BMO Real Estate Investments

Q2 2019

Manager Commentary
Peter Lowe

Total returns for the UK property market, as measured by the MSCI UK Quarterly Property Index for Quarterly and Monthly Valued Funds (the 'Index'), showed some stabilisation in the second quarter at the all-property level, delivering 0.5%. All-property capital values fell by 0.6%, with rental falls of 0.1%, led lower by the retail sector. The annual all-property total return slowed to 3.3%, underpinned by a 4.4% income return.

The postponement of the initial Brexit deadline, the resignation of Theresa May and the consequences of the subsequent constitutional crisis have kept political issues in the forefront of investors' minds. Slower economic growth in the eurozone and beyond, together with the threat of a US-China trade war, has also affected sentiment. Consensus estimates for UK GDP growth forecasts for 2019 continue to be revised lower but remain positive. Labour market data is encouraging, and consumer price index inflation ended the period at the Bank of England's target level. Monetary policy was unchanged during the quarter and market sentiment became more dovish regarding the likely trend of official UK interest rates. The trade-weighted value of sterling fell by 3% during the quarter. Ten-year gilt yields fell further in the second quarter, to finish the period below 1%. With all-property yields edging marginally higher, the yield gap between property and gilts widened slightly, which offered some support to pricing.

The continued market uncertainty has translated into far lower quarterly transactional volumes, with purchasers – particularly foreign buyers – adopting a 'wait and see' approach. Some high-profile deals have failed to complete, which has also affected sentiment. Net investment from overseas is still positive, helped by a few large deals, and institutions have been net sellers of property alongside property companies (both listed and unlisted). Local authorities are still buying, with much being made of their shopping centre purchases, an area of the market where value pressures are particularly evident. Virtually all segments of the market experienced reduced levels of investment in the first half of 2019, compared with a year earlier, and almost every sector saw activity below the long-run average in the quarter. UK direct property funds are seeing outflows; in addition, the issue of liquidity in open-ended funds has come back into focus following the much-publicised problems with Woodford's equity funds.

The polarisation of performance continued at the subsector level, though with some moderation. Negative total returns from the retail sector persisted but the pace moderated slightly in comparison with the previous three-month period. Store rationalisation programmes continue alongside a more adversarial approach to lease negotiations from occupiers. Despite greater recognition of the role that accessible retail can play in a multichannel offer, the performance of the retail warehouse subsector is weak, particularly for the larger, less liquid and highly rented fashion parks. Quarterly performance of offices eased back marginally, with the regions out-performing London. Industrial and distribution property continue to out-perform the all-property average, with a quarterly total return of 1.7%, unchanged from the previous quarter. Alternatives registered a marginal improvement, also outperforming at 1.3%.

The Company portfolio delivered a total return of 0.6% over the quarter, versus 0.5% for the Index, led by an income return of 1.3%. The capital value of the portfolio decreased by 0.8% over the quarter.

Positive performance was attributable to the crystallisation of asset management initiatives at several properties, particularly within the offices sector, for example at Berkeley Street, London and with the completion of the pre-let of the majority of the space at the proposed refurbishment at County House, Chelmsford to the UK Government.

The retail market is experiencing considerable headwinds, both structural and cyclical, with continued stress in the occupier markets putting pressure on rents and weighing on investor sentiment. The retail element of the Company's portfolio decreased in value by 2.6% over the quarter, again led lower by the high street portfolio. The portfolio's retail warehousing assets outperformed the Index but still fell 1.8% in value terms.

C.40% of the Company's asset base is comprised of industrial and logistics assets located within the South East, which continue to deliver income growth either via lease events or as a result of active management. These assets experienced capital growth of 0.4% over the period and delivered a total return of 1.6%.

Disposals from the retail portfolio continued over the quarter, with the completion of the sale of the high street asset at Kings Heath, Birmingham for a price of £2.0m. This was in line with the previous quarter's valuation.

At the end of the period, the portfolio void rate was 0.1%, a demonstration of encouraging occupational demand for the Company's properties, and the average weighted unexpired lease term was c.6 years.

Market sentiment is extremely cautious, given the political and economic uncertainties coupled with the structural problems in retail. Investment activity has been affected and the occupational market has seen muted rental growth. The downward revision to GDP forecasts offers little prospect of improvement in rents at the all-market level, though the marked difference in outlook between the sectors offers significant scope for improvement in relative performance through stock selection and portfolio composition. Performance is being driven by the income return. The lack of progress in Brexit negotiations ahead of the revised deadline, the change in the premiership and the possibility of further political changes seem likely to prolong market uncertainty.

