

European Property Fund

Q1/10 Update

Julian Taylor

Presenter: The Fund Manager of the European Property Fund is Julian Taylor. Julian, you've recently reopened your Fund, what would you say to an investor who instead of thinking about putting money into the Fund is considering taking money out?

Julian Taylor: Well over the last 24 months we've seen significant decreases in valuations across most of continental Europe. We strongly believe that those have plateaued out now, and going forwards we do expect property to return to a growth story. In terms of property itself, most are now yielding levels significantly higher than they did 12-24 months ago as a result of those valuation falls but rental income's staying broadly the same. So for example, the European Property Fund is now at the property level showing a running yield of around 8%, which is obviously attractive in comparison to a lot of other asset classes.

Presenter: Do you as a fund manager regret having to close the Fund?

Julian Taylor: Well we really didn't have any option. At the end of 2007 we started to see valuations fall away. That accelerated during 2008, obviously the Lehman bankruptcy in Q3 didn't help and in the three or four months running up to the date when we closed, which was 4th November, we saw a number of large investors take money out for asset allocation reasons which put our liquidity levels under pressure, and therefore we had no option but to close the Fund unfortunately. And in order to restore it we had to go through a period selling a number of the assets.

Presenter: At one point your cash position was up to the 45% mark, that's changed, what's its position now?

Julian Taylor: Well at the moment it's about 20%. The 45% was just before the Fund reopened when we sold one of the Fund's larger assets, and 20% is roughly where we'd look to keep it over the short to medium term.

Presenter: So why 20% cash?

Julian Taylor: When we launched the Fund our target was broadly 15% in liquid products, so that would generally be a mixture of cash and property securities. There was obviously an issue around retail funds in the run up to the period when we actually suspended over liquidity, and so we've deliberately kept cash levels higher than we perhaps normally would have done. Now the Fund has reopened we're at that level again, we're round about 20%, and we feel very comfortable that we have that.

Presenter: You invest with some of that cash into property shares?

Julian Taylor: We have done in the past. It was quite a small amount. There was a lot of volatility in that market in 2007 and so the exposure didn't get up to a particularly high level, and then when we were looking to release some of that liquidity we sold those equities.

Presenter: Did you get in terms of price what you expected to get for the largest property in your portfolio?

Julian Taylor: Yes we did. The Fund is monthly valued so we were tracking quite carefully where valuations were going. In all four cases we got at or slightly above where they were then currently valued, and in terms of the Swedish asset, that was the largest property in the Fund, it was important for us to sell us in terms to getting the Fund reopened. We completed the sale at the end of November last year and then we were able to open the Fund with effect from 11th December.

Presenter: So what's the current shape of the portfolio?

Julian Taylor: Well at the moment we've got nine assets which is spread across seven countries. Roughly half the property portfolio is invested in offices, and round about 13-14% is in the retail sector, which is actually one retail warehouse park in Sweden. The intention over the short to medium term as and when we start investing again would be to increase that, probably at the expense of offices and the warehouses.

Presenter: So your outlook presumably is that retail is the place to be as we come out of recession.

Julian Taylor: Well we certainly feel the weighting towards retail within the portfolio at the moment is lower than where we'd want it to be. Retail generally tends to have good defensive, is a good defensive strategy for real estate but 13-14% is lower than we'd like it.

Presenter: What about geographically?

Julian Taylor: Geographically we are spread across seven countries, from Finland in the north to Spain in the south. There's a stronger focus on the more core markets, such as France, Germany, the Netherlands. We have one office building Spain which is a market which has suffered considerably. We expect those core markets to bounce back more quickly than some of the others, and so going forwards again there'll be a stronger focus towards those markets.

Presenter: How actively are you looking for new properties? Aren't you just consolidating at the moment?

Julian Taylor: Well what we're really doing at the moment, or what we have been doing for the past 12 months is sort of monitoring where the market has been going. Obviously in order to start buying again we need money coming into the Fund and while the Fund

was suspended that obviously wasn't happening. Since the Fund reopened, as I said, on 11th December we're seeing money coming in, we're still seeing some money going out, broadly in line with what we expected. But as the argument for property improves, and we think it has done considerably, we expect money to come in and we would look to start to invest that.

