

Aviva Irl Irish Property Fund

Monthly report

31 January 2011



Introduction to Irish property

Property assets are regarded as an effective hedge against inflation, and participate in the general growth and levels of activity within the economy. Returns are therefore influenced by the economic cycle. Property offers a relatively stable income yield from rents and also offers the potential for capital growth as values rise. Irish Commercial property benefited from the phenomenal growth during Ireland's economic boom and conversely more recently, declined in line with the overall economy. This document outlines our views on the current position of the property market and its outlook.

Long-term performance from Irish property

Despite the very poor performance of the Irish real estate sector over the last three years, the IPD Ireland Index suggests all property total returns have averaged an annualised 10.0% over the 26 year history of the index. In our opinion such a level of return more than sufficiently compensates investors for the liquidity risk that investing in real estate necessarily involves. Income returns have also displayed remarkable consistency over the 26 year history of the index, not falling below 4.4%¹ per annum at any point.

The IPD Ireland Quarterly Index recorded total returns of 0.4% for the first quarter of 2010, the first time positive numbers had been recorded since 2007. Unfortunately returns for the second, third and fourth quarters slipped to being marginally negative, resulting in all property returns over the year of -2.4%², which whilst still negative, is much improved on the -19.2% overall return recorded in 2009. Returns for Irish "All Property" for Q4 were -1.1%, comprising an income return of 2.3% and capital growth of -3.3%.

The Jones Lang LaSalle Overall Returns Index³, recorded a decline of -1.6% in the Irish market over 2010, and a -0.7% fall over Q4. Capital values in their index fell by 3.0% over Q4 and 10.5% over 2010. The rate of decline in capital values has improved through 2010, with the lowest quarterly capital value decline recorded by the index in Q4 2010 since Q4 2007.

Confidence in the fund

We believe investors in the Aviva Irl Irish Property Fund are in a relatively beneficial position for a number of reasons:

- The list of 17 buildings below shows that the locations of all properties held in the Fund are of very high calibre. For example, our retail holdings are all in prime main street locations that receive some of the highest consumer footfall in Ireland e.g. Grafton Street and Henry Street in Dublin and Patrick Street, Cork.
- The tenant base of the Fund is also strong and there are no speculative developments or properties under construction.
- Six office buildings comprise approximately 56% of the Fund's value. They are all located in Dublin city centre.
- Eight retail properties comprise approximately 37% of the fund's value. The properties are positioned in prime retail locations and are occupied by a diverse range of consumer goods retailers.
- Three industrial/warehouse buildings comprise approximately 7% of the Fund's value. They are the highest yielding sector within the Fund with an average income yield in double digits.

Fund performance

Over 2010 the portfolio of the direct property has fallen in value by approximately 5.7% which is a significant improvement on the previous year when between January 2009 and December 2009, the portfolio fell in value by approximately 27%. The net initial yield on the Fund was 8.08% as at 31 January 2011, which is a reduction from the previous month due to a tenant vacating one of the warehouse buildings.

Performance to 31 Jan 2011	1 month %	YTD %	1 year %	3 years p.a. %	5 years p.a. %
Aviva Irl Irish Property Fund (Gross)	0.8	0.8	2.5	-24.3	-13.8
Aviva Irl Irish Property Fund (Pension)	0.8	0.8	2.8	-24.1	-13.6
Aviva Irl Irish Property Fund (Gearing)	0.8	0.8	2.5	-51.6	-34.3

Source: Lipper Hindsight, bid to bid, net income reinvested.

Irish property market outlook

Investment turnover for 2010 was €270 million according to JLL⁴, which is approximately 54% higher than 2009. There remain a large number of overseas investors expressing interest in the Irish market, although the focus remains on prime retail and office stock. Prime yields are well below 25 year averages with offices at 7.00%-7.75%, high street retail at 6.00%-6.75% and industrial at 8.50%-9.00%, with CBRE⁵ reporting that prime yields have improved over 2010 by 0.25% in the retail and office sectors due to the large volume of capital chasing a small number of transactions.

