BMO Real Estate Investments

BMO

Q2 2020

Manager Commentary
Peter Lowe

Total returns for the UK property market, as measured by the MSCI UK Quarterly Property Index (the 'Index'), deteriorated further over the second quarter to -1.8%. All-property capital values fell by 2.8%, with rental growth at -1.1%. A key characteristic of the quarter was a 7.1% quarterly fall in net operating income growth, reflecting difficulties in rent collection during the pandemic.

Performance in the second quarter was impacted by the lockdown and ongoing uncertainty regarding the containment of the coronavirus outbreak. Operational restrictions were loosened as the quarter progressed, but business, consumer and investor sentiment is still extremely cautious. In March, valuers invoked the "material uncertainty" clause (this is a precautionary step undertaken when extraordinary events, in this case the pandemic, mean that there is a shortfall in transaction data for property which makes it difficult for valuers to appropriately price properties) across the sector. There was some relaxation of this status for some subsectors over the quarter (and after quarter-end), but open-ended funds remained suspended throughout the period.

Economic forecasts have been revised down still further and a major recession is now expected in 2020, both in the UK and globally. Fiscal and monetary policies have been eased dramatically to support the UK economy. The jobs-retention scheme was extended, helping to limit the impact on unemployment to date. Gilt yields moved lower over the quarter, and the gap between the yield on property and the yield on gilts widened to historic highs.

The deterioration in performance was apparent across all parts of the market, but with retail and hospitality recording the sharpest falls. The prolonged weakness within the retail market continued, with administrations and company voluntary arrangements (CVAs) weighing heavily on sentiment. The sector delivered a -4.2% quarterly return, with all standard segments making negative total returns. Offices recorded a -0.8% total return, with City and "Rest of UK" offices outperforming the sector average but still negative. Industrial and distribution delivered a marginally positive quarterly total return at 0.1%, with the South East outperforming other regions. The performance of Alternatives weakened markedly in the quarter to -2.2%, with problems in the leisure, student and hotel segments.

The quarter has seen occupiers demanding more flexible lease terms and rent concessions particularly, though not exclusively, in the retail and leisure sectors. There may well be permanent changes to lease structures resulting from the disruption caused by the pandemic.

Against this backdrop, the Company portfolio delivered a total return of -1.3% over the quarter, with the positive income return of 1.3% and a capital value decline of 2.6%. The Company's portfolio delivered an ungeared return of -0.6% over the 12 months to June versus the Index return of -2.7%. The Company has delivered returns in excess of the Index over 1,3, 5, 7 and 15 years since inception. This relative performance has been primarily driven by our conviction in industrial and logistics assets (now 43% of portfolio weighting by capital value) and the sustained yield pickup assisted by the consistently low vacancy rate, which currently stands at 3.3% (7.5% for the Index). Over recent quarters, the absence of shopping centre, department store, hotel, leisure and student exposure, and the very small exposure to the food and beverage sector, has been of significant benefit to rent collection. The collection rate currently stands at 94% for the March to June quarter, and 75% for the June to September quarter (by early August). This level of collection will increase further in the coming weeks.

Both the industrial and office assets delivered marginally positive returns over the quarter of 0.4% and 0.2%, respectively, with capital growth slightly negative for each. These two sectors now makeup approximately 75% of the portfolio by value.

The retail market continues to suffer with the pace of value falls accelerating, led by the anticipated rebasing of rents across much of the high street and shopping centre submarkets. The Company retail portfolio as a whole delivered -5.4 % versus -4.2 % for the Index as a consequence of greater value write-downs. A large portion of the Company's "retail" exposure is low rented, functional, retail warehouses. The vast majority of the Company's tenants in this space were able to remain open throughout lockdown. This was demonstrated by the 91% collection from this part of the portfolio for the March to June quarter, with monthly payment plans having been put in place to assist some tenants with cashflow where justified.

