



Aberdeen

Nordic Quarterly Property Snapshot

Economy

Recent performance

Manufacturing output and exports have been leading emerging and mature economies, across the world, out of recession, resulting in a surprisingly strong global economic expansion during Q4 2009. The Nordic economies have been amongst those that have benefited from the increased global demand and huge domestic fiscal stimulus. Increased activity has supported labour markets, where unemployment rates have been relatively stable in recent months. Better economic prospects, combined with low interest rates, have raised consumer confidence to historic averages, and the indication is that the rising growth will be sustained during the first half of 2010 and beyond. Despite increasing economic momentum in recent quarters, absolute activity levels are low, compared to where they were before the financial crisis.

The Nordic countries have small and open economies, heavily dependent on the shape of international economic activity and demand. During the global credit crisis, when global trade almost stopped, the Nordic countries suffered badly. The economies of Finland and Sweden, which are those most closely linked to the international manufacturing cycles, suffered in particular, with export-led collapses placing economic growth in these countries below OECD averages in 2009. The Danish economy has seen some positive signals, following a broadly based economic setback. Outlook for consumer spending is better than it has been for some time, while exports are likely to benefit from growth elsewhere. The setback for the Norwegian economy has been mild compared to most other countries, supported by extremely solid public finances and oil prices picking up.

Economic outlook

We expect rising world growth to be sustained during the first half of 2010, helped by very loose economic policy. European economic performance will be moderate for this year and the next, compared to Asia in particular, but also the US. Growth is likely to be curbed by fiscal tightening in some form across countries, although this impact is likely to be much less severe on the Nordic economies than the dramatic manufacturing collapse experienced in late 2008 and early 2009. Going forward, the Nordic economies are likely to feel the benefit of their strong fundamentals. Current account surpluses are strong and public finances solid in an international perspective, allowing for more fiscal policy flexibility than for most advanced economies.

Increased global demand, has improved the outlook for the Danish economy, while domestic demand is only reviving slowly. Following the sharp drop in private consumption during 2009, household confidence indicators have climbed at a cautious rate and housing prices now show signs of stabilisation. Norway will continue to benefit from high oil prices and extremely strong public finances. The Central Bank has already hiked interest rates twice, due to the relatively solid performance of the economy. The dilemma for monetary policy is that further hikes can be blocked by a strong Norwegian currency, while continued low levels of interest rates could fuel a new housing bubble.

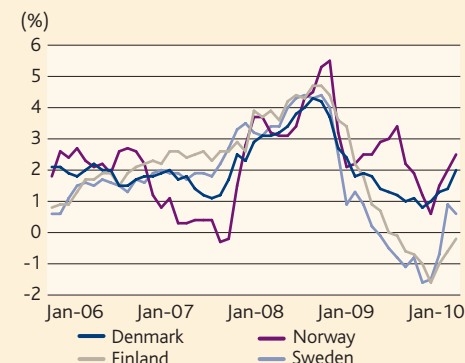
The exceptionally low interest rates have kept home prices up in Norway and Sweden, where most mortgages have floating rates. These two countries, Sweden in particular, are likely to benefit from relatively weak currencies supporting exports. Finland and Sweden have export structures that are advantageous in the recovery phase, and will benefit from the global upswing in demand for industrial products. We expect interest rates to stay at abnormally low levels into 2011, amid fears of a double-dip recession as household and the financial sector de-leveraging will be ongoing.

