Fund Commentary

In its February statement the IPD reported that UK commercial property is close to flatlining and that the market could continue to remain lacklustre over the months to come.

Across the main sectors (retail, office and industrial) there is little differential evident. The key difference lies between primary and secondary property and location.

Global property specialists DTZ give a more detailed analysis in their February UK Update, pointing to the widening yield spread between the two markets.

In short, the strong recovery the Board and the Manager expected in 2010 has only really affected the primary market (particularly in London). The IPD's "flatlining" aggregate figures mask much more disappointing performance in the secondary market, which DTZ say is "still very weak". They predict a "further softening for secondary pricing in 2011".

The Glanmore Property Fund is a portfolio of secondary market properties – the great majority of which are outside London. It is also leveraged, which means any movement in property values is accentuated and impacts on the share price and loan-to-value (LTV) ratio.

Last year saw some welcome stabilisation of property valuations within the Fund. Since the beginning of December the Fund's independent valuers have unexpectedly downgraded the valuation of many of Glanmore's properties. This is reflected in the latest net asset value of £13.823 per share, after a £10.97m aggregate property valuation drop in February.

Challenged to explain this, the Fund's independent valuers cite serious concerns about the lending environment that underpins property prices. They argue that the Basel III directive on capital adequacy and liquidity will effectively reduce the quantum lenders have available to lend, which will in turn impact on the purchasing power of the debt-driven investor market, which is a significant part of the market.

Late last month Bloomberg and others published a report by the Property Industry Alliance evidencing a drop in property lending by UK banks of over £17bn in 2010.

The reduction in lending comes as the huge wall of existing debt maturities is growing, adding to competition for what few available credit facilities there are. Concerns are growing that the next few quarters will see a drop in the value of secondary market properties in the UK, particularly given the gloomy economic environment that has led to an increase in vacancies (especially outside London).

Against this backdrop the independent valuers say that they have no choice but to take a cautious approach.

The Board and Manager have no influence over the property valuers. It is arguable that the current valuations are pricing in expected bad news prematurely, though it would be foolish to write off the possibility of further falls.

In the meantime the Board and Manager continue to manage the Fund as effectively as possible in difficult market conditions, following prudent estate management principles. On the positive side, the Fund is throwing off significant free cashflow and has a relatively low void rate of 7.02% (the IPD Monthly Index shows average UK All Property void rates at Jan 2011 as 9.8%). Additionally, the Manager is still proving able to renegotiate upward rent reviews.

The Fund is continuing to meet its debt repayments. Naturally, the lowering of indebtedness impacts on NAV and is an effective way of both bolstering shareholder value and reducing volatility in the long run. At the end of last month the Fund met an RBS debt repayment of £37m – a month earlier than expected. It met a £7.5m debt repayment with Canada Life in December. There are no further payment covenants to make against Canada Life.

Before the "B" share class capital raising in 2009 the Fund's LTV ratio was around 80%. Shortly afterwards that figure came closer to 70%. Today – even with the property devaluations – the figure is 68% (as at end of February 2011).

The Fund is cash positive, and as we repay down debt we are edging closer to the LTV ratio of 65% at which point the constraints imposed by the lending banks should lessen and will permit the Board to implement its stated intention of allowing dividend payments to resume.

Though 2011, for the reasons stated above, will be a testing time, the Fund's Board and Manager are mindful of the need to generate liquidity for 2012 and the ultimate strategic goal of returning the Fund to its normal trading pattern. The Board is committed to provide enhanced updates to shareholders and to informing them of material developments in the progress of stabilisation of the Fund.

Important Note

Real estate investments are generally of a higher risk profile than other investments available for investors. Investors must be able to bear the risks involved and any investment in the Fund must be considered suitable for the investor. The Fund will utilize substantial leverage and may utilize hedging strategies. This Fund invests in commercial property in the United Kingdom, and investors without expertise or experience in this asset class should consider carefully with their financial advisor the suitability of this investment for their needs and read and fully understand the prospectus for full details of the proposed investment. This commentary is a summary only of certain aspects of The Glanmore Property Fund and is not an offer for sale. Past performance is not a reliable guide to future performance. This commentary should be read in conjunction with The Glanmore Property Fund prospectus which contains full information regarding the Fund, its terms and conditions, details of additional risk factors and other important information.

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