UK Commercial Property REIT
Q1 2019

Standard Life

Investment Objective

UK Commercial Property REIT (UKCM) is a Guernsey registered investment company which aims to provide an attractive level of income together with the potential for capital and income growth by investing in a diversified portfolio of UK commercial property.

Key Statistics as at 31st March 2019	
Launch date	20 Sep 2006
Total assets	£1.5bn
Share price (per closing LSE price)	85.8 p
NAV	93.9 p
Premium/(Discount) to NAV	(8.6)%
Occupancy levels	93.4%
Average lease length	9.6 years
Net Gearing	15.3% (Gross Gearing 17.3%)
Gross dividend yield	4.3%
Management fees	0.6% on gross assets up to £1.75 billion, 0.475% on gross assets over £1.75billion
Stock code	UKCM
Dividend pay dates	May, Aug, Nov, Feb

* Gross borrowing less cash divided by total assets (excluding cash) less current liabilities

Corporate Performance – % growth

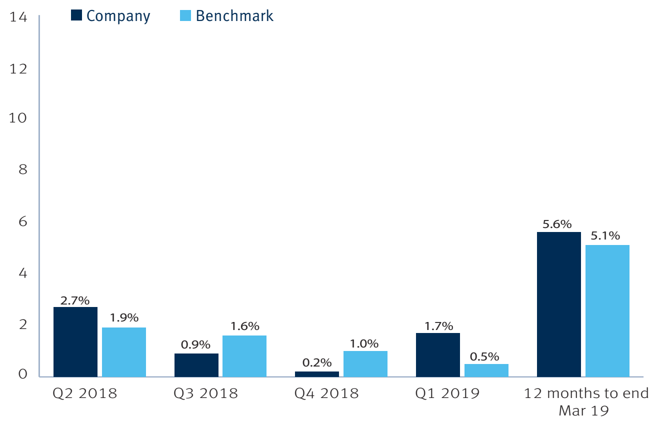
	Q1 2019	1 yr	3 yrs	5 yrs
NAV Total Return	1.6	4.5	23.4	55.3
Share Price Total Return	4.2	0.0	17.1	32.1
IPD Benchmark	1.7	5.1	21.5	57.2

Source: Internal as at 31/03/19. IPD Quarterly Benchmark Report to end March 2019. Past performance is not a guide to future performance. The value of investments and any income generated can fall as well as rise and is not guaranteed.

Top 10 holdings	Location	Value Band
Ventura Park, Radlett	Radlett, M25/M1	Over £100m
Dolphin Est, Sunbury-on-Thames	London	£50-£70m
Hatfield Business Park	Hatfield	£50-£70m
Junction 27 Retail Park	Leeds	£50-£70m
Great Lodge Retail Park	Tunbridge Wells	£50-£70m
Hannah Close,Neasden	London	£50-£70m
The Rotunda	Kingston on Thames	£50-£70m
Kew Retail Park	London	£30-£50m
Phase II Newton's Court	Dartford	£30-£50m
The White Building	Reading	£30-£50m

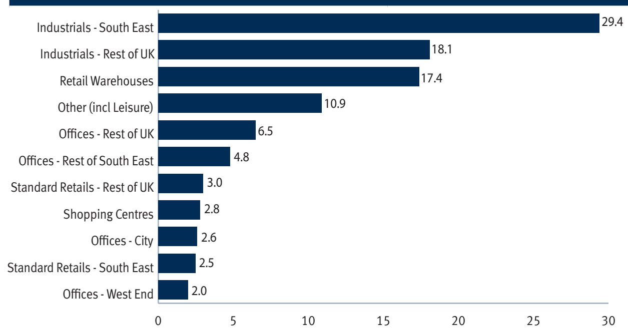
Source: Internal as at 31/03/19

Portfolio Total Returns



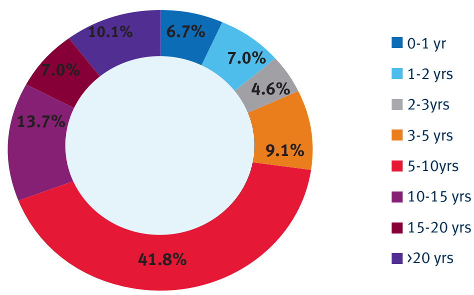
Source: IPD Balanced Monthly and Quarterly Funds to end March 2019. Past performance is not a guide to future performance. The value of investments and any income generated can fall as well as rise and is not guaranteed.

