Phoenix Spree

Combined Fund Update

Fund Update
Q3 2011





PMMPARTNERS

Phoenix Spree Combined Fund

- Berlin rent inflation strong, portfolio rent per sqm risen 4.4% year on year, expected to hit 5% by year end
- Rent increases continue – net rents increased in 2011 by €136,000 per annum to the end of September
- €1.3m Berlin refurbishment programme nearing completion. Initial lettings activity encouraging. First 24 tenancies signed at average rent of €8.7 per sqm
- Combination of 2011 rent increase and refurbishment programme expected to contribute around €4 million to Fund's capital value
- Borrowings and cash have remained at healthy levels. Loan to value stands at 60.2%
- Estimates suggest German GDP to grow 2.9% in 2011. Macroeconomic headwinds and instability in Europe may dent economic growth in 2012. On the ground, trends and demand so far remained encouraging

RESIDENTIAL PORTFOLIO

Berlin residential

Berlin represents the Fund's largest market, accounting for a 49% share of the residential portfolio by value. In 2011 €1.3 million has been spent in the city, with apartment refurbishment expenditure making up the bulk of investment and representing just over €1.15 million of the total. Under the programme, some 62 apartment units or just over 4,300 sqm of lettable area was refurbished. The average cost of refurbishment per unit was €18,400 or €260 per sqm including VAT. The balance of around €150,000 of investment was made into replacing roofs, renovating facades, communal areas and other structural capex. In 2012, PMM expect the Fund to spend a further €1.3 million on investment and improvements into its buildings across the wider portfolio.

The renovation programme has seen these previously unlettable units return to the market for re-letting, coinciding with a time of rising rents and healthy demand for good quality housing. PMM had targeted that the net rents for these apartments would rise on average from €4.3 to €8.7 per sqm, or an increment of around €230,000 per annum of additional income. The capital value of the increment (less costs) is just under €2 million on a 15x factor multiple.

At the time of writing, some 49 units had been completed and 24 tenancies for just over 1,500 sqm had been signed. The average price achieved on these units was €8.8 per sqm versus €4.2 per sqm previously, in line with our targets and expectations. The remaining 13 units are expected to be completed before the year end.

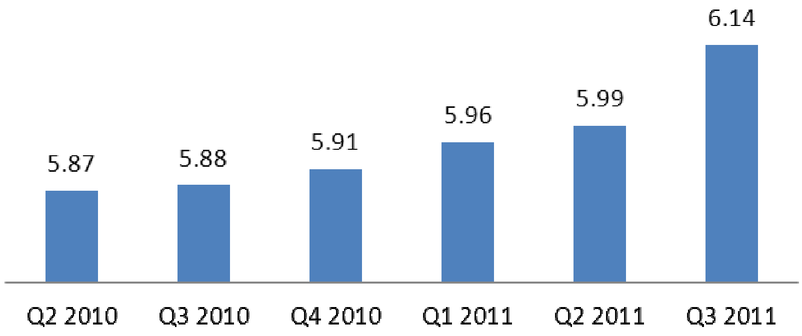
Average lettings prices achieved for new tenancies in Berlin has risen markedly since 2008. An analysis of average rent prices for "in place" tenancies showed that for the Berlin portfolio, rents achieved for new tenancies have risen from €6.13 per sqm in 2008 to €7.04 per sqm on average in the first 9 months of 2011. Similar trends have been apparent in other markets such as the Southern German cities of Nürnberg & Fürth.

The Fund has also continued to implement rent increases for existing tenancies. Rent increases put through in 2011 currently stand at €136,000 per annum, up from €126,700 to the end of August and €20,600 to the end of the first quarter. The resulting capital value increase is just over €2 million assuming a 15x multiple. Work on rent increases will continue into 2012.

One of the side effects of the rent increase programme has been a rise in the number of lease terminations and as a result, the residential vacancies at the end of the third quarter were 8.6% overall, led by a higher than expected number of cancellations in Berlin which saw the vacancy rate rise from 7.3% in Q2 to 9% at the end of Q3. Although this has had a detrimental impact on occupancy metrics, we see a much greater opportunity to raise rents in many cases above levels than would otherwise have been possible. For example, the average in-place rent for lease cancellations range anywhere from €3 to around €6.5 per sqm, therefore offering good potential for growth when re-letting.