On 3 June 2020, the Company announced its quarterly dividend payment of 0.625 pence per ordinary share in respect of the financial year ended 30 June 2020, which was paid to shareholders on 30 June 2020. This was a 50% reduction on previous quarterly dividends, reflecting the fact that rent collection was likely to be challenging in the coming months and that the Company had been paying a dividend which had not been fully covered over the course of the financial year. The Board therefore considered it prudent to reduce the level of its future quarterly dividend payments in order to protect cash reserves and the long-term value of the Company. The Board will continue to monitor closely the impact of Covid-19 on rental receipts and earnings and keep the future level of dividends under review.

Although the next few months may see positive economic data as restrictions ease and growth resumes from a low base, there are a number of headwinds. There is likely to be increased unemployment as the furlough scheme ends in October, which could delay recovery, and more waves of infection and lockdowns cannot be ruled out. The Brexit negotiations have been slow and the UK remains on course to leave the EU at the end of the year. The property market will need to adjust to a probable permanent shift to more online retailing and increased working from home. The outlook is uncertain, but on consensus economic forecasts, and with no further major lockdowns, we expect a difficult 2020 to be followed by a partial recovery in 2021 and modest positive total returns thereafter, led by industrials/distribution.

Key facts

Trust aims: To provide ordinary shareholders with an attractive level of income with the potential for income and capital growth from investing in a diversified UK commercial property portfolio.

Fund type: Investment Trust

Launch date: 1 June 2004

Total assets: £329.69 million

Share price: 56.00p

NAV*: 96.64p

Discount/Premium (-/+): -42.05%

Dividend payment dates: Mar, Jun, Sep, Dec

Dividend yield †: 7.81%

Net gearing:** 25.57%

Vacant property: 3.27%

Weighted average lease length: 5.68 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.30%

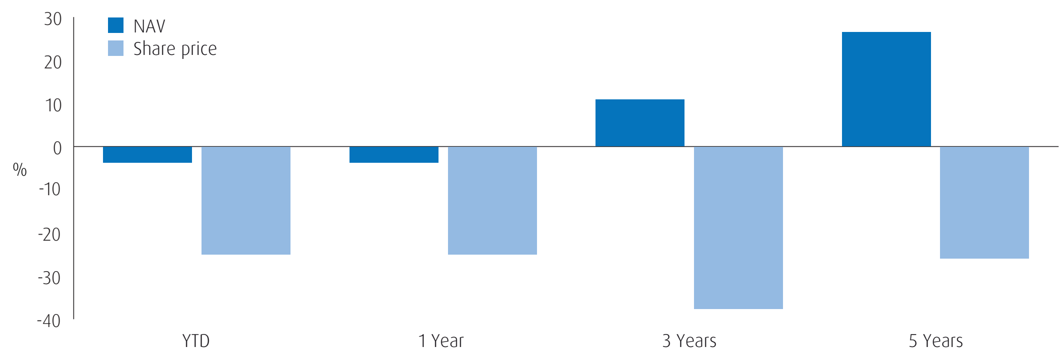
Year end: 30 June

Sector: Property Direct - UK

Currency: Sterling

Website: www.bmorealestateinvestments.com

Fund performance



Cumulative performance (%) as at 30.06.2020

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	-2.5	-3.7	-3.7	10.8	26.4
Share price	-18.2	-24.9	-24.9	-37.5	-25.9

Discrete annual performance (%) as at 30.06.2020

	2020	2019	2018	2017	2016
NAV	-3.7	1.3	13.6	6.1	7.5
Share price	-24.9	-15.2	-1.9	26.8	-6.5

Past performance is not a guide to future performance. Source: Lipper and BMO. Basis: Percentage growth, total return, bid to bid price with net income reinvested in sterling. Basis in accordance with the regulations of the Financial Conduct Authority.

Telephone calls may be recorded

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Key risks

Stock market movements may cause the value of investments and the income from them to fall as well as rise and investors may not get back the amount originally invested. If markets fall, gearing can magnify the negative impact on performance.

The value of property related securities are likely to reflect valuations determined by professional valuers. Such valuations are the opinion of valuers at a particular point in time and are likely to be revised and movements may cause the value of investments and the income from them to fall as well as rise and investors may not get back the amount originally invested. Property and property related assets can sometimes be illiquid. A fund investing in a specific country carries a greater risk than a fund diversified across a range of countries. If markets fall, gearing can magnify the negative impact on performance.

