Aberdeen Global Property Market Outlook

Aberdeen Asset Management

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Aberdeen

Contents

Introduction: Global Property Market Outlook

Highlights:

- On a global basis, we believe major advanced Asia Pacific markets offer the best opportunity to pursue at this point in time, with a slowdown in key emerging markets like China, already factored into property market pricing.
- The US joins the UK and the Nordics in making a transition from significant underpricing back in 2009 to a position of overpricing today. Eurozone markets present far from a uniform picture, with northern Europe underpriced, while southern markets appear overpriced by almost 10%. In the Asia Pacific region, lower interest rates have made Australia even more attractive among major global markets, while in Japan the office market remains expensive but other Japanese sectors are estimated to be underpriced.[A]
- In North America and Asia, short-term indicators imply that pricing is likely to be stable or rise which contrasts with Europe where prices are likely to fall.[B]
- Looking 12 months ahead, lower capital values in Europe should put the region in a better priced position, with underpricing a strong possibility. If the eurozone sovereign debt crisis were to worsen in 2012, the eventual low in property prices should be even deeper.[B]

Asia Pacific

We believe the best investment opportunities in Asia are located in Australia and Japan due to still relatively high domestic interest rates in the former, and only modest economic growth in the latter. Australia's retail and industrial sector offer the best investment opportunities. For-rent apartments and the industrial sector offer the best investment opportunities in Japan. Real estate in Hong Kong and Singapore are in overheated territory; however, Singapore retail is considered a defensive sector. Like other regions in the world, prime office markets in Asia Pacific remain overpriced and carry considerable risk. Core real estate in China currently looks expensive, particularly in the primary, or Tier 1, markets. As such we recommend looking beyond the Tier I cities for investment opportunities in China. It appears to be too early to enter the Chinese residential sector but investors should continue to monitor as we expect an attractive entry point soon. India is looking attractively priced, especially in the retail sector, but we reflect that opportunities are very micro-location dependent.

Europe

Aberdeen's long-term leading indicator suggests that the best opportunities lie in the retail and industrial sectors in France, Germany and the Nordic economies. France and Germany are close to fundamental value; substantial overpricing exists in the 'gateway' cities in Europe. The best investment opportunities in the Nordics are likely to be found within the retail sector, as the office markets tend to be overpriced. However, within the Nordic office sector, the best investment opportunities are likely to be found in core, well-let, high quality assets away from the most prime locations. In the UK, Aberdeen's long-term leading indicator suggests that supermarkets offer the best risk-adjusted investment opportunities while central London offices are the most overpriced segment, pricing in an unrealistic rental growth rates. With income growth prospects significantly stronger than other sectors, due to inflation-linked uplifts for the majority of assets, and a low risk premium, UK supermarkets are, in Aberdeen's view, underpriced, despite the apparently low yields being paid currently.

United States and Canada

Aberdeen's long-term leading indicator suggests that at a country level, US and Canadian real estate is broadly overpriced. However, investment opportunities can be found in retail, warehouses, and certain suburban apartment and office locations throughout both countries. At a segment level, our analysis shows that US CBD office, Canadian office, and US urban apartments are highly overpriced. CBD offices, in particular, are likely to underperform over the next few years but we expect capital value to fall eventually providing buying opportunities. We believe better value can be found in Canadian retail, US retail, US warehouses, and US suburban apartments, all of which offer the highest five year total returns in our projections. We favor warehouses located near import-oriented ports and intermodal facilities given US supply chain dynamics. With major office markets overpriced, better opportunities can be found in certain secondary office submarkets across the US where office using employment is on a cyclical upswing and supply remains relatively constrained.

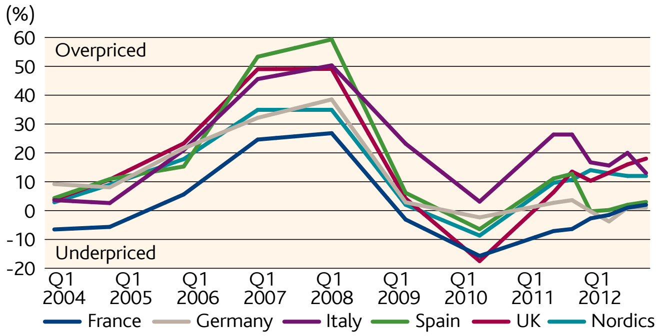
[A] Market pricing indicators do not translate into a short-term market forecast because momentum and investor sentiment can lead to marked and prolonged periods of over or under pricing. Our pricing calculations only indicate how stretched prices are relative to fundamentals. Prices do not need to fall or rise for our indicator to reach a neutral position. A change in income growth expectations or in the risk free interest rate, can also lead to such adjustment, or indeed a combination of all three. We use the indicator to establish risk tolerance at a very broad level.

[B] Forecasts are offered as opinion and are not reflective of potential performance, are not guaranteed and actual events or results may differ materially. Forecasts are based on a number of assumptions including capital and rental growth assumptions.

