

Accelerated economic growth this year, but moderate slowdown in 2007 likely

The European economy is predicted to see the strongest expansion this year since 2000 with Consensus Economics forecasting real GDP growth of 2.6% for Western Europe and 6.2% for Eastern Europe. Economic growth is however expected to weaken somewhat next year especially in Core Europe and economic performance will continue to remain very diverse in the coming years. Eastern Europe, the Nordic Region, Ireland, Spain, Greece and the Netherlands have the best economic prospects.

Property returns forecast to decrease slightly in 2006

Most countries recorded property total returns in excess of 10% in 2005 with the European average return amounting to a record 11.8%. Our forecasts for 2006 indicate a continued strong level of performance and we expect Ireland, Norway, the Netherlands and the UK to register the highest all property total returns this year. We are predicting that Germany will continue being the weakest performing country in terms of returns, although our forecasts indicate that all property total returns will increase to 4.6% this year

from just 0.5% in 2005. Returns next year are likely to decelerate due to our expectation that the potential for capital growth will be much more limited than it has been in the past. We expect returns to become increasingly driven by income growth.

Yield compression should end soon

European property yields have compressed and converged across all markets and sectors over the last years. As property yields are now on low levels and interest rates have increased further this year we expect the potential for further yield compression

to be very limited. It is likely that yields could begin to drift higher in some markets in the near future.

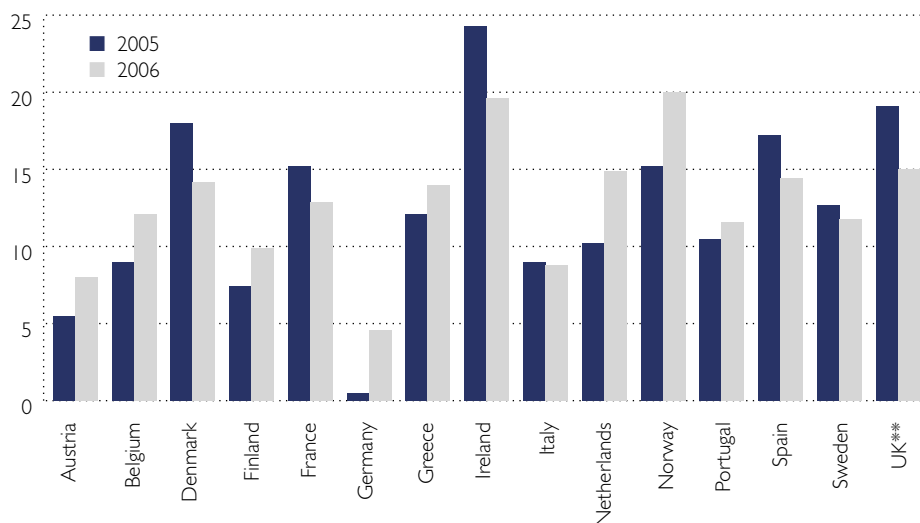
Direct commercial property investment in 2006 could reach €200bn

Property yields have essentially been driven lower by very strong investor demand. According to JLL the volume of direct commercial real estate investment transactions in 2005 reached over €156 billion and 2006 is likely to see a record volume of around €200 billion. The investment volume for the first-half of 2006 amounted to €95 billion with cross border investors accounting for around two-thirds of the total volume. During the first six months of 2006 close to 75% of the investment volume was concentrated in the UK, Germany and France.

Office market recovery continues

Most European office markets continue to recover this year. The majority of markets are recording lower vacancies, higher levels of gross take-up and rental growth. Rental growth so far this year has been especially strong in London, Barcelona, Madrid, Dublin, Paris and Oslo. The worst performing office markets in terms of rental growth this year are expected to be in Frankfurt, Berlin, Brussels and Amsterdam. These cities have vacancy rates that are at or near record highs, however, the worst appears to be over.

All Property Total Returns*, 2005 – 2006 (in % p.a.)



