecasts

	2008	2009	2010
Real GDP Growth (%)			
Denmark	(1.2)	(3.0)	1.4
Finland	1.0	(5.5)	1.8
Norway (mainland)	2.6	(1.0)	2.2
Sweden	(0.2)	(4.5)	1.9
Consumer spending (%)			
Denmark	0.1	(5.0)	1.4
Finland	1.5	(2.4)	2.0
Norway	1.2	(0.3)	3.0
Sweden	(0.4)	(1.2)	2.0
Unemployment rate (%)			
Denmark	1.8	6.0	6.5
Finland	6.4	9.0	9.5
Norway	2.6	3.4	3.8
Sweden	6.2	9.0	10.0

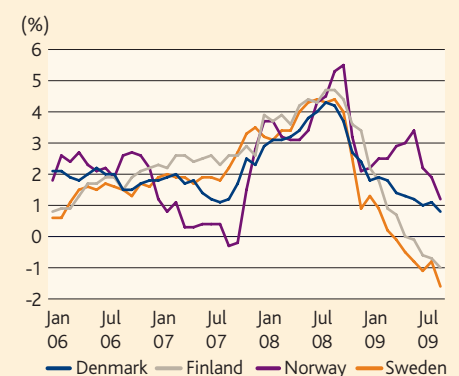
Source: Aberdeen Property Investors

Real GDP growth year-on-year



Source: Aberdeen Property Investors, Reuters EcoWin

Inflation year-on-year



Source: Aberdeen Property Investors, Reuters EcoWin

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Property market overview

Recent performance

Activity in the transaction market has improved from the very low levels seen in the first half of 2009, although is still low compared to previous years. Debt financing is gradually becoming more available, and banks are demanding somewhat lower margins, compared to earlier this year. Domestic investors have been the dominant driver behind liquidity improvements in the transaction markets, possibly attracted by the relatively high property income yields, compared to other asset classes. International investors have not been very active so far. However, interest might pick up, as the sentiment for property investments is slowly picking up and several of the largest and most liquid property markets are showing signs of recovering property values.

Investors are still focusing on prime assets with limited risk to income streams, while liquidity for secondary assets remains very low. So far, Nordic banks have, in general, been acting carefully and not calling for forced sales, despite breaches of loan-to-value covenants. The few forced sales seen have, in general, not been at distressed prices.

The driver behind capital declines in 2009 has been a combination of rising yields and weaker rental markets. The latter has been the dominant factor since the summer, as vacancies have picked up putting market rents under pressure.

Office

- Vacancy rates picked up further throughout the third quarter, as labour markets remained weak and some new supply entered the market. By the end of third quarter, vacancy rates in the Nordic capitals stood at 3-4 percentage points above the levels at the beginning of 2009. A general trend is that new and efficient premises are keeping up better than secondary office space.
- Prime office rents in the Nordic capitals fell by 8% on average in the first three quarters of 2009, led by Oslo and Stockholm, where prime rents fell by 15% and 9% respectively.
- Prime office yields generally remained stable in Q3, or showed small falls, as was the case for Norwegian offices as capital growth re-emerged.

Retail

- Despite private consumption declining and retailers' margins coming under pressure, vacancies for retail space have remained surprisingly stable. Landlords would rather accept significant cuts in rents than have vacant space in shopping centres, which would otherwise undermine the synergies between remaining tenants.
- Disposable income has been supported by low interest rates, although uncertain labour markets have influenced consumption patterns. Sales of retail basics, such as food, drink and clothing, have held up quite well, while capital goods such as cars, furniture and electrical goods, have suffered.

Industrial

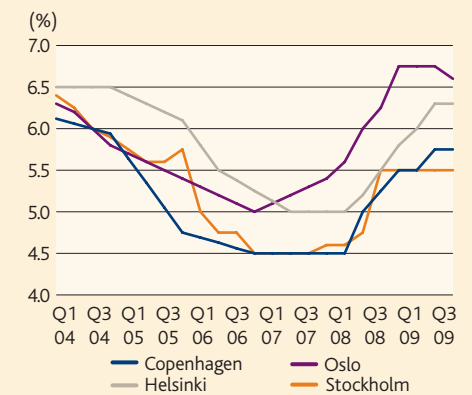
- Prime industrial rents fell by 5.6% on average in the Nordic region over the three first quarters of the year. Demand for logistics space has weakened, as declines in exports, imports and industrial production have been severe, meaning there have been lower volumes of goods to move around. With industrial production falling by more than 20%, the largest drop in prime industrial rents has been seen in Finland, where industrial rents have weakened by 8.7% from the beginning of the year.
- Yields for prime industrial properties remained unchanged in Q3, ranging from 7.0% in Copenhagen to 7.75% in Oslo. For properties outside the capital regions, prime yields are even higher.

