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Credo Property International Limited
Credo European Properties Limited ("Fund II")
December 2009



Executive Summary

- The Directors of Credo European Properties Limited have declared a dividend of £500,000 (147 pence per share) for the six month period from 1 May 2009 to 31 October 2009. This, together with the dividend paid in June 2009 equates to 3.19% pa on the remaining capital. Since inception in March 2006, Fund II has paid a total of £15.1m to investors (44% of the initial capital invested).
- Net Asset Value (NAV) per share (which was £68.18 in May 2009) decreased to £67.28 ex the November 2009 dividend.
- The NAV of the remaining assets in Fund II, together with the all distributions made since inception in March 2006 to date, equates to a value of £111 for every £100 invested upon the launch of Fund II.
- 23% of the current fund invested is invested in the Swiss shopping centre (“Wohncenter”) which has benefited from a strong currency. The board has taken out a forward contract to lock in part of this currency gain.
- 18% of the current fund is invested in the Hilton portfolio which has suffered the most from the economic climate, primarily because it is a management contract that is based on the performance of the hotel business. Negotiations continue with the lending bank to restructure the debt.
- The valuations of investments in Europe have benefited from the strengthening of the Euro against Sterling. The Burger King and Star portfolios have been underperforming but the other Assets in Europe – the ATU portfolio and DRM - are performing per original expectation.
- The Volkswagen (“VW”) portfolio is performing as per initial forecasts.
- Care Capital has been written down based on the reduction in the share price.
- The planning application to develop 33 flats and 10,000 sq ft of offices in Surrey has been submitted and the outcome is expected this month.
- The investment in Cornwall was marked down for the last report and remains at this value. The debt is being amortised.
- The investment in Carphone Warehouse is stated at gross acquisition cost as it will only be revalued following the planning application.



Net Asset Value per share: £67.28

Current Properties	Initial Equity	NAV Nov - 09	% Change	Pro rata Per Share £	% of current fund
Cornwall Council	415,000	303,248	-27%	0.89	1.3%
Hilton	5,956,000	4,415,006	-26%	12.98	19.3%
VW	633,500	681,765	8%	2.01	3.0%
Burger King	1,636,041	1,488,462	-9%	4.38	6.5%
ATU Germany	303,616	495,808	63%	1.46	2.2%
ATU Austria	90,859	152,043	67%	0.45	0.7%
GWB2	1,161,283	630,300	-46%	1.85	2.8%
Wohncenter	4,287,000	4,402,507	3%	12.95	19.2%
CareCapital	776,943	113,049	-85%	0.33	0.5%
Surrey development	1,872,541	1,872,541	0%	5.51	8.2%
Carphone Warehouse	3,805,950	3,805,950	0%	11.19	16.6%
DRM	2,805,058	3,172,212	13%	9.33	13.9%
Total Current	23,743,791	21,532,891	-9%	63.33	94%
Sold					
Peugeot	747,749	901,915	21%		
Toom	474,772	605,422	15%		
Marilyn	1,671,698	1,880,949	7%		
Netto	584,083	991,024	70%		
GWB	1,021,441	1,168,132	14%		
Ashbourne	4,573,000	5,998,995	31%		
Total Sold	9,072,743	11,546,437	27%		
Equity invested	32,816,534	33,079,328			
Uninvested	1,183,466	1,342,036		3.95	6%
Total	34,000,000	34,921,364	1%	67.28	100%



Valuation

The UK property market started to recover in August 2009 but in our opinion this was not due to a sustained recovery in the UK Economy. Rather growth has been primarily due to the lack of supply of product as investors chased yield. We believe the property fundamentals such as tenant demand and rental growth are absent from the market. UK commercial property posted its largest monthly capital growth in almost four years in October 2009, climbing 1.9% according to the IPD UK Monthly Index. Capital values have now risen 3.2% since the market started its recovery in August. The year-to-date capital growth is currently 10.5%, with a fall of 45% in average capital values recorded by the IPD since the beginning of the downturn in June 2007.