European Property Market Outlook Summary

- **Aberdeen's long-term leading indicator suggests that the best opportunities lie in the retail and industrial sectors in France, Germany and the Nordic economies. France and Germany are very close to fundamental value (Chart 1).**
- **Short-term leading indicators imply that capital values are likely to dip again over the next year, particularly for secondary property and in southern Europe, which remains overpriced in aggregate.**
- **Our city level analysis highlights substantial overpricing of offices in 'gateway' cities.**
- **For such assets tactical disposals should be considered, it certainly implies minimising risk by avoiding short leases, secondary locations, voids and speculative development.**
- **Spain and Ireland are projected to deliver poor performance in the short term.**
- **However, our long-term leading indicator leads us to believe that these markets may be attractive for long-term investors, particularly high quality, core assets, after a dramatic fallin prices.**
- **In the full report, we include our five year city level forecasts of rents, yields and total returns and our assessment of individual cities' pricing against long-term fundamental value.**

Chart 1: Aberdeen long-term leading indicator: market prices versus fundamental value[A]



Source: Aberdeen Asset Management, April 2012
Past performance is not a guide to the future.

Economic outlook

- Europe is likely to suffer a mild recession in 2012.
- The outlook remains mixed, with Germany likely to enjoy better growth while southern European nations are forecast to face a deep recession.
- The near-term risks emanating from the eurozone have diminished markedly after the European Central Bank injected liquidity into the markets although there remains no comprehensive long-term solution to the eurozone crisis.

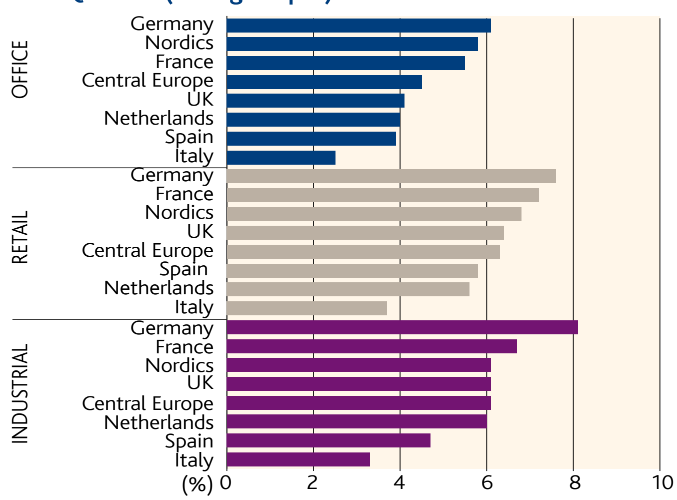
Property and the capital markets

- The decision of the European Central Bank to increase significantly the provision of liquidity to eurozone banks has eased concerns regarding defaults in the financial sector.
- However, funding costs have remained high for commercial property, even in relatively strong markets such as the Nordics.
- Banks remain under pressure to increase their capital base in response to the sovereign debt crisis as well as Basel III, which is projected to result in more secondary stock gradually coming onto the market over many years, depressing prices.

Property market recent performance

- Prime rents have been mostly stable after increasing in the first half of 2011.
- Prime yields have been largely stable too, although there are increasing signs of upward pressure in some markets.
- Both secondary values and secondary rental levels have continued to fall outside Germany and the Nordics, and particularly in southern Europe.
- Vacancy rates have been more stable for prime locations aided by minimal new completion levels, but have remained elevated and rising for secondary accommodation.

Chart 2: Forecast[B] total returns in local currency end Q4 2011 - end Q4 2016 (average % p.a.)



Source: Aberdeen Asset Management, April 2012

[A] The indicator does not translate into a short-term market forecast because momentum and investor sentiment can lead to marked and prolonged periods of over or under pricing. Our pricing calculations only indicate how stretched prices are relative to fundamentals. Prices do not need to fall or rise for our indicator to reach a neutral position. A change in income growth expectations or in the risk free interest rate, can also lead to such adjustment, or indeed a combination of all three. We use the indicator to establish risk tolerance at a very broad level.

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Property market forecasts – overview

- Our long-term leading indicator highlights that the retail and industrial sectors are marginally underpriced and projected to outperform the office sector, which is marginally overpriced, over the next five years.
- Core markets such as France, Germany, and the Nordics are forecast to outperform over the next five years (Chart 2).
- Our short-term leading indicator implies that capital values are projected to dip again in most markets in 2012, particularly for secondary property and in southern Europe.
- However, prime, well-leased retail and industrial assets are close to, or above, fair value and any falls in value are projected to be modest.

