

Viewpoint

F&C REIT - Strong Performance and New Initiatives

In our last issue of Viewpoint, we noted that 2009 had been a year of outstanding performance for F&C REIT in its first full year as a merged company. We are therefore very proud that F&C REIT has recently won two awards for mandates that it runs:

European winner for the highest UK total return annualised over 3 years to December 2009.



Friends Provident Life and Pensions Limited
– Fund Manager – Richard Kirby.



UK winner for the Balanced Pooled & Traditional Funds between £100m - £500m. Highest 3 year annualised return to December 2009.



IRP Property Holdings Limited
– Fund Manager – Ian McBryde.



Both of these awards are based purely on performance over a three year period and reinforce F&C REIT's superior asset management credentials.

Latest data from IPD show that a hypothetical "house" fund of all F&C REIT IPD monitored funds would be placed on the 10th percentile over the year to March 2010.

We continue to develop our business and in this issue we focus on two new funds:

- F&C UK Property Fund, an open-ended fund launched on 28th June 2010.

- FOSCA II which has just completed its first closing raising c. €100m.

Our German business is going from strength to strength and this issue looks at how this part of F&C REIT has developed as it approaches its tenth anniversary.

UK Activity

We believe that the UK property market still offers the opportunity to buy stock on attractive terms taking advantage of mispricing and the scope to add value through active management. F&C REIT

ended the second quarter of 2010 by completing on £88.35 million in transactions.

- On the acquisitions side, Bank House, Birmingham was purchased by F&C REIT on behalf of clients for £20.5 million which represents a net initial yield of 8.15%. The multi-let office is centrally located within the prime retail and core office areas and consists of 78,500 sq ft of office space over 18 floors. F&C REIT has also purchased on behalf of clients, a new distribution warehouse development at Revolution Park, Chorley for £24.6 million at a 9.15% net initial yield. The scheme totals almost 370,000 sq ft and is located close to both the M61 and the M6. Upon completion, it will be let to Kimberly Clark Limited on a new 11 year lease, subject to a rent free period of 12 months with fixed 2% annual uplifts.
- Two sales in London have recently completed. A mixed use building in Kensington High St was sold for £28 million representing a net initial yield of 6.12%. Waitrose and Magnet Ltd lease the ground floor retail element with the upper floor offices let to GMW Architects and a rear block of 41 residential apartments let on 999 year long leaseholds. Additionally, 11 Stanhope Gate in Mayfair was sold on behalf of Friends Provident for £15.25 million representing a net initial yield of 3.8%. The 10,670 sq ft office building is fully let with rents totalling £618,300 pa.



F&C REIT[®]
Asset Management

Passionate about adding value



F&C REIT to manage UK Open-Ended Fund

F&C REIT is set to manage a new open-ended UK property fund. The Fund has been launched through a four week offer period commencing 28 June 2010 and is expected to appeal to institutional investors, private client discretionary asset managers and investment IFAs. The Fund has approval from the Financial Services Authority (FSA).

The F&C UK Property Fund is structured as a Non-UCITS Retail Scheme (NURS), aiming to provide a total return based on income and capital appreciation through investment in UK commercial property. The Fund will have daily pricing and liquidity with the underlying property investments valued on a monthly basis.

Both F&C and F&C REIT believe that the UK property market is now well placed to deliver performance in a post recessionary environment. Prices for commercial property have adjusted to more affordable levels, with limited downside risk and the income return from property is highly attractive when compared with cash and other asset classes.

The Fund's property portfolio will be co-managed by Julian Smith and Guy Glover of F&C REIT, who have 29 years and 20 years experience respectively in property investment management. The managers aim to construct a balanced portfolio for the Fund which will be diversified in terms of geographical positioning and sector weightings. Market risk will be managed through diversification at sector, geographic, property and tenant levels and the Fund will maintain a cash balance to manage liquidity.

Unlike some previous open-ended property funds launched with a seed portfolio of legacy assets, the F&C UK Property Fund will build a 'clean' portfolio of new assets specifically identified for the Fund. This eliminates the possibility of these "old" or "legacy" assets acting as a potential drag on performance.