Economic forecasts

	2009	2010	2011
Real GDP Growth (%)			
Denmark	(5.1)	1.7	2.0
Finland	(7.8)	2.0	2.4
Norway (mainland)	(1.5)	2.3	3.1
Sweden	(4.9)	2.5	2.5
Consumer spending (%)			
Denmark	(5.0)	1.9	0.6
Finland	(1.9)	0.5	1.4
Norway	(0.1)	3.7	3.1
Sweden	(0.9)	2.3	2.7
Unemployment rate (%)			
Denmark	6.0	7.2	7.0
Finland	8.3	9.2	8.8
Norway	3.2	3.5	3.4
Sweden	8.2	9.3	9.2

Source: Aberdeen Property Investors

Inflation year-on-year



Source: Aberdeen Property Investors, Reuters EcoWin

Prime rents Q4 2009

	Office	Retail	Industrial	
Copenhagen	1,750	13,500	500	DKK/sqm/year
Helsinki	324	1,560	110	EUR/sqm/year
Oslo	2,800	14,250	1,050	NOK/sqm/year
Stockholm	4,000	16,000	1,050	SEK/sqm/year

Source: Aberdeen Property Investors

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Property market overview

Recent performance

Fuelled by stabilisation in real economies and the recovery of other asset classes, property seems to be more in favour amongst investors once again, with investment volumes picking up towards the end of last year in all the Nordic countries. As property yields have risen sharply from their trough, the sector is looking more attractive, relative to the yield on cash, which is at historically low levels. Total transaction volumes for the region in 2009 were down approximately 60%, compared to the year before, although the second half of the year was much stronger than the first; a consequence of improved sentiment among investors and a gradual improvement in credit conditions.

The spread in price expectations between sellers and buyers, which has been a hurdle to overcome, has narrowed, and counterparties are now on a similar level. The increased interest in property investments has resulted in values stabilising for prime assets, and even a recovery for some markets in the region. Prime yields were, in general, stable throughout 2009, with some markets experiencing falling yields at the end of last year. Prime properties and those properties with long leases are the main beneficiaries of improved market conditions, while those properties with short leases, vacancy risks or a poor location have, in general, experienced values deteriorating even further.

IPD/KTI Total Property returns for 2009 were unexpectedly positive, with all Nordic markets reporting positive total returns. Negative capital growth was more than offset by the income return, and total returns ended at 4.8%, 3.9%, 3.8% and 1.4% for Norway, Denmark, Finland and Sweden respectively. Residential was by far the top performing sector in Finland and Sweden, the latter market returning 13.9%. In Denmark, the retail market was the strongest sector and residential the weakest. The better than expected performance may be a result of property markets turning earlier than expected. However, there is also reason to raise questions on whether true market performance is really reflected in valuations, especially for some markets with an extensive use of internal valuations.

Office

- Vacancy rates continue to trend upwards in all capitals and secondary office locations, especially for older properties.
- Market rents continued to fall in Q4 2009, although the pace of decline slowed. Prime office rents in nominal terms in the Nordic region fell by 8-10% on average in 2009, led by Oslo, with a fall of 17.6%.
- Prime yields in Oslo have dropped by 35 basis points since the bottom of the market, and yields for prime offices in Copenhagen also dropped in Q4. Stockholm and Helsinki have seen fairly stable values for the best assets in Q4 2009.

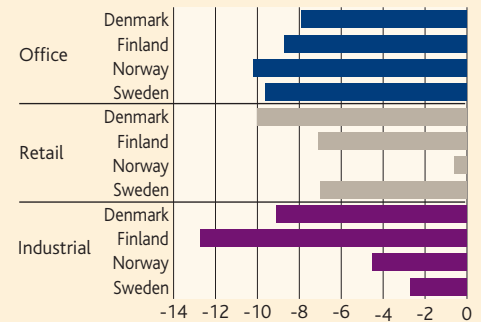
Retail

- Prime retail rents in the Nordic region fell by an average of 8% in 2009. Retail sales volumes held up relatively well, considering the economic environment. This was, to some extent, a result of retailers cutting prices and having more sales and campaigns than usual. The fall in private consumption and goods being sold at low prices have reduced retailers' margins, and their ability to pay for retail space has suffered as a consequence. Retail basics, such as food, drink and clothing held up quite well, while capital goods have suffered more.
- Yields for prime retail properties have been fairly stable throughout 2009.