Sub Sector Weightings



Portfolio Value (%)

Lease expiry profile (% of Portfolio Income)



Source: Internal as at 31/03/19

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Investment Objective (Continued)

Discrete year data	31/03/2019 (%)	31/03/2018 (%)	31/03/2017 (%)	31/03/2016 (%)	31/03/2015 (%)
NAV Total Return	4.5	11.3	6.1	6.7	17.9
Share Price Total return	0.0	8.5	7.9	-5.2	19.0
IPD Benchmark	5.1	10.4	4.7	10.9	16.6

Will Fulton
Lead Manager

UK Real Estate Market

UK GDP grew by a robust 0.5% in the first quarter of this year. This acceleration from the sluggishness seen in the back-end of 2018 might seem surprising given the spate of relatively weak survey data and ongoing political uncertainty around Brexit. However the recent economic strength may very well have been because of Brexit, in the sense that firms were stockpiling inventory in preparation for the risk of a disruptive no deal. Given that the UK's putative exit from the EU has been delayed until the autumn, this stockpiling is likely to be unwound in the near term, presenting a temporary headwind to growth. With the risk of a no deal exit having reduced significantly, but uncertainty around the UK's future having been extended, growth is likely to remain around or slightly below current levels. The UK labour market has also performed well recently, and much better than survey data would suggest, with the unemployment rate holding steady at a 44-year low of 3.9%. Once again, this strength could actually be because of Brexit, with firms responding to growing demand by hiring workers rather than investing new capital. When there is some resolution to the Brexit uncertainty it is likely that investment will pick up, which is likely to cause employment growth to slow, so we may be close to the peak of the UK labour market. With lower labour-force growth, and a very low unemployment rate, the labour market now appears tight enough to generate wage growth consistently well above 3%. Combined with very weak productivity growth unit labour costs continue to rise and domestic inflation pressures are building. This means, despite the prolonged Brexit uncertainty, the Bank of England is likely to hike interest rates by 25 basis points in the second half of this year. Assuming a 'no deal' Brexit is avoided and uncertainty around the terms of exit is not prolonged for too long, the economy is poised for a recovery in the second half of the year and into 2020. Pent-up investment demand should be unleashed, while the ongoing recovery in real incomes should help support consumption, albeit potentially tempered by a rebuilding of savings from record lows. Fiscal policy is also set to be modestly supportive of growth.

Recent patterns in the occupier market have changed little, setting aside the short-term turbulence caused by Brexit-related uncertainty which is making leasing deals more difficult to complete. The structural drivers of demand in the industrial sector are ensuring that rental value growth continues to come through. Constrained supply in London and the South East, as well as some urban areas in other parts of the UK, is accentuating that growth, while an increase in development activity in some regional logistics markets is tempering it. At the other end of the spectrum average retail rental values are falling with lease events and tenant distress prompting downward adjustments to retail rental income in many cases. Core regional office markets have seen a prolonged period of net absorption and falling vacancy rates, supporting steady rental value growth over the last four years. While fundamentals have been stronger still in central London, rents have largely been flat or falling.

Liquidity in the direct property market remains polarised, with evidence growing that appetite for risk has diminished in the face of the considerable Brexit-related uncertainty, and while overall investment activity in Q1 2019 was lower than recent years some large portfolio deals boosted the figures. Pricing and activity are holding up better in the secure income space which typically consists of good quality, long-let assets. Overall capital values, according to the February MSCI Monthly Index, have fallen for four consecutive months, while retail values have experienced 12 consecutive months of decline; February was the first month in which office values have fallen since the 2016 EU referendum. Capital growth has also slowed in the industrial sector. The listed market continues to build in large discounts for retail, although a rising wider equity market has narrowed discounts to NAV for generalists and a number of stocks focused on industrial and alternatives continue to trade at a premium. Companies trading at or above NAV have either good income growth prospects, are exposed to areas of the market which will benefit from structural drivers in the occupier market, or offer long secure income streams.

Net Asset Value

- NAV per share of 93.9p (31 December 2018: 93.3p), resulting in a NAV total return of 1.6% in the period with continued low net gearing of 15.3%*.
- Like-for-like portfolio capital value increased by 1.2% with overall capital performance net of capital expenditure investment of 0.6%. This compares to the -0.8% fall in the MSCI monthly index over the period. The portfolio is now valued at £1.46 billion (31 Dec 2018: £1.45 billion).
- The Company's strategy of building an overweight position to Industrials and logistics property over the past few years and successful asset management activity combined to produce strong positive capital returns, which were partially offset by a decline in values across the Company's retail holdings.