Properties will therefore be incrementally added to the Fund following the launch, with Julian Smith and Guy Glover focused on selecting core quality assets which they believe offer both a secure income stream and asset management opportunities. Performance will be driven by detailed research, asset allocation, stock selection and the active management of property assets.

The Fund is targeting the following types of property:

High Street retail – quality pitches within major towns and attractive market towns

Retail Warehouses – unrestricted planning use, limited local competition, affordable rents

Industrial – multi-let industrial sites with diverse occupiers

Distribution – established locations close to major transport routes

Regional Offices – strong regional cities or towns with a Diversified occupier base

Central London offices – established office districts

Alternative property classes – hotels, car dealerships, doctor's surgeries

Once acquired, these assets will be intensively managed by F&C REIT's 16 strong sector focused asset management team. This team has an enviable track record with IPD data showing that a hypothetical house fund which aggregated all IPD monitored F&C REIT managed funds has delivered top quintile performance over 1, 3 and 5 years.

Key details	
Fund Type	Non-UCITS Retail Scheme (NURS)
IMA Sector	Property
Benchmark	IPD UK PPFI All Balanced Funds
Launch Date	28 June 2010
Accounting Dates	April, October
Dealing	Daily
Valuation point	12 noon
Settlement	T+4
Distribution Policy	Six monthly
Property Valuation Frequency	Monthly
Share Classes	SC1 Inc and Acc SC2 acc
Initial Charge	SC1 5%, SC2 1%
Annual management charge	SC1 1.5%, SC2 0.75%
Minimum Investment	SC1 £1,000 or £50pm, SC2 £500,000
Sedol Codes	B611821 B620FM6 B6449M4
ISIN Codes	GB00B6118210 GB00B620FM64 GB00B6449M48
UK Distributor Status	Yes



Property – Focusing on income

Investors have traditionally favoured property for its relatively high and stable income return. Despite the volatility seen in prices over the past three years, this characteristic of property has persisted as shown in Chart 1. The income return on commercial property in the UK is now more than 7% per annum which is very attractive in comparison with rates available in other asset classes.

So, what is driving income returns? How is the market changing? What skills will be needed to drive performance in coming years?

In the past, property investment was a relatively straight-forward business. Funds bought a prime property let to a strong covenant, on a long lease with upward only rent reviews and if it did go wrong they were able to pursue the previous tenant. The focus for driving income was to boost rental growth and a sustained period of GDP growth and inflation could help here too. In the 1980's, the all property income return averaged 5.9% pa with rents rising by 9.3% pa.

The analysis above is an over-simplification but serves to illustrate the point that property asset management has subsequently become more complex.

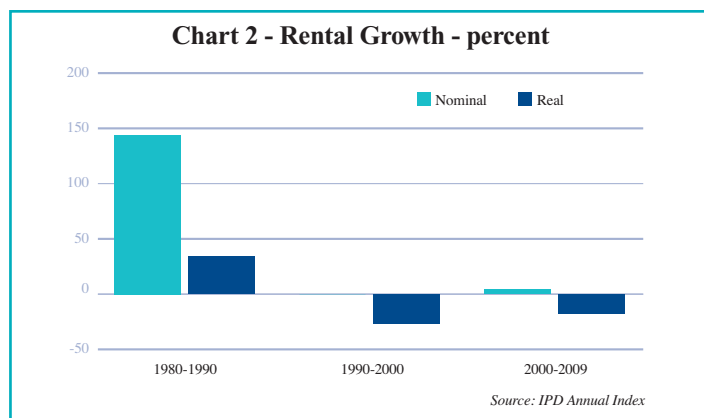
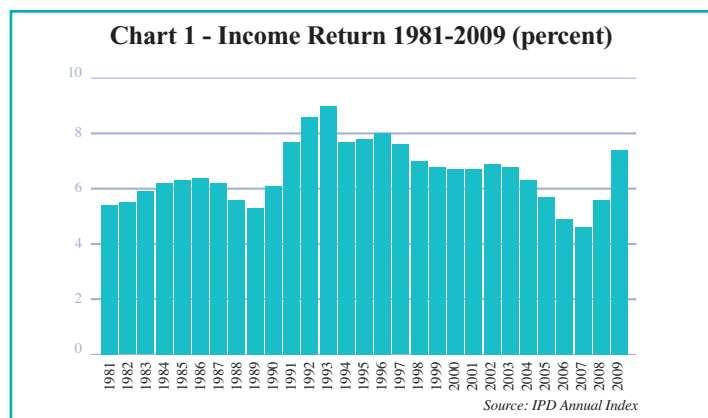
The key to this is the change in rental growth patterns. Over the past 20 years, all property rental values have moved up by just over 4% compared with c 150% in 1980-90. In part, this reflects the