Investment themes and risk tolerance

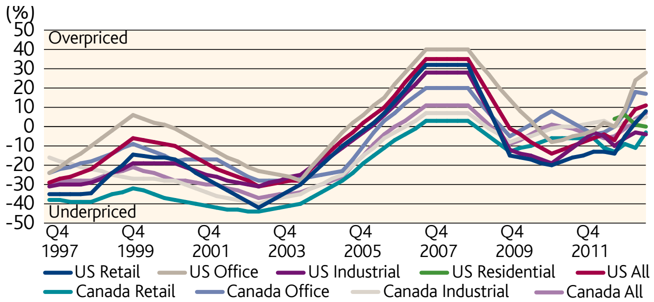
- Investors should target core, well-leased retail and industrial assets and avoid 'gateway city' office markets; we explore this further in our white paper on 'gateway' and 'second tier' office markets.
- Retail and industrial markets in core northern European markets, such as France and Germany, are underpriced and expected to outperform, particularly in the short term.
- Portfolios should be biased towards core, lower risk investments, with secondary values expected to fall further over the next 12 months.
- Looking 12 months ahead, significantly lower capital values should make some neglected markets such as Spain and Ireland more attractive. We have recently produced a paper on the outlook for Irish property and a paper on Spanish property is imminent. In addition, secondary stock more generally should have repriced considerably and may offer the potential for reaping strong medium-term returns.
- Opportunities include dominant shopping centres and retail parks, supermarkets, and long-let prime logistics units and multi-let estates in supply constrained urban areas.
- Assets at risk include secondary shopping centres, retail pitches and retail parks, as well as non-core office locations, where our view is that prices have further to fall.
- Offices in 'gateway' markets generally remain exceptionally overpriced.
- Beyond the three mainstream sectors we see value in private-sector residential, social housing and senior living.

John Danes, Director, Property Research

Americas Property Market Outlook Summary

- **Aberdeen's long-term leading indicator (Chart 1) suggests that at a country level, US and Canadian real estate is broadly overpriced. However, investment opportunities can be found in retail, warehouses, and certain suburban apartment and office locations throughout both countries.**
- **Short-term indicators show capital values are likely to rise in 2012 given the low interest rate environment. A decline in capital values in both the US and Canada is expected in 2013 and 2014.**
- **Total returns in Canada and the US are expected to be lower in 2012 than in 2011 as the extremely strong appreciation seen in 2010 and 2011 is unlikely to be sustained.**
- **At a segment level, our analysis shows that US CBD office, Canadian office, and US urban apartments are highly overpriced. CBD offices, in particular, are likely to underperform over the next few years but we expect capital value to fall eventually providing buying opportunities.**
- **We believe better value can be found in Canadian retail, US retail, US warehouses, and US suburban apartments, all of which offer the highest five year total returns in our projections (Chart 2).**
- **In the full report, we include our five year city level forecasts of rents, yields and total returns and our assessment of individual cities' pricing against long-term fundamental value.**

Chart 1: Aberdeen long-term leading indicator: market prices versus fundamental value[A]



Source: Aberdeen Asset Management, April 2012.

Past performance is not a guide to the future. All property refers to retail, office, and industrial in Canada and retail, office, industrial, and apartments in the US.

Economic outlook

- Our assessment of future US economic growth strengthened over the quarter while our outlook for the Canadian economy weakened. For the US this outlook translates into sustained capital value increases in 2012 and a slightly faster market recovery in occupier market fundamentals. For Canada this outlook translates into weaker total return growth near the end of the five year forecast period.
- Signs of a strengthening US economy include a relatively stronger labor market, rising consumer confidence and spending, and housing market stabilization.
- Lower federal and provincial spending, lower housing investment, and weaker consumer spending over the next three to four years are likely to weigh on Canada's economic growth. The country's strong natural resources base is likely to boost business investment and exports helping to obviate a major correction.

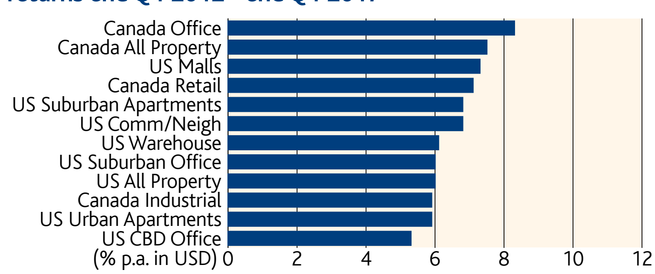
Property and the capital markets

- Given the low interest rate environment in both the US and Canada, Aberdeen's short-term indicators believe that capital will continue to flow into real estate during 2012 sustaining the momentum in capital values.
- Financing for US commercial real estate is available for high quality assets in major markets from banks, life insurance companies, and CMBS. As lenders loosen standards on the back of brighter economic prospects, more financing is likely to become available for lower quality assets and locations.
- The selling of distressed commercial real estate assets is likely to pick up in 2012. Few significant discounts are likely to be seen in the primary markets where prices have risen 40% since the trough but significant discounts are likely to be seen outside of the primary markets. We believe investors should consider waiting until pricing bottoms in these non-primary markets before seeking investment opportunities.

Property market recent performance

- Canada's commercial real estate market continues to recover well ahead of that in the US. With the exception of US apartments, vacancy rates across US property types remain high and rental growth remains muted.
- Rents are growing and vacancy rates are falling across office and retail markets in Canada, spurring new development. Mixed used development is either underway or being considered in Calgary, Vancouver, and Montreal. These mixed used projects in western provinces offer significant opportunity.
- The strongest performing sectors in the US are very large warehouse distribution centers, apartments, high quality malls, and offices in technology focused markets. New construction is being seen in the multifamily and prime warehouse sectors.
- New supply remains nearly non-existent for retail and offices in the US.

