Quarterly Update December 2012

Q4

European Property Fund

LOTHBURY Investment Management

European Property Fund

Fund Description

The European Property Fund (EPF) is an investor fund structured to provide an indirect exposure to Real Estate across Continental Europe. Regulated by the Irish Financial Regulator it invests into best in class managers and funds across all commercial sectors.

Fund Objectives

- To provide a diverse investment opportunity to investors seeking indirect exposure to the Continental European real estate markets, excluding UK and Ireland.
- To provide investors with exposure to a large portfolio of underlying assets across countries and sectors through a fund of funds structure.
- To continue to implement a core/active investment strategy.
- To deliver a positive and stable income return.

Fund Returns

calculated as at valuation date 31 December 2012

	Total Return (%)
3 months	**-4.14**
12 months	**-7.64**
3 years	**-1.90**
Since Inception	**-42.11**

Fund Data

calculated as at valuation date 31 December 2012

Net Asset Value	€ 75,098,818.14
Net Asset Value per share	€ 499.7990
Quarterly distribution per share	€ 1.341672
Number of underlying Funds	12

European Economy

Looking forward into 2013 the macroeconomic outlook remains one of a slow and steady global recovery. During the last six months, there have been numerous policy initiatives to assist with Europe's recovery. The most recent of these was the outright monetary transaction (OMT) programme where the ECB stated that it would buy the short-term sovereign debt in countries where borrowing costs had become unsustainably high subject to certain conditions. This provided a short term boost to sentiment, although its long term impact is yet to be assessed.

However, European GDP forecasts have seen downward revisions. In December 2012 the forecast for Eurozone GDP growth in 2013 was 0.3% a reduction from the 0.5% forecasted mid way through 2012. Norway's GDP is expected to remain above average as a result of its booming oil sector. However, Spain remains a focus during 2013. In August 10-year Spanish government bond yields reached all time highs of 7%, although these have since eased following the announcement that the ECB will support any struggling European nation through the OMT.

In December the Economic Sentiment Indicator (ESI) improved by 1.3 points in the EU 17 to 87.0. Economic sentiment registered increases in industry and construction, however, these were partly counterbalanced by decreases in the service sector and volume of retail trades. Therefore, consumer confidence in the EU remained broadly unchanged. Inflation in the 17 Eurozone members also remained unchanged at 2.2% in the year to December. This rate was 2.7% a year earlier. Official figures released from Eurostat showed that the unemployment rate across the Euro area worsened in November, hitting a record high of 11.8%. The countries that saw the largest increases in unemployment compared to a year earlier were Greece, Spain, Cyprus and Portugal (Eurostat). Spanish unemployment hit 26.6% in November up from 26.2% recorded in October. On the 10th January, the ECB kept interest rates at 0.75%. Rates have now been at this level for six months.

Executive Summary

- EPF recorded a Q4 2012 total return of -4.14%. The 12 month total return now stands at -7.64%.
- The capital return was -4.4%, this has declined markedly since last quarter. Pressure continues on real asset values in the European markets, particularly Southern Europe due to the sovereign debt crisis. Despite this, some yield contraction in prime core markets within the portfolio does exist; however asset values elsewhere diminished the total return for the quarter.
- The income return was 0.26%; this is lower than the previous quarter and over the last 12 months, however this does not take into account bi-annual and withheld distributions.
- Total Eurozone investment volumes were €41.5bn over the fourth quarter of 2012, an increase of 48% on Q3 2012 and by 16% on Q4 2011 according to CBRE. A few large transactions in Germany and Norway meant that activity in both areas were at their highest level since 2007.
- In particular, the purchase of over €1bn of assets in Eastern Germany by US firm Lone Star both opportunistic and diverse type of assets, suggests that investor interest may have started to return to the secondary market albeit in selective areas. Prime European rents are showing a sign of resilience even in an uncertain economic environment.