Fund II has performed relatively well compared to the market although the investments in Care Capital and Hilton may still prove challenging.

Despite the downturn in the economy and the impact on retailers in the UK, all the tenants of Fund II properties continue to pay rent and subsequently the debt is being amortised out of cashflow.

The current banking environment is such that banks are looking closely at existing borrowers who are servicing their interest but are either in breach of their loan to value ("LTV") covenants or whose loans are expiring and need to be renewed. Apart from the issues detailed below concerning the debt restructuring for Hilton, all investments are within their LTV covenants and we have had no issue with the lending banks.

The IPD property derivative curve provides evidence of a big boost in short term sentiment but also indicates a more negative outlook in the long term. Our strategy is to hold the assets and actively manage where possible to improve values and exit when appropriate. The income streams have been protected as most assets are funded on long term loans at fixed interest rates. The rentals on most of the assets are linked to inflation providing income protection over the term of the lease.



Tenant: Cornwall County Council

Location: Cornwall

Background

Fund II owns 20% of this property with the balance owned by another Credo fund. The property is let to Cornwall County Council until 2020 subject to five yearly upwards only rent reviews (11 years remaining on the lease). The tenant has an option to break in September 2015, subject to a six-month rental penalty.

Funding

The £5.1m funding from Leeds & Holbeck is in place until June 2014. The loan has been amortised by 1.8% to circa £5m. The current loan to value is within the LTV covenant of 80%.

Valuation

The property was acquired at a gross acquisition cost of £7.2m in 2005 at a net initial yield of 6.7%. It was valued in 2008 by King Sturge at £6.6m. It will be revalued following the next rent review.

Cashflow

Loan repayments commenced in March 2008 hence the cashflow from this investment is forecast to decrease to 4% per annum for the next two years but increase to circa 7% following the next rent review in October 2010. Based on the RPI formula in the lease, the rent should increase to approx £531,000 per annum. To date Fund II has received back 23% of its initial investment in Cornwall.

Asset management

We are scheduled to meet with the tenant in the new year to discuss value add opportunities with them.

Management Contract: HILTON

Location: UK

Background

Fund II owns 6.327% of the investment in Hilton. The portfolio consists of 16 hotels in the UK managed by the Hilton Group through a management agreement for a period of 30 years.

Funding

Royal Bank of Scotland ("RBS") provided a £319m, 10-year non-recourse debt facility until November 2015. The aggregate level of debt increases until the end of 2010. The bank is entitled to 25% of the capital profit when the portfolio or the assets are sold or in the case of a refinancing.



As previously reported the company is close to breaching its debt cover ratios. The investment bank, Rothschild has been appointed to restructure the debt and these negotiations continue. No agreement has been reached with RBS to date.

Valuation

The portfolio was acquired at a gross acquisition cost of £407m in 2005, at a net initial yield of 6.52%. Fund II's investment in Hilton is stated at cost. The NAV has decreased as the debt has increased.

Cashflow

The latest PriceWaterhouseCoopers (PWC) forecast for the hotel industry (September 2009) states that the hotel industry is "not out of the woods yet". Concerning occupancy, they forecast that in general, occupancy declines should start to reduce through 2010. According to PWC there is evidence that although blanket discounting may be less problematic than in the last recession, there is still an aggressive price war.

Overall the Hilton portfolio continues to trail behind both the market and their competitors set in terms of revenue per room performance due to the poor occupancy in twelve of the sixteen hotels. This is largely due to competitors' ability to drive volume into their hotels and sustain their rates. There are, however, some encouraging results from the hotels in Coventry, Edinburgh and Swindon, where they are outperforming in their local markets.

The 2010 revaluation for Business Rates will be based on economic circumstances on 1 April 2008. For the 10 hotels outside of London there should be a net saving of £40,000 year on year. The London properties are, however, being very hard hit, having to absorb both the increase and the Crossrail extra charge. This will see bills for Gatwick and Olympia going up a net £200,000.