Chart 2: Forecast unleveraged 5 year valuation based total returns end Q1 2012 - end Q1 2017[B]



Source: Aberdeen Asset Management, March 2012.

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Property market forecasts – overview

- Compared to the last quarter, the US rental and vacancy rate recovery is forecast to be faster and stronger across most property types due to a stronger US economic outlook.
- Continued strength in technology and energy CBD office markets is likely to offset some of the weakness in the financial services CBD office markets. US warehouse, retail and suburban apartments are expected to have the highest five year total returns. US urban apartments have among the lowest total return outlook due to oversupply risk.
- The downward revision to Canada's economic growth in the latter part of the five year forecast period are likely to weaken market fundamentals in the retail sector and throughout the eastern provinces. Strong rental rate recoveries are expected in the western provinces in 2012 due to the strong energy industry and growing finance-related industries, particularly in Calgary. The strong five year total returns in Canada are driven by the strength seen in the western provinces.

Investment themes and risk tolerance

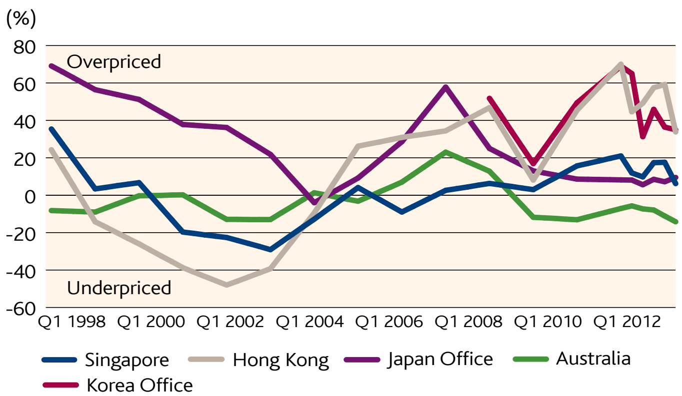
- US and Canadian real estate appears overpriced. However, investment opportunities can be found in US retail, warehouse, and suburban apartments located in urban nodes. In both the US and Canada CBD offices appear highly overpriced but falling capital values in the outer part of the forecast period could provide some good buying opportunities of high quality real estate.
- Investors should target core, well-leased assets in the fringe locations of primary markets. It is too soon to enter into the secondary markets due to an overhang of distressed properties in these markets. After distressed properties in secondary markets have cycled through and pricing is near trough, we believe investors should consider buying in a few urban secondary markets like Portland, Kansas City, and Miami.
- Across the sectors, investors should focus on minimizing risk by trying to lease up vacancies with high quality credit tenants, selling off low-quality or poorly located assets, deleveraging and avoiding development.
- In the US, the best warehouse products are likely to be located near intermodal facilities and import-oriented ports. Retail investments should take advantage of the high and low ends of the retail markets which are performing the best, as well as redevelopment opportunities. Although overpriced in the primary markets, fringe urban office assets with non-traditional office tenants like media and high tech firms are likely to outperform the broader urban office assets in prime locations with finance oriented tenants.
- The best investment opportunities in Canada are likely to be in the western provinces where rents grow on a real basis and the economies are driven by the energy industry. Calgary, in particular, is gaining relevance in the financial services industry. Retail properties located near overbuilt suburban housing markets in Toronto and Vancouver are likely to be the most negatively affected should a housing correction materialize.

Melissa Reagen, Head of Property Research - Americas

Asia Pacific Property Market Outlook Summary

- **Aberdeen's long-term leading indicator (Chart 1) suggests that the best investment opportunities are located in Australia and that Hong Kong and Singapore became less overpriced over the quarter.**
- **Short-term indicators imply pricing is likely to be stable over the coming months, which contrasts with Europe where prices are likely to fall.**
- **Macro conditions are supporting real estate prices in most markets, economic growth has slowed and confidence expectations have dipped but remain positive.**
- **In Japan our long-term leading indicator leads us to believe we should be concentrating on for-rent apartments. Retail and industrial are fairly priced although we think consideration should be given to the industrial sector at this stage.**
- **Both Hong Kong and Singapore are likely to have more difficultly achieving appropriate risk-adjusted returns; however, we consider Singapore retail to be a defensive sector.**
- **For risk sensitive investors Asia Pacific is showing its diversification benefits currently. Unlike Europe, which is heading for a recession, Asia Pacific is not a major source of global uncertainty at the moment and is slowing to just under trend level growth, supporting the local real estate markets. While some markets are contracting others are only cooling. Confidence is generally high that the region will return to more normal conditions by the end of 2012 or early 2013.**
- **In the full report we include our five year city level forecasts of rents, yields and total returns and our assessment of individual cities' pricing against long-term fundamental value.**

Chart 1: Aberdeen long-term leading indicator: market prices versus fundamental value[A]



Source: Aberdeen Asset Management, April 2012
Past performance is not a guide to the future.