Presenter: What indicators do you look at in order to support your argument?

Julian Taylor: Well we obviously track on a regular basis what's been happening in the individual markets, both in terms of general investment activity as well as the occupier markets. We have a strong research and strategy team who work with us in identifying markets which we think will obviously deliver growth going forwards.

Presenter: Whenever I speak to a property fund manager it seems that tenants really do have the upper hand at the moment, what's your view and how are you combating that?

Julian Taylor: Yes they certainly have. I mean it's clearly been a tenants' market across all the sectors, wherever you've got vacancy rates increasing, which has been the case across all sectors, you start to see rents decrease and clearly tenants are in a stronger position. In terms of being a fund manager is a question of managing that. Clearly if you've got tenants who have a specific strategy so maybe they've released people so their occupational requirements are not as high, they'll probably go and look to move to new space no matter really what you offer them. But it's a question of working with tenants and basically having a good relationship with them, and so when there are issues like that which come up you can work through them, which we've done on a few cases within the portfolio.

Presenter: And you're happy about the strength of covenants of your tenants in your properties?

Julian Taylor: Yes, I mean we haven't really had any major issues over the past couple of years. We've got a couple of tenants in the retail sector who we have worked with in terms of sort of the way they pay the rent for example. On a couple of other tenants we've had discussions in terms of reducing their rent in return for extending the lease for example, so that effectively preserves the valuation, which is important for us, but on the other hand it reduces the occupational cost to the tenant which keeps them happy.

Presenter: Yes. So there are ways round it, as it were?

Julian Taylor: Yes, absolutely.

Presenter: Okay, tell me about interest rates across Europe that affect your particular world, what's your outlook and how do they affect you?

Julian Taylor: Well there's probably two parts to it. Firstly, the European Property Fund is ungeared so as a cost it's not something we have to bare, so our rental income will effectively stay the same despite interest rates rising. The other issue is clearly interest

rates as an asset class, or cash as an asset class which is obviously seen as an alternative to property, clearly there's a spread in terms of returns. At the moment there's a pretty healthy spread, as I said, the European Property Fund is yielding nearly 8% at the moment at the property level. And cash is obviously significantly lower than that so in terms of an asset allocation decision there's a pretty good story for real estate. Obviously if interest rates increase that story to a certain extent is reduced.

Presenter: We heard today in a survey that in the UK for the first time for some time, there are more buyers than sellers in commercial property. Is that the general outlook across Europe?

Julian Taylor: Yes, I think that is true. Certainly investment activity over the past 24 months has been significantly lower than it was in say 2007, which was when the market peaked. For 2009 we understand there was roughly €70bn of investment transactions across Europe, and we're certainly seeing investment activity, particularly in the core markets like Paris offices for example, an increase in buyers and as a result of that we've actually started to see yields appreciate for the first time.

Presenter: So what's your outlook on European property for the rest of 2010?

Julian Taylor: The outlook has certainly improved over the last few months, largely as a result of seeing valuations plateau really. There's still an issue around rental values which we still feel have got a bit further to fall. Investment activity over the second half of last year has certainly picked up, and we've even seen situations now in Paris, for example, in the office sector, we're starting to see yields appreciate which is the first time really for a couple of years. So it's sort of been following on what's been happening in the UK market but with a bit of a time lag.

Presenter: So what ought to be an investor's expectation from a fund such as this?

Julian Taylor: Well the first thing we offer is really diversification from other asset classes. It's particularly attractive to say a UK investor who is strongly focused on that market and is looking to diversify away. In terms of returns, the story going forwards is certainly significantly better than it has been for quite a long period of time.

Presenter: Julian Taylor, thank you very much indeed.

Julian Taylor: Thank you.

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The value of an investment and any income from it can go down as well as up and is not guaranteed.

The Fund invests in a relatively small number of properties and carries more risk than a fund spread across a large number.

When funds invest in overseas stock markets, the value will go up or down in line with movements in exchange rates as well as the changes in value of the Fund's holdings.

Investors may not be able to cash in their investments when they want because property can't be easily converted to cash. If this is the case, we may have to suspend dealing meaning we cannot carry out requests to cash in shares.

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