

GLOBAL OUTLOOK

Grosvenor's research perspective on world real estate markets

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Emerging markets - returning to growth?

With advanced economies continuing to struggle against the dual brakes of public sector austerity and private sector de-leveraging, the role of emerging markets in the global economy has rarely been of more significance. However doubts have arisen over whether these markets can continue to drive growth with external demand likely to be weak, especially in the short-term.

Annualised GDP growth in emerging markets in the final quarter of 2011 was at its slowest since the end of 2009. China has seen a simultaneous slowdown in exports and domestic demand. The former as a consequence of the Eurozone crisis and the latter due to falling property prices as a result of government measures introduced since 2010. In other large emerging markets growth is also slowing, but momentum is strong. While the external environment may not drive growth as it has in the past, domestic demand should remain strong helped by lower food prices.

The industrial production rate of growth (a much more timely series than GDP), in the BRIC nations (Brazil, Russia, India and China) has been on a downward path

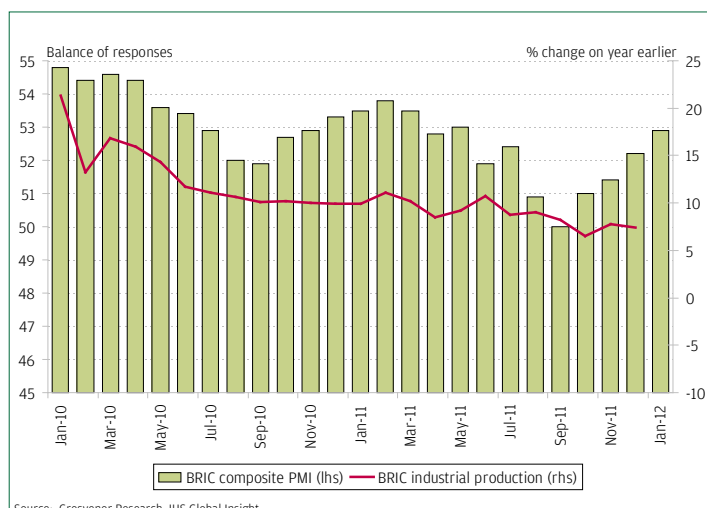
since peaking at the start of 2010. However in the final two months of 2011 it appeared to stabilise, in spite of uncertainty elsewhere in the global economy. This is illustrated in the chart. It may also come as a surprise to see that despite the escalation of the Eurozone crisis, a combined, GDP-weighted PMI index for the BRIC nations has shown improvements for the last four months. In fact in January this index was at its strongest level since May 2011.

It is dangerous to read too much into data for any given month. The important point is if recent encouraging data turns out to be a 'blip' and the slowdown continues then governments are in a position to loosen policy, unlike their Western counterparts. In the case of China it looks likely that there will be a pause in monetary easing as the government assesses whether the improved US outlook will lead to a trade rebound. With a government changeover in Beijing due in the autumn, any further slowdown in GDP growth will be enough to prompt some form of new stimulus package.

As is often the case for emerging markets, the potential spanner in the works is inflation. This is receding across the OECD, but is this the case in emerging markets which still have positive output gaps? In fact, recent data suggests that it is, with consumer prices increasing at their slowest rate in more than a year. In the case of India, where inflation has been particularly persistent, it fell to a 26-month low in January. Although admittedly it has taken 13 interest rate rises in the past 18 months to achieve this.

None of this is to say that growth will return to levels recorded over the past decade, and it may well slow further during the coming few months. However we can take some encouragement from the fact that emerging markets will continue to be the engine of global growth, both this year and beyond.

Still going: growth indicators in the BRICs



David Inskip
Britain & Ireland

Opportunities in Norway: retail real estate

As the Nordic real estate markets are increasingly attracting interest from international investors we take a closer look at Norway and its prospects.