Economic outlook

- Macro indicators confirm the region is in a period of slowing growth but should continue to be a large contributor to global growth.
- Retail and car sales are both slowing, contributing to the reduced overall consumption picture.
- There are early indicators this downturn will be limited and shorter than previous cycles, particularly in Japan.
- However, risks remain and China's weak March PMI reading reminds us of these.
- This period of heightened caution and lower growth is likely to cause tenants in Advanced Markets to be particularly aware of their forward occupancy costs and capital expenditure budgets. It's unlikely that we will see much precomittment activity or large tenant relocations in the short term.

- Once global conditions become more favourable and local growth stabilises or recovers, we are expecting demand for quality premises to return.

Property and the capital markets

- Base lending rates have been broadly level for some time now but we expect lower rates as central banks respond to easing inflation and slower growth.
- Lending terms generally reflect global conditions although they are not as tight as in Europe. Some easing can be seen in China and conditions remain very loose in Japan as banks have high liquidity. We do not expect to see banks bring to market property from their control, unlike in Europe where they will feature.
- A recently released survey by the Asian Association for Investors in Non-listed Real Estate Vehicles highlights over 80% of investors are set to increase their allocations to non-listed funds over the coming 2 years.
- The listed sector has performed very well over the quarter led by developers and management companies (+21%). REITs posted a 9% gain with Japan up 19% compared to Australia's more modest 8% increase.[B] Several REITs were active during the quarter with JREITs typically buying residential assets.

Property market recent performance

- Rental growth slowed during the quarter as occupational demand was concentrated on renewal activity as opposed to expansion. Markets in Singapore and Hong Kong saw rents continue to contract, although declines have been modest so far.
- Some markets saw office vacancy rates rise as new completions entered the market with uncommitted space, for example Tokyo.
- Capital values were broadly flat over the quarter as were prices. There are very few markets where buyers are actively pursuing opportunities and most are reviewing deals, hoping for more attractive pricing levels in the coming months.
- China's residential market remains very subdued with prices edging down. A very restrictive buying policy remains in place, although signs of easing are on the horizon.

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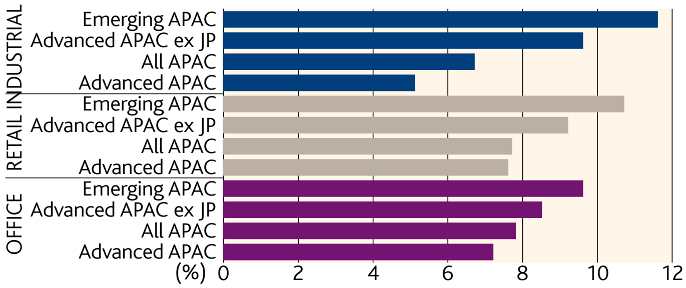
[B] Performance measured using MSCI AC Asia Pacific Real Estate Investment Trusts and Real Estate Management & Development index in local currency.

Source: FactSet, April 2012.

Chart 2: Forecast[C] total returns in local currency end Q4 2011 - end Q4 2016 (average % p.a.)



Source: Aberdeen Asset Management, April 2012

Property market forecasts – overview

- At a country level our short-term leading indicators show pricing is likely to be weak in Japan, Singapore, Hong Kong and India over the coming few months. Markets in Australia, Korea and China are expected to be broadly stable.
- The low interest rate environment indicates support for pricing in Hong Kong, Singapore and Australia.
- Short-term conditions in the region are looking more supportive than we had previously anticipated. We have slightly increased our five year return expectations (Chart 2) by increasing our near-term rental growth forecast. However, we continue to believe that there are several markets which are significantly overvalued.
- On a core, direct asset, total returns basis our top pick in the less risky Advanced Markets is Australia, while Japanese returns are likely to be comparatively lower but still positive.

Investment themes and risk tolerance

- We continue to believe investors should be careful of the risks involved in prime office markets. Although pricing has eased somewhat in recent months, we think better value can be found elsewhere.
- In the Advanced Markets we believe investors should consider Australia. As previously mentioned we believe the prime markets will see robust returns in both rental growth and yield firming. Although we see opportunity in all sectors, we rank retail and industrial over the office sector. Investors need to be cautious of currency and interest rate trends though.
- Our near-term rental upgrade has improved the position of Hong Kong and Singapore in our long-term leading indicator but both continue to look expensive. Within these markets we think Singapore retail looks appropriately priced at this stage and we believe active investors should look for soft pricing in Hong Kong office, if they can secure such opportunities.
- Core product in China currently looks expensive, particularly in the Tier I markets. We believe investors should look at opportunities beyond Tier I, although access can be difficult for those not active in the country or region. It appears to be too early to enter the residential sector but investors should continue to monitor as we expect an attractive entry point soon.
- India is looking attractively priced, especially in the retail sector, but we reflect that opportunities are very micro-location dependent.
- We believe investors seeking alternative property sectors should consider healthcare in Japan or Australia. Both have insurance systems that include some form of government support, providing a level of income security. Australian healthcare total returns have been high and stable over the past five years and Japanese healthcare returns have been comparatively stable as well.

