BMO Real Estate Investments

BMO

Q2 2021

Manager Commentary
Peter Lowe

Despite a challenging period in the wake of the Covid-19 pandemic the labour market continues to improve with the unemployment rate falling as companies begin to rehire. Headwinds remain, principally in the form of inflation, which has been steadily rising as sectors previously closed have reopened and raised prices, giving rise to the potential for an increase in interest rates. Supply chain issues have been particularly prevalent in the food and fuel markets.

The pandemic, in combination with the impact of Brexit trade disruption has further polarised the fortunes of the various segments of the commercial property market. Some sectors have experienced a beneficial demand shift, with the reimagining of food-stores as essential infrastructure and the continued growth of ecommerce delivery being two of the most obvious. On the other hand, nervous consumers, government mandated store closures, and the encouragement of employees to work from home have brought unprecedented challenges for our city centres. There is expectation that the easing of restrictions will see a return to previous patterns of consumption. While this is likely to be true for the most part, we do expect to see a lasting impact in behavioural changes, particularly via an acceleration of trends that had already taken root prior to the onset of the pandemic. Prime and core real estate assets are commanding premiums, with some marginalised locations and asset types risking becoming stranded. The growing awareness and application of the ESG agenda with a new focus on net zero carbon will play an increasingly important part in investment decisions.

Liquidity has returned to the investment market, with transaction levels having increased considerably since the depths of 2020. Industrial property continues to be the most sought after, experiencing the strongest half year of volumes on record. Despite the uncertainty around the 'return to office', the Office sector has seen an uptick in activity to complement an improvement in the occupational markets. Not all retail has been affected in the same way by the pandemic and divergence within the sector continues. Supermarkets are the most sought after with demand returning for well let retail parks, especially those supported by alternative use. Investment activity in the Alternatives sector was boosted by residential and student housing, but also a recent pickup in hotel deals. Foreign investors accounted for well over half of second quarter deals, much more active than the equivalent quarter in 2020 when lockdowns and travel bans were first introduced.

Against the backdrop of improving sentiment and sub-sector divergence, the MSCI All-Property total return over the quarter was 3.41%, driven principally by capital growth of 2.3% with income return at 1.1%. At sector level, Industrials remain the standout performer generating a 7.5% total return over the quarter. Attractive occupational fundamentals and rental growth prospects continue to attract a significant weight of capital from a widening investor base and across all geographies, driving capital growth of 6.5% over the quarter. The Retail sector posted its first positive total return in three years at 1.7%, albeit with yield compression in the retail warehousing sub-sector being the defining factor in the wider sector's performance. The high street retail sub-sector continues to see signs of stabilisation while shopping centres remain challenged. Both occupier and investor sentiment in the Offices sector continues to improve with capital growth turning positive for the first time since the on-set of the pandemic, contributing to the total return of 1.56%. However, the recovery in Offices remains uneven across the sub-sectors with London and the core cities being the main beneficiaries of increased take-up and investment volumes. The 'Other' category within the Index (including leisure, student, healthcare and residential) has seen a positive quarter with a total return of 1.9% and with increasing investor appetite, attracted by the relative value offered by the sector which had seen capital depreciation throughout much of 2020.

The Company's portfolio delivered an ungeared return of 3.43%, driven by capital growth of 2.2%. The portfolio has delivered in excess of the MSCI Index over 1, 3, 5, 10 and 17 years since inception, with this long run outperformance now reaching 100bps per annum.

The relative outperformance continues to be driven by favourable asset allocation, particularly by the high exposure to Industrials (47% of portfolio by capital value) and the sustained yield premium, assisted by the consistently low vacancy rate which currently stands at 4.1 per cent (versus 8.0 per cent for the Index). Supporting the outperformance have been successful asset management initiatives, particularly the redevelopment and partial pre-letting of the Office at County House, Chelmsford and the development and pre-letting of a foodstore at Enterprise Way, Luton.

All sectors of the Company's portfolio posted positive total returns albeit with the Industrial assets continuing to be the primary driver of performance, delivering a 5.8% total return over the quarter. The Office holdings posted 1.1% total return over the period, driven by active asset management of the portfolio in the context of relatively benign market conditions. The portfolio's Retail assets outperformed their peers and generated a total return of 1.84%, with positive returns from the high street assets indicative of increasing stabilisation within the sector. However, the key driver within the Retail sector remains Retail Warehousing which posted a total return of 3.1%. Indeed, the Company's relatively high weighting of 17% to the Retail Warehousing sector and allocation to the favourable convenience/essential occupiers, let off relatively low rents has proven a strong driver of return over the last 12 months.

Post-period, the Company has increased its weighting to the Industrial and Retail Warehousing sectors, targeted for their robust occupational demand, income resilience and favourable performance prospects. In September 2021, the Company successfully concluded the off-market acquisition of two assets, acquired for £19.4m and at an accretive combined yield. The first property, an industrial asset in Colnbrook, Heathrow, was acquired for £12.1 million at 4.0% initial yield and is highly reversionary. The asset is fully let to a vehicle servicing centre in a market characterised by very tight supply dynamics, offering opportunity for value creation through near-term asset management. The second property comprises a retail warehousing scheme in Banbury, Oxfordshire, occupied by home-improvement tenants Wickes and Topps Tiles. The property was acquired for £7.3 million, reflecting a net initial yield of 6.3%. The acquisition enhances the Company's exposure to the functional, non-fashion and low-rented segment of the retail warehousing sub-sector, which continues to see material yield compression, coupled with the potential for repurposing for alternative uses, protecting long-term value.