Industrial

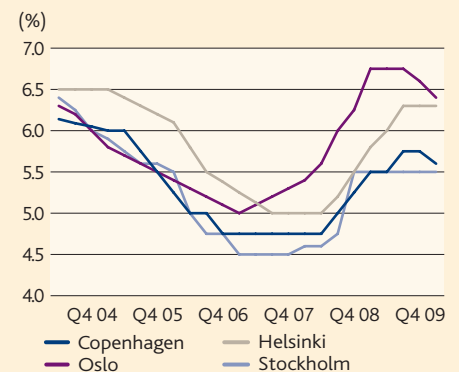
- Prime industrial rents fell by 6%, on average, in the Nordic region during 2009. As trade and manufacturing have suffered badly, demand for logistics space, in general, is low.
- Yields for prime industrial properties have been stable for the past six months, at a regional average of 7.6%. Low interest rates and decreasing bank margins have created an attractive financing gap, although weak demand for industrial and logistics space has made investors cautious.

Prime rental change Q4 2008 - Q4 2009 (%)



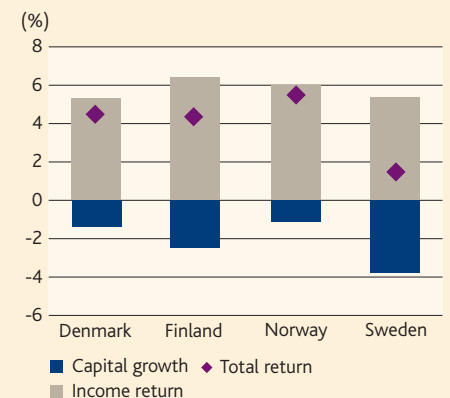
Source: Aberdeen Property Investors

Prime office yields



Source: Aberdeen Property Investors

IPD/KTI 'All property' returns 2009



Source: IPD, KTI

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Sector prospects

Outlook

Our view on the Nordic property market has been upgraded significantly for 2010, although we expect a two-stage recovery in returns. The first stage, which some markets have already entered, is driven by the investment market. Low interest rates and attractive yields are boosting investors' appetite for property, which is likely to push property yields down and values up in the coming year especially for prime assets. Yields are already falling sharply in some European markets, such as in the UK, where capital values have already risen by over 10% since summer 2009. The same trend is evident in Norway, where prime yields have fallen by at least 35 basis points since the peak. Yields are expected to trend downwards for most prime markets in the region in 2010. However, investors are still generally very cautious, and the willingness to pay higher prices is reserved for prime locations and well let modern buildings, mainly in the office and retail sectors.

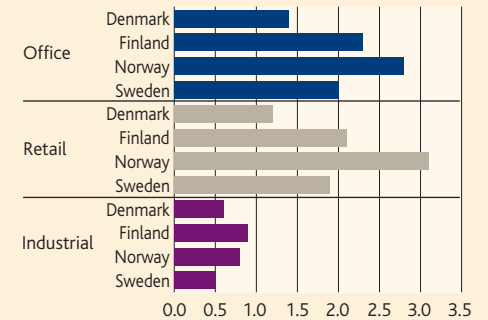
Europe is unlikely to see any new liquidity in property lending markets in the foreseeable future, as banks need to re-capitalise, which will have a negative effect on outstanding lending volumes. We expect 2011 to be a year with lower property returns. Interest rates and bond yields are expected to rebound and put a floor under property yields, while rental growth is still very modest. However, performance will be dependent on asset qualities and lease structures, and we expect to see a more divided property market. Hence, the second stage of the recovery is not expected until 2012, when rental markets begin to improve aided by an improving labour market and a very low level of new completions.

Vacancies in the Nordic property markets have picked up sharply, a trend expected to continue into 2010. Labour markets are expected to be relatively weak, despite an increase in economic activity. As such, take-up for commercial properties will not be sufficient enough to result in falling vacancies until 2011, at the earliest. However, as new completions are expected to be limited in 2011 and 2012, and employment growth is forecast to pick up over the same period, rental growth may be strong at the back end of our forecast period. The office sector is expected to see the strongest recovery in rents.