Prime rents Q3 2009

	Office	Retail	Industrial	
Copenhagen	1,800	14,000	500	DKK/sqm/year
Helsinki	324	1,580	115	EUR/sqm/year
Oslo	2,900	14,250	1,050	NOK/sqm/year
Stockholm	4,100	16,300	1,050	SEK/sqm/year

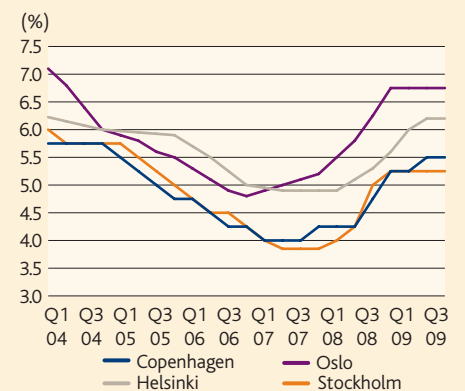
Source: Aberdeen Property Investors

Prime office yields



Source: Aberdeen Property Investors

Prime retail yields



Source: Aberdeen Property Investors

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Sector prospects

Outlook

Prime 'All Property' total returns for 2009 are forecast to be approximately -0.6%, with income offsetting a capital return of -6.4%. Low interest rates and an improvement in credit markets have been more than offset by falling market rents and increasing vacancies. Capital values are estimated to have fallen by approximately 5% in the first three quarters of the year, with the pace of decline gradually slowing.

Even though the contraction of real economies is slowing or showing signs of bottoming out, prospects for rental markets remain weak in the short term. Market rents are forecast to decline for all sectors in the region into 2010, before most markets are expected to bottom out in 2011. Rental growth in real terms is not expected until 2012.

Prime property yields are likely to peak earlier than previously expected as capital growth resumes. Yields for Oslo offices, with prime qualities or long leases, fell slightly during the third quarter, while yields for such assets elsewhere in the region have stabilised. Investors seem to be finding confidence in the recovery of other asset classes and by the fact that there is limited evidence of distressed sales. There have been several transactions in recent months confirming this trend.

Prime yields are expected to fall in 2010, supported by low interest rates and improving investor sentiment. The yield spread between prime and secondary assets is likely to remain high for some time, as appetite for risk is expected to remain low. Parts of the market might experience lower rents, increasing vacancies and continued upward yield pressure, at the same time as the prime end of the property markets experience a recovery.

A five year average 'All Property' total return of 7.2% is projected from the end of September 2009. Capital values are expected to stabilise during the first half of 2010, but real rental growth is not projected to resume until 2012. Increasing investor appetite means yields are peaking a little earlier than expected and at lower levels, offering stronger short-term performance, but our five year return forecast has not changed significantly, as this leaves less room for recovery.

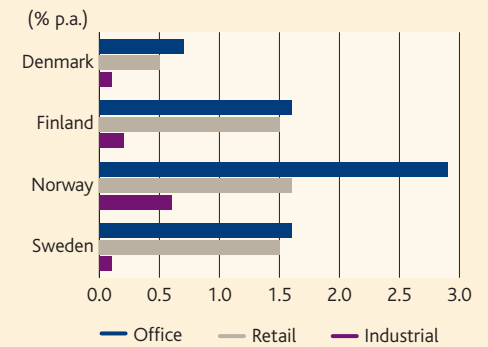
Office

- Office markets are expected to see the biggest fall in rents from peak to trough. However, the sector is also likely to see the strongest recovery when demand picks up. Supply pipelines beyond 2009 are in general limited, and are estimated to correspond to approximately 2% of current stock in the Nordic capitals. Few new projects are expected to start in the coming 12 months, as weak rental markets and difficult financing conditions for developers limit their profitability.
- New and efficient space is expected to hold up better at the expense of older stock and less attractive areas. As prime rents become more affordable and landlords easier to negotiate with, more tenants are likely to choose CBD locations over other areas.