Glyn Nelson, Head of Property Research - Asia Pacific

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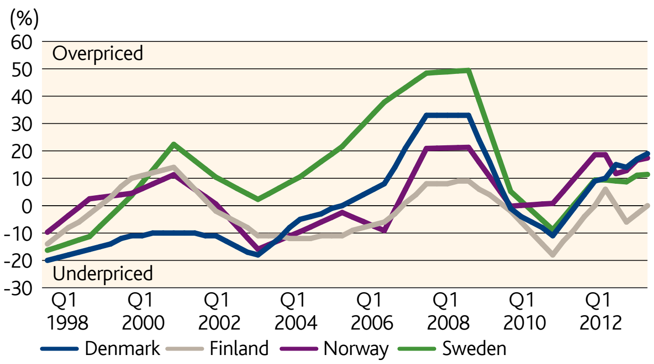
Nordic Property Market Outlook Summary

- **Strong fundamentals compared to other developed European markets and high prime property yield premiums over government bonds are likely to support the pricing of core properties over the short term, despite a weaker economic outlook.**
- **Aberdeen's long-term leading indicator suggests that the best investment opportunities in the Nordics are likely to be found within the retail sector, as the office markets tend to be overpriced.**
- **Within the office sector, the best investment opportunities are likely to be found in core, well-let, high quality assets away from the most prime locations. Due to the high interest from investors, current income yields in CBD markets are close to their historic lows.**
- **Vacancy rates are expected to remain stable and investors should be able to find attractive, inflation-linked cash-flows in the Nordic property market.**
- **Office tenants are increasingly focused on space efficiency and environmental issues. This is not only likely to result in different rental growth prospects between sub-markets, but also between buildings. Old, inefficient stock in secondary locations risks becoming obsolete and should be avoided.**
- **Secondary assets are likely to see values fall in the coming six months and the prospect of recovery is limited in the medium term, given low rental growth prospects and limited investor appetite. Bank financing for such properties is a challenge.**

Chart 1: Aberdeen long-term leading indicator: market prices versus fundamental value[A]



Source: Aberdeen Asset Management, April 2012
Past performance is not a guide to the future.

Economic outlook

- We have upgraded the outlook for Nordic GDP growth in 2012 from a forecast[B] of 0.6% in Q4 2011to 1.1% currently. We forecast GDP in the eurozone to decline by 0.5% in 2012.
- The growth pattern within the Nordics has changed over the last six months. Norway has now taken the lead, while the Swedish economy has slowed sharply.
- Key economic risks are still mainly related to the development of the international economy and financial markets.
- Forecast short-term economic performance is not likely to be strong enough to generate much real rental growth in 2012. However, a slightly positive forecast for 2012 employment growth paired with low new supply is expected to lead to stable rents over the next 12 months.

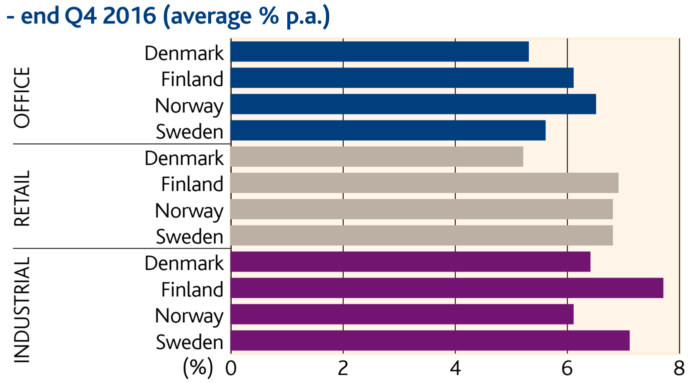
Property and the capital markets

- Long-term interest rates were relatively stable in Q1, while short-term interest rates fell by 40 basis points on average.
- Banks are, in general, reluctant to enter into new loans and margins have stabilised at a high level. We might expect alternative sources of financing, such as secured bonds, becoming more common, as regulations are constraining access to bank financing.
- Nordic unlisted property fund returns rebounded in Q4 2011, delivering 2.3%, compared to -1.7% in Q3, according to the IPD Nordic Property Fund Index.
- Share prices for listed property companies in the region were up 6% in Q1 2012 and down 14% year-on-year as of end March 2012.

Property market recent performance

- Capital values in general remained stable over the quarter. Values in Sweden increased slightly, partly because of higher than expected indexation.
- Sweden experienced the strongest transaction activity, with a quarterly volume of approximately EUR 2.8 billion. This is 20% higher than the volume for Q1 2011. Several large transactions in Norway resulted in a transaction volume of EUR 1.7 billion, which represents almost 40% of the full year volume for 2011. Activity in Denmark and Finland continues to be low.
- Market rents do not yet seem to have been influenced by a weaker economic outlook, and rents were stable for most sectors during the quarter. Some cities are continuing to see falling vacancy rates.

Chart 2: Forecast[B] total returns in local currency end Q4 2011 - end Q4 2016 (average % p.a.)