Successful debt refinancing further strengthens balance sheet

On 21 February 2019, the Company announced that it had restructured its debt facilities. The refinancing increased UKCM's total debt availability by £50 million and means the Group now has £95 million available but undrawn to take advantage of investment opportunities that may arise. In addition, the refinancing provides the Group with:

- An increase in the weighted maturity profile of its fixed term debt from 4 years to 10 years;

- Additional flexibility with £150 million or 43% of total available debt (£350 million) now in the form of a revolving Credit Facility ("RCF") which is available until 2024;
- Based on the current cost of the drawn RCF, a reduction in the Group's current blended cost of debt from 2.89% per annum to 2.80%; and
- Net gearing of 15.3%* and gross gearing of 17.3%** that is one of the lowest in the Company's peer group and the quoted REIT sector.

*Net gearing - Gross borrowing less cash divided by total assets (excluding cash) less current liabilities

**Gross gearing - Gross borrowings divided by total assets less current liabilities

Asset management and leasing momentum underpinning performance

Most significant this quarter was the pre-letting of the entire 180,000 sqft of the Company's Wembley logistics distribution centre, Central Way, Neasden, ahead of the current tenant, Marks & Spencer, moving out at the end of March 2019. The Company has exchanged contracts on a new 10 year index-linked lease with an international business at a rent of £2.7 million per annum capturing and exceeding the property's reversionary rental value. The new occupier is expected to take occupation in October 2019 following a comprehensive refurbishment by the Company, with work having already started on site.

Other notable asset management initiatives in the period included:

- St George's Retail Park, Leicester – the completion of three new 10 year leases to Wren Living, Tapi Carpets & Floors & Laura Ashley generating £599,500 per annum after lease incentives. These follow construction of a new terrace of units and the reconfiguration of the park's entrance to improve customer access.
- 81/85 George Street, Edinburgh - now 100% occupied with the letting of the third floor office suite on a 10 year lease with a break option at year 5 to a global information technology company at a rent of £304,399 per annum, in line with the estimated rental value ("ERV") for the property.
- Junction 27 Retail Park, Leeds – at this prime destination which is adjacent to Ikea, the last remaining vacant unit was let to NI North West Ltd t/a Natuzzi for 10 years at a rent of £225,450 pa. This 5,000 sq.ft unit, previously let to Carpetright, which vacated following a CVA process and the rent is in line with both ERV and the previous tenant's rent.
- Cineworld, Glasgow - Comic Enterprises which trades as The Glee Club, signed a new 15 year lease at a rent of £100,000 per annum, completing the asset management plan for this asset which is now 100% let. In addition, £83,960 of annual rental income, 3% ahead of ERV at the time, secured from one lease renewal and three rent reviews, including:
    - A new five year lease renewal completed with The Arts Council England at Central Square, Newcastle, at a new rent of £39,616 per annum, 22% ahead of ERV.
    - Rent reviews agreed with Malibu Health, Azzuri Restaurants & Five Guys at various assets, secured a new rent of £70,466 per annum, 13% ahead of the previous passing rent and 2% ahead of ERV at the time.

Occupancy improved slightly from 93% to 94% during the quarter and remains ahead of the benchmark number of 92.8%. Over half of the remaining vacancy is in well located industrial assets. The largest of these is the Company's recently refurbished well located 377,000 sq ft cross-docked distribution warehouse at Magna Park, Lutterworth, in the centre of the logistics "Golden Triangle".

Investment Outlook

UK Commercial Property REIT

The UK market is being weighed down by Brexit where numerous outcomes remain possible including a 'no deal' scenario. The risk to market pricing and of occupier distress is greatest in that scenario but, even if it is averted, the UK's future trading relationships remain uncertain. In areas of market strength, it is important to focus on asset-specific risks and opportunities. With investment demand still strong for long, secure income product and a dearth of quality stock, investors should not relax their parameters around covenant strength and underlying asset quality. With a 'no deal' Brexit being the most disruptive, and with more prolonged uncertainty the alternative, we do not expect risk to be rewarded in the short term. It is prudent to secure income as a priority over pushing for the highest rent.

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