* Total returns are defined as consisting of capital & income growth. ** UK 2006 return relates to Jan – Oct 2006.
Sources: IPD, KTI & Aberdeen Property Investors, Investment Strategy.

News

Strategic partnership in France. In September, Aberdeen Property Investors strengthened its presence in France through a strategic partnership agreement with L'Etoile Properties, a leading property asset manager. This partnership will provide Aberdeen's clients with access to attractive property investments in France.



Three successful fund closings in October. Aberdeen's Asian Fund of Property Funds, AIPP Asia's first closing on 20 October was successfully completed with three institutional lead investors and commitments of \$91 million. The fund is now open for other institutional investors seeking exposure to real estate in Asia.

Aberdeen Property Funds SIVAC Pan-Nordic was equally successful in its first closing on 31 October, attracting €125 million from investors in Norway, Sweden, Finland, the Netherlands, France and the UK. The fund will build up a diversified portfolio in the Nordic and Baltic regions and expects to invest the committed capital in a three months period.

Finally, the recently launched *Aberdeen European Balanced Property Fund*, which offers investors balanced exposure to the property sector in selected European markets attracted €96 million from institutional investors at its first closing end of October.



Top position in Euromoney ranking. For the second consecutive year, Aberdeen topped the investment management category in Euromoney "Excellence in Real Estate Awards"



Retail market prospects are positive, but not for the UK

Retail markets in Europe are by and large performing better than offices in terms of stronger rental growth and lower vacancy rates. The outlook for prime rental growth remains positive across Europe as retailer demand is expected to be strong and development activity fairly restrained. We expect the retail sector to produce good returns in the coming years especially in Ireland, Spain, France, Norway and Sweden. We are predicting that UK retail, which produced total returns of 18.9% in 2005, will see significantly lower returns in future as the yield gap (to the cost of financing) has narrowed considerably in the recent past and consumer spending is likely to slow due to strong increases in consumer debt.

Tenant demand for distribution space is strengthening

Tenant demand is strengthening for modern distribution space across Europe and investor interest remains very strong. We expect that well located facilities and regional distribution assets will perform better than those operating at a localised level in future.

European house price growth is decelerating

House price growth in Europe remains positive for the majority of markets, although there are now indications that price increases are decelerating. Performance continues to vary widely across Europe with Denmark, Estonia and Spain registering the strongest increases while prices have remained stable or declined slightly in Austria, Germany and Portugal. In the UK, house prices are increasing strongly again after a slowdown last year. This being due to especially strong demand and limited supply in London and the South East. Housing markets, especially in Denmark, Spain and Eastern Europe, are also being boosted by credit liberalisation, which has made it easier and cheaper to obtain mortgage financing.

Listed sector in Europe is outperforming Asia & North America this year

The EPRA / NAREIT Europe Index, which measures the performance of listed European property companies, rose 2.4% in November resulting in YTD returns reaching 37.3%. Europe is thus outperforming both Asia and North America, which have generated lower

returns of 15.1% and 23.3%, respectively, over the same period. During the first eleven months of 2006, France, Germany and the UK have produced especially strong returns of 54.9%, 42.5% and 37.7%, respectively

Germany will soon have a REIT structure & Italy is also considering establishing one

Germany's federal cabinet has approved the legislation for G-REITs from January the 1st 2007. The draft law will now have to be approved by the German parliament before it becomes law. Meanwhile Italy is considering fast-tracking the creation of an Italian REIT structure, which might be modelled along the lines of a French SIIC.

Growth in unlisted property vehicles continues

The INREV database registered 481 vehicles at the end of October 2006 with a combined gross asset value of €328.5 billion. Over the coming five years 123 funds with €71.5 billion of assets are due to end their life, potentially leading to an influx of assets coming onto the market. However, most funds have the capability to extend their life and many investors are expected to be keen to retain property exposure.

