

# German Property Snapshot



## The economy

The global economic expansion has gathered pace since mid-2009. We estimate that world quarterly growth was a strong 1.2% for Q4 2009, which is significantly above the trend of the past decade of 0.8%. Emerging Asia has been the main driver of this stronger growth, although Europe and the U.S. have also benefited from a substantial improvement in financial market conditions. Rising world growth should be sustained during the first half of 2010, helped by very loose economic policy.

Within the eurozone, economic growth turned higher in the second half of 2009, helped by a strong upturn in exports and industrial activity. However, consumer demand, with the exception of an incentive fuelled rise in car sales, is poor. Confidence is being held back by a relatively high unemployment rate of 9.9% in January 2010, compared to a cyclical low of just 7.2% in early 2008.

Eurozone growth is set to be characterised by a stronger 'core euro' group, comprising Germany, France, and the Netherlands, whilst the peripheral countries are likely to be significantly weaker. This implies a moderate recovery for 2010/11, with growth and inflation below that of the U.S. The European Central Bank (ECB) is expected to keep interest rates at a very low level, even as the US Federal Reserve begins to tighten monetary policy at the end of the year.

We expect Germany to lead the eurozone recovery. The economy is well-positioned to benefit from improving global demand, while recent tax cuts and a steady labour market have supported consumer spending in the past year. Although the recovery stalled at the end of 2009, there are signs that it will resume this year, helped by a pick up in exports. The improvement, so far, has been related to demand from Asia and elsewhere in Europe, although exports to the US should also start to rise before long, as growth has accelerated across the Atlantic.

Even though the euro weakened during the last two month, the recent surge in unit labour costs is a worrying sign for competitiveness. However, wage growth is already slowing. Meanwhile, Germany's specialism in capital goods, and the previous slump in exports, has left the economy in a strong position to benefit from the global recovery. Prospects for the consumer sector have deteriorated slightly, partly due to negative expectations for the future employment. There remains a risk of job cuts later this year as subsidies for the many workers that registered for the Government's 'Kurzarbeit' scheme in summer 2008 run out. Currently the government is debating an extension of the subsidies. For the time being though, survey measures of hiring bode well for the next few months.

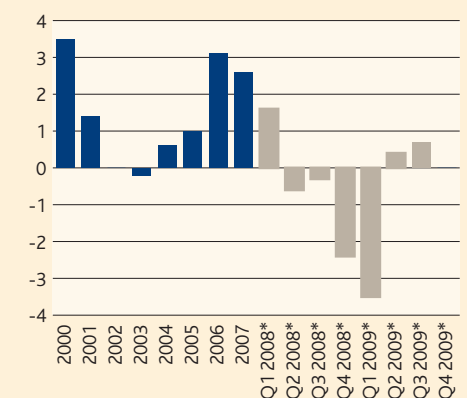
Furthermore, recently agreed income tax cuts, worth €10 billion per year will boost household incomes. Cautious consumers are likely to save some of this extra income. However, with consumer confidence starting to edge up, we think that part of the increase will be spent. Tighter fiscal policy will eventually be required if the Government is to adhere to a law requiring cyclically-adjusted borrowing to fall to 0.35% of GDP by 2016. Consolidation will not start until 2011 and need not be as aggressive as elsewhere in Europe. Overall, we expect the economy to expand by around 2% this year and into 2011.

### Economic forecasts

	2009	2010	2011
<b>Real GDP growth p.a. (%)</b>			
Germany	(4.8)	2.1	1.7
EU 27	(4.1)	1.6	1.9
<b>Inflation p.a. (%)</b>			
Germany	0.4	1.3	1.9
EU 27	0.7	1.4	2.0
<b>Consumer spending growth p.a. (%)</b>			
Germany	0.6	0.7	1.5
EU 27	(1.4)	0.9	1.7
<b>Unemployment rate (%)</b>			
Germany	8.2	8.7	9.0
EU 27	8.9	9.7	9.8

