Real estate investments and asset backed businesses for private investors

evolve

- Existing funds activity update
- Strata fund raising IHT relief
- "Create and evolve..."

"Creationists... but not what you are thinking!"

Market Catch Up

Amidst so much uncertainty in financial markets, what news is there from the commercial property market?

Central London remains the market witnessing the most demand, mainly overseas buyers of investment stock but including UK property companies and REITs for major redevelopments. In the face of such demand there has been a recent increase in supply, perhaps up to £5bn (eg the landmark Lloyds Building, the old Nat West Tower and the £1bn KanAm portfolio), with some opportunistic selling by UK institutions. This suggests a calming, or even cooling market for Q4 2011. We remain of the view, in general, that City office investments are for trading and the West End suffers from too much trophyism.

Prime provincial is also in demand across all sectors, from private as well as institutional investors, as witnessed by the recent sale by evolve of the Oxford Trade Park at 5.98% initial yield.

Supply of such stock is much more limited compared to central London - with banks already having released their better stock, existing owners holding tight and less active occupational markets across all sectors not creating new investments. The primary investment criteria are well located and specified property that will deliver certain income of 6-7% p.a., through strong covenants and the best lease renewal or re-lettings prospects. In our view, the pricing for c10 year income looks keen at present. Better, more appropriate value can be achieved via >15 yr plus leases, or <5 yrs with good re-letting prospects.

Values are not being driven upwards by reckless bidding nor by widespread rental growth. The focus is clearly on markets where occupational demand can be considered robust over the medium term to deliver income. Then it depends on a fund manager's view on the different markets. As a rule we like roadside or other locations where planning is more difficult than offices and big sheds.

Some of the banks are also now attempting to sell secondary portfolios...with mixed success. Interested buyers must be hoping UK plc delivers enough growth for office and industrial based businesses to remain in their current premises, or even expand - Bonne chance!

Against this theory is an oversupply of secondary stock relative to prime, a rationalisation of government occupational requirements plus a looming catalogue of lease expiries from the 1980's development boom. For these and other reasons, we would expect industrial estates to have a marginally better chance than regional offices, but will ourselves be keeping away from such a volatile occupational lottery.

The retail sector is typified by mixed messages. Very mixed - certainly to us. The food sector marches on. It is responsible for the most new floorspace being built. The big, market dominating shopping centres, like the new Westfield at Stratford, are the alternative safe investment. However it seems, to non-retailers like us, that there are also a large number of mid-sized, expertly managed retail businesses that are doing well.

Anecdotally, and it is an odd fact, we are involved with 7, perhaps 9, new retail lettings in one regional town at the moment

all but one of whom will be new to that location! All are in roadside locations.

Shopping centres are being traded more than out-of-town retail warehouses. Perhaps because out-of-town markets are better positioned to offer what retailers (and thus investors) want? This is certainly so when compared to secondary shopping centres.

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Existing Funds – Activity Update

St. Nicholas – 12,000 sq ft Ex Bennetts Electrical unit under offer to Family Bargains.

5,400 sq ft unit let to Lituanica, on assignment from the original developer, at the passing rent of £13.00 psf. Assignment completed.

Asda re-branded the Netto on adjoining site. Report and accounts sent to Investors in September 2011.

St. Ursula – Property sold for £4.67m on 19th August. Investor's to receive return of equity and profit as soon as possible.

St. Christopher – The car park spaces re-let to previous tenant. Chutney and Everyday loans have rent reviews in September and November 2011 respectively.

Report and accounts sent to Investors in September 2011. Meeting to be held late autumn to review fund options.

St. Mary – The hotel is now fully finished and trading. Updates on this Fund can be found by visiting www.cisx.com, searching for the St. Mary Fund and then clicking on 'News'.

St. Austell – Savills instructed to carry out the rent reviews.

St. Margaret – Rent review surveyors appointed. Report and accounts sent to Investors in September 2011. Meeting to be held late autumn to review fund options.

All Saints – www.evolveallsaints.co.uk
Fund retains investments in Norwich, King's Lynn and Epsom. Rent review at Epsom on-going.

Report and accounts due to be sent to Investors in early October 2011 with Distribution.

Strata Fund – www.thestratafund.co.uk
4.5 years since launch of Fund in April 2007, Distributions totalling 18.2% have been paid and the Unit price increased from £1,000 to £1,051 (unaudited) – a combined total return a little over 23%.