European footprint

Weightings as at 31 December 2012, based on underlying Fund strategy and current valuation

Country Allocation

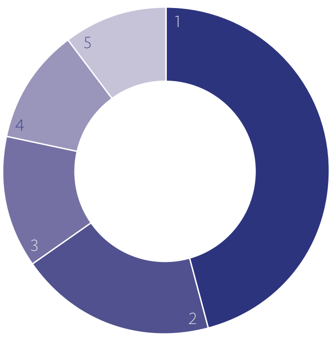
1 **Core Europe 45.93%**
(France, Germany)

2 **Southern Europe 19.56%**
(Spain, Italy, Portugal, Greece)

3 **Nordics 13.01%**
(Sweden, Denmark, Finland, Norway)

4 **Benelux & Other 11.31%**
(Austria, Netherlands, Switzerland, Belgium)

5 **CEE 10.19%**
(Poland, Czech Republic, Hungary, Romania)



Sector Allocation

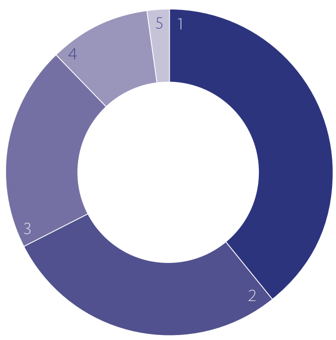
1 **Retail 39%**

2 **Logistics 28%**

3 **Office 20%**

4 **Residential 10%**

5 **Other 2%**



Aviva – Central Eastern Property Fund

The Aviva Investors Central European Property Fund (AICEPF) is a closed-ended Luxembourg FCP, established in January 2005 with an initial lifespan of 10 years. This Fund is part of the seed portfolio that was in place at the time of the inception of EPF.

The Fund's holdings of 12 assets are currently valued at €274.79m as at December 2012. The Fund's initial strategy was to invest directly in a diversified portfolio of office, warehouse and retail property assets across Central and Eastern Europe. 85% of the Gross Asset Value was targeted at the core markets of Czech Republic, Hungary and Poland. Up to 15% of the Fund was to be invested in secondary markets, defined as Slovakia, Croatia, Romania, Bulgaria, Serbia, Montenegro, Slovenia and the Baltic States. However, only 7% is currently allocated to these markets as the core markets are the Fund's key area for growth. 12 months ago the Fund had a high weighting, 42% to Hungary. In 2012 the Fund manager successfully completed on the sale of Hungarian offices, reducing the weighting to 19%. This was despite CEE volumes being down by 25% in 2012 year on year, according to CBRE. Furthermore, the majority of transactions were in the retail and industrial sectors.

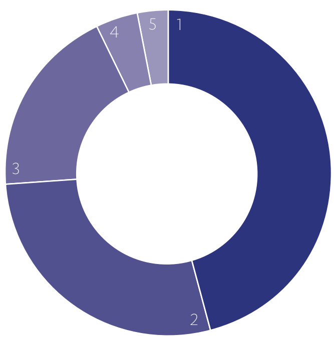
The current gearing of the Fund stands at 53.86% a reduction from 58.16% at the end of 2011. Indeed, the Fund has completed a positive refinancing exercise during 2012. The new facility was agreed with Deutsche Pfandbrief & Unicredit (Bank Austria) for 3 years with a 3 year extension option at a margin of 290 basis points. There is no ammortisation and 85% of the loans amount is hedged. Interest service cover ratio was 225% at the time of refinancing. The completion of the Hungary office sales facilitated a further €87m debt repayment in February 2012. Post completion of the Hungary office sales, the overall LTV for the portfolio reduced to 49.5%. The vacancy rate is 8.9%, which is still comparatively low in terms of the average vacancy rate for comparable funds in Central and Eastern Europe. The Manager's primary focus is on the asset management of the property portfolio to ensure capital value growth and to maintain competitive property income levels.

Most CEE countries are forecast to record positive economic growth for the next 5 years, more so in the latter years which will benefit the EPF's overall future performance. This is particularly prevalent for the type of assets the AICEPF Fund holds, in prime locations and predominantly in capital cities in the primary country markets of Poland, Czech Republic and Hungary. The Fund Manager is considering an extension to the Fund's life to take advantage of the recovery of the region beyond 2015.