BAA confirmed the sale of Gatwick Airport to Global Infrastructure Partners ("GIP"), who already own City Airport in the UK. The sale is good news for Hilton Gatwick which has already contracted the hotel requirements at GIP for the next 12 months, for an estimated 2,000 rooms.

Hilton has commenced the £23m refurbishment programme of the hotels as well as an extension of the Edinburgh Airport Hilton over a two year period. In October 485 bedrooms have been refurbished and by the year end the first phase of the refurbishment will be complete including: 600 bedrooms, the Gatwick Bar and Lounge and the Swindon Restaurant & Bar. As a consequence of this and the poor performance noted above, there have been no distributions from this investment in the last reporting period and no distributions are forecast for the next reporting period.

To date Fund II has received back 10% of its initial investment in Hilton.



Asset Management

There are ongoing restructuring discussions with the banks but we believe that given the poor level of trading there will be uncertain years ahead for this investment.

Tenant: Volkswagen UK (VW)

Location UK

Background

Fund II owns 1% of this portfolio which consists of 73 freehold and 12 long leases let to Volkswagen UK, a wholly owned subsidiary of Volkswagen AG.

Despite the crisis in the motor industry the tenant remains strong. Speaking at the Frankfurt Motor Show in September 2009, Martin Winterkorn, chief executive, Volkswagen Group stated. "We've done a lot better than the competition in this crisis," Volkswagen has seen its global market share soar from single-digits to 11.7% so far this year, with its sales slipping just 2.1% while the industry as a whole has suffered a 14% drop in sales, according to Mr Winterkorn. Net profits fell during the first half of this year, yet the group remained in the black, netting some £249m.

Funding

RBS provided £241.5m of 15-year funding, expiring in December 2019, with a blend of senior, stretch senior and mezzanine debt. There are no capital repayments in the first 10 years. The level of debt increased as a result of the funding structure until October 2007. After this date the net debt decreased. As at October 2009 the amount of debt outstanding was £242m. RBS is entitled to 25% of capital profits on a sale or refinancing.

Valuation

The portfolio was acquired at a gross acquisition cost of £286m in 2006 at a net initial yield of 6.53%. Fund II acquired a 1% stake in 2006 at a 30% premium. The portfolio has not been revalued externally and, as minority shareholders, we have not instructed external valuers. The investment has been valued internally at 6.5% and the resulting net asset value per share is approximately £1,076 based on the October 2009 rent. This valuation takes no account of any profit share that RBS may be entitled to or any deferred tax in the holding company. The NAV has increased as the debt is being amortised.

Cashflow

Due to the terms of the funding structure, the distributions are lower in the period 2007 to 2010, and will increase in 2011. A dividend of £6,667 was received from this investment in the period under review. To date Fund II has received back 8% of this investment.

Asset management

The asset has held its value and we will investigate a strategy to exit in the near future.



Tenant: Burger King

Location: Germany

Background

Fund II owns 30% of this portfolio of 12 properties located in Germany, with 9 having Burger King as the main tenant, 2 properties are petrol forecourts and the remaining property is a retail centre leased to Lidl and KIK.

Funding

Funding is in place from Barclays Capital until October 2012. The loan has been amortised by circa €1.5m and equates to a LTV of circa 78.6%.

Valuation

The portfolio was acquired for a gross acquisition cost of €26.8m in 2006 at a net initial yield of 7.57%. External valuers, CBRE have provided us with a desk top valuation as of 30 June 2008, of €25.331m. It has not been revalued externally since this date. We have revalued the investment internally based on the current exchange rate and have had confirmation from the majority shareholders that they do not anticipate that the valuation has changed materially from the June 2008 valuation.

There have been a number of problems with this portfolio since acquisition particularly due to the fact that some of the outlets were not delivered as per initial specification.