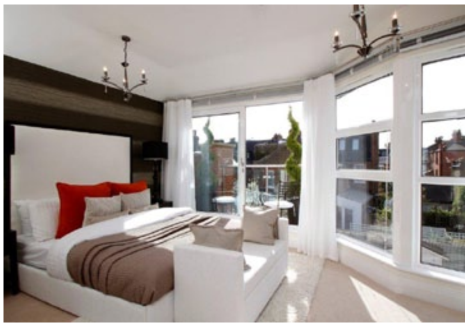
Existing and new investors considering opportunity to invest another £3m (see next page).

Distribution of 6.7% to be paid in September 2011 to initial investors (less to EPUT investors due to tax rebate).

26 loans have now been completed with a GDV of £103m. 11 have been redeemed/concluded.

The most recent loans advanced (July and August) were in Ascot and Barnes respectively. A total of £725,000 has been loaned on these two developments.

The next redemption is expected to be Fulham in late September 2011. All four houses are either sold or subject to an exchange of contracts (£1,090,000 and 100% interest of c£530,000). Lawyer's have been instructed for two new loans requiring £630,000.



(Fulham –£1,090,000 loan to be redeemed in Oct 2011 with interest)

Report and accounts sent to Investors in September 2011 with Distribution.

Pigeon East of England Property LP – The first closing took place in September 2010 with the £11m acquisition of Anglia Water's HQ in Peterborough. The Fund is concentrating on commercial property investment opportunities in the eastern region and is intending to grow significantly. A second closing is expected in the next month or two.

Report and accounts sent to Investors in September 2011.

Strata Fund – New Investment Opportunity

www.thestratafund.co.uk

Inheritance tax – an issue for you?

- Did you know that once you have owned Units in the Strata Fund for more than 2 years then they are outside of your estate for IHT reasons?
- You keep the Distributions too.
- Why invest in an IHT product that only saves you the IHT?

From the recent Strata Trading Statement we would highlight the following:

- Over the 4.5 years since the launch of the Fund in April 2007, **Distributions totalling 18.2%** have been paid (including Sept 2011 Distribution);
- **Distribution of 6.7%** now being paid in Sept 2011;
- Strata Unit Price has increased from £1,000 to £1,051 at 31st August 2011 (ex 2011 Distribution, un-audited) – meaning a **combined total return of over 23%** since Fund establishment;
- **Anticipated September 2012 Distribution of 7.0%** on existing and new equity;
- Strata has now advanced **26 loans on £103.13 million** of property development (gross development value);
- Loans rejected exceeds **£1.6 billion**;


Fulham

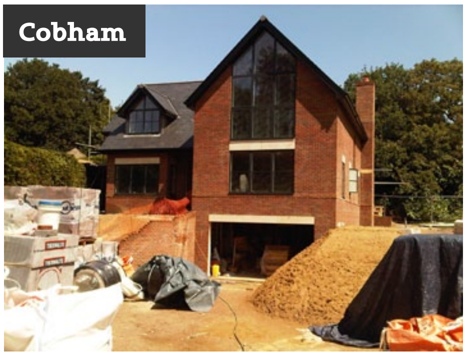
- **11 loans have been redeemed / concluded** – the next redemption is due in late Sept 2011 from the development in Fulham;
- Strata remains well positioned in a less competitive lending market due to its track record and liquidity. The Funding Adviser is still able to recommend the **'best in class'** developments proposed by **experienced developers, with a proven track record**; and
- The portfolio of Strata loans benefits from an attractive '**spread of risk**' in terms of number of developments, number of developers, locations, end values, etc.

The Information Memorandum to extend the Fund by New Equity of up to £3.0 million is being updated. **All interested existing or new Investors yet to submit an application should please contact evolve as soon as possible.**

Strata is tax transparent and available to SIPPs as well as non-pension equity. Direct investors should benefit from Business Property Relief after 2 years, thus placing the value of their Units outside of the Investor's IHT valuation.

Please also look at the Fund's bespoke website www.thestratafund.co.uk. Not only is this convenient for potential investors, but it is also updated with news regarding acquisitions, fund closings and will have NAV Unit prices.
The next Closing is anticipated to be in Q4 2011.

