

Aviva Investors Pensions Property Fund

Quarterly Update

Q2 2011



Market background

Recent months have brought further evidence that the market is easing into a period of more muted returns. Following a significant re-pricing over the past two years, investors are seeing less scope to drive pricing further and yield compression is petering out and capital growth is easing. According to the June IPD Monthly index (IPDMI), for Q2 as a whole, capital growth was 0.4%, its lowest level in two years.

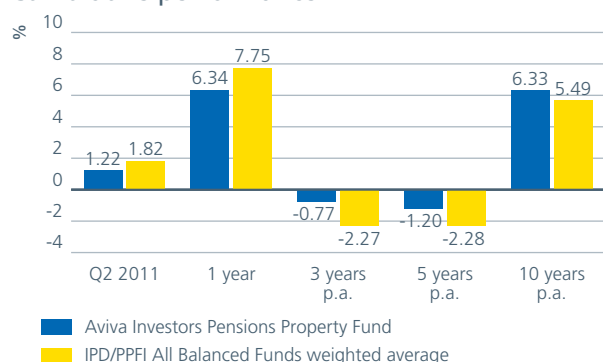
The IPDMI estimates that capital values have recovered by 18% since the cycle low reached in July 2009 driven by inward movement in equivalent yields of over 200 basis points. Nonetheless, values remain almost 35% below the peak reached in June 2007. Q2 also brought further evidence that the rental cycle is close to turning for the market in aggregate, with robust rental growth in Central London office rents cancelling ongoing, though moderating, rental decline in some other sectors. For the overall market the IPDMI recorded flat rents for the second consecutive quarter. The IPDMI recorded an all-property total return of 2.1% for Q2, marginally lower than the previous quarter's return. In year-on-year (y-o-y) terms, returns eased to 9.1% from 10.7% in Q1 and 23.9% a year earlier. Though easing also, Central London offices remain the major out-performer with total returns running at 18.4% y-o-y in the City and 16.5% in the West End in June.

Key fund facts

Total Fund size	£1,201.4m
Number of properties	83
Average lot size	£13.0m
Average lease length	8.9 years
Direct property initial yield	5.75%
Fund level yield	5.40% (standard 0.7% AMC share class)

Performance

Cumulative performance



Source: IPD/PPFI as at 30 June 2011 – nav to nav, net of fees.
Past performance is not a guide to the future.

Discrete years' performance

30 June to 30 June	Fund %	Benchmark %
2010-2011	6.3	7.7
2009-2010	19.0	19.0
2008-2009	-22.8	-27.2
2007-2008	-15.0	-15.6
2006-2007	13.4	13.2

Source: IPD/PPFI as at 30 June 2011 – nav to nav, net of fees.
Past performance is not a guide to the future

The Fund returned 1.2% over the quarter, underperforming the 1.8% recorded by the benchmark index, the IPD/PPFI All Balanced Funds Weighted Average.

Income return makes up the majority of the total return figures although capital returns have also continued to be positive over the quarter. The rate of capital appreciation has slowed dramatically compared with 12 months ago but remains positive. The polarisation of the market continues, with values for prime assets holding up whilst secondary assets are seeing value falls. These falls are principally through a combination of outward yield movement, falling income and falling Estimated Rental Values (ERVs).

The Fund's income return was marginally below benchmark in Q2 due to an above-average void rate and associated void costs. We expect the void rate to fall significantly in Q3 through exchanged sales and lettings.

The Fund has underperformed the benchmark over Q2 2011, due to a lack of gearing, cash levels and sector allocation. We consider that our sector allocation to be underweight to City offices and shopping centres remains appropriate, given the higher volatility and more cyclical nature of these markets. The Fund has a lower-risk strategy which targets low volatility. Should value falls occur during 2011 then the Fund's above benchmark cash position (c. 10.4% at end of Q2) and lack of gearing should enhance relative returns. The Fund continues to outperform the benchmark over three, five and ten years.

Fund activity

Transactions during the quarter included the partial sale of an industrial property in Northampton. The Fund also exchanged contracts on a supermarket in Welling (SE London) although this did not complete until 1 July 2011 so is not reflected in the figures for Q2.

At Eversholt Street, London NW1, the Fund completed a deal to remove a break option from a tenant's lease and funded the installation of air-conditioning to an 8,000 sq ft suite, creating an 8 year unexpired lease term and improved specification that will capture forecast rental growth in Central London offices.

The Fund secured planning consent for the development of a pod unit on Exeter Retail Park. Construction of the 1,600 sq ft unit (that has been pre-let to Costa Coffee Ltd) will commence in August.

The Fund has a strong asset management pipeline, with a number of initiatives planned for 2011 which should deliver value for the Fund.

Sector weightings

Sector	Current fund weighting %	Benchmark %
High Street Retail	15.4	22.8
Retail Warehouse	33.5	21.5
Office	32.6	29.6
Industrial	14.0	17.0
Other	4.5	9.1
Total	100	100

Source: IPD/PP FI as at 30 June 2011

Top ten holdings

Property	Sector	Lot size range (£m)
Exeter Retail Park, Exeter	Retail warehouse	40-45
Sainsburys, Bishop Auckland	Retail	35-40
163-203 Eversholt Street, London NW1	Office	35-40
111 The Strand, London WC1	Office	35-40
25 Soho Square, London W1	Office	30-35
Abbott House, Maidenhead	Office	30-35
Westgate Retail Park, Basildon	Retail warehouse	30-35
Cantium Retail Park, London SE1	Retail warehouse	30-35
Summit House, Red Lion Square, London WC2	Office	25-30
Gemini Business Park, London E14	Industrial	25-30
Total		28.5% of fund

Source: CBRE as at 30 June 2011

Market outlook

The near term is likely to see further easing in real estate returns as the rally in yields peters out for the market in aggregate. Though prime assets remain in strong demand, elevated income and financing risks mean that most investors are wary of secondary assets and some slippage in secondary yields is expected in the near term. The next leg in the recovery for real estate values requires a pickup in rental prospects but, with occupier markets outside of Central London offices still generally muted, widespread rental growth does not appear likely in the immediate future. As a result, we continue to expect a period of sub-trend returns in the near term, with Central London offices to remain the strongest-performing sector.

Robust returns are expected for 2012 and 2013 as the rental recovery broadens out across the market. With economic recovery continuing and low levels of development in the near term, we remain confident that rental recovery will come and that medium-term prospects for the asset class are healthy. The major risk to the sector comes from debt, either via the considerable refinancing needs of the sector itself in coming years or through a marked move higher in sovereign bond yields.

Dealing

The Fund is only open to UK tax-exempt pension funds.

The Fund is open ended and daily priced. Units can be purchased via the manager on any business day. Details of fees and charges are available on request. A bid/offer spread of circa 6.0% is applied to the creation or sale of units relating to the underlying costs of transactions. Aviva Investors provides a secondary market dealing facility for buyers and sellers of units which may not include transaction charges.

The team



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Important information

Unless otherwise stated, the source of all information is Aviva Investors Global Services as at 30 June 2011.

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Investors should also bear in mind that the valuation of property is generally a matter of valuers' opinion rather than fact.

Telephone calls may be recorded.

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