A five year average annualised 'All Property' total return of 7.7% is projected from the beginning of January 2010. Capital values are expected to stabilise during the first half of 2010. However, real rental growth is not expected to resume until 2012. Prime yields are likely to have peaked, which is earlier than expected and at lower levels than feared. Our view on short-term performance has been upgraded, although our five year return forecast has not changed significantly, as there is less room for recovery at the back end of the forecast period. Over the coming five years, we expect retail and offices to be the top performing sectors, while logistics and industrial properties will underperform. Differences in performance will be significant across markets, sectors and assets, as tenants, investors and banks will be very selective.

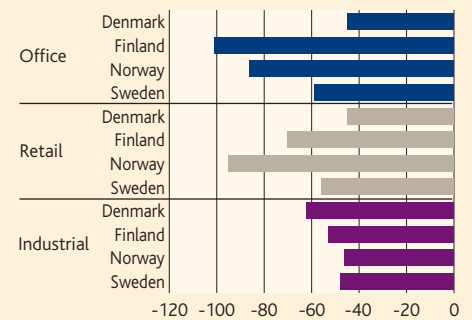
In addition to attractive return projections for the Nordic property market, property owners will benefit from any future inflation. Property yields are, in practice, close to real returns, as income returns are normally linked to inflation. Once the economic recovery gains more momentum, the likelihood of higher inflation remains a distinct possibility.

Five year prime rental growth forecasts: 2010-2014 (% p.a.)



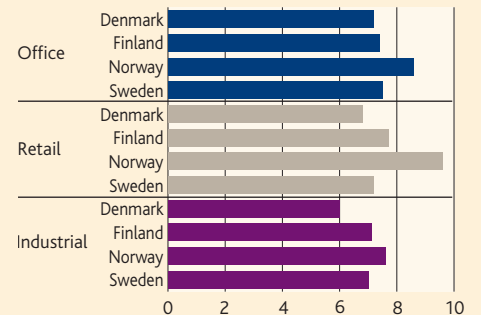
Source: Aberdeen Property Investors

Five year prime yield shift forecasts: end 2009 to end 2014 (basis points)



Source: Aberdeen Property Investors

Five year prime total return forecasts: 2010-2014 (% p.a.)



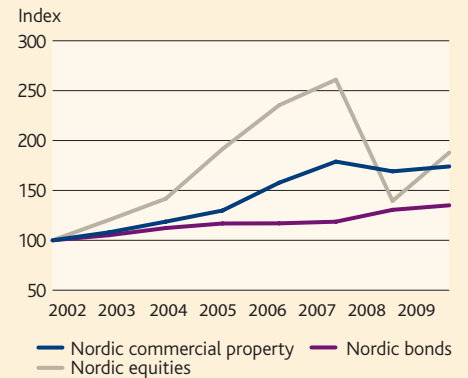
Source: Aberdeen Property Investors

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Opportunities

- We consider the current time to be very good for investments in the Nordic property market. We are in an early phase of a global economic recovery, liquidity in property markets is picking up and prime yields have reached or passed their highest levels in this cycle. Prime yields are expected to fall in 2010, although the property market recovery will not be equally distributed across markets, sectors and assets. Challenges in letting markets are going to persist and investors should be aware of all layers of risk still remaining in Nordic property market.
- Despite improvement in the transaction markets, investment volumes are still way below those seen in previous years. Most investors and lenders have a preference for a narrow niche in the market – the very prime assets and properties with long leases and stable sustainable cash flows. This creates opportunities to exploit any potential mispricing opportunities between different property types.
- Successful leasing activities are going to be an important source for value creation in the coming years. Through the signing of new leases on properties with vacancies, or where current leases are short, a property can potentially expect a significant re-pricing. The transformation from an asset with an insecure or non-existing cash flow to an asset with a stable, solid cash flow is likely to boost investor interest and the prices they are willing to pay.

Asset classes - performance since 2003



Source: Property: IPD, Aberdeen Property Investors
 Equities: MSCI Nordic countries total return
 Bonds: Datastream, equally weighted country specific government bond total return indices

Important information

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