



# Seven Dials European Property Fund

## Q4 2009 Update

### **1. NAV\* Movements in the three months to December 2009**

\*Please note that the NAVs reported below are indicative only. The Fund has suspended dealing and the official calculation and publication of net asset values.

We report small positive movements in the Fund NAVs in the quarter to 31<sup>st</sup> December 2009. These NAVs incorporate the end of year external property valuations of the underlying funds.

#### **Fund NAVs as at 31<sup>st</sup> December**

Share Class	Bid NAV	Sep 09 NAV	Change
A	6.13	6.09	0.7%
B	6.17	6.12	0.8%
C	6.19	6.14	0.8%
R	5.96	5.93	0.5%
P	6.00	5.96	0.7%

### **2. Performance Analysis**

During 2009 the Manager had been estimating the Fund NAVs based on the assumption that the property assets in the underlying funds were falling by 10% p.a. or 2.5% per quarter. This was done because the property assets of the underlying funds were not being re-valued during the year so as to avoid any unnecessary breaches of LTV covenants whilst negotiations with the lending banks were taking place. The assumed rate of decline of 10% p.a. was not a forecast of market movements but was considered to be more useful to investors than assuming no change.

The actual outturn for the average of the two underlying property portfolios was slightly better than the assumed 10% p.a. decline. The Nordic property portfolio fell approximately 10.7% and the German portfolio fell by 4.8%. These two figures combined, together with movements in currency rates and values of interest rate hedging instruments, means that the overall fall over the year in the NAVs for the Seven Dials



European Property Fund are very similar to the falls the Manager had estimated up to the end of September.

#### *Nordic Aktiv*

The end of year valuation for the Nordic portfolio was 10.7% lower than at the end of 2008. Within the portfolio, the assets in Denmark fell most, by 16.3%, and those in Norway least, by 6.8%. Most market commentators, including the fund's valuer DTZ believe that the peak in market yields has been reached at the end of 2009. However, even if this proves correct, there remain substantial risks from increasing void rates and lower rental values.

The Nordic portfolio consists of primarily of multi-let assets and the current void level is quite high owing to the run off of rental guarantees and larger vacancies in Denmark. However, the Manager is confident that the level of void can be reduced substantially even in the current difficult economic climate as the space offered appeals to cost conscious occupiers.

The biggest concern for the Nordic fund during 2009 has been the possible breach of the LTV covenant at the end of the year and the re-financing that will be necessary following such a breach. The manager has been in discussions with the lending banks for most of the last year. This process has taken a long time, mostly owing to the major upheavals in the banks following the financial crisis. At the time of this report, final negotiations are ongoing and it is inappropriate to disclose further details at this stage. However, it is inevitable that the Fund will have to pay significant additional fees and margins for a new debt facility. Seven Dials anticipates that a new financial structure will be in place before the end of the first quarter.

With a new financial structure in place and stabilisation in valuation yields, the near term outlook for the Nordic fund will be much improved, albeit from a low level. Risks remain of course but for the first time since the downturn in the market there will be prospects for positive returns.

#### *German Aktiv*

The end of year valuation for the German portfolio was 4.8% lower than at the end of 2008. This a much smaller fall than in the Nordic portfolio, but it is consistent with smaller falls in value seen in Germany commercial property in general. The German market tends to be less volatile than most others and this has proved to be the case in 2009.

The German portfolio is of a similar nature to the Nordic one, i.e. has many smaller leases and the near term results for this fund will be determined by the success of the manager in maintaining the income of the portfolio. The results for the final quarter of



the year are not yet available but for the year to date the loss of rental income through increased voids has been moderate given the economic environment.

The German fund has no LTV covenant test until June 2012, which means the fund has been under no pressure to sell at what may turn out to have been the low point of the market. Given an improving economic backdrop the fund has good prospects of delivering positive returns over the next few years, although the near term outlook is undoubtedly challenging. This fund has recommenced making income distributions.

### **3. Outlook**

The last few months of 2009 saw a remarkable resurgence in interest in UK commercial property, which has led to substantial improvements in values. The majority of buying interest has been targeted at prime assets let on longer leases to good covenants, although the inflows of money into open ended funds is also driving up prices for non-prime assets.

The Western European markets appear to be experiencing a similar evolution of pricing, with a lag of 3-6 months. Market yields for all types of assets are believed to have now stabilised and yields have tightened for some prime assets. However, slow economic growth and poor occupational markets may well lead to further price declines in 2010 for weaker assets.

The near term prospects for the Seven Dials European Property Fund and its investments are at last beginning to steady which is a good way to start the year. Once the Nordic fund has been re-financed then both of the Fund's investments will be stabilised, and if the income on the underlying properties can be maintained then the prospects will start to improve considerably. It is too early to suggest when and how the Fund might be re-opened for dealing but hopefully an important milestone will shortly have been reached in the path towards that.

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