Country and sector allocations

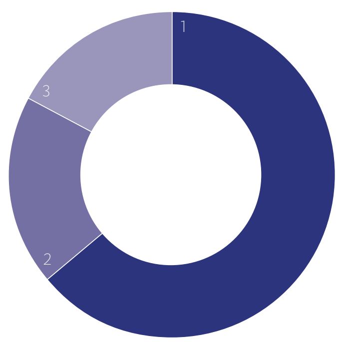
Country Allocation

1 **Czech Republic 46%**
2 **Poland 28%**
3 **Hungary 19%**
4 **Slovakia 4%**
5 **Romania 3%**

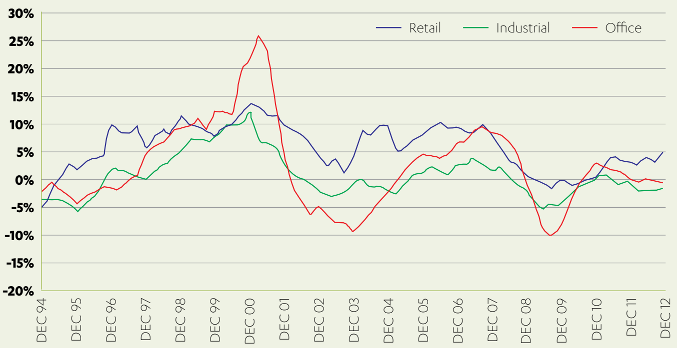


Sector Allocation

1 **Office 64%**
2 **Retail 19%**
3 **Logistics 17%**

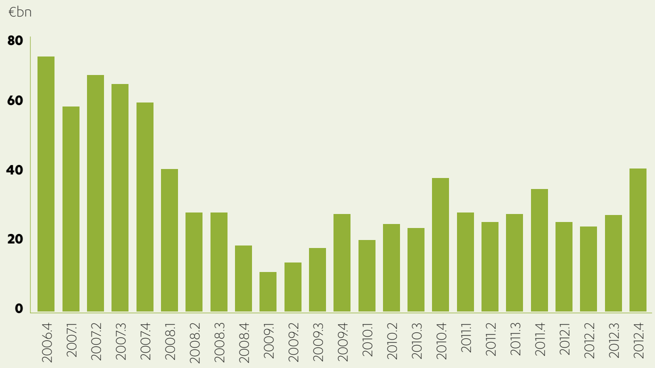


CBRE EU-15 Rent Index – Annual Change



Source CBRE

European Investment Turnover



Source CBRE

Real Estate Markets

Total Eurozone investment volumes were €41.5bn over the fourth quarter of 2012, an increase of 48% on Q3 2012 and by 16% on Q4 2011 according to CBRE. The total number of completed European transactions was €120.4bn for 2012 matching those for 2011. A number of large transactions in Germany and Norway mean that activity in both regions was at their highest level since 2007. The purchase of over €1bn of "opportunistic" assets, in eastern Germany by US firm Lone Star, in particular, suggests that investor interest may have now begun to return to the secondary market albeit in selective areas. The increase in Western Europe has offset the slowdown reported in Central Eastern Europe (CEE). For Poland, Q4 2012 was the most active quarter since 2006 however this did not compensate for the other markets in CEE. Although, activity in Southern Europe has reduced during 2012, there was some activity in Spain in the final quarter of 2012; this was estimated as €922m of completed transactions according to CBRE.

Investors are still cautious to move up the risk curve. However, the continued release of assets by the banks should see more stock becoming available and clearer pricing, allowing some investors to go beyond prime. DTZ have stated that there are now 45 European markets identified as under-priced and only 19 overpriced. The UK and Germany remain the "safe havens" together with other selected European markets in the CEE and the Nordic region.