Close to €50bn CMBS issuance so far this year

The European CMBS market has grown 60% year to date compared to 2005 issuance, on the back of increased investor demand for higher yielding ABS (Asset Backed Securities) bond instruments and lower costs relative to bank financing for real estate investors. Continued progress in standardisation of documentation and structure indicate that CMBS will continue to grow into a crucial instrument for both debt investors, banks and borrowers. So far this year, Barclays Capital Securitisation Research estimates that €27.5 billion has been transacted in continental Europe and the equivalent of €21.9 billion in the UK.



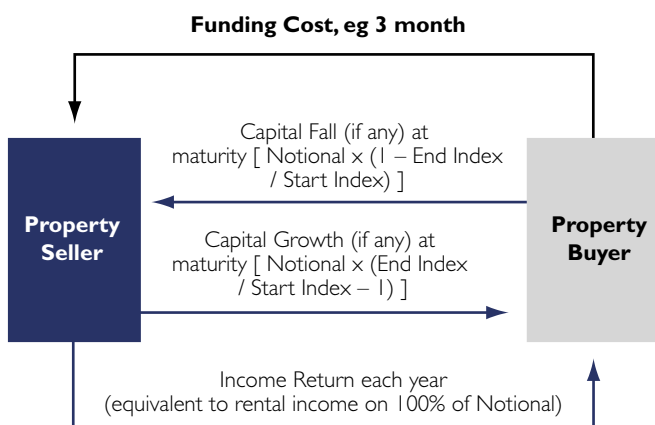
What are Property Derivatives?

Our topic this quarter takes a look at how Property Derivatives work and how they could affect European Real Estate. Charles Weeks, Principal at Protego Real Estate Investors, kindly answers our questions.

What is a Property Derivative?

The most widely used property derivative is a "Total Return Swap (TRS)" for example whereby a party wishing to "hedge" or "sell" current property market exposure will contract to pay, for a defined period, usually between one and seven years, the annual income return on the relevant index and the capital return over the period should values increase. In return, a bank will contract to pay a rate of interest on the agreed capital exposure, based upon LIBOR / EURIBOR plus or minus a margin. Should capital values fall over the period of the trade, rather than rise, the bank will pay the seller an appropriate sum. Thus it is a swap of floating rates of income return on property for a financial return in combination with a capital hedge.

Total Return Swap



Typically, a bank will then mirror this trade in the opposite direction with another party, whereby it will contract to pay the relevant IPD index in return for a higher interest rate. The bank's interest is therefore in taking the spread between the two rates of interest. The two parties on either end are therefore paying and receiving the property index respectively. The most common structure that Protego has adopted for recycling exposure to investors is through a Property Index Certificate ("PIC").

What are the advantages of Property Derivatives?

The main advantage is that it allows investors to meet their strategic and tactical aims as with a derivative they can instantly buy or sell parts of their portfolios. Derivatives not only save time as the actual assets do not need to be traded, but they also have significant cost advantages.

Derivatives therefore lubricate the system, leaving more money within it for investors and creating greater liquidity. Another advantage is that smaller investors as well as financial players who do not normally participate directly in real estate are able to get some real estate exposure.

How important is it to have a Property Index?

It is absolutely crucial to have an established credible and robust IPD type index in place, which is likely to be regarded by both sides of the transaction as being an authoritative representation of the market in which they wish to deal. Without this the level of due diligence would become onerous, removing a significant advantage that derivatives offer relative to physical transactions.

How has the market grown in the UK?

For the ten years, from 1994, some £800 million of TRSs in the form of Property Index Certificates (PICs) were transacted in the UK, with lives of between one and seven years. There was also some £400 million turnover in Property Index Forwards (PIFs), between 1996 and 1998. PICs (in 1994) and PIFs (in 1996) were devised by two of the Principals at Protego together with BZW (the predecessor of Barclays Capital). All of these instruments were pitched at the UK IPD "All Property" level.