The following action is being taken to rectify the situation:

- Nuremberg – Legal action continues against all parties in relation to the insufficient ventilation in the basement of this unit.
- Nuremberg – Negotiations are now underway with AMS (Physiotherapy Training School) for a letting of 400m² representing the majority of the first floor space. This letting would require an additional capital expenditure of approximately €50,000.
- Remscheid - this unit, which is on the first floor above the Burger King Unit, has never been occupied. The capital expenditure required for the fit-out necessary to finalise a letting of this unit has been budgeted at €50,000.
- Weingarten – The Burger King franchisee went into administration. Another existing Burger King franchisee has taken over this unit at a reduced rent of €10,000 per month, fixed for 3 years. The reduction of €1,500 per month on the previous rental, was in recognition of the upcoming competition a new McDonalds in the area will present to the new operator. The lease term was extended from 10 years to 15 years and with a stronger covenant.



Cashflow

There has been no cashflow from this investment to date. The capital expenditure required at Nürnberg and Remscheid combined with the ongoing legal and professional fees associated with resolving the dampness issue at Nürnberg, means that the portfolio is not yet in a positive cash position to start distributing to investors.

In 2009 it is expected that the annual profit the portfolio will make is €639,000. The cashflow generated from this profit is utilised to amortise the bank loan by €587,000 and fund €50,000 of capital expenditure of the properties.

Asset management

The property managers are hopeful of achieving lettings at Nürnberg and Remscheid in the near future as well as obtaining a positive resolution of the building issues at Nürnberg. This will result in the portfolio stabilising and being in a position to start distributing in 2010.

Encouragingly early signs of activity have started to appear in the German investment market. Bearing in mind that the current bank financing is in place until October 2012, it is critical to let the vacant space as soon as possible, and then look at a possible exit strategy aligned to the position of the investment market.

Tenant: Auto-Teile-Unger GmbH & Co.KG ('A.T.U')

Location Germany

Background

Fund II owns 4.72% of the A.T.U investment. The portfolio consists of 19 A.T.U properties located in Germany. All 19 German A.T.U properties are freehold and have long leases until May 2020 with an average length in excess of 10 years. Their combined contractual annual rent is €3.7m, subject to a formula calculated on annual CPI escalations (which has averaged 1.62% over the last 10 years).

A.T.U is Germany's largest auto spare parts and servicing business. It operates 460 stores throughout Germany and 9 in Austria. As Germany's leading specialist non-affiliated car parts' stockist, with registered vehicle services centres, A.T.U's core business is the retail sale of car parts and accessories for all common cars and models and immediate fitting of those parts in its own workshops. The company sells a range of approximately 45,000 products and employs over 12,000 people.

Funding

A loan of €33.8m was provided by Barclays Capital Mortgage Servicing Ltd for 7.5 years until January 2013. This loan has been amortised and has €30.7m outstanding as at October 2009 (66% loan to value).



Valuation

The total portfolio was purchased at a gross acquisition cost of €45m, at a net initial yield of 7.6%. The investment was revalued internally in April 2009 at 8% to reflect the current state of the market. The investment has benefited from the amortisation of the loan and the strengthening of the Euro against Sterling and hence the NAV has increased since our May 2009 report.

Cashflow

Distributions from A.T.U Germany are treated as loan repayment. A loan repayment of £16,494 (4.15%) was received for October 2009. This repayment together with the loan repaid in May 2009 equates to 5.7% of the initial investment repaid in 2009. To date Fund II investors have received approximately 20% of their initial investment in A.T.U Germany.

Asset Management

The loan falls due in 2013 and in due course we will look to refinance on more favourable terms.

Location: Austria

Background

Fund II owns 4.72% of the A.T.U investment in Austria. The portfolio comprises 8 properties in Austria located in 7 cities. Two of the properties are in Vienna, the others are in Leoben, Rum, Salzburg, Villach, Wels and Wiener Neustadt. Each of the properties have long leases with an average length in excess of 10 years.

Funding

Funding is in place from Barclays Capital Mortgage Servicing Ltd for 7.5 years until October 2012. The loan has been amortised to €14.1m as at October 2009. (65% loan to value).

