

# Pengana Credo European Property Trust Investor Update – June 2010



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## Executive Summary

In our December Investor Update we announced the finalisation of the restructuring of the debt facility for the Pengana Credo European Property Trust ("Trust"). In short, the lender has undertaken to waive any breach of the loan to value (LTV) covenant for the period until May 2011.

Colliers has provided an updated valuation for the portfolio as at 31 December 2009, which has shown a decline in portfolio value. Although the portfolio continues to operate strongly with near full occupancy, and the Trust is meeting its financial obligations, economic conditions in Europe remain extremely challenging and the outcome of the investment following the forbearance period until May 2011 remains uncertain.

## Portfolio Valuation

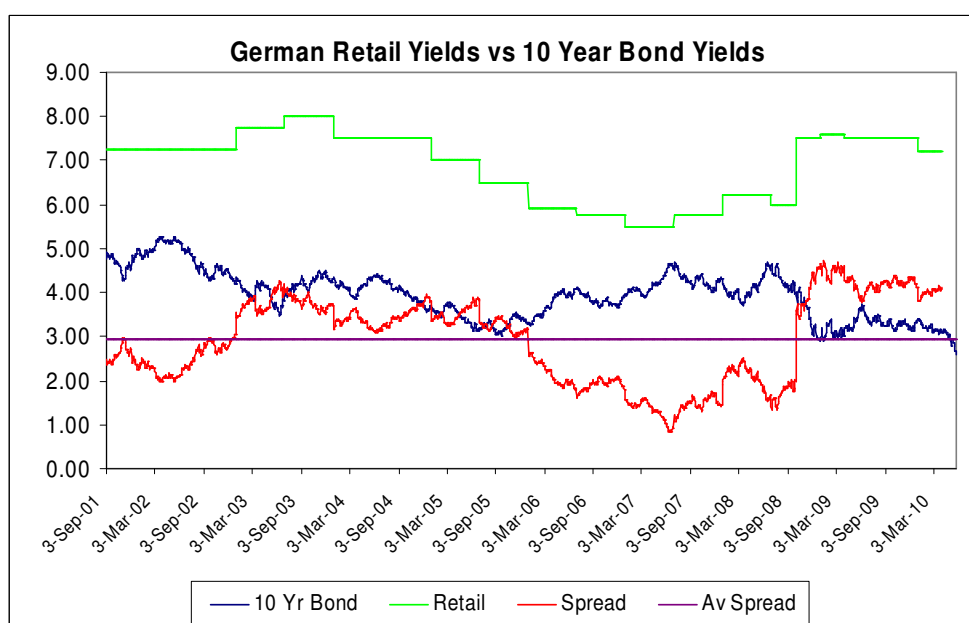
The portfolio has been independently re-valued by Colliers as at 31 December 2009 at a value of €73.45m, which represents a portfolio yield of 8.0%. The portfolio was last valued at €78.85m in December 2008 reflecting a yield of 7.4%.

Colliers commented that market activity outside of city centres remained subdued in 2009, and whilst there was demand from opportunistic buyers, there continues to be a gap between potential buyers and sellers. Furthermore, financing remains difficult and the return of financing packages to the market will be required for transactions to return.

It should be noted that the portfolio's net income has remained stable since inception. The fall in the portfolio value is a reflection of the increase in return (ie yields) demanded by investors.

Property yields theoretically should show a correlation with government bond rates, with the spread between property yields and the bond reflecting a "risk premium". In recent years, the spread between property prices and bond rates has increased reflecting diminished liquidity in the banking system and higher risk aversion.

The chart below shows the historic relationship between German retail assets and the 10 year bond rate.



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Currently, the spread between property yields and 10 year bonds is above the long term average, and near 10 year highs. Over time, as the European banking system improves and the availability of finance returns, the "risk premium" and hence the property yields may be expected to fall (ie values will increase).

### Portfolio Update

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 approximately 7 years.

Occupancy remains high at approx. 99%, (including 2% of the NLA which is under a rent guarantee until 31 October 2010) and the vast majority of the leases continue to operate without any issues.

The portfolio remains almost fully leased, and given the secure nature of the leases, income is expected to remain stable over the next 12 months.

The key asset management issue currently being addressed is the space that Peugeot has vacated. Peugeot still has four years left on its lease and continues to pay the rent according to its legal obligation to pay rent for the full lease term. The Manager has commenced searching for a new tenant to replace Peugeot.

### Trust Debt Position

As previously advised, the debt facility has been in breach of its 85% LTV covenant since the revaluation of the properties in February 2008. The LTV on the portfolio loan is approximately 88% using the most recent valuation.