decline in inflation seen over the period but even stripping out price changes, rental growth has diminished in importance as a driver of income, as seen in Chart 2. The past nine years were marginally better than the 1990's but it would take a seismic shift to move rental growth back to centre stage.

F&C REIT believes that although some areas and properties will see rental uplifts – this more muted tone of rental growth is unlikely to change. Inflation is currently above target and consensus projections are for the CPI to average around 2.5% pa over the next ten years which provides only minimal scope to lift rents at the nominal level. This is especially true within the context of the limited growth predicted for the economy. The UK saw the steepest recession in sixty years in 2009 and growth remains fragile. On consensus forecasts, it would take until late 2012 to make up the ground lost in 2009 – never mind to see growth at a pace that drives economic expansion, occupier demand and generates rental growth – and fiscal policy is set to tighten. Rental growth at the aggregate

level, we believe, will not be a panacea for income driven investors – managers will need to look elsewhere.

The property industry has been mindful of the changes taking place at the macro level and in addition has hardly been able to ignore the structural changes within the asset class which has provided them with further challenges. The long leases that characterised the 1980's are becoming increasingly rare. Investment Property Databank (IPD) data indicates that only 15% of leases are for ten or more years now. Additionally, privity has been abolished, tenants are demanding rent concessions and monthly rental payments, empty rate payments are applied to vacant property after a limited void period and the upward only rent review is looking increasingly vulnerable – if not from legislation as in Ireland then from the fall-out of the company voluntary administrations (CVA's) and tougher rental negotiations by tenants at lease breaks and expiries. Fund managers are operating in a different world.





Does that invalidate property as an investible asset? We would say no – it still delivers strong income returns and it still acts as a diversifier against equities and bonds. What has changed is the skill set needed by the manager. The focus has shifted from boosting rental growth to stock selection and active asset management.

Stock selection has always been important in property but with leases becoming much shorter – it is imperative that the asset is easily re-lettable. So factors such as location and building quality and flexibility take a greater prominence. Tenant covenant remains important but rather less than before and the large single let trophy asset may have a greater potential risk than a more modest but easily re-let building with several tenants in occupation. The second strand of the stock selection process is actually being able to source and acquire the limited amount of stock that meets these demanding criteria. Strong relationships with potential vendors, agents and banks will pay dividends in the current market climate – as will a track record of completing transactions in a timely, professional and honourable manner.

The second factor is the need for active asset management. This has several elements. The big negative for property income streams during the recent downturn was the rise in void rates – as seen in