Source: Aberdeen Asset Management, April 2012

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Property market forecasts – overview

- Average properties are likely to see yields increasing in 2012 due to a lower appetite for risk and more challenging financing terms. On average, we expect capital values in the region to decline by 1.1% in 2012 mainly as a result of higher yields.
- The resilient economic fundamentals of the Nordics have led to increased interest from international investors, at least in investor surveys. This, together with a high prime property yield premium over government bonds, should give short-term support to capital values for prime or long-leased assets with strong covenants.
- We forecast property returns over the next 5 years to consist mainly of income return, with a total return forecast of 6.0%[B] per annum for the period Q2 2012 to Q1 2016 (Chart 2). This is lower than historic averages, but higher than most other developed regions of Europe.

Investment themes and risk tolerance

- With stable property prices and a more or less unchanged outlook over the quarter, most of our forecasts from the last quarter remain unchanged.
- Core properties in prime markets are likely to outperform in 2012 due to investors' strong preference for such properties. However, our analysis indicates that prime office markets in the largest cities are currently the most overpriced, which implies a risk of underperformance over the medium term.
- Given the weak and uncertain economic outlook and likely further falls in values for secondary properties, in general it looks to be too early to invest in shorter income, higher risk stock.
- Office tenants are becoming more focused on space efficiency and environmental issues, including access to public transport. Old, inefficient properties in secondary locations risk becoming obsolete and should be avoided.
- With prospects of limited capital growth and strong focus on income, there should be some interesting opportunities within the industrial sector. However, only well-let properties on long leases where tenant risk and risk related to the exit value is minimised should be considered.
- We also see opportunities for income with limited risk in the Swedish residential sector. We discuss this in more detail in our recently published white paper on the topic.
- According to our analysis, the Swedish office market is significantly overpriced. However, this is partly due to the high weight of the low-yielding Stockholm CBD market in the market index. Better opportunities in the Swedish office market are likely to be found in other major cities, with a yield premium of more than 100 basis points and lower historic volatility.

Lars Flåøyen, Head of Nordic Property Research

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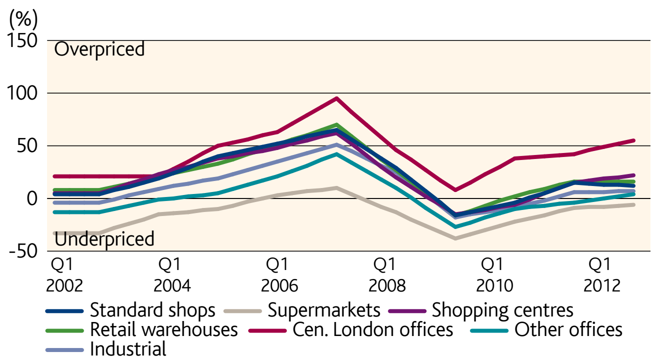
UK Property Market Outlook Summary

- **Aberdeen's long-term leading indicator suggests that supermarkets offer the best risk-adjusted investment opportunities in the UK market at present (Chart 1).**
- **Other property with fixed or inflation-linked uplifts to income is fairly priced in our view, with income expected to dominate returns over the medium term.**
- **In the short term, weak economic growth prospects are dampening tenant demand across all sectors, with much of the market over-supplied and suffering from high vacancy to compound this. We are, therefore, forecasting further rental declines in the short term.**
- **With interest rates at an all-time low, a fall in market prices represents the only real prospect of pricing, in aggregate, improving versus fundamental value.**
- **While pricing is generally quite neutral for much of the market, central London offices are, in our view, the most overpriced segment by some distance, pricing in a highly unrealistic rate of rental growth.**
- **With income growth prospects significantly stronger than other sectors, due to inflation-linked uplifts for the majority of assets, and a low risk premium, supermarkets are, in Aberdeen's view, underpriced, despite the apparently low yields being paid currently.**
- **The short-term outlook for the economy remains very weak with a number of downside risks. Occupational markets are reflecting this, while we are convinced that structural changes are having a big effect on comparison goods retail in particular.**
- **Nevertheless, structural shifts are likely to create wider opportunities in the traditional sectors and there are emerging commercial property types to consider.**
- **In the full report, we include our five year forecasts of rents, yields and total returns at a city level and a breakdown of our forecasts for the IPD universe.**

Chart 1: Aberdeen long-term leading indicator: market prices versus fundamental value[A]



Source: Aberdeen Asset Management, April 2012
Past performance is not a guide to the future.

Economic outlook

- The UK economy contracted by 0.2% in Q4 2011, meaning GDP grew by just 0.8% over 2011 as a whole.
- The contraction was mainly driven by a sharp fall in business investment, alongside a running down of stocks, more than offsetting an improvement in consumer spending and exports.
- Despite short-term leading indicators having been slightly more positive for Q1 2012, the UK entered technical recession with a 0.2% contraction in the quarter. We do not anticipate a sustained improvement this year, given the increasing impact of fiscal austerity and ongoing weakness externally.
- Weak economic growth points to weak occupier demand, particularly where austerity is biting hardest, which is set to continue to adversely affect non-prime property values in particular.