During the December quarter, the lender agreed to renegotiate the debt facility and the terms of this were finalized in late December. Under the revised agreement the lender agreed to waive its 85% Loan to Value covenant until May 2011. This will avoid a forced sale of the portfolio in the short term and will provide time to allow property prices to potentially recover some value.

In return for the waiver, the lender:

- Increased the interest rate margin on the facility to 4%;
- Used Euro 1,350,000 of the retained cash flow from 2009 to reduce the debt facility; and
- Held a further Euro 650,000 from the retained cash flow in escrow, as security against potential break costs on the fixed rate loan.

Whilst the increased margin will reduce the free cash flow from the portfolio, the renegotiation has given the portfolio the opportunity to recover to stronger levels, where the LTV covenant will not be in breach.

### Financial Statements

During the ongoing negotiations to restructure the loan, it was not possible to finalise the 2008 financial statements. Having successfully extended the loan, the auditor was then in a position to sign off on the accounts. These are almost complete pending receipt of final confirmations from offshore auditors in relation to offshore subsidiaries and we expect to finalise them by the end of June. We will provide all unit holders with a copy as soon as available.

Furthermore, work has commenced on the 2009 financial statements and the Manager will endeavour to have these finalised as soon as possible thereafter.

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## Estimated Net Tangible Assets per Security (NTA)

The portfolio was last valued as at 31 December 2008. At the time the resultant unaudited NTA was \$0.16 (see Investor Update February 2009).

Based upon the 31 December 2009 valuation above, and the current levels of debt, an indicative NTA <sup>(1)</sup> for units in the Trust is zero. This means that as at 31 December, if the portfolio was sold, then the prices achieved would only be sufficient to discharge the Fund's liabilities, and no capital would be paid to equity holders.

However, it should be stressed that the Fund continues to pay all of its interest costs and other financial obligations and the lender has agreed not to enforce the loan to value covenant until May 2011 (The facility expires in May 2014). There is no immediate pressure nor any intention to sell the properties at these depressed pricing levels in the short term. The Manager will continue to manage the portfolio, paying the ongoing financial obligations, with the hope that property values will revert to normalised levels.

Given the high gearing in the Trust, the indicative NTA is extremely sensitive to changes in the value on the portfolio. Whilst valuations ultimately reflect supply and demand of investment properties, higher values/ lower yields might be expected from the following factors:

- Investors return to the property market in Germany;
- Bank lending to retail properties of this kind recommences;
- German bond yields fall. Since 31 December 2009, German bond yields have fallen approximately 0.80%.

The table below provides the sensitivity of the indicative NTA<sup>(1)</sup> to a change in the yield on the portfolio.

Portfolio Yield	Indicative NTA <sup>(1)</sup>
8.0%	Zero
7.75%	\$0.05
7.5%	\$0.11
7.25%	\$0.19
7.0%	\$0.27

Notes:

- (1) This is an indicative value only based upon unaudited financials and the 31 December 2009 valuation undertaken by Colliers.

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### Distributions

As previously discussed, under the renegotiated debt agreements, the interest margin has been increased to 4%. Furthermore, the lender has the right to retain any free cash until the LTV falls below 80%. Therefore, the manager expects that throughout 2010 the lender will retain all cash flow from the properties, with any excess income (after interest costs) to be applied to reducing the LTV of the portfolio, which remains in excess of 85%.

Given this, it is not expected that distributions to unit holders will be resumed in the near term.

European property markets remain depressed and financial institutions stretched. Although the lender has agreed to waive the LTV covenant until May 2011, there is no agreement for an extension of the waiver beyond that date. Accordingly, there is a risk that the lender may elect to enforce its rights at that time.

The Manager is continuing to work on strengthening the relationship with the lender to provide some mitigation against that risk.

### Future Outlook and Focus

In the near term, the Manager will focus on finding a replacement for the vacant Peugeot space (rent still being paid), and leasing up the rental guarantee space.

In the medium term, the Manager will continue to maintain a close relationship with the lender, and in the event that the LTV breach is not rectified by May 2011, look to extend the current LTV waiver.

The overall strategy is to retain control of the assets with a view to returning some capital to investors as opportunity allows.

### Contact Details

If you have any questions about the Pengana Credo European Property Trust or your investment, please visit our website at [www.pengana.com](http://www.pengana.com) or call Tom Curtis on +61 2 8524 9986 or Gavin Rabinowitz at Credo on +44 207 291 3200.