Norway is Europe's northernmost, and has one of the highest standards of living in the world, ranked seventh by GDP per capita globally. Propelling the country's economic performance is its abundance of natural resources - hydropower, fish, forests, and minerals but Norway is most dependent on its petroleum sector which accounts for almost 50% of total exports. The Norwegian economy has been particularly resilient throughout the financial crisis, experiencing a relatively small contraction in GDP (-1.6%) during 2009 compared to other European countries.

In order to put in to perspective the economic performance of Norway, Chart 1 outlines the average annual GDP growth rate for each region in the Nordics between the past decade and that expected for 2011-2020. The median GDP growth in the Nordics was 1.6% pa between 2000 and 2010 and this is set to improve this decade. Of the 19 first-level administrative counties in Norway over 50% are in the top quartile of all Nordic regions in terms of forecasted GDP growth.

Norway's GDP growth in 2011 has been subdued, anticipated at 1.7%, mainly due to a sharp decline in energy goods output with production in some oil fields suspended for maintenance, and the ongoing Eurozone situation. But going forward the economy is expected to grow at an average of 2.5% per annum over the next five years.

In terms of the different regions across Norway and their contribution to Norway's GDP, unsurprisingly Oslo, with a population of ca 611,000, makes up the majority of Norway's annual output (comprising

23% of the total in 2010) with the other three main regions being Hordaland, Akershus and Rogaland, all found towards the south of the country. Medium term forecasted growth rates are also strongest for these locations due to their concentrated wealth, population and services.

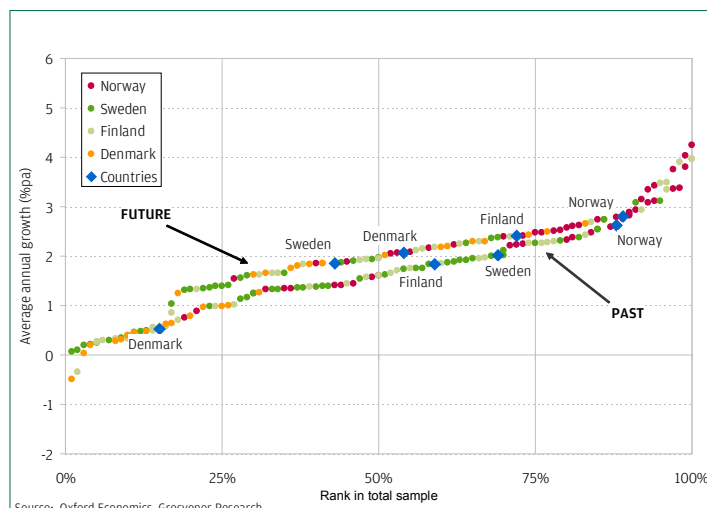
The Norwegian property market is relatively small, but is both mature and transparent. In an international investment perspective it suffers from similar drawbacks to other Nordic markets, primarily that local players dominate the market making the sourcing of product an issue. As a whole the real estate investable universe is dominated by offices (63%) but retail makes up a relatively large proportion of the market (30%).

The downturn in 2008/9 hit total returns across all real estate sectors. The decline in annual returns was less severe for retail than for offices and industrial. Retail returns had been consistent up until the end of 2007, on gradually increasing trajectory with the average annual return between 2000 and 2007 at 14.3% with a standard deviation of 2.5.

Chart 2 gives an overview of annual retail total returns since 2000 for the four Nordic countries. All but Denmark show a relatively similar trend. The three year average total return to 2010 for Norway retail was at 3.9%, (compared to 3.8% in France, -2.0% in the UK and -2.5% in the US). As Table 1 highlights, the Sharpe ratio for Norwegian retail between 2000 and 2010 was higher than other sectors in Norway but also than countries such as France, Sweden and the UK. With a Sharpe ratio of 1.63 it is above the "1.00" marker, giving scope for delivering excess returns over the long term¹.

The ongoing performance of the real estate sector is supported by lessons learnt from the experience the country went through during the early 1990s when Norway was forced to nationalise all of its major banks², having gone through a period of significant fiscal overspending. It was not until after the early 1990s crisis when structural reforms were implemented, similar to Sweden, in order to secure a sustainable economic future whilst minimising volatility for the country. The Government Pension Fund³, which collates surplus Norwegian wealth, was also created then.

