

World Overview

Growth: Revised US Q2 GDP was 4% annualised, so not yet showing the full effects of the housing market downturn. Rising risk premiums could weaken investment and falling house prices undermine consumer confidence, leading to a much weaker second half. Recession is unlikely due to a healthy labour market, reasonable incomes growth and easing inflation. In Q2 Eurozone growth decelerated to 0.3% q/q from 0.7% in Q1, a result of a fall in the volatile parts of investment but overall growth momentum is strong. We expect around 2.5% growth in 2007, well above trend. Product recalls are embarrassing for the Chinese but are unlikely to seriously damage exports. China's Q2 growth was 11.9% y/y, with industrial output posting a staggering 18% y/y in July.

Inflation: In the US the personal consumption deflator was 1.9% in July, sharply down on earlier this year. Furthermore, a small negative output gap has opened up (-0.4% of potential GDP) suggesting, alongside the fall in gas prices, inflation pressure have substantively eased. Eurozone CPI is 1.8% y/y, down from 1.9% in March and looks stable and well behaved. China's CPI is running at 5.6% but excluding food is closer to 1%

Policy: The Fed now has room for a small cut in interest rates, possibly in September, but it would be wrong to expect a succession of cuts. Elsewhere, central banks will wish to assess the impact of the sub-prime "crisis" before taking action, but still with a bias to tighten. For example, strong growth and monetary expansion suggest that the ECB may raise rates once more to 4.25%. China's official lending rate is 6.84% the highest in a decade and will be further raised to cool the economy.

Region by Region (changes in bold)

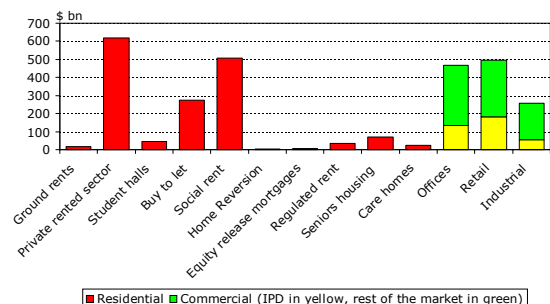
	<i>Growth</i>	<i>Inflation Rate</i>	<i>Short Int Rate</i>
USA	Slowing	Easing	Falling
Euro zone	Strong	Steady	Rising
UK	Strong	Easing	Rising
Japan	Moderate	Weak	Holding
Canada	Strong	Steady	Rising
China	Booming	Increasing	Rising
Australia	Strong	Steady	Rising

The potential for investment in European residential property

According to the ONS, Around 60% of the UK's £6.5 trillion wealth is in residential property. So the value of the UK residential market is around £3.9 trillion (\$7.9 trillion). The total value of properties included in the IPD Databank is £192 billion (\$390 billion), equivalent to 55% of the total property assets of UK institutions and listed property companies suggesting the size of the commercial sector is around £349 billion (\$708 billion).

Whilst the size of the residential market in the UK is larger than the commercial market, the majority is owner-occupied and not 'investible'. But, the sheer size of the residential market means that the sub-sectors which are investible are large relative to the commercial sector (Chart 1). Further, whilst the value of the commercial market does not increase significantly over time, excepting retail, the residential market is characterised by sustained long term capital appreciation.

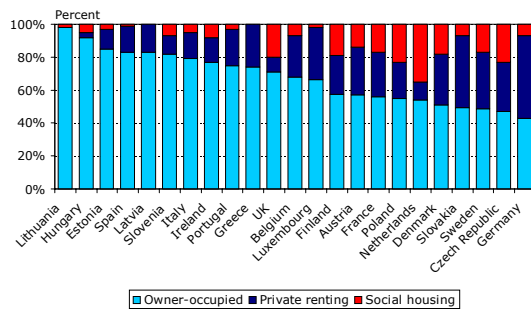
Chart 1: Size of residential vs. commercial market in the UK



Source: Grosvenor on Savills, IPD and DTZ data, 2007

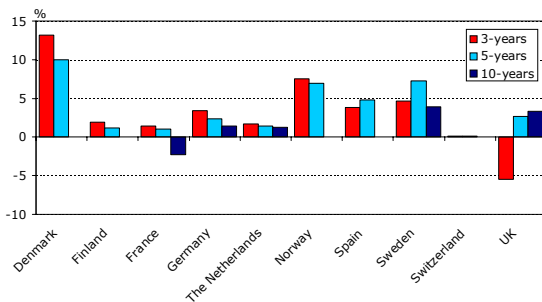
Official data on the size of the European residential market does not exist, but it is possible to create an estimate. The ratio of the value of the UK residential market to the value of the commercial market is approximately 6.5. Applied to the European commercial market (\$8.6 trillion), the ratio suggests a value of the European residential market of \$55 trillion¹. Most of this market is not accessible to professional investors as owner-occupation is on average 65% of total stock. However, significant opportunities may exist in the social housing market, especially in the larger countries such as France, Germany and Italy. Chart 2 shows that owner-occupation is very high in countries such as Spain and Italy but much lower in France and Germany. Provided that stock is accessible, expected returns attractive and risk manageable, a viable strategy is to acquire private or public stock in those two countries. Government disposals of residential assets and 'corporates' selling-off property to finance core investment all represent sources of stock². While Germany is currently the

Chart 2: European residential stock by tenure



Source: Grosvenor on local sources data, 2007

Chart 3: Performance of residential vs. office investment



Source: Grosvenor on IPD data, 2007

time, due to short leases. However, cash-flows in the residential sector are generally quite stable and, moreover, there are other segments such as student housing and senior housing where the length of the leases is on average longer than in the traditional commercial sector. Investors also think of residential investment as a management-intensive sector. However, companies with a long track record of managing residential investment are probably well placed to do well in other markets as well. Low initial cap rates in the residential market are another reason for concern but some segments and some countries offer higher cap rates than in the traditional sectors. Finally, investors are worried about a price correction across the continent. However, as it has been already shown, volatility in the residential sector is historically lower than in the commercial sector.

In summary, as competition for commercial property is becoming tougher, investors have to source stock in less traditional, alternative, markets. European residential investment is characterised by attractive risk-adjusted returns, a range of leasing contracts and a sizeable and increasingly open market.

¹ Due to the strong appreciation in UK residential prices, this ratio produces an upper estimate of the size of European residential stock.

² Examples include the German government and local authorities and the Italian banking sector.

³ Recent examples include Bouwfonds in Germany, Hines in Spain and ING in France.