Valuation

The portfolio was acquired at a gross acquisition cost of €21.2m at a net initial yield of 7.55%. The portfolio was valued at €23.62m by external valuers CBRE in February 2008 at a yield of 6.35% and revalued internally subsequently at a yield of 8% (€21.7m) to reflect the current market. The combined projected gross annual rental income has increased to €1.73m. Six of the eight units had rent uplifts in 2008. One further unit is due a rent uplift in September 2010 subject to a formula calculated on annual CPI escalations. The final unit uplift is due in 2011. The NAV has increased due to the rent increases, the strengthening of the Euro and the amortisation of the loan. The strength of the tenant has improved based on the most recent published accounts. The loans are being amortised and the cashflow available for distribution has improved as a result of the increased rent. We will continue to hold this investment but may look to refinance at an opportune time.



Cashflow

A dividend of £8,002, (6.73%) was received for the period ended October 2009. This together with the dividend paid in May 2009 equates to 11% in 2009. Since inception Fund II has received approximately 26% of the initial investment in A.T.U Austria.

Asset Management

The loan falls due in 2012 and in due course we will look to refinance on more favourable terms.

Tenants: Various - Edeka, Real, ATU, Schlecker ('GWB2')

Location: Germany

Background

Fund II owns 50% of the Star portfolio which consists of 5 shopping centres operated by GWB Immobilien AG ("GWB") in Germany. GWB guarantees all leases for a 10 year period. The properties are let to various tenants including:

- Edeka – Germany's largest supermarket chain
- Schlecker - one of Germany's largest chemist chains
- Dassow – Real SB – a major national retail group
- Schlecker - one of Germany's largest chemist chains
- Netto - a major national retail group
- ATU – Germany's leading auto parts
- SANA - a major operator of health facilities

Funding

Funding from GMAC Commercial Mortgage Bank Europe Plc is in place until April 2011. Amortisation of the loan commenced in January 2008 and the amount outstanding as at October 2009 was €11.95m. The LTV is circa 89% - well within the covenant of 95%.

Valuation

The centres were purchased in April 2006 for a gross acquisition cost of €15.7m at a net initial yield of 7.19%. CBRE valued the properties in January 2009 at €13.475m. The decrease in value is partly due to the state of the market and partly due to the lower rental achieved from Netto (€91,000 per annum vs €96,000 of the previous tenant, Aldi). This has resulted in a lower valuation of the property, which has affected the unit price.

Cashflow

Distributions from Star to Fund II are treated as loan repayment and to date £84,000 has been repaid which equates to 7% of the initial investment. Due to the capital payments re the Netto Lease there have been no distributions from Star since July 2008 and we do not anticipate that there will be distributions within the next six months.



Asset management

Now that we have finalised the lease arrangements with Netto we will look to refinance as the debt falls due in April 2011.

Tenant: Wohncenter

Location: Switzerland

Background

Fund II owns 28.58% of Pentrich Investments Limited ("Pentrich") the ultimate holding company of the Wohncenter shopping centre in Emmen, Switzerland.

Funding

Deutsche Bank provided funding of 90% of the purchase price. The funding is in place until October 2013. Amortisation commenced in October 2009. The interest is fixed by an interest rate swap at 3.7225% pa.

In Switzerland, interest rates decisions are taken by the Swiss National Bank. The official interest rate is the three-month Swiss franc Libor. This interest rate has fallen from 1.5% in September 2006 to 0.25% in November 2009. Deutsche Bank valued the interest rate swap at a loss of £11m. This would be the cost the company would incur if it repaid the Deutsche Bank Loan early and broke the swap. If however the debt remains in place until expiry in 2013 than the swap value is nil.

The credit markets have changed dramatically since this transaction was completed. In the event that the property has not been sold, we will need to refinance in late 2013. By that time CHF7.8m of the debt will have been amortised and the debt will amount to CHF187.5m, circa 80% of the current market valuation. It is impossible to forecast the state of the debt market in four years time.