Chart 1: Nordics: Real GDP growth
Norway is set to outperform over the decade

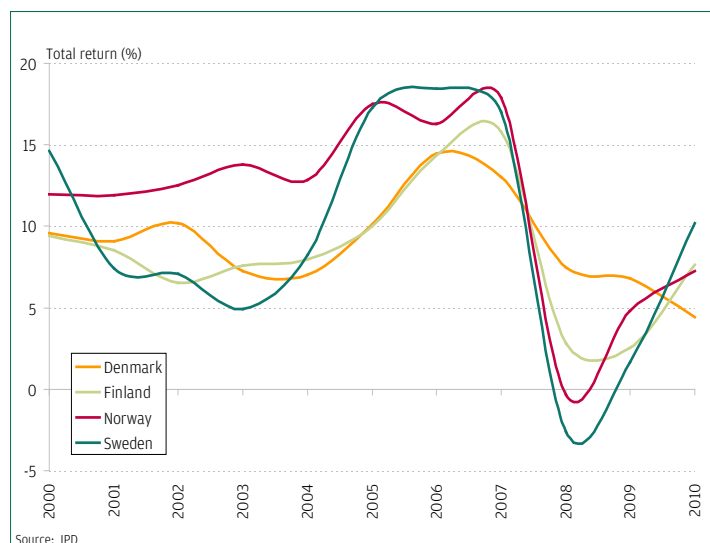


¹ The Sharpe ratio is a measure of risk-adjusted performance. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been.

² Two banks were subsequently sold 100% to private owners but the Government kept 34% share in DnB Nor.

³ The fund was set up to counter the effects of falling production in the future so to ensure prosperity is passed down the generations. As at June 2011 the fund is largest 'pension' fund in the world. It returned 9.6%, or 264 billion kroner, in 2010, driven by widespread gains in global stock and bond markets. The fund is now worth roughly 120% of Norway's GDP.

Chart 2: Nordic retail total returns



Source: IPD

The creation of the Fund coupled with more prudent economic policies meant that the government's fiscal balance has been in surplus since 1993, and Norway is in a much more stable position to weather future crises as other governments implement austerity measures in order to reduce their deficits. Nonetheless Norway is an open economy and cannot be unscathed from outside shocks. The Norges bank recently chose to cut policy rates by 0.5 percentage points to 1.75%, justifying the move on global financial instability and the Eurozone sovereign debt problems (the Eurozone is Norway's largest export market). The inflation outlook is encouraging with prices tempered by competitive trading conditions on the high street and a strengthening Krone has meant that import prices have lowered.

Importantly for the retail market in Norway consumer spending is experiencing strong upward growth, boosted by near record low interest rates. The Norwegian people have seen their real disposable income significantly elevated and although the savings rate also increased during the last couple of years, overall household consumption increased by 2.2% in 2011.

Growth in retail sales, albeit recently tempered, has been supported by the increase in consumer spending and the trend is likely to continue. Consumer confidence is relatively high due to the

comparatively healthy housing market coupled with a low unemployment rate (3.3%). Future issues may lie with a potential overpricing in the housing market; it exhibited strong growth of 11% p.a. from 2004 to 2007 and despite a slowdown during 2008 and 2009 growth has resumed on a similar trend with house prices now 20% higher than at the end of 2007⁴. With one of the highest price to rent ratio within the OECD economies, a house price correction would have an impact on future consumer spending. Nonetheless, domestic demand will remain a key driver of growth for Norway.