Chart 1 below shows the average rent price development in the core Berlin market since Q2 2010. A combination of refurbishment and rent increase programmes as well as successful re-letting have seen rents across the portfolio grow from an average of €5.88 per sqm in Q3 2010 to €6.14 per sqm at the end of Q3 2011, equivalent to year-on-year rent inflation of 4.4%. PMM expect this measure to pass the 5% mark for the full year.

Chart 1: Berlin portfolio rent progression €/sqm



Residential - rest of Germany

The performance of the Fund's other residential assets was mixed in the third quarter. The vacancy rate in Hanover has remained relatively consistent over the last year at around 7%. Apartments in central Hanover are experiencing high demand and the Fund has been successful in raising rents through re-letting and a small number of rent increases. Outside of the centre is more mixed, with demand in Hildesheim in particular suffering in the last 6 months.

Leipzig (2% of assets) remains a difficult market with the vacancy rate broadly unchanged at 25%. The surplus of vacant apartments in the city is unlikely to be reversed in the near term resulting in further downward pressure on rents.

The Fund's portfolio in Nürnberg / Fürth continues to perform well, with a vacancy rate of just 3%. Given the high demand for apartments PMM has instructed the property manager to pursue a rent increase program which, coupled with setting higher prices for newly vacant apartments, should result in a decent level of rent inflation over the next 12 months.

Vacancies in Bremen stand at 12%, compared to 3.5% at the same point in 2010. The increase can be partially explained by the decision to remove a number of non-paying tenants in an attempt to improve the tenant structure of the properties. The majority of these units are currently being refurbished and we expect the vacancy rate to return to around 5% by mid-2012.

Across the residential portfolio, the overall vacancy rate increased slightly in the third quarter to 8.6% partially reflecting a higher number of cancellations in Berlin following recent rent rises. Offsetting the higher vacancy rate was an increase in average net rent discussed above.

Table 1: Residential vacancy progression

	2010				2011		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Berlin	7.4%	7.9%	8.3%	8.6%	9.1%	7.3%	9.0%
Hannover	12.2%	6.7%	7.8%	6.8%	8.2%	7.8%	7.0%
Leipzig	11.4%	16.0%	20.4%	19.0%	25.0%	26.0%	25.3%
Nürnberg	4.5%	4.5%	6.2%	2.3%	1.8%	2.3%	3.2%
Other	9.3%	5.0%	11.6%	7.3%	16.2%	7.8%	5.3%
Bremen	10.3%	8.2%	3.5%	8.3%	9.8%	12.5%	11.7%
North Germany	3.8%	1.9%	1.8%	3.7%	2.9%	2.0%	2.7%
Residential	**7.9%**	**7.3%**	**7.6%**	**7.8%**	**8.6%**	**7.9%**	**8.6%**

Commercial portfolio

The Fund is in the process of disposing of its two nursing homes. The disposal of one of the homes was completed in August 2011, while the second is being sold on a room by room basis to private investors and is expected to be fully sold by May 2012. Following these disposals, commercial property will represent 21.5% of the Fund's total assets. The Fund owns three dedicated office buildings, while the rest of the commercial space is represented by small retail and office units within residential buildings.

Despite strong macroeconomic data emanating from Germany at the moment, the commercial lettings environment remains difficult. The vacancy rate for the Fund's commercial portfolio is currently running at around 22%. The majority of vacant space is at the Fund's office property in Willy Brandt Platz, Nürnberg. A flat local office market together with few new firms moving to the city has meant that re-letting has been slower than initially predicted. That said, the property has recently attracted various suitors looking to acquire space, with a number of discussions now having reached an advanced stage. Our property managers are hopeful that occupancy will improve in the first half of 2012.

We are currently in the process of renegotiating terms on a number of commercial tenancy agreements where the fixed terms have come to an end. Renegotiations of commercial leases contracts include new fixed terms, option agreements, improved rental security, stipulated indexation and in many cases include a higher rent.

The Fund continues to monitor its commercial portfolio and in 2012 it is likely that more disposals will be considered should market conditions permit.

