BMO Real Estate Investments

BMO

Q1 2021

Manager Commentary
Peter Lowe

Business sentiment is improving, largely supported by the speed at which the vaccination programme is reaching the population. This has translated into upwardly revised GDP figures for the UK, with the economy now expected to expand by 7.2% in 2021. The Bank of England is now expecting GDP to return to the pre-crisis peak in Q4 2021 rather than in Q1 2022. The relaxing of restrictions and the reopening of non-essential retailers and outdoor hospitality is a significant step in triggering a much hoped for consumer-led rebound in activity. Retail sales rose by 5.8% in March as consumers prepared for 'reopening', fuelled by more than £100 billion of excess savings. A note of caution remains though with variants of the virus offering continued cause for concern and high street footfall subdued.

The real estate market has reacted broadly positively to the brighter economic prospects. Industrial and Logistics, continues to be the stand-out sector led by the acceleration of retail demand moving online, coupled with a reimagining of supply chains and a consumer seeking ever tighter delivery times and more flexible returns policies. Pricing however is becoming increasing challenging, especially for urban logistics. Offices continue to see some investor appetite but largely the sector is dragging its heels until there is more clarity on how corporates will utilise their space going forward and what return-to-work really looks like in terms of physical demand. Some comfort can be found in a raft of recent statements highlighting the importance of the office for organisations as a breeding ground for idea generation, creativity and brand identification. Retail remains a mixed bag with some segments faring better than others. Grocery and convenience are performing well, while shopping centres continue to struggle weighed down by the structural changes that were already entrenched prior to the onset of the pandemic. Retail parks have shown a level of resilience over the last year or so, offering drive-to, outdoor, and spacious formats more in tune with social distancing requirements and consumer preferences, while delivering store formats and accessibility at a price point that is attractive for many occupiers.

The MSCI All-Property total return over the quarter was 1.8% with the first quarter of capital growth since late 2018. Retail delivered marginally positive returns, albeit dragged down largely by Shopping Centres, the most challenged of the retail segments, while retail warehouses were in positive territory with yields moving in. Office market returns turned positive this quarter but with a two-tier market emerging with a flight-to-quality in larger urban centres. Industrial continues to be the stand-out sector driven by both rental growth and significant investor appetite leading to sharpening yields across all geographies. A degree of stability returned to the wider Alternatives markets after a challenging year for Hotels, Student and Leisure. BTR Residential and Healthcare continue to be perceived as relative safe havens.

The Company portfolio delivered a total return of 1.9% over the quarter to March 2021, with income return of 1.3% and capital value growth of 0.6%. The portfolio delivered an ungeared return of 3.9% over the 12 months versus the Index return of 1.2%. The Company has delivered returns in excess of the Index over 1,3, 5, 7, 10 and 15 years since inception, driven primarily by the conviction to Industrial, logistics and distribution assets (46% of portfolio composition by capital value) and the sustained yield pickup assisted by the consistently below market vacancy rate. The absence of shopping centre, department store, hotel, leisure and student exposure, has been a boon to relative fortunes. Following the sale of the high street asset at High Street, Winchester for £2.9m over the quarter, the portfolio now has only one restaurant tenant and less than 8% High Street exposure. The Company has a highly diverse tenant base, the vast majority of whom continued to trade through the lockdown. Rent collection rate for the 12 months to March is in excess of 95%, with 93% of the current (March to June) quarters rent having been collected at the time of writing.

Unsurprisingly given the weight of money chasing Industrial assets and the robust occupational market data from this sector, the Companies exposure delivered 3.7% positive returns over the quarter. Offices and Retail returns were also positive and marginally outperformed their peers, with the former driven by accretive asset management initiatives and the latter by a solid showing from the Retail warehousing a subsector to which the portfolio has 17% exposure. The Retail Warehouse portfolio has been relatively more resilient, particularly so in terms of rent collection with an absence of fashion occupiers and a strong bias towards functional, 'essential' retailers, occupying space on low rents. A number of tenants remain on monthly payment plans to assist with cashflow, but for the full year to March end the sector has delivered 95% rent collection for the Company demonstrating the polarisation in performance within the wider retail sector. Occupational demand for the Company's property portfolio remained resilient over the period with vacancy at 4.0% of Rental Value (compared to an Index void rate of 8%) with the Average Weighted Unexpired Lease term steady at c.6 years following new letting activity.

On 2 December, the Company announced a quarterly interim dividend in respect of the year ending 30 June 2021 at an increased rate of 0.85 pence per share, consistent with both the encouraging rent collection statistics and the Boards prudent approach to protecting cash reserves in the current environment. The dividend for the March 2021 quarter was also paid at this rate. The Board will continue to monitor revenues closely and keep the future level of dividends under review. The sale of the asset at Winchester, with terms agreed at the time of writing to dispose of a further High street property continues the policy of down-weighting to the High Street. The Company's favourable cash position should enable the Manager to continue to explore asset management opportunities within the existing portfolio, as well as identify suitable acquisition targets to compliment the current asset characteristics. Opportunities within the logistics, trade and foodstore markets are all under consideration at the present time.