The purchases conclude the successful redeployment of proceeds realised from a number of strategic disposals from the High Street and Office sectors, including the sale of The Parade, Sutton Coldfield for £1.5m in May 2021 and Marlborough House, St Albans for £7.9m in July 2021. Combined, these disposals were concluded at a 5% premium to valuation and underline continued liquidity within the Company's portfolio.

On 9 September, the Company announced an increase in the quarterly interim dividend for the year ending 30 June 2021, up by 17.6% to 1.0 pence per share. The increase in dividend reflects the strong rent collection statistics over the 12-month period to June in excess of 97%. At the time of writing, rent collection for Q3 2021 already stands at 99%, with the majority of the balance subject to repayment via payment plans, indicating a return to more normalised payment patterns.

The outlook for the UK property market remains positive with some welcome stabilisation in the previously unfavoured sectors. Investor sentiment towards UK real estate is continuing to improve, attracted by relative value against both bonds and global real estate markets. Income resilience is the key investment driver, with the standout rental growth being delivered by the Industrial sector continuing to attract a weight of money. The Retail Warehousing sector and parts of the Alternative sector appear to offer relative value. With further yield compression expected across the market (perhaps with the exception of High Street Retail), opportunities for capital growth remain, while active asset management to turn rental growth into income growth likely to remain key in delivering performance.

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: £345.24 million

Share price: 71.00p

NAV*: 102.10p

Discount/Premium (-/+): -30.46%

Dividend payment dates: Mar, Jun, Sep, Dec

Dividend yield †: 4.47%

Net gearing:** 24.38%

Vacant property: 4.07%

Weighted average lease length: 5.91 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.20%

Year end: 30 June

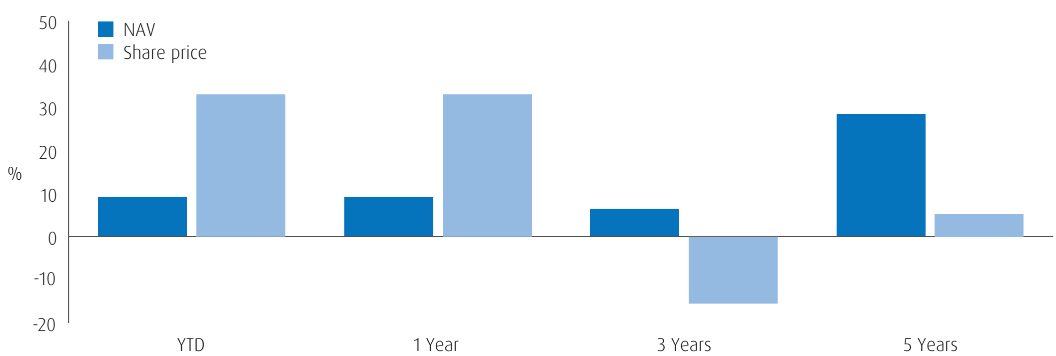
Sector: Property Direct - UK

Currency: Sterling

Website: www.bmorealestateinvestments.com

Telephone calls may be recorded

Fund performance



Cumulative performance (%) as at 30.06.2021

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	3.9	9.1	9.1	6.3	28.3
Share price	-3.7	32.9	32.9	-15.4	5.3

Discrete annual performance (%) as at 30.06.2021

	2021	2020	2019	2018	2017
NAV	9.1	-3.7	1.3	13.6	6.1
Share price	32.9	-24.9	-15.2	-1.9	26.8

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. 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.

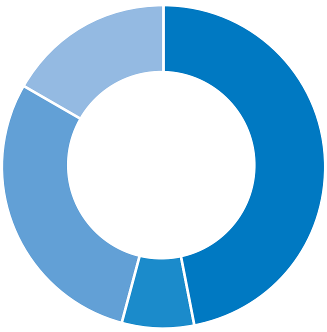
Trust codes

Sedol	
BREI - GBP	B012T52

Top 10 property investments (%)

London W1, 14 Berkeley Street	8.6
Colnbrook, Units 1-8 Lakeside Road	8.1
Banbury, 3663 Unit, Echo Park	7.9
Eastleigh, Southampton International Park	6.6
Hemel Hempstead, Hemel Gateway	5.7
Bracknell, 1/2 Network Bracknell, Eastern Rd	4.3
Chelmsford, County House, County Square.	4.1
Theale, Maxi Centre	4.0
Luton, Enterprise Way	3.7
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.6
Total	56.6

Sector breakdown



Industrial	47.0
Retail	7.2
Offices	29.2
Out of Town Retail	16.6

Geographical breakdown

South East	50.1
London - West End	10.6
Yorkshire and Humberside	5.1
West Midlands	2.1
Rest of London	2.7
Eastern	17.4
Scotland	4.2
East Midlands	5.2
North West	2.6

Net dividend distributions pence per share

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
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	0.85
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	0.625	0.85
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	0.625	1.00
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	0.85	
Total	7.2	7.2	7.2	7.2	7.2	6.1	5.00	5.00	5.00	5.00	5.00	5.00	3.35	2.70

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 2021, borrowings consisted of a £90 million fixed term facility from Canada Life due to expire in November 2026. There was no draw down of the £20 million 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 30.06.2021 unless otherwise stated.

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