Prime European rents are showing a sign of resilience even in an uncertain economic environment. According to CBRE, overall European retail sales growth in the Euro area was almost flat over the past 6 months; this is a continuation of the trend started 18 months ago. However, prime retail rents for the EU-15 showed an increase of 2.1% over Q4 2012. This was more prevalent in prime locations and dominant shopping centres. Although overall Eurozone industrial production has been on a general downward trend since the start of 2012, prime industrial rents increased over Q4 2012 by 0.3%. The European office occupier demand remains constrained as occupiers remain cautious whilst the economic outlook is uncertain. Prime office rents, therefore, witnessed a slight decrease of -0.3% over the final quarter of 2012. Quarterly office take-up levels are generally below 10-year averages with the exception of Warsaw and core German markets, such as Munich and Dusseldorf. In general, occupier demand across Europe remains in prime core markets and Southern Europe continues to record rental declines as expected. Despite cautious occupier markets, the overall European office vacancy rate continues to decline, albeit slowly. It has dropped by 10 basis points over Q4 2012 to 9.6% and by 30 basis points over the year, mainly falling in Frankfurt and Stockholm, staying static in London and Paris and increasing in Madrid according to JLL.

Fund Activity

The EPF Fund continues to invest into a portfolio of 12 funds with exposure to 20 countries and 371 commercial assets. 77% of the portfolio is invested in the Eurozone, of which 46% is within France and Germany. The EPF Team is also working with managers on asset management initiatives in order to secure income and to take advantage of attractive investments coming on to the market.

The void level in the Fund stands at 8.84% as at Q4 2012, remaining under the European average of 9.6% according to JLL. Despite the current fragile European occupier market, various successful asset management strategies have been completed across the underlying portfolios.

The AXA European Added Value Fund continues to be very active in respect of sales within the Fund and also with asset management initiatives. A few examples are as follows. With regards to the Fund's Ben asset in Germany, at the Ortrand retail asset, a 5 year extension has been agreed with the tenant taking the lease to December 2019. This asset has now been re-introduced to the market for sale. The Fund manager has also managed to agree a lease renewal at the Benevento shopping centre in Italy. The 7 year lease is with Piazza Italia, the third largest tenant in the Centre for a stabilised rent of €210k which is 16% above ERV. A further negotiation is currently underway with a Hypermarket tenant for a lease re-gear to increase the overall weighted average lease term which will improve the liquidity of the asset in the current market environment; this is currently extremely limited for properties in Southern Italy.

The Goodman GELF Fund has achieved practical completion on an acquisition at Erfurt I, Germany which is leased to Zalando on a 7 year fixed term. The Fund Manager has also managed to complete leasing events totalling 350,784 sqm in Q4 2012, which is 11.0% of the total Fund GLA, representing €16.2 million of annual rent. The leasing activity together with the new transactions helped to maintain the overall Fund weighted average lease expiry of 5 years.

The EPF fund management team have also continued to work closely with the underlying managers with a particular focus on the active funds. Underlying gearing has remained on target and was 46.28% in the 3 months to December 2012 as funds continue to restructure loans and some valuations continue to slowly increase or stabilise for prime located assets.

Quality of assets and income continue to be key for value and to provide defence against the continued uncertainty in the European markets. Although the regions with solid economic fundamentals will remain the most attractive, investors are turning towards good secondary assets in these core locations rather than investing in the peripheral regions.

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Unitholder Information

Launch date

31st March 2006.

Valuation Day

Last business day of March, June, September and December.

Prospectus

Copies of the Prospectus and Application Form are available from Lothbury Investment Management Limited.

Subscriptions

Quarterly. Applications required by the last business day of March, June, September and December. Payment must be received no later than four business days after the dealing day.

Minimum Subscription

Minimum investment is €250,000.

Redemption

Quarterly. Notice to be served four months prior to the last business day in the quarter.

Secondary Market Trading

No stamp duty is payable on the purchase of existing units.

Distributions

Quarterly. Paid gross of tax on the last business day of April, July, October and January.

Charges

Investment Management and Trustee fee of 0.55% per annum.

Contact

The European Property Fund is managed by Lothbury Investment Management Limited. For any further information on this Factsheet or investment in the Fund, please contact:

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