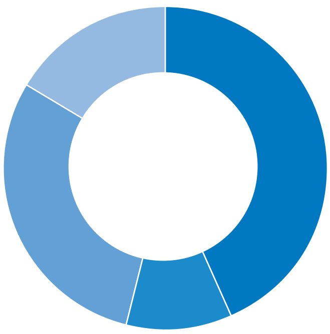
Trust codes

Sedol	
BREI - GBP	B012T52

Top 10 property investments (%)

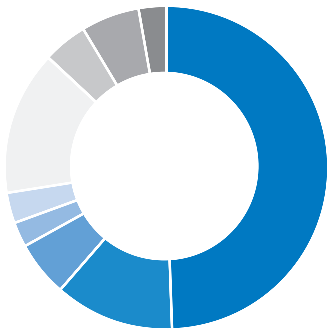
London W1, 14 Berkeley Street	9.2
Banbury, 3663 Unit, Echo Park	7.6
Colnbrook, Units 1-8 Lakeside Road	7.3
Eastleigh, Southampton International Park	6.2
Hemel Hempstead, Hemel Gateway	5.0
Bracknell, 1/2 Network Bracknell, Eastern Road	4.0
Theale, Maxi Centre	3.7
York, Clifton Moor Gate	3.7
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.6
Eastleigh, Wide Lane	3.4
Total	53.7

Sector breakdown



Industrial	43.4
Retail	10.5
Offices	29.8
Out of Town Retail	16.3

Geographical breakdown



South East	49.5
London - West End	11.9
Yorkshire and Humberside	5.6
West Midlands	2.6
Rest of London	3.1
Eastern	14.3
Scotland	4.5
East Midlands	5.8
North West	2.7

Net dividend distributions pence per share

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
March	1.8	1.8	1.8	1.8	1.8	1.8	1.25	1.25	1.25	1.25	1.25	1.25	1.25
June	1.8	1.8	1.8	1.8	1.8	1.8	1.25	1.25	1.25	1.25	1.25	1.25	0.625p
September	1.8	1.8	1.8	1.8	1.8	1.25	1.25	1.25	1.25	1.25	1.25	1.25	
December	1.8	1.8	1.8	1.8	1.8	1.25	1.25	1.25	1.25	1.25	1.25	1.25	
Total	7.2	7.2	7.2	7.2	7.2	6.1	5	5	5	5	5	5	1.875p

Structure

At launch on 1 June 2004, the Company had a capital structure comprising approximately 60 per cent Ordinary Shares and 40 per cent bank debt.

Ordinary shareholders are entitled to all dividends declared by the Company and to all the Company's assets after repayment of its borrowings. As at 30 June 2020, borrowings consisted of a loan drawn down of £90 million: £90 million fixed term facility from Canada Life due to expire in November 2026. There was no draw down of the revolving credit facility from Barclays due to expire in March 2025. The weighted average interest rate on the Group's current borrowings is 3.1%.

All data as at 30.06.2020 unless otherwise stated.

All information is sourced from BMO, unless otherwise stated. * The NAV is calculated under International Financial Reporting Standards. † Calculated with reference to the previous annual dividend of 4.375p per share. ** Bank Debt (less net current assets) divided by investment properties. *** Please refer to the latest annual report as to how the fee is structured. **** Ongoing charges are total expenses (excluding direct property expenses) as a percentage of average net assets for the year ended 30 June 2020. The share price may either be below (at a discount) or above (at a premium) the NAV. Discounts and premiums vary continuously. Performance information excludes any product charges which can be found in the Key Investor Document ("KID") for the relevant product. Views and opinions have been arrived at by BMO Global Asset Management and should not be considered to be a recommendation or solicitation to buy or sell any funds that may be mentioned. The factsheet is issued and approved by BMO, a trading name of BMO Asset Management Limited. Authorised and regulated in the UK by the Financial Conduct Authority. (08/20)

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