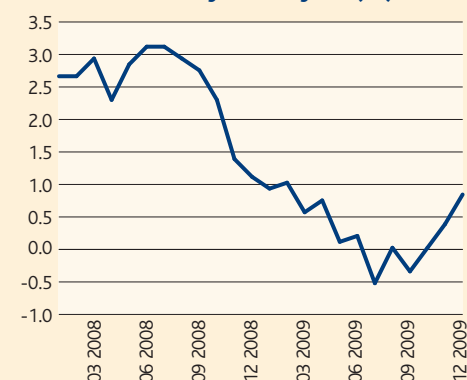
Source: Aberdeen Property Investors

### German real GDP growth 2000 – Q4 2009 (real, % p.a.)



Source: Aberdeen Property Investors, destatis  
\*quarterly change

### German inflation year-on-year (%)



Source: Aberdeen Property Investors, destatis

# German Property Snapshot

## Recent property market trends

### Office

In comparison with the rest of Europe, German property centres were slower to react to the turbulence in the financial markets with rental price adjustments impacted to a lesser degree. Nevertheless, the weakening in the office rental markets, which had already begun to set in at the turn of the year 2008/2009, has had a significant effect in the face of global economic developments during the course of 2009.

The nine German office centres of Berlin, Dresden, Düsseldorf, Frankfurt/M., Hamburg, Cologne, Leipzig, Munich and Stuttgart saw letting transaction volumes amounting to just under 2.5 million square metres in 2009, almost 25 % less than in 2008. The lack of major transactions and prolonged rental agreements, which by definition are not included in the turnover result, were the major contributors to this significant reduction. Location and space optimisation were fundamental motives for relocation.

In contrast to 2008, the vacancy volume rose by 6.8 % during the course of last year, in line with a reduced demand and a negative average net absorption of space.

At the turn of the year 2008/2009, the major German office centres reached their peak within the current rental cycle. Subsequently, due to the prevailing conditions, a fall in prime rents, averaging -3.8% in 2009 was seen. However, in some locations, average rents remained at a more stable level and even rose: Frankfurt/M. (+14.3 %) and Düsseldorf (+1.5 %).

### Retail

Retail turnover in Germany continued to fall in 2009. According to information provided by the German Federal Statistics Office, a nominal reduction of 2.4 % was recorded.

Prime retail locations, within the largest metropolises, remained stable during 2009, and as yet have not shown any loss in rental value. In fact, due to the limited supply of space, rental values even rose in some places during the year. For example, compared with the first half year of 2009, prime rents in Frankfurt's Zeil rose moderately, by 4%, to €260 per square metre. In contrast, medium and smaller sized cities recorded slight falls in rental values, causing the average rental value for prime locations to fall by 0.4%, to €58.65 per square metre.

Take-up of retail space increased significantly in 2009, compared with the previous year. This was the result of the high rate of expansion demonstrated by supermarkets and consumer goods markets, as well as self service stores and specialist market centres, which have been predominantly constructed in city peripheral locations and on "Greenfield" sites respectively.

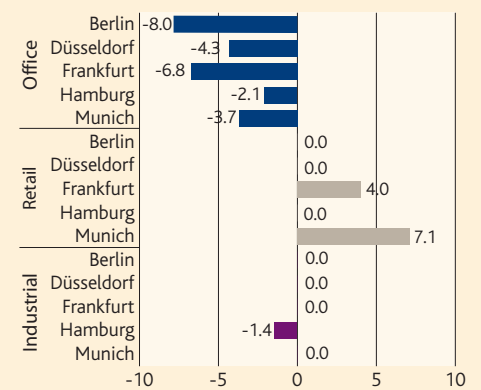
### Industrial

Rather unexpectedly, approximately 1.3 million square metres of logistics space were let during the past year. Although this value lies below the level of the previous year, it is nevertheless, equivalent to the five year average. Increases were recorded in Hamburg and Frankfurt/M., while significant reductions were suffered by Berlin, Munich and Düsseldorf.

However, a relatively high proportion of the turnover is due to the occupation of owner-occupied space. In particular, this applies to major retailers (e.g. Lidl or P&C), who are currently restructuring their logistics networks.