The recovery of the investment market is directly linked to the performance of the occupier markets and the Irish office, retail and industrial occupier markets are recovering at different speeds. In the office market Q4 proved to be the most productive quarter in 2010 with take-up reaching 38,747 sq m4 - this is half of the total take-up in 2009. In the retail market both Grafton Street and Henry Street have seen new letting activity and there are a large number of tenants seeking to expand or enter the market for the first time - it is likely therefore that we are now at the bottom of the occupier market cycle for high street retail property, although the effect of the Budget and the Finance Bill on consumer spend and disposable income is likely only to filter through into the market following Q1. The industrial market also showed improvement in Q4, although lease terms remain very much in favour of tenants as short term flexible leases, significant rent free periods and low rental levels are being seen.

In Ireland, for prime property we believe that most of the necessary rental adjustment is behind us and although the income outlook is weak, we believe it is improving. For the secondary market, however, we still expect significant and prolonged weakness.

1. IPD as at January 2010

2. SCS/IPD Ireland Quarterly Property Index – 31 December 2010

3. JLL's index is based on a sample of 32 properties with a gross capital of approximately €280 million.

4. Jones Lang LaSalle Quarterly Research Report – Quarter 4 2010

5. CBRE Rent & Yield Analysis – Quarter 4 2010

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Property fund manager outlook

The investment market outlook for Irish commercial real estate is now greatly improved compared to a year ago.

Very significant price adjustment has taken place meaning that at current yields there is plenty of scope for arbitrage between real estate prices and the cost of debt. Prime yields for example are still 350 bps higher than their 2007 peak according to Aviva Investors' Q4 2010 European Real Estate Market Report.

Through the National Asset Management Agency (NAMA), the Irish government is expected to remove impaired real estate debts from Irish banks' balance sheets by purchasing impaired loans at a discount in return for government bonds. This will reduce the risk of fire sales adding to market distress. There was a common consensus at the beginning of 2010 that there would be a re-emergence of liquidity and supply as it was believed that debt related pressures would lead to more forced

sales through NAMA, but this did not materialise. However, both NAMA and Bank related transactional activity has already started in 2011 and a significant improvement in liquidity is expected from these sources.

Current pricing generally appears to offer long-term investors an attractive entry point to the Irish commercial real estate market. However, a successful investment strategy will be dependent on an acute awareness of the risks and challenges involved and any significant improvement in conditions in Ireland is likely to have to wait until there is greater visibility over the country's economic future.

Fund information

Pricing basis: The Aviva Irl Irish Property Fund is currently priced on a disposal basis.

Fund Holdings

The Aviva Irl Irish Property Fund holds 17 properties. The table below gives a full list of the holdings in the Fund (in descending order of value as at 31 January 2011).

Property address	Sector	Tenant
AIB Bankcentre, Dublin 4	Office	Allied Irish Bank
Creation House, Grafton St., Dublin 2	Retail	A-Wear
66, Grafton Street, Dublin 2	Retail	HMV
Riverside 1, Sr. John Rogerson's Quay, Dublin 2	Office	McCann Fitzgerald
Retail Park East, Liffey Valley, Co, Dublin	Retail	B&Q
43-44 Patrick St., Cork	Retail	Wallis
Plantation House, Herbert St, Dublin 2	Office	Windmill Lane Ltd
Ormonde House, Earlsfort Terrace, Dublin 2	Office	DTZ Sherry Fitzgerald
44 Henry Street, Dublin 1	Retail	Carroll's Gifts
45-47, Nassau Street, Dublin 2	Retail	Porterhouse Group
Bray Business Park, Co. Dublin	Industrial	Trinity Biotech
5, Henry Street, Dublin 1	Retail	Hickey & Co.
Longphort House, Earlsfort Centre, Dublin 2	Office	Allergan, Standards in Public Office Commission (multi-let)
Block 7, Clanwilliam Court, Dublin 2	Office	ESB
Kilcarberry Distribution Park	Industrial	TDG plc
Unit D, Greenhills Road, Dublin 12	Industrial	IDA
37, Grafton Street, Dublin 2	Retail	Under Offer

Source: Aviva Investors

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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