

THE VAM PROPERTY FUND

Update from John Dwyer, Investment Manager at Fleming Family and Partners



As stated in the September presentation, my strategy going forward for the VAM Property Fund is firstly to increase the liquidity of the portfolio.

The fund is currently locked into very reputable unlisted property units trusts (PUTs) which have had to close their doors to redemptions because of the weight of money wanting to come out and their lack of ability in the current market to sell any assets at reasonable prices and generate cash to fund redemptions. Our hands are therefore largely tied for the moment but we should be able to get out of Threadneedle and UBS Triton by the end of Q1 2009. We could also sell our listed holdings but I would be loathe to do this at the very bottom of the market unless we really have to.

I am looking to invest more into the listed property sector which I believe has been oversold and offers great value, particularly in terms of yield. The PUT sector is lagging the listed sector and still has some pricing correction to go. I remain very enthused that we are getting close to a once in a life time opportunity to buy into the property sector at very good levels although any recovery is predicated on the improvement in the global economy as a whole which may not come through until 2010. The good news is that interest rates are coming down, inflation pressures are abating and liquidity in the banking sector is beginning to come back, albeit slowly. All positive factors for real estate.

As for the assumption that real estate is a steady income earner and not subject to capital valuation fluctuations – well I'm afraid the latter part is just not true. Real estate is generally a good income play as evidenced by the IPD UK All Property Index which has shown an average monthly income return of 0.5% per month throughout 2008. Nevertheless IPD All Property Total Returns are down 18.1% (unleveraged) in the 12 months to September 2008 implying a capital value fall of some 24.0%. While the income stream has been steady, the valuation of the income stream has changed dramatically. What has happened is that the All Property Initial Yield has moved from 4.57% at the peak of the market in May 2007 closer to 6% now and is likely to head to 7%. This is back to the levels seen in 2004 but went as high as 7.26% in 2001. VAM has therefore enjoyed a considerable positive shift in yield from Jan 2003 to mid last year which has since gone into reverse. This is all investor driven. In the run up to 2007 debt was freely available and investors were able to finance deals with yield enhancing debt. That all went away when the credit crunch hit and removed many of the buyers from the market. The experience of the last year has been brutal and some would say unprecedented. The yield and debt impact on capital values can be seen from the following simple examples:

Example 1:

Property bought for £100 with all equity and an income stream of £5 = 5% yield
Income stream remains stable but yields rise to 7% - value therefore falls to £71.43 = equity value fall of -28.57%

Example 2:

Property bought for £100 with 50% equity and 50% debt and an income stream of £5 = 5% gross yield.

INVESTMENT OBJECTIVE

The investment objective of the Fund is to seek exposure to real property through various Investment Funds (including Hedge Funds pursuing property related strategies) and/or by investing directly in transferable securities. The Fund may, for up to 10% of its net assets, invest in non-listed securities (including closed-ended Investment Funds) providing exposure to real estate

INVESTMENT MANAGER

John Dwyer, Fleming Family & Partners

FUND DETAILS*

Advisory Company

VAM Advisory S.A. 26, avenue de la Liberté, L-1930 Luxembourg

Promoter

VP Bank (Luxembourg) S.A. 26, avenue de la Liberté, L-1930 Luxembourg

Central Administration

VPB Finance S.A. 26, avenue de la Liberté, L-1930 Luxembourg

Custodian

VP Bank (Luxembourg) S.A. 26, avenue de la Liberté, L-1930 Luxembourg

Minimum Direct Investment

\$10,000 / € 8,000 / £5,000 initial and \$1,000 / € 800 / £500 additions.

AVAILABLE SHARE CLASSES

- Sterling
- Dollar
- Euro

Debt interest cost = £2.25 or 4.5% of £50 leaving £2.75 of net income for the equity or an enhanced return of 5.5% on £50.

Income stream remains stable but yields rise to 7% as in example 1. reducing gross value of property to £71.43.

Debt is £50 so equity value falls to £21.43 (£71.43-£50) or an equity value fall of -57.14%
50% leverage has therefore doubled the fall in the equity value fall.

The same applies in reverse when yields fall and values rise.

Yields are impacted by investor sentiment and interest rates. Yields started to rise in mid 2007 as interest rates rose and debt became less readily available.

Base rates in the UK have since fallen and are now at 3% (lowest level for 50 years) so one might assume that with actual yields probably close to 7%, the positive yield arbitrage of some 4% will begin to entice buyers back into the market. Transactions are not happening yet as prospective sellers are not having to sell as yet and do not want to get out at these levels unless they have to. Likewise deals cannot be financed as yet and prospective buyers are reluctant to put in all equity. We think this will begin to unravel in 2009 and the market will become more active as sellers are forced to liquidate to repay debt and buyers get more bullish. There are some bargain basement deals to be done in the direct market for those who have cash.

In the listed sector stocks are trading at significant discounts to both current and prospective NAVs and we believe they have been oversold. This applies not just to the UK markets but to all markets. The Morgan Stanley Global Real Estate Index was down -26% in October and is down -53% for the year. The index is back to levels last seen in December 2003 and offers an average yield of 13.4% at these levels. I believe that to be very attractive on any risk adjusted basis.

I know the past 12 months have been very hard on VAM Property's existing investors but I hope they stay with us and benefit from what I see as a great investment opportunity in 2009.

Best regards,
John Dwyer
Head of Real Estate
FF&P Asset Management Limited

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