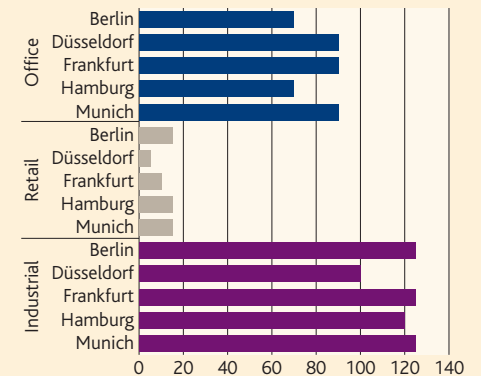
During the course of the year, prime rents remained virtually stable.

Prime rental change Q4 2008 - Q4 2009 (%)



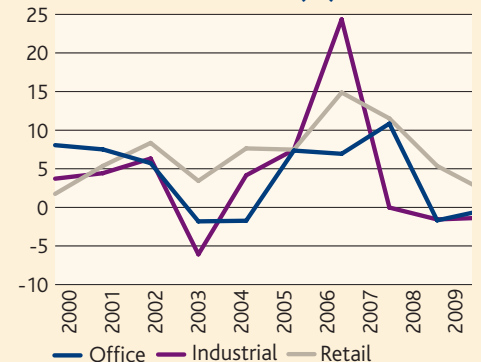
Source: Aberdeen Property Investors

Prime yield shift from peak to Q4 2009 (basis points)



Source: Aberdeen Property Investors

Prime total return Germany office, retail and industrial 2000-2009 (%)



Source: Aberdeen Property Investors

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## Recent property market trends

### Investment market

Following an unsustainably high investment volume, recorded during the boom years of 2006 and 2007, the reduction seen in 2008 continued into 2009. After a serious collapse in the investment markets during the first half of 2009 (-77%), the second half saw a clear revival, with approximately €11.5 billion commercial property investments (including residential portfolios) changing hands. Consequently, a reduction of "only" 56% was recorded in 2009 compared to the previous year.

The largest proportion of deals last year was concluded in office and retail properties, with warehousing or logistics properties playing a minor role. In contrast to the boom years, individual deals dominated market activity. Portfolio transactions only amounted to 12%, with the focus on security oriented core products.

With an almost 90% share in total turnover, German investors dominated the investment market. The main purchasing groups were public open-ended and special funds, institutional investors (banks, insurance companies and pension funds) and closed-ended funds. Besides project developers, the major selling groups were listed property companies. Foreign investors, who were very active during the boom years of 2006 and 2007, particularly in the "value add" and "opportunistic" market segments on the purchasing side, appeared in 2009 as sellers of core properties.

So far, investors have concentrated on the core segment (above all long-term rental agreements but also good location and quality). For example, approximately 60% of the investment volume was realised in the seven largest office market centres (Berlin, Düsseldorf, Frankfurt/M, Hamburg, Cologne, Munich and Stuttgart).

In 2009, prime yields rose by about 10 basis points, both in central as well as in the adjoining established locations, whereby slight reductions were already being recorded in some cities in Q4. In decentralised submarkets, prime initial yields increased by about 30 basis points during the course of the year, illustrating investors' increased aversion to taking risks.

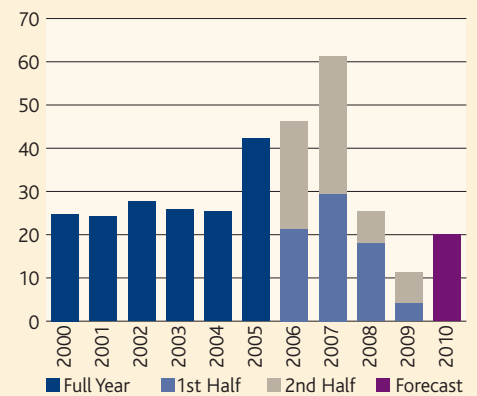
Based on a change in the mood of the market and improved financing terms, we anticipate a further increase in transactions in 2010, resulting in some yield compression. It is to be expected that the largest investor group in 2010 will again be domestic investors who will seek assets that provide a high degree of secured income and are expected to invest with moderate gearing. Accordingly, a sustained high demand for core properties is to be expected, which should result in declining prime yields. The strong restraint, with regard to the development of speculative new construction projects, will also have a stabilising effect on prices.