Borrowings

The Funds borrowings and cash balances have remained at healthy levels. Aggregate Loan to Value (LTV) currently stands at 60.2%, with net debt of €110.9 million set against property values of €184.3 million. Cash balances at the end of the third quarter were around €3.5 million. Following the completion of the remaining disposals which were made in 2011, the value of the Fund's property portfolio is expected to reduce to €178.8 million. Although no further disposals are planned at this stage, PMM constantly monitors the situation.

The Fund's debt has an average remaining duration of 4 years and no loans, excluding amortisation, are due for repayment before 2014. PMM is happy to confirm that the Fund remains inside its loan covenants.

During the last 6 months PMM has been in discussions with its principal lenders Eurohypo and Deutsche Hypo with regard to setting new interest rates. As a result of these discussions, approximately €14.5m of loans have new interest rates. PMM estimates that the average interest rate on these borrowings will fall from 4.85% to 3.2%. A further €22.5 million of loans are expected to be re-fixed at new interest rates towards the end of 2011. When complete, the aggregate pro-forma saving to the Fund is expected to be in the region of €600,000 per annum in lower interest costs.

Fund Duration and Dividend Policy

The two Phoenix Funds which make up the combined Fund raised capital in 2006 and 2007. The Funds were set up to have a minimum duration of five years and a maximum of ten. The strategy of the Fund is to use surplus capital to invest in its property portfolio and to repay debt rather than paying dividends. In 2011 PMM expects the Fund to invest a total of €2.4m in its properties (capital expenditure), while debt repayment (amortisation) will represent a further €2.3m.

NAV PERFORMANCE

The Combined Fund was last valued at the year-end 31 December 2010 at €195 million, which represented a 9% premium to the 2009 valuation. As a result of the improved valuation, net asset values per share (“NAV”) increased by 21% to €0.92 for Phoenix Spree Property Fund investors and €1.32 per share for Phoenix Spree Deutschland investors, representing an average discount of 8.7% to the initial investment price. This discount excludes any currency gains for sterling based investors arising from foreign exchange movements, which would result in valuations being around 13% higher for PSD investors and 15.8% for PSPF investors to the end of December 2010. The next valuation has been scheduled to take place in early 2012 after the December year end, with updated NAV’s expected to be released alongside annual accounts in summer 2012.

Table 2: Investment performance

*Indicative, based on last valuation, as at 31st December 2010. † Based on last valuation and an exchange rate of 0.857

Fund	Initial price (€)	NAV Y/E 2009 (€)	NAV Y/E 2010 (€)	YoY % change	Value of €1,000 invested*	Value of £1,000 invested*†
Phoenix Spree Property Fund (2006)	1.00	0.76	0.92	+ 21%	€919	£1,158
Phoenix Spree Deutschland Fund (2007)	1.45	1.09	1.32	+ 21%	€910	£1,130

MARKET & ECONOMY

The crisis currently engulfing much of Europe has until now had a limited effect on Germany. Recent economic data points to a stable economy and *The Economist* estimates that the German economy will grow by a respectable 2.9% in 2011. Much of Germany’s success has been perpetuated by its resilient export sector, with ready demand for technological products and innovations from the emerging markets of the East. Despite these positive signs, we do not believe that Germany will be immune from the general uncertainty which overhangs the Eurozone, meaning GDP growth is likely to suffer in 2012.

The housing market has shown strong signs of recovery since the financial crisis in 2008. In 2011, Phoenix Spree made three residential property disposals at prices some 32% over the purchase price paid or at €1,265 per sqm. Rental levels achievable for good buildings and locations have also risen considerably above previous high points. This has been particularly the case in certain parts of Berlin, such as Kreuzberg and Friedrichshain, but also in Nürnberg where there has been a strong development in the past 18 to 24 months.

In the wider market, a number of high profile acquisitions have taken place in recent months, including Deutsche Wohnen’s €154 million acquisition of 2,600 apartment units split predominantly between Berlin and Dusseldorf. TAG Immobilien has also been particularly active acquiring various portfolios in recent months. Aberdeen Asset Management announced the launch of a series of Funds focused on Europe and Germany in particular, likely to launch towards the year end. The notable rise in acquisition volumes and new Fund start-ups points to investors looking at Germany as a good long term prospect, with much consolidation still to come in the residential sector.