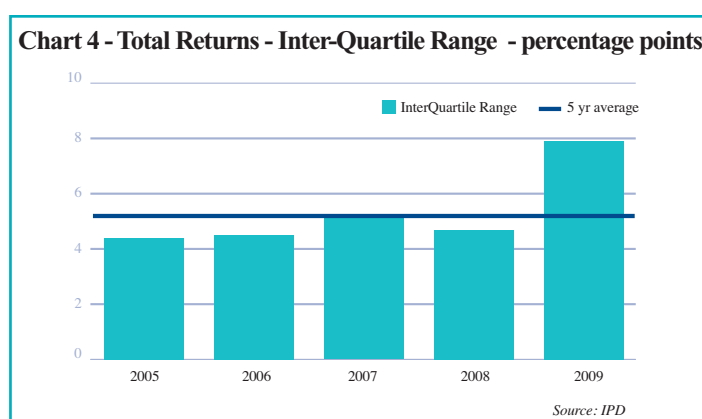
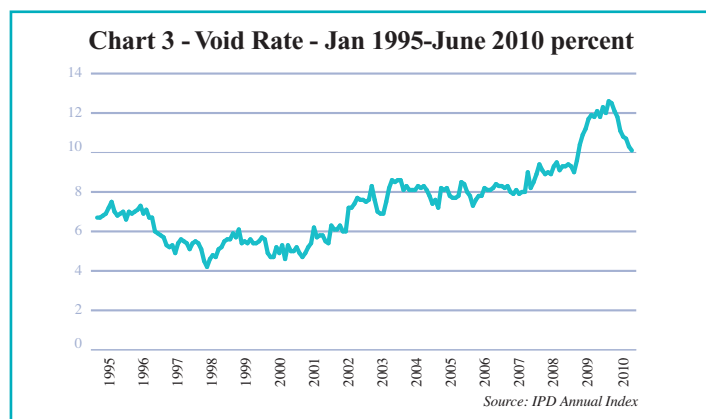
Chart 3. Voids peaked in late 2009 at more than 12% and whilst part of the rise was undoubtedly due to cyclical factors – there also appears to be a structural trend to higher void rates. One way round this was outlined above – choose prime property that is well let and easily re-lettable. Recent market performance has vindicated this approach with income on prime stock proving more resilient. The other way is to focus on mispricing – stock which may have voids but which with active management can be improved to become a better quality product, attracting tenants and provide an immediate lift to income by letting vacant space. Separating the wheat from the chaff in these less prime markets is a process involving long experience working in property – it needs a specialist; it is stock specific and is a highly skilled and scarce resource.

Active asset management involves such elements as lease re-gearing, optimising tenant mix through the reconfiguration of units and relocation of tenants where appropriate. It also involves constant re-appraisal and analysis of the portfolio. The next few years may well see depreciation become much more of an issue. The development boom was in the late 1980's and much prime quality stock was built but just how prime is it 20 years on? Do current valuations of such property always reflect the full passage of time? Active asset

management means regular evaluation and site visits with on-going maintenance and updating of stock crucial.

Finally, the more complex world of property asset management requires experienced and skilled property managers. The past year was a departure from trend with IPD data showing the variance between top and bottom quartile performance widening dramatically (Chart 4). That divergence in performance may become a feature of property funds in coming years – choosing the right manager who can secure the right assets and manage them effectively may be the key to unlocking performance.

This is an extended version of the article published in the June issue of Professional Pensions.





F&C REIT launch second French real estate fund with OFI REIM

F&C REIT and its partner OFI REIM have announced the initial closing for FOSCA II having raised almost €100m. This closed-ended investment vehicle is focused on the French real estate sector and is the successor to FOSCA which raised in excess of €200m in 2005/2006.

The subscriptions have been made by eight European institutional investors, mainly insurance companies and pension funds. Subsequent subscriptions are expected before the end of the year with the target size being €300m. Once leverage is applied to the fund, this will lead to a €600m portfolio.

Our partner, OFI REIM is a specialist real estate investment manager established in 2005, with a focus on office buildings and the Paris region. It now manages a portfolio of €650m of real estate assets. It benefits from the support of its minority shareholder the OFI Group, which has €22 bn under management. As Nick Criticos, Chief Executive Officer of F&C REIT commented “We are excited to be launching this fund which further expands F&C REIT’s product range for institutional investors. This is our second collaboration with OFI REIM which will build on the success of our first joint venture”.

The French real estate market is one of the largest and most diversified in the Eurozone and has shown signs of being among the first to move into the recovery phase with prime yields now starting to move in for offices and retail property both in Paris and regional French cities. Prime rents are also stabilising and have started to move upwards in certain locations. With investors focused on core markets with high levels of transparency, interest in the French property market is high. Transaction activity has been constrained by the credit crisis but for those with access to equity and finance,

the arguments in favour of investing in French real estate at this point in the cycle appear compelling.

