

Pengana Credo European Property Trust Investor Update - December 2008



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Executive Summary

Since our last communication with investors in early 2008, global financial markets have experienced unprecedented volatility and economic conditions have deteriorated rapidly.

Pengana Credo European Property Trust ("Trust"), like many of its peers, has been severely affected by these events. The key issues since the last update include:

- The Trustee recently terminated the foreign exchange ("FX") hedging contract in order to protect the Trust from the risk of any further collateral calls by the FX hedge provider, if the AUD fell below current levels against the EUR
- The Trust has an obligation of €3.7m to the FX hedge provider as a consequence of terminating the FX hedging contract
- Free cash flow generated from the Trust must be applied to reduce the liability to the FX hedge provider and consequently the Trustee must temporarily suspend distributions to investors
- We are also actively exploring asset disposals to accelerate the repayment of this liability and to recommence distributions
- The Trustee has received an indicative valuation from Colliers CRE at 28 November 2008, showing portfolio valuation of €88.4m, a 4% reduction from the last valuation (February 2008). The valuation is expected to be finalised at 31 December 2008.

Given the current volatility and weakness in global markets and very limited availability of debt financing, there is a risk of further reduction in value of the portfolio.

Strategic Review

The Trustee has commenced a strategic review with the aim of considering all potential avenues to preserve and maximise value for the investors.

Our first priority is to recommence paying distributions which should occur once the FX liability has been repaid. We are also focused on strengthening the Trust's balance sheet through asset sales, potential joint ventures or corporate transactions.

We are expecting to complete the strategic review in the first quarter of 2009, and will provide an investor update including the future distribution policy at that time.

Market Conditions

The unprecedented severity and extent of the dislocation in global investment markets has had a substantial impact on the state of major global economies. In particular, Germany's economy, Europe's largest, recently fell into technical recession as GDP declined 0.5% from a previous quarter, when it dropped 0.4%.

The negative economic outlook coupled with the lack of availability of credit have resulted in a substantial reduction in the volume of real estate transactions, and have affected valuations of real estate assets and REITS around the world, including Europe.

At the same time, weak sentiment on the global economy and volatility across equities and commodities markets have caused a substantial decline in the value of the Australian dollar against all major currencies, including USD, Euro and Yen.

Foreign Exchange Hedge

As a result of the significant and rapid deterioration in the value of the Australian dollar against the Euro, the value of the FX hedge contract that was entered into by the Trust to protect the investors' income and capital against fluctuations in the EUR/AUD exchange rate fell substantially, which exposed the Trust to collateral demands by the FX hedge provider, that the Trust would be unable to meet at short notice given the illiquid nature of the Trust's real estate assets.

Given the gravity of potential consequences of any breach of FX hedge terms for the ongoing stability of the Trust, and the continued negative and volatile outlook for the Australian dollar, the Trustee determined that it was in the best interests of investors to terminate the FX hedging contract on 21 November 2008.

The total cost of terminating the FX hedge was €5.5m. Part of this cost has been funded by the Trust from existing cash reserves, and a further €3.7m is owed to the FX hedge provider ("FX liability").

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As a result of the termination of the FX hedging contract the Trust is no longer subject to the risk of collateral demands or potential further losses on the FX hedge, however, any income or capital returns for the investors will no longer be protected from fluctuations in the EUR/AUD exchange rate.

Specifically, while the net tangible asset backing of the Trust has been negatively impacted by the loss that was incurred as a result of terminating the FX hedge contract, there has been a corresponding and largely offsetting increase in the AUD-denominated value of the Trust's real estate assets as a result of AUD depreciating against the EUR.

Distributions

As a result of the termination of the FX hedging contract, the Trustee has suspended distributions effective immediately, and will be applying the free cash flow to repaying the FX liability.

The Trustee is currently reviewing a number of options as part of the strategic review, including selected asset disposals and asset joint ventures with the aim of enabling the Trust achieve an expeditious repayment of the €3.7m FX liability so that the Trust can recommence the payment of distributions to the investors.

Gearing and LTV Covenants

Based on the latest portfolio valuation of €92.08m (Colliers CRE, February 2008) the loan to value ratio stands at 76.76%, compared to 72.4% at the time of the Information Memorandum.