In 2005, the market place began to grow significantly in the UK after the successful resolution of some tax issues and, importantly, the acceptance by the FSA that these instruments used responsibly could qualify as "admissible assets" for insurance companies, which had not been their stance previously. This has resulted in a further £1 billion of transactions in these instruments, being undertaken by Barclays Capital and Protego. Other banks have also written significant volumes with a number of new entrants into the marketplace. Notable in this is ABN Amro, who has dealt for the first time in sector instruments, specifically the "Retail" and "Office" segments of the UK IPD Annual Index.

What is the current global position of Property Derivatives?

Aside from the UK, the first transaction in the United States is believed to have taken place recently through CSFB and I would regard the marketplace in The Netherlands as likely to produce a transaction of some kind in the near future. Interest is developing in many other areas including Australia, Asia, France, Ireland, Germany, Switzerland and the Nordic region. Whilst the ultimate criterion of whether any of the local indices are capable of supporting a derivative instrument is simply provable investor acceptability, the most likely issues will revolve around the

Aberdeen Topic

percentage of the overall market which the index covers, the representativeness of its spread and, perhaps most importantly, the credibility of the valuation process, commonly adopted for the constituent real estate.

What will drive growth around Europe?

In my view, derivatives can help to absorb some of the enormous investor demand in the property market by granting investors quick and easy exposure. In addition, derivatives can help established real estate investors, which tend to be hugely concentrated on their domestic market, gain more international exposure.

What is the outlook for a Pan-European Derivatives Marketplace?

I believe that property derivatives, from what is now a firm base in the UK property market, will spread progressively through the different countries of Europe and elsewhere around the world over the next five years.

A number of factors are coming together, which I believe will ensure the steady spread of this marketplace across Europe, over the next few years.

- The instruments themselves are becoming more established and understood;
- Their attractions, particularly in cost saving, are being increasingly recognised;

- The markets across Europe are becoming more rationally priced for the long term investor; meaning a range of views on the outlook;
- There is a big push to gain exposure at the strategic level by cross border investors;
- The range of suitable indices provided by IPD and others is becoming rapidly more robust and capable of supporting a variety of instruments.

The bigger picture imperatives will, I believe, ensure the establishment of a Europe-wide market place.

What is a Property Derivative?

The most widely used property derivative is a "Total Return Swap (TRS)" whereby a party wishing to "hedge" or "sell" current property market exposure will contract to pay, for a defined period, usually between one and seven years, the annual income return on the relevant index and the capital return over the period should values increase. In return, a bank will contract to pay a rate of interest on the agreed capital exposure, based upon LIBOR / EURIBOR plus or minus a margin. Should capital values fall over the period of the trade, rather than rise, the bank will pay the seller an appropriate sum. Thus it is a swap of floating rates of income return on property for a financial return in combination with a capital hedge.

For further details please contact:

Jon Lekander

Head of Investment Strategy

E-mail: jon.lekander@aberdeenpropertyinvestors.com

T: + 46 70 211 80 77

Alessandro Bronda

Head of Research

E-mail: alessandro.bronda@aberdeenpropertyinvestors.com

T: + 32 476 349 279

About Aberdeen

Aberdeen Property Investors is one of Europe's leading property investment managers with some €10 billion in property investments through property funds and management mandates.

The group some 500 employees at offices in ten European countries. Clients are primarily institutional investors, such as life and pension funds. We assist institutional investors to well-diversified property exposure with high risk-adjusted returns across Europe. A structured investment management process, underpinned by best in class research of the European property markets, delivers superior and consistent performance. Numerous solutions are available for our clients through a comprehensive range of investment vehicles and tailored mandates.

Aberdeen Property Investors is part of Aberdeen Asset Management PLC, a global asset management group listed on the London Stock Exchange, with asset management activities in bonds, equities and property. At September 2006, total funds under management by Aberdeen Asset Management exceeded €100 billion. www.aberdeen-asset.com