The strategy of the new Fund is to build a diversified portfolio of offices and attached retail shops in France with a high level of quality. The emphasis will be to adopt a highly selective approach to acquisitions and the managers intend to create added-value by a customised tenant approach and repositioning strategies focused on increasing the consistency of the assets. The Fund is targeting a 9-11% pa total return.

The Fund will have no legacy assets and will target acquisitions with the ability to deliver stable income streams with potential capital growth with the following characteristics:

- Strong real estate fundamentals
 - Re-pricing potential: undervalued or under-rented assets
 - Refurbishment or repositioning opportunities
 - Diversified income stream from multiple tenants
- More specifically, the Fund will target
- Parisian offices: prominent, well-located, good public transportation access
 - French regional offices: modern buildings, quality specifications, high yield
 - Refurbishment and redevelopment projects or forward sale to a maximum of 25%



4 Place de L’Opera, Paris
A FOSCA property



8 Rue de Copernic, Paris
A FOSCA property

Key details

Investment Focus	Closed End Fund investing in office and retail assets in France
Fund Target Size	€300 million equity
Minimum Commitment	€10 million
Fund Structure	Luxembourg Partnership SCA
Fund Life	8 years (+ 2 years extension)
Target Return	9 –11% IRR
Target Yield	4% net after investment period
Investment Period	2 years
Leverage	50% max
Management Team Co-investment	0.25% of equity raised up to €1 million
Fees	Annual fee of 1.5% on invested equity -0.5% on undrawn equity during investment period -Performance fee: 20% above 9% IRR



Germany – The story so far...



Iris Schöberl,
Managing Director
F&C REIT, Germany

REIT Asset Management Germany opened its small 50m² Munich office on 1st January 2000. The ambitious target of Managing Director Iris Schöberl and her team was to build up an Asset Management Company combining the British idea of asset management with a German property business - at that time the profession “Asset Management” in property business did not exist in Germany.

The first investment with joint venture partner DEPFA Bank, a 20,000 m²

office building in the South of Hamburg City, was made in 2001. It was followed by an investment in an inner-city retail portfolio in small and mid-sized cities, this time with GE Capital as joint venture partner. The second deal, in particular, marked the foundation of the company's specialty of “retail in mid-sized cities”. The young enterprise was able to secure cash flow stability of such locations through excellent letting results even in difficult economic times and has used this experience as the basis for its future growth.

The company moved offices to a prime city centre location, Oberanger 34 in Munich, in October 2003.

In July 2006 the company broke the €1 billion mark of Assets under Management with a team of 14 experts.

The company was renamed as F&C REIT Asset Management GmbH & Co.KG in September 2008 when F&C Asset Management's property business and REIT Asset Management merged in 2008, becoming a 100 percent subsidiary of F&C REIT Asset Management LLP.

Meanwhile Managing Director Iris Schöberl and her team (now 26 strong) developed a sound reputation for identifying and exploiting hidden opportunities within the German real estate market. F&C REIT Germany can demonstrate a transaction record of over €2bn with a proven track

record showing an IRR exceeding 40% on closed transactions.

Since the merger F&C REIT has been working closely with F&C Investment's institutional business to launch a new product. The German team used its vast experience in the property investment field to structure a special fund for German institutional investors called Best Value Germany I. Target properties are inner-city retail in mid-sized cities. Despite difficult times in both the finance and property industries, the fund raising commenced in February 2010 and has been well received. Through the discussions with prospective investors F&C REIT Germany has also been able to procure a segregated mandate for a single investor.

With a sound foundation secured and a prosperous future in view, F&C REIT Germany's 10th anniversary will be celebrated on 22 July 2010 together with 150 guests at Hotel LaVilla at Starnberger See.

Iris and her team are very proud of their achievements in the past and are striving to secure the company's future success.



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Asset Management

Passionate about adding value