The Trustee has recently received an indicative valuation from Colliers CRE at 28 November 2008, showing a portfolio valuation of €88.4m, a 4% reduction from the last valuation. The valuation is expected to be finalised as at 31 December 2008. At this level of valuation, the Trust is expected to continue being in compliance with existing debt covenants.

The Trust has no debt refinancing scheduled until February 2017 and interest on the borrowings relating to the Trust's portfolio has been fixed until February 2017.

While the Trust is not in breach of any debt covenants at present, we are staying in close contact with the senior lender in Europe to make sure that they remain comfortable with their position through this turbulent period.

NTA and Unit Price

	Last Reported as at 30 June 2008	As at 1 Dec 2008 ¹	Adjusted as at 1 Dec 2008 ²
NTA Per Unit*	\$0.74	\$0.67	\$0.53
Unit Price*	\$0.70	\$0.67	\$0.53

* Unaudited

¹ Based on the last independent property valuation of €92.08m

² Based on the indicative property valuation of €88.4m

The calculation of NTA and Unit Price include the impact of the cost incurred by the Trust as a result of terminating the FX hedging contract.

Property Update

Despite the weakness in global markets and a slowing German economy, the assets included in the initial portfolio are continuing to trade well.

The portfolio is 99.73% let (including 2% of the NLA which is under a rent guarantee until 31 October 2009) and continues to generate property-level cashflow in line with expectations.

The Trust's real estate assets are leased to a diversified mix of pan European retailers and a major car manufacturer and have a weighted average lease term to expiry of 7.6 years.

The portfolio also provides built-in rental growth with 99% of the rental income subject to CPI linked indexation. During the 2008 calendar year to date, the Trust's rental income has grown by 1.7%.

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Major tenants, which represent 83.3% of the rental income of the Trust's portfolio, are the Edeka Group (owner of Netto, a leading food retailer in Europe and the largest food retailer in Germany), Rewe Group (one of the leading food retailers in Europe and the second largest food retailer in Germany), Schwarz Group (Germany's second largest network of food discount retailers), Norma (a German discounter), Tengelmann (a grocery, DIY, and a clothing retailer), and Peugeot (Europe's second largest car manufacturer).

Discount Supermarkets

Discount supermarkets are thriving in the current economic downturn, according to the latest statistics from TNS Worldpanel. As family budgets are reduced, discount supermarkets such as Lidl and Netto are cashing in on their reputation for selling grocery items at marked down prices.

According to the recent survey, the total discounter sector (which comprises Aldi, Lidl and Netto) now represents a record 6.2% of the grocery market share, with strong year on year growth for the discounters.

Car Manufacturers

The car manufacturing sector has been severely impacted by the slowdown in the global economy, with large manufacturers reducing profit forecasts and announcing staff cuts.

The Trust's only exposure to this sector is in the form of a portfolio of car showrooms leased to Peugeot, Europe's second biggest carmaker with current market capitalisation of approx €3.2b.

The Trustee does not expect the Trust's income from the Peugeot portfolio to be affected by the slowdown in the car manufacturing sector.

Future Outlook and Focus

In light of the significant challenges outlined above and the difficult economic and operating environment we anticipate in 2009, the Trustee's key priorities are as follows:

1. expedite the repayment of the FX hedge liability
2. recommence the payment of distributions to investors
3. strengthen the Trust's balance sheet, by reducing gearing through asset sales, potential joint ventures or corporate transactions
4. continue to create additional value through active asset management

The Trustee is closely monitoring the European real estate market and will continue keeping the investors informed as to any material developments affecting the Trust.

Contact Details

Pengana Capital Limited • Level 29, 20 Bond Street, Sydney, NSW 2000, Australia • T +61 2 8524 9900 • F +61 2 8524 9901
ABN 30 103 800 568, AFSL 226566

If you have any questions about the Pengana Credo European Property Trust or your investment, please visit our website at www.pengana.com or call Alex Vynokur on +61 2 8524 9900 or Gavin Rabinowitz at Credo on +44 207 291 3200.