Retail

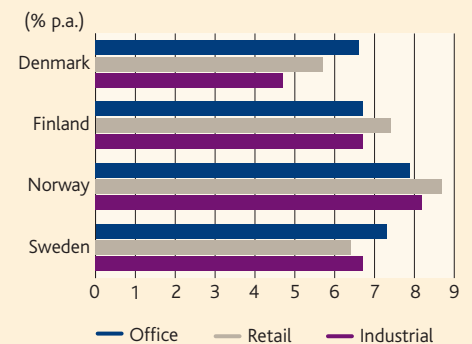
- Private consumption in the region is expected to pick up from 2010, resulting in a better environment for retailers. Shopping centres have, in the current downturn, proved to be more resilient than other segments. They are expected to outperform retail parks, which have a larger share of tenants selling capital goods such as electrical appliances, furniture and refurbishing materials.
- As many retailers have seen trading losses for some time, the frequency of bankruptcies and store closings is expected to stay high for some time, as some of these retailers will eventually run out of cash. The implications will be higher tenant turnover and possibly more vacancies.

Five year annualised rental value growth (to March 2014)



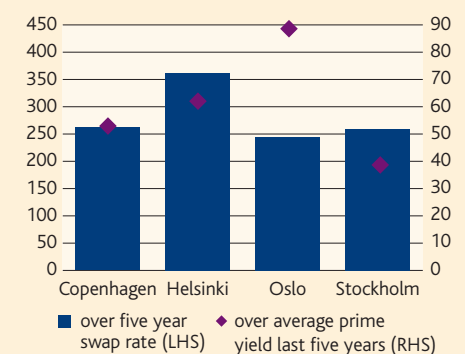
Source: Aberdeen Property Investors

Five year rolling total returns (to September 2014)



Source: Aberdeen Property Investors

Prime office yield spread Q3 2009 (basis points)



Source: Aberdeen Property Investors

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Industrial

- Prime logistics properties are likely to be a preferred investment for many property investors with a long investment horizon, due to the long leases characterising the sector, a large yield gap and low maintenance needs. However, the industrial sector is likely to be the last sector to see a recovery in rents.
- Some of the older logistics space is expected to become redundant. Retailers and other users of logistics space will be looking at ways to improve efficiency, as they see pressure on their business margins. This is expected to benefit the efficient properties with the best locations, while demand for more inefficient premises will be very weak.

Opportunities

- Even though rents are falling, there is still room to improve cash flows through rent renewals, as rents are still above levels seen at the bottom of the previous rental cycle. As at Q3 2009, prime office rents in the Nordic capitals are, on average, 20% above levels seen in 2004.
- Demand for properties with insecure cash flows is very low, as most investors are still focusing exclusively on core investments and prime assets. This has led to spreads between prime and secondary assets widening, and has created a pricing of risk that more opportunistic investors can exploit.
- As the liquidity in the transaction markets improves, some property owners are likely to sell some of their assets to strengthen their balance and liquidity positions. This is especially the case for companies that do not have property as their core business. There has been evidence of companies in exposed sectors, with low credit ratings, selling their headquarters and other property holdings in sale-and-lease-back activities to finance their core business, as financing in the bond markets have been very difficult for such companies. These factors will probably lead to many good investment opportunities in the region, even though the pricing is not likely to be classified as distressed.

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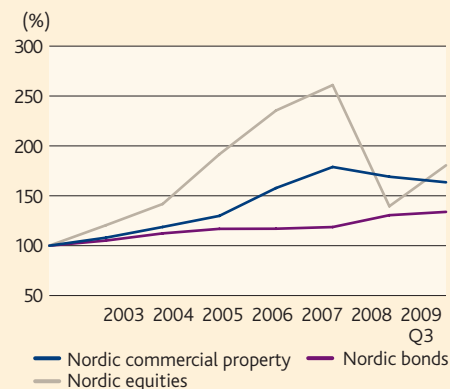
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Asset classes - performance since 2003



Property: Aberdeen Property Investors,
Equities: MSCI Nordic countries total return,
Bonds: Datastream, GDP-weighted country specific government bond total return indices

Contact details

Lars Flåøyen

Head of Nordic Research and Strategy

Email: lars.flaoeyen@aberdeenpropertyinvestors.com

Helene Jørgensen Etter

Investment Strategy Denmark

Email: helene.etter@aberdeenpropertyinvestors.com

Leena Sipilä

Investment Strategy Finland

Email: leena.sipila@aberdeenpropertyinvestors.com

Alessandro Bronda

Head of Global Investment Strategy

Email: alessandro.bronda@aberdeenpropertyinvestors.com

Thomas Beyerle

Head of Global Research

Email: thomas.beyerle@degi.com

Milan Khatri

Chief Economist

Email: milan.khatri@aberdeen-asset.com

Website: www.aberdeenpropertyinvestors.com