

Aviva Irl European Commercial Property Fund

Monthly report

31 January 2011



The Aviva Irl European Commercial Property Fund (“the Fund”) targets income and long-term capital appreciation through property investment in the European Economic Area (excluding the UK) and Switzerland

Please note that with the exception of the performance section, the information contained in this report is based on the underlying Aviva Investors European Property Fund in which the Aviva Irl European Commercial Property Fund entirely invests.

Fund summary

- Total assets under management as at 31 January were £249.5million, which includes fourteen properties invested across nine countries¹. The net initial yield on the underlying properties in the Fund is currently 7.1%.
- On 21 January 2011, the two European assets of the Aviva Investors International Property Fund (“AIIPF”) merged into the Aviva Investors European Property Fund. The assets are both warehouse properties, and are located in Poland and the Czech Republic. The merger of the assets follows Aviva Investors management take-on of the International Property Fund from Henderson Global Investors on 2 August 2010. The merger took place following regulatory and AIIPF investor approval.

European market

- After a particularly strong second quarter, economic growth in the Eurozone decelerated in the third quarter to 0.4%. While fourth quarter data is not available yet, the Aviva Investors house view is that the Eurozone economy grew by 1.7% in 2010, but with a large disparity in economic performance between northern and southern member states. For example, we believe that Germany probably grew by more than three percent in 2010 while some weaker economies may have struggled to achieve any positive growth at all.
- Large regional variations are also apparent in the labour market. Eurozone unemployment changed very little over 2010 ending the year at 10.0%, but this masks divergent trends at the national level. Last year unemployment fell in Sweden from 8.9% to 7.8% and in Germany from 7.4% to 6.6% whereas in Greece unemployment increased from 9.7% to 12.9% and in Spain it is up from 19.1% to 20.2%².
- Looking forward, as the Eurozone struggles with poor credit conditions and lower government expenditure, we expect economic growth to be fairly muted. In 2011 we expect a sub-trend rate of 1.5% but with the divergence in performance among the region likely to continue.
- In the real estate sector, occupier markets remain weak and although prime rental markets have generally displayed significant resilience through the downturn, vacancy rates are still edging out. However, an increasing proportion of markets are achieving rental growth and we believe further declines are only likely in Europe’s weakest markets. Overall, headline rental adjustment during the cycle has been less than we had expected in the prime sector. In part, this is likely to reflect the generous packages landlords have been willing to offer tenants, although, the length of rent-free periods appears to have now stabilised.
- In the investment market, real estate pricing continued to recover in the fourth quarter of the year. Over 2010, the CBRE European market yield index (including the UK) declined by 35 basis points, with the markets that saw the largest inward yield movement including Amsterdam, Stockholm and Paris. German yields, which have been characteristically stable over the cycle, compressed by far less and there were relatively small inward movements in Italian, Spanish and Irish markets. Paris, and to a lesser extent France overall, remain amongst the markets attracting most investor interest. Similarly, Germany is also a market attracting increased interest as investors respond to its improved economic performance and relatively defensive real estate characteristics.
- There are signs of recovery in investment volumes too. According to CBRE, in Q4 circa €24.3bn transacted in the European (ex UK) market, the highest quarterly total since Q3 2008 and 70% up on Q3 2010.
- With bond yields remaining low and the chances of an extended period of low returns on cash and low-risk assets increasing, we expect yields for prime real estate assets to also remain low over the coming period. However, for prime assets, given the extent of inward yield movement in 2010, we expect that further inward movement is likely to be modest. For the five-year period 2011-2015, Aviva Investors is currently forecasting All Property Europe (ex-UK) total returns of 7.0% p.a.³.

¹ Total assets under management are defined as gross asset value

² Source Factset as at 31 January 2011

³ Source: Aviva Investors forecasts as at February 2011

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- With divergent conditions across the Eurozone we maintain a preference for the core markets of Germany, France, and the Nordics. However downside risks remain apparent. For example, there is a danger of an economic relapse if fiscal stimulus measures are removed, perhaps prematurely, and in an uncoordinated way, leading to a deficiency of demand. Similarly there is a risk that inflation will increase more than expected, perhaps due to an increase in commodity prices, which could mean interest rates increase quickly and therefore reduce the attractiveness of real estate on a relative price basis.
- There are, however, also upside risks to our forecasts. These include an economic outlook which is better than we are currently envisioning, or an excess of global liquidity flowing into European commercial real estate markets causing competitive bidding on prime assets.

Fund strategy

- As mentioned overleaf, on 21 January 2011 the two European assets of the Aviva Investors International Property Fund ("AIIPF") merged into the Fund. The two assets are warehouse properties and are located in Poland and the Czech Republic. Both properties are fully leased to well-regarded industrial occupiers with long income duration, increasing the weighted-average lease length of the Fund portfolio which now stands at 4.4 years.
- Since the middle of 2010, positive net inflows have returned to the Fund. In line with the inflows, the Fund's cash position has also increased. The cash position for the Fund currently stands at 19%, a decrease from the position at the end of 2010, as a result of exchanging on a retail investment acquisition in Germany. Completion of this transaction is due at the end of February and the purchase price is classified as part of "restricted cash". We are also in due diligence on a second similar transaction.

Current investment profile (as at 31 January 2011)

Geographical distribution



Sector distribution



Asset distribution



■ Germany 26%
 ■ Netherlands 12%
 ■ Sweden 1%
 ■ Luxembourg 8%
 ■ Poland 7%
 ■ France 8%
 ■ Spain 6%
 ■ Finland 12%
 ■ Czech Republic 10%

■ Retail warehouse 1%
 ■ Office 44%
 ■ Industrial 45%

■ Direct properties 63%
 ■ Cash - restricted 14%
 ■ Cash - unrestricted 19%
 ■ Other net receivables 4%

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Fund performance (at 31 January 2011)

Over the three months to the end of January 2011, the valuations of the direct property in the Fund have increased by 0.7%. This increase has largely been led by inward yield movements in the core markets, alongside leasing activity and rental indexation. The focus for the Fund during 2011 is on driving rental income via asset management initiatives.

Share class	1 month %	3 months %	YTD %	1 year %
Aviva Irl European Commercial Property Fund (Gross)	4.44	1.45	4.44	2.04
Aviva Irl European Commercial Property Fund (Pension)	4.46	1.52	4.46	2.30
Aviva Irl European Commercial Property Fund (Geared)	8.58	10.19	8.58	2.77

Source: Lipper Hindsight. Performance figures are net of fees, net income reinvested at dividend pay date. Past performance is not a guide to the future.

Important Information

The content of this document has been produced by Aviva Investors Global Services Limited, the investment manager appointed by Aviva Life & Pensions Ireland Limited to manage the fund.

Except where stated as otherwise, the source of all information is Aviva Investors Global Services Limited (Aviva Investors) as at 31 January 2011.

Unless stated otherwise any opinions expressed are those of Aviva Investors, the investment adviser to the scheme. They should not be viewed as indicating any guarantee of return from an investment managed by Aviva Investors nor as advice of any nature.

Past performance is not a guide to the future. The value of an investment in the Fund and any income from it may go down as well as up, and the investor may not get back the original amount invested. The fund may be affected by changes in currency exchange rates.

Where funds are invested in property, investors may not be able to switch or cash in their investment when they want because property in the Fund may not always be readily saleable. If this is the case we may defer or suspend investors' requests to switch or cash in their shares. Investors should also bear in mind that the valuation of property is generally a matter of valuers' opinion rather than fact.

Full written terms and conditions are available on request.

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