Faring less well are the open ended commercial Funds. These funds which were “closed” following the financial market crisis of 2008 have, under rules passed by German legislators, until May 2012 to decide whether they are to dissolve their Funds or return to the market. Although a number of wind-ups have already been set in motion, which included Morgan Stanley’s P2 value fund and a number of funds managed by Aberdeen Asset Management’s DEGI, more are expected to follow. What could prove most challenging in the event of mass redemptions is that many of these funds have been valued on a long term average basis and have yet to be marked to market.

SHARE TRADING

In the last Fund update, we announced a share trading facility for Phoenix Spree Deutschland (PSD) investors which started trading on Sharemark, an alternative stock market which operates an order driven trading system for small to midsized companies. Regular auctions are held where buyers and sellers submit their respective "bids" and "offers" in advance. Auctions are held on the 2nd Friday of each month. For more details please refer to the Sharemark website - www.sharemark.com

Those wishing to sell shares in PSD should first contact Appleby, the Fund administrator (psdl.team@applebyglobal.com) to obtain an up-to-date original written confirmation of your holding (a "share certificate"). You should then contact The Share Centre on 01296 41 41 41 to request an information pack; this will include a stock transfer form and instructions as to the Anti -Money Laundering requirements. Follow the instructions regarding completion of the forms, ensuring you enclose all required original documentation (including the "share certificate" obtained from Appleby). Those wishing to buy shares in PSD will first need to open an account with The Share Centre which can be done on-line. Go to www.share.com and follow the instructions. Funds must be paid onto your Share Centre account prior to an order being placed. In the interests of controlling the administrative burden resulting from the trading facility, the Directors request that buyers/sellers observe a minimum order size of 10,000 shares (approximately €10,000).

In past auctions, the highest bid price was 50p per share, while the lowest offer price was 115p per share. As a result of the disparity, no trades have taken place in PSD shares to the end of November 2011.

Please note, with Phoenix Spree Property Fund (PSPF) being a German partnership, unfortunately a similar trading facility cannot be made available to PSPF investors.

Phoenix Spree

Focus: German Real Estate
Lifespan: 3-8 years (maximum 10)
PSD ISIN: JE00B248KJ21

Investment objective

In 2009, the Phoenix Spree Property Fund and Phoenix Spree Deutschland Fund underwent an effective economic merger. The Combined Fund's investment objective is to focus on acquiring and actively managing high quality pre-let properties in Germany. Buildings were mainly bought individually or in small packages. The majority of the Fund's investments were made in the residential market, supplemented with selective commercial properties. Loans were taken out up to 70% of the purchase price.

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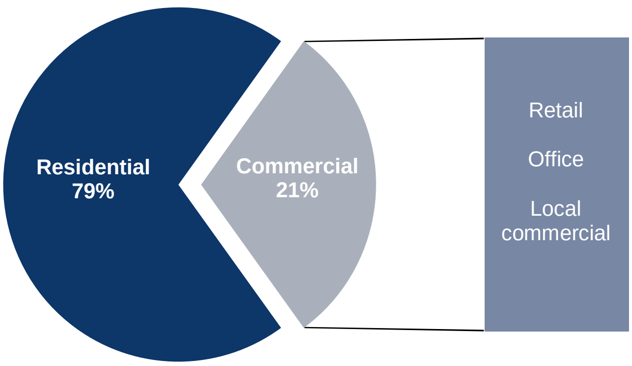
Key metrics (post completed disposals)

Gross asset value (€ million)	€178.8	Total disposals to date (€ million)	€16.8
Borrowings (€ million)	€110.9	Total rental units	2,487
Current loan to value (including cash)	60.2%	Residential vacancy rate to 30 September 2011	8.6%
Gross lettable area (sqm)	186,807	Commercial vacancy rate to 30 September 2011	22%

Portfolio (indicative distribution)



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Fund advisor

The Combined Fund is advised by PMM Partners which was formed to address opportunities in the real estate market. PMM Partners has advised on over 100 real estate transactions since 2005 valued at more than €200 million. Through analytical, research-driven processes and direct deal experience the property advisory team have greater insights into the strategies and disciplines of the Funds they advise on.

Visit our website at **www.pmm-partners.co.uk**

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