[A] The indicator does not translate into a short-term market forecast because momentum and investor sentiment can lead to marked and prolonged periods of over or under pricing. Our pricing calculations only indicate how stretched prices are relative to fundamentals. Prices do not need to fall or rise for our indicator to reach a neutral position. A change in income growth expectations or in the risk free interest rate, can also lead to such adjustment, or indeed a combination of all three. We use the indicator to establish risk tolerance at a very broad level.
[B] All property refers to retail, office, and industrial in the region.

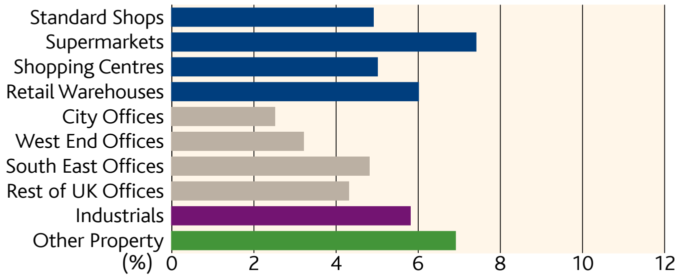
Property and the capital markets

- Lending to UK property remains constrained.
- There is little new lending and, where finance is available, maximum loan-to-values are low and margins elevated.
- Moreover, there is very little appetite to lend against development, even with solid pre-lets in place, or existing secondary property; lenders are almost exclusively lending on prime, long-let property in tranches of rarely more than £50 million.
- UK Real Estate equities enjoyed a strong rebound in Q1 2012 after slumping towards the end of 2011, delivering a 12.5% total return on the quarter.
- UK net investment in Q1 2012 was dominated by overseas investors, with sovereign wealth particularly active, mainly targeting trophy assets in London. UK institutions have generally been sellers.

Property market recent performance

- Capital values were static in Q4 2011 and, according to the IPD monthly index, have been gradually declining in the first quarter of 2012.
- This is an extension of the trend seen since mid-2010 when capital growth began slowing. Only the continued capital growth in central London offices has prevented capital values at the 'All Property'[B] level declining sooner.
- Rental values have been broadly flat for 18 months, the exception being central London office markets where meaningful rental growth has been seen. Indeed, some segments have experienced uninterrupted decline over that period.
- Generally, London and the South East have performed best across all sectors. Supermarkets have also performed strongly in a risk-averse environment. Regional offices and shops have been the weakest segments.

Chart 2: Forecast [B] unleveraged total returns in local currency end Q4 2011 – end Q4 2016 (average % p.a.)



Source: Aberdeen Asset Management, April 2012

Property market forecasts – overview

- Short-term pricing in the UK is being underpinned by the exceptionally low yields on other asset classes and, therefore, the relative attraction of property's income return, where that income is long and secure.
- Yields on more secondary and tertiary stock with weaker and shorter income are now drifting outwards; the market is characterised by heightened risk aversion.
- We are forecasting a total return over the period 2012-16 of 5.2% per annum, which represents a slight downgrade from 5.7%, over the quarter. This reflects continued downward revisions to the economic outlook and, therefore, the prospects for income growth (Chart 2).
- We continue to expect supermarkets, with their strong and sustainable income growth to outperform.
- We maintain that, in aggregate, central London offices are overpriced, leading to underperformance as yields rise.

Investment themes and risk tolerance

- We believe investors should consider a significant exposure - overweight relative to IPD - to supermarkets. We are particularly positive about small to mid-sized, purpose-built stores. Supermarket covenants can de-risk standard shop units but, with the exception of key commuter areas, we believe the rental growth story is weaker in town centres.
- Such is the poor outlook for open market rents in the traditional sectors that, aside from supermarkets, we are advocating exploring other types of fixed or inflation-linked uplifts, albeit with close attention to be paid to the impact on affordability for the tenant and over-renting potential.
- From a more top-down perspective, industrial property, with its high income return, is the long-term outperformer and can be expected to perform better than the other main sectors over the next five years, with income dominating returns. We believe consideration should be given to London locations where supply is limited and demand is likely to be more robust.
- Our strategic forecasts have changed little over the quarter. There remains considerable risk in the markets that only a decisive resolution of the eurozone sovereign debt crisis and a more consistent upward trajectory to domestic growth can alleviate.
- This perception of risk is reflected in the wide - and still widening - gap between prime and secondary yields. There is little appetite for tenancy risk, while structural changes, in the retail sector in particular but also the office sector, are further narrowing the definition of prime with regard to location and specification.
- Nonetheless, some secondary assets are offering very high income yields that, in the case of some leases, will mean the purchase price is yielded on the current lease. While we believe there is no urgency to take on secondary risk, investors should be mindful of the possibilities.

Graham Porter, Senior Analyst, UK Property Research

[B] Forecasts are offered as opinion and are not reflective of potential performance, are not guaranteed and actual events or results may differ materially. Forecasts are based on a number of assumptions including capital and rental growth assumptions.

Important Information

FOR PROFESSIONAL INVESTORS ONLY - NOT FOR USE BY RETAIL INVESTORS

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