On balance, going forward, economic growth is expected to be robust and the policies brought in after the end of the recession during the 1990s mean that the government has ensured the long term economic future of the country. With the unemployment rate low and population levels projected to show good levels of expansion over the medium term, the fundamentals are in place to support capital growth in Norway and strong future retail sales. A potential correction in the housing market is a concern, but careful management of savings should temper any negative impacts on consumer spending. Occupier demand for retail space is expected to increase and retail locations near prime will see positive spillover effects as zero vacancy rates force retailers to consider other areas. Several large retailers, both domestic and international, are gearing up for expansion in Norway and this should lead to further interest from other brands. Yields over the short term should remain stable with the potential for further compression in prime locations. Whilst the recovery of commercial real estate in some countries has been very much ahead of what the fundamental economics can support, this cannot be said for Norway.

Tim Barlow and Beatrice Guedj
Continental Europe

Grosvenor Fund Management (GFM) has reinforced its presence in the Nordic markets having recently acquired four assets in Sweden on behalf of two major institutional investors and Grosvenor. Following its recent opening of an office in Stockholm, GFM is on the lookout for further opportunities in the region including Norway.

Table 1: Sharpe Ratios: 2000-2010

| Sector | Norway | Sweden | France | Germany | UK | US |
|--------------|--------|--------|--------|---------|------|------|
| Retail | 1.63 | 0.89 | 1.22 | 0.60 | 0.28 | 0.54 |
| Office | 0.73 | 0.36 | 0.81 | (0.98) | 0.23 | 0.25 |
| All Property | 1.03 | 0.55 | 0.95 | (0.89) | 0.28 | 0.32 |

Source: IPD

⁴ IMF (2012). Norway: 2011 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Norway, IMF Country Report No. 12/25, February 2012.

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Questions & Answers with Maurizio Grilli, Global

Q: What were the main trends in real estate investment in 2011?

A: Overall, real estate investment activity had a good run last year, with global turnover improving around 20% year on year, and all macro-regions enjoying solid growth. Investor activity was reduced in the fourth quarter, as a result of a) the slowing of the global economy and b) renewed and heightened tension surrounding the Eurozone sovereign crisis. The largest gains were recorded by the US and Germany. The US started from a very low base and benefited from attractive market pricing while Germany benefited from good economic performance and its safe haven status.

Overall investors remained extremely nervous and risk aversion was one of the major themes in 2011. On average, investors were more attracted to markets characterised by high spreads between real estate yields and bond rates. The flight-to-safety theme is expected to stay for some time, with large and liquid markets such as London, Tokyo and New York still receiving a large share of capital, despite the keen pricing reached for the best assets.

Q: What do you expect the trends to be in 2012?

A: We expect turnover to increase from current levels as both institutional and private investors are still attracted to the income generated by property. We should not forget that, from the perspective of optimal asset allocation, many investors are still largely under-allocated to property in their mixed-asset portfolios and desire to increase their exposure to this asset class. Geographically, we expect improving activity in the Americas and Asia-Pacific regions while renewed weakness in Europe and the lingering sovereign crises means that investment activity in the region is likely to stay flat. The gap between prime and secondary assets is not expected to narrow, as the majority of investors are still reluctant to take on excessive risk. On the other hand, scarcity of prime product is likely to motivate some investors to broaden their horizon and chase higher yields. More adventurous investors will test the waters in new markets such as emerging Asia and Latin America, where higher yields or the chance of higher growth are more likely.

Q: Do you expect the market environment to be very different going forward?

A: The lack of debt and deleveraging will continue to disrupt market activity. Bank activity will also be constrained as equity buffers need to be raised to comply with Basel III requirements. This means that banks will still be focusing on lending on safe, income-producing core assets. On the other hand, it is likely that insurance companies will increase their share of overall lending to the real estate sector although this is unlikely to plug the funding gap. Overall, financing conditions are not expected to improve significantly any time soon and as a result cash-rich investors will still enjoy the upper hand. We are aware that there is still a significant amount of debt, scheduled to mature over the next years, to be found in assets that will unavoidably be sold at a discount. As a result, we expect some interesting opportunities to emerge. The other good news for investors is that development finance will still be quite hard to obtain, which, in turn, will provide a floor to rental values. Even more than before we believe that the key to out-performance lies in the ability of experienced investment specialists to access as many sources of potential opportunities as possible and execute them effectively.

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