Some recent Strata loan developments:


Cobham

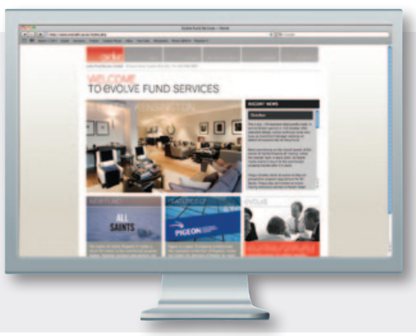

Fulham


Sunninghill

evolve website interactive for Investors

The evolve website is now interactive for Investors. Passwords have been circulated to enable Investors to download the most recent reports and accounts for each fund.

There is a direct link to the All Saints and Strata websites and information about each of the funds.



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What are today's returns

From a general asset allocation perspective, compared to equities, gilts or gold, the message of UK commercial property providing a 'safe haven', a provider of yield and essential investment quality appears to be getting through. The UK pooled property funds attracted £1bn of new equity in the first half of 2011.

These two main attractions of property today are critical; the 'safe haven' of bricks and mortar and the positive real income return. Index linked gilts now have a negative real return of –2-3% and the FTSE All Share Dividend yield hovers around c3%, depending on whether it has crashed or rallied the day the calculation is made.

Commercial property remains alone in offering a positive real income return. The 2012 forecast is 6.3% (IPF UK Consensus Report). That said, with little or no rental growth realistically forecasted for all markets overall in 2012, total returns exceeding 6.5% will need to be 'created'.

Creationists...

Creation of value is what active, specialist asset managers are about. Today the asset manager's property and human skills are more important than ever, and certainly more important than sitting at a desk to manipulate a cashflow and arrange some debt – not that the latter is available! It also means having the motivation and experience to make things happen and not always relying on consultants or agents. Consultants have their place, especially to those 'new' to the market, but they will rarely be as motivated as the investor / asset manager.

Creationists and evolutionists have their battles elsewhere, but in property they are both good news. Creation and evolution... Create and evolve!

If income returns compare favourably with other sectors, how does the downside look?

Wealth preservation is the foremost requirement, before 'creating' the inflation beating return.

Most of the old arguments remain true – bricks not paper, upwards only rent reviews, full repairing and insuring leases, restrictive planning to name a few. But in an environment of limited rental growth over the next few years, property's traditional ability to act as a hedge against inflation must be driven from yield not rent review increases.

Beating inflation by more than 2-3% today relies entirely on the investor's access to market and then the creation of value previously mentioned, the human element.

'Access to market' would be better phrased 'access to the right deal' (we discussed this somewhat in our last newsletter). The right deal is of course a property that ticks all the aforementioned 'old argument' boxes plus, in our view, the evolve 'lack of land' stock selection box.

It must also of course, in the context of wealth preservation, have a strong covenant and be a good enough opportunity to let your friends, not the anonymous, co-invest.

Forecasts

Our expectation for the next 6 months is that there will continue to be an increasing amount of secondary stock and receivership sales coming forward. In numbers terms this will be mostly failed residential schemes, mostly outside the south east. For the hardcore property creationists to get involved.

The City will cool in the face of so much investment supply, but the West End's super illiquidity will hold back pent up demand and hold values.

Prime in the provinces will still be fought for due a genuine lack of decent stock. Pricing will remain at appropriate levels. Buyers appear to have learnt their lessons - for now. (Or perhaps there is now a proper regard for fiduciary duty not personal fee income?)

The auctions retain their appeal for the instant purchaser and/or bargain hunter, but the pricing for the well let stock, as ever, looks hot.

New bank lending on prime will stutter. For those with the right asset and relationship, and sub 50% LTV, current banking terms work well given the fall in swap rates to c1.4% (5yrs). Other lending sources will continue to appear, to add to the existing sources of mezzanine, stretch-equity and CMBS endeavours.

Rental growth will be discussed in certain sectors, but only in very localised areas and sectors. The lack of empty development really is the noticeable difference 'this time round'. And no matter what is said in the media, getting any planning consent is a total headache for developers, complete with so much red tape and fuss.

In all, prime yields outside the City will remain static through the winter. Secondary will flounder further as those brave enough to give it a go will want to trawl the bottom of the ocean for the biggest bargains and are in no rush.

What we do not forecast, for the record, is that Darwin will suddenly be proved wrong!

But 'belief plurality' in property – creation and evolution to name two– is a good way to think. They are linked.

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