Valuation

Wohncenter's was acquired at a gross acquisition cost of CHF 231m. The centre was purchased at a net initial yield of 4.9% on gross acquisition cost in September 2006. The Wohncenter was revalued in August 2008 by Engel and Volkers at a 5% yield equating to a sale price of CHF 236m. It has not been revalued externally since this date.

The value of the investment in Wohncenter has appreciated as a result of the strengthening of the Swiss Franc. This investment was made when Sterling was relatively strong against the Swiss Franc at an exchange rate of around CHF2.36:£1. Sterling has since weakened and at the current spot rate of circa CHF1.65:£1, there is a current currency gain of around 30%.



Pentrich entered into a forward contract on behalf of Fund II in June 2009 to hedge two thirds of the original equity investment (to sell £2.858m worth of Swiss Francs in June 2010 at a rate of £1: CHF1.754.) In order to enter into the contract a 10% deposit was required by the bank. This serves as the bank's security should the rate move against the hedge i.e. if the spot rate at the end of the period is lower than the forward rate in the contract. The bank is also entitled to call for a top up of the margin if the rate goes against the hedge (the Swiss Franc strengthens) so that at all times the bank maintains a margin deposit of 10% of the contract value. In September 2009, due to the continued depreciation of Sterling the bank called for a top-up of the margin requiring restoration of the 10% deposit plus mark to market loss cover.

Although no formal valuation of the property has been done, the value has been recalculated at the exchange rate of CHF1.6465:£1 as at 27 October 2009. The adverse interest rate swap valuation of CHF11m has been included in the valuation although this would only be relevant if the Wohncenter was sold prior to the expiry of the swap. As a result the value has decreased by 20% since the May 2009 report.

Cashflow

From October 2009 amortisation commenced on the bank loan and therefore future distributions will be reduced accordingly. Future dividends will also be lower than initially anticipated due to higher tax, additional costs re insurance, marketing, irrecoverable service charges and additional capital expenditure incurred in planning the catering outlet to be built in the car park. Credo Property Group Limited has deferred part of its management fees on this investment going forward in order to offset the impact of these costs on shareholders' dividend cashflow. To date Fund II has received back 33% of the investment in Wohncenter.

Asset management

One of the tenants Bau & Hobby has traded poorly since the inception of its lease. We are currently in advanced negotiations with Bau & Hobby to surrender its lease and replace it with two other tenants, Top Tip (which is already a tenant and requires more space) and Fly a major international furniture retailer. We are of the firm view that this restructuring will create substantial value for the centre.

Tenant: Care Capital

Location: UK & Germany

Background

Fund II acquired shares in Care Capital in May 2007, a company listed on the Alternative Investment Market of the London Stock Exchange. Its principal activity is to develop and invest in healthcare related properties, predominantly in the primary healthcare sector in the UK and Germany. This is an asset backed investment - Care Capital has a portfolio of properties with long leases of 20 – 25 years and a pipeline of primary healthcare centres to be developed.



Funding

On October 2008 a £4 million loan facility was provided to Care Capital by one of its directors, Dr Michael Sinclair. We are aware that the company is trying to raise more capital but have not yet received formal notification of the terms.

Valuation

The value of this investment has fallen dramatically like all shares in the listed property market - and the share price at 27 October 2009 was 5.12p.

Cashflow

There has been no cashflow from this investment to date and we are not forecasting to receive any in the next reporting period.

Asset management

We are in discussions with the existing management and the company does need to raise further equity. However we are not optimistic concerning the prospects for this investment.

Surrey Development

Location UK

Background

In January 2007 Fund II committed to fund 50% of Brettenwood Investment Holdings Limited. This company was set up as a joint venture with the developer to acquire two adjoining freehold properties to provide a development site of approximately one acre in extent. These properties are located on Wey Hill, Haslemere Surrey. The acquisition and planning consent and full development is co-ordinated by Brian Sheridan of Brittanica Developments Limited and The Wolpe partnership.