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: £355.90 million

Share price: 80.00p

NAV*: 104.80p

Discount/Premium (-/+): -23.66%

Dividend payment dates: Mar, Jun, Sep, Dec

Net dividend yield †: 6.30%

Net gearing:** 26.65%

Vacant property: 0.10%

Weighted average lease length: 5.80 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.20%

Year end: 30 June

Sector: Property Direct - UK

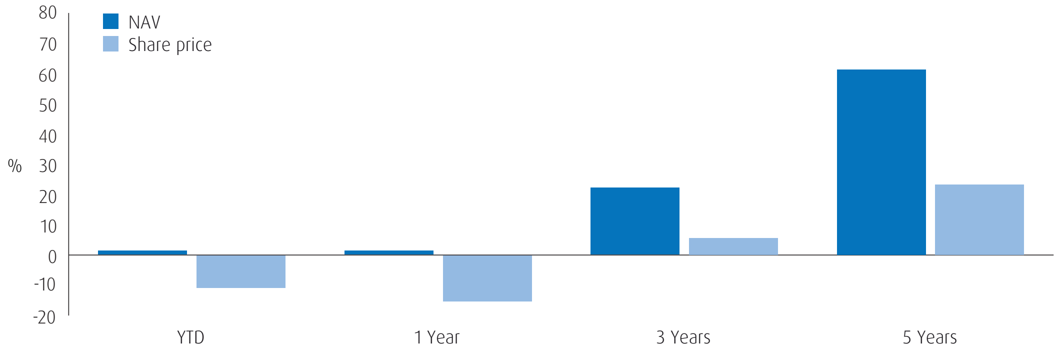
Currency: Sterling

Website: www.bmorealestateinvestments.com

****Ongoing charges calculated in accordance with AIC recommendations. Please refer to the latest annual report as to how the fee is structured.

Telephone calls may be recorded

Fund performance



Cumulative performance (%) as at 30.06.19

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	0.0	1.3	1.3	22.1	61.2
Share price	-7.4	-10.7	-15.2	5.5	23.2

Discrete annual performance (%) as at 30.06.19

	2019	2018	2017	2016	2015
NAV	1.3	13.6	6.1	7.5	22.7
Share price	-15.2	-1.9	26.8	-6.5	24.9

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.

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. Changes in rates of exchange may have an adverse effect on the value, price or income of investments. 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.

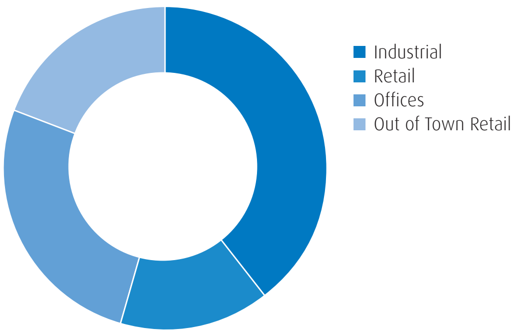
Trust codes

Sedol	
BREI - GBP	B012T52

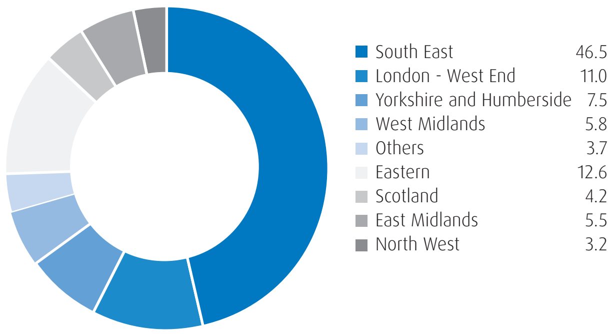
Top 10 property investments (%)

London W1, 14 Berkeley Street	8.5
Banbury, 3663 Unit, Echo Park	7.1
Colnbrook, Units 1-8 Lakeside Road	6.4
Eastleigh, Southampton International Park	5.7
Hemel Hempstead, Hemel Gateway	4.6
York,Clifton Moor Gate	3.8
Bracknell, 1/2 Network Bracknell, Eastern Rd	3.7
Theale, Maxi Centre	3.4
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.2
Eastleigh, Wide Lane	3.1
Total	49.5

Sector breakdown



Geographical breakdown



Net dividend distributions pence per share

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
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
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
September	1.8	1.8	1.8	1.8	1.8	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	
Total	7.2	7.2	7.2	7.2	7.2	6.1	5	5	5	5	5	2.5

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 2019, borrowings consisted of loans drawn down of £97 million: £90 million fixed term facility from Canada Life due to expire in November 2026 and £7 million of the revolving credit facility from Barclays due to expire in November 2020. The weighted average interest rate on the Group's current borrowings is 3.2%.

All data as at 30.06.19 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 projected annual dividends of 5.0 pence 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. 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. (09/19)