### Outlook

The German economy should benefit from the revival of the world's economy. However, in the short term Germany will be negatively impacted by reductions in the workforce and the associated drops in consumer optimism and private consumption. In combination with a moderate level of completions during the current year, this should result in a slight decline in prime rental levels (office: -2.4% / retail: -3.9% / industrial: -3.2%). Driven by low yields in other asset classes, and improving investor sentiment, we expect decreasing prime yields (office: -20 bps / retail: -10 bps / industrial: -20 bps). For the period 2011-14, we forecast an increase in prime rents across all sectors ranging from 1.5% to 2.7% per annum.

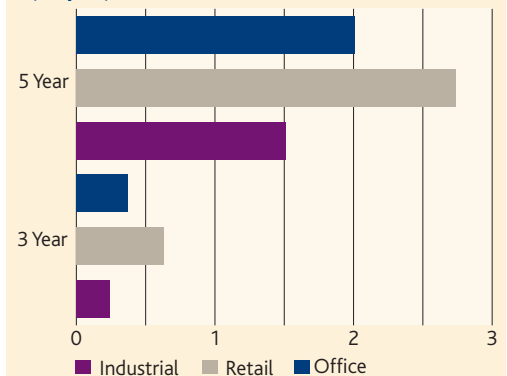
For prime yields, we anticipate reductions of up to 50 bps during the next five years. This will therefore, result in five year average all property total returns of more than 5% per annum.

Commercial investment volume Germany (€ billion)



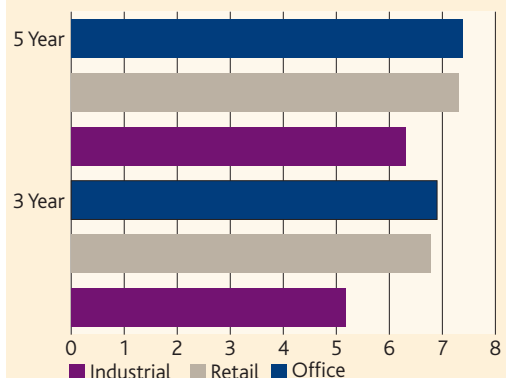
Source: Aberdeen Property Investors

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



Source: Aberdeen Property Investors

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



Source: Aberdeen Property Investors

# German Property Snapshot

## Aberdeen market view

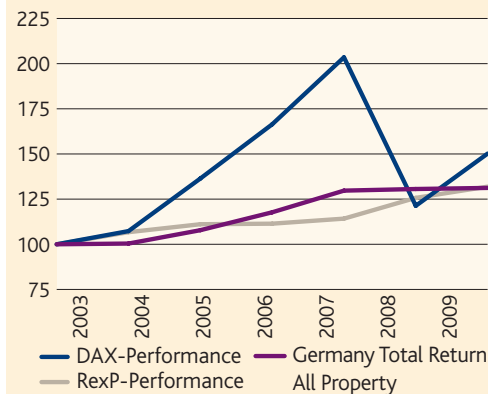
The table below shows Aberdeen’s recommended positions on the German commercial property market, relative to the benchmark (Germany Total Return All Property), in order to achieve outperformance over a five-year period.

Sector	
Germany office	Neutral
Germany retail	Neutral
Germany industrial	Underweight

Source: Aberdeen Property Investors

Note: Sector weightings are based on the annualised prime five year total return forecasts: "All Property" 7.0%, Germany offices 7.3%, Germany retail 7.3% and Germany industrial 6.2%.

## Asset classes – performance since 2003



Source: Aberdeen Property Investors, Deutsche Börse

## Important Information

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