Funding

There is no bank funding in place yet. As at October 2009, £1.87m has been drawn down from Fund II.

Valuation

The investment is stated at cost of £1.87m. This is primarily the cost to acquire the initial site and submit planning permission. A meeting was held with Waverley Borough Council in November 2009. The unresolved issue is the question of affordable housing provision or non-provision as is currently intended.

The current scheme now has 24 one bedroom flats and these are presently valued around £150,000 and 9 two bedroom flats valued around £185,000. The office space has dropped in value in the current market from around £325 - £350 per foot to circa £225 per foot.



Cashflow

There has been no cashflow from this investment as it is a development.

Asset Management

Planning permission is imminent and once we have this we will assess our options.

Tenant: Car Phone Warehouse

Location: Warrington

Background

In March 2008 Fund II invested £3.84m in Gladstone Investment Holdings ("Gladstone"), which acquired Stanford House, a two storey office building let to Opal Telecom Ltd (guaranteed by Carphone Warehouse Ltd) for 15 years. Fund II owns 88% and the balance is owned by the developers Capital & Provincial ("C&P"). The site has planning permission for development of further office space and a prelet is being sought.

Funding

Chelsea Building Society provided £9.5m of debt provided on an interest only basis for 10 years.

Valuation

The gross acquisition cost for the site was £13.85m (net initial yield of 6.55%). The investment is stated at gross acquisition cost as it will only be revalued following the planning application.

A new planning application is being made to replace the existing application, which is a much better scheme and should make a prelet more likely.

The office design is pictured opposite.



Cashflow

Fund II has received dividends totalling £178,354 from this investment to date (6% of the initial investment). Average cash on cash returns of 7% pa over the 10 years are forecast, which excludes any additional return from development of the site. Gladstone has committed £50,000 out of the free cashflow from this investment to progress the planning project referred to above.



Asset management

We have now submitted our planning application and if granted this will create additional value to the site. It is likely that we will look to exit in the new year.

Tenant: Netto (Diverse Retail Markets Portfolio 'DRM')

Location: Germany

Background

In July 2008 Fund II invested £2.75m in Redfields Sarl which owns 3 retail units in Germany with a weighted average lease term of 5.6 years.

Funding

The portfolio was acquired with 100% equity and finance will be sought at an appropriate time.

Valuation

The portfolio was acquired at a gross acquisition cost of €3.35m at a net initial yield of 7.7%. The investment is stated at gross acquisition cost. The increase in value since our last report is a result of the strengthening of the Euro against Sterling.

Cashflow

The cash on cash is forecast as 6% per annum. The surplus cash has not yet been distributed as there are costs involved in the lease renegotiation.

Asset management

There are a number of opportunities to add value and increase cash flow that are currently being pursued and include lease re-gearing and development/extension of existing units. It is however proving uneconomic to develop the Vellahn property without excessive capital expenditure, even though a 10 year lease extension on acceptable terms has been agreed in principle. We continue to explore this opportunity.



Conclusion

Notwithstanding 60% of the current equity invested did not generate income in 2009 (Hilton, Care Capital, Burger King, GWB2, DRM), Fund II was still able to pay out 3.19% this year as a result of active asset and financial management.

The debt on all the assets except Hilton is being amortised. Taking this into consideration the return on capital employed ("ROCE") is 17% since inception and circa 5% pa.

The past year has been exceptionally challenging for the property market, but Fund II has managed to maintain its value as a result of proactive asset and financial management including currency diversification, rent increases and the amortisation of the debt. We are in a strong position to create further value.

Important notice

The fund invests in property which can be difficult to sell and you may not be able to encash your investment when you want to. Investment should be intended for the long term. The value of property is generally a matter of valuer's opinion rather than fact.

Past performance is not a guide to future performance. The value of your investments may go up or down, returns are not guaranteed and the original amount invested may not be returned. The value of your investments may rise or fall due to changes in tax rates and/or rates of exchange in which the investments are determined from the investor's own currency and such changes may have adverse effect on the price or income of investments.

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