The approval of three different vaccines now being distributed across the UK will spur on reopening of the economy and provide a layer of comfort to the population and consumers when they venture out again. Despite some valid inflation concerns linked to supply bottlenecks, pent up savings and monetary easing, interest rates are likely to remain low, with the expected strength of the recovery set to provide leeway to potentially slow the pace of QE.This should add support to pricing. Unemployment will be a key metric to track. The majority of the COVID-related support schemes have been extended to September 2021, giving the economy some headroom to adjust before the support is withdrawn. While such initiatives have protected the labour market from mass job losses unemployment is expected to peak in late 2021. The number of business insolvencies is also expected to rise once the government's moratoriums expire at the end of June and September, while the ban preventing evictions ends on June 30 2021 and is putting the government under pressure to help resolve a £6 billion rent arrears crisis and prevent a deluge of legal disputes between commercial tenants and landlords. Net income will be therefore continue to be the primary focus for investors. While short-term, there may be some bumps in the road, the longer-term outlook for both the UK economy and the property market is much more positive, with continued yield support verses both the base rate and international real estate markets. Prospects for Industrials and Logistics sector look well set, with parts of the retail warehouse market now showing welcome signs of improvement. While income growth at the All Property level will be difficult to come by, portfolio composition and asset management will have a huge baring on outcomes.

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: £338.00 million

Share price: 74.60p

NAV*: 99.11p

Discount/Premium (-/+): -24.73%

Dividend payment dates: Mar, Jun, Sep, Dec

Dividend yield †: 3.95%

Net gearing:** 25.27%

Vacant property: 4.03%

Weighted average lease length: 5.88 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.30%

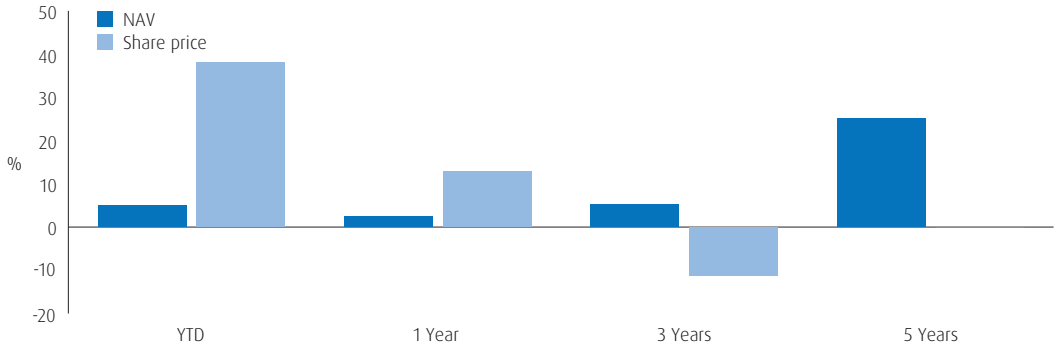
Year end: 30 June

Sector: Property Direct - UK

Currency: Sterling

Website: www.bmorealestateinvestments.com

Fund performance



Cumulative performance (%) as at 31.03.2021

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	1.9	5.0	2.4	5.1	25.2
Share price	23.7	38.0	12.9	-11.2	0.0

Discrete annual performance (%) as at 31.03.2021

	2021	2020	2019	2018	2017
NAV	2.4	-1.3	4.0	14.1	4.4
Share price	12.9	-15.0	-7.5	3.3	9.0

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.

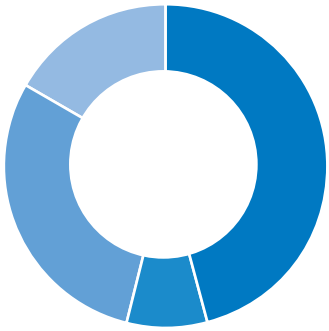
Trust codes

Sedol	
BREI - GBP	B012T52

Top 10 property investments (%)

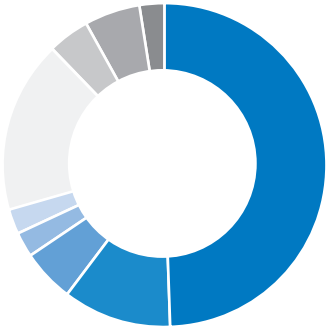
London W1, 14 Berkeley Street	8.7
Colnbrook, Units 1-8 Lakeside Road	8.0
Banbury, 3663 Unit, Echo Park	7.8
Eastleigh, Southampton International Park	6.4
Hemel Hempstead, Hemel Gateway	5.5
Bracknell, 1/2 Network Bracknell, Eastern Rd	4.3
Theale, Maxi Centre	4.0
Chelmsford, County House, County Square.	3.9
Luton, Enterprise Way	3.7
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.6
Total	55.9

Sector breakdown



Industrial	45.9
Retail	8.0
Offices	29.6
Out of Town Retail	16.5

Geographical breakdown



South East	49.6
London - West End	10.8
Yorkshire and Humberside	5.2
West Midlands	2.5
Rest of London	2.7
Eastern	17.0
Scotland	4.4
East Midlands	5.3
North West	2.5

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	
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	1.7

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 31 March 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 31.03.2021 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. (06/21)