BMO Real Estate Investments

BMO

Q1 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, showed a further deceleration in the first quarter at the all-property level to 0.4%. Capital values fell by 0.7%, and rental growth was 0.1% lower. The annual all-property total return was 4.6%, underpinned by a 4.4% income return.

The quarter was dominated by Brexit as the initial deadline of 29 March 2019 approached. Although employment data has been robust, reflecting the economic and political uncertainty; investors have held back until the outcome of the negotiations is more certain. This has impacted the property market, with some cooling in occupational demand evident, and weaker volumes of investment transactions.

The quarter saw no changes to UK monetary policy, but with the Federal Reserve and European Central Bank apparently less hawkish, sentiment shifted in the quarter with regard to UK interest rates, which are now expected to remain lower for longer. The yield on 10-year gilts was barely 1% at quarter-end, widening the yield gap between property and gilts.

The polarisation between the different parts of the property market persisted. Industrials and distribution continued to outperform, although with a 1.7% total return versus 3.4% three months earlier, there was some evidence that momentum was easing. Retail was troubled, with -1.3% total returns. In addition, sentiment was poor among both occupiers and investors, as the trend of company voluntary agreements (CVAs) and store rationalisations continued. Although Central London and more affluent towns have been hit less hard, the problems affecting the sector are now widespread. Secondary stock, shopping centres, regional shops and department stores have been particularly affected. The Central London office market has seen a slight cooling, attributable to Brexit-related uncertainty, political risk and forthcoming changes to capital-gains taxation for overseas investors. Offices in the City and West End delivered total returns of 0.8% and 1.1% respectively. Regional offices have proven slightly more resilient, at 1.2%. Alternatives continue to grow in importance, with several large deals involving hotels, healthcare and student accommodation completed during the quarter. This segment recorded a 1.2% total return in the quarter.

With the economy delivering only muted growth, rental growth at the all-property level has been constrained and largely confined to the industrial/distribution sector. Rents have been falling for retail assets, even in prime locations.

The Company portfolio delivered a total return of 1.4 % over the quarter, led by an income return of 1.3%. The capital value of the portfolio increased by 0.3% over the quarter, compared with the 0.7% fall in the capital values for the market measure over the same period.

Positive performance was attributable to the successful outcome of asset management initiatives at several properties, particularly leasing activity within the rest-of-UK offices subsector, the West End office assets and the South East industrial assets. Of particular note was the letting, after extensive refurbishment, of the office at Standard Hill, Nottingham to the College of Law on the basis of a new 15-year lease at a rent of £576,000 p.a. There has also been refurbishment work at the office property at 14 Berkeley Street, London, and following completion, the first and fifth floors were let during the quarter, delivering combined additional rental income of £271,000 p.a. These initiatives helped the office portfolio to deliver a total return of 2.7% over the quarter.

The retail market is still under considerable pressure, with continued stress in the occupier markets weighing on investor sentiment. The retail element of the Company's portfolio decreased in value by 3.3% over the quarter, with the impact most keenly felt across the high street portfolio. The decrease in value of the portfolio's retail warehouse assets of 1.9% was attributable to a further downgrade to the property at Northfields, Rotherham, currently let to Homebase and subject to reduced rent under a CVA.

Meanwhile, 39.2% of the portfolio comprises industrial assets located within the south east, which continue to deliver income growth. These assets experienced capital growth over the period of 2.4%, and delivered a total return of 3.6%.

During the quarter disposals from the retail portfolio continued, with the completion of the sale of the retail warehouse property in Sands Road, Swalwell, Gateshead for £2.2 million. This was in line with valuation at the end of 2018.

At the period-end, the portfolio void rate was 0.1%, and the average weighted unexpired lease term was 6.1 years.

The market is softening, with Brexit uncertainty and its aftermath in both political and economic terms compounding the situation. The structural problems affecting retail are also expected to persist, with further rerating possible. Given the modest projected rate of GDP growth, and with little in the way of a cyclical rebound expected, the market seems set for a period of more subdued total returns. Performance is expected to be driven by the income return. We expect industrials and distribution to be the outperforming sector over the next five years, helped by changing technology and the continued growth of online retail. That said, we expect performance to be more asset-specific than in the recent past. Alternatives are also expected to continue to grow in importance, and should offer relative performance. A prolonged period of low interest rates should provide some support to the market as a whole, and clarity further down the line on Brexit could eventually bring benefits as delayed investment decisions are implemented.

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: £357.90 million

Share price: 87.60p

NAV*: 106.04p

Discount/Premium (-/+): -17.39%

Dividend payment dates: Mar, Jun, Sep, Dec

Net dividend yield †: 5.71%

Net gearing:** 26.41%

Vacant property: 0.10%

Weighted average lease length: 6.15 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.20%

Year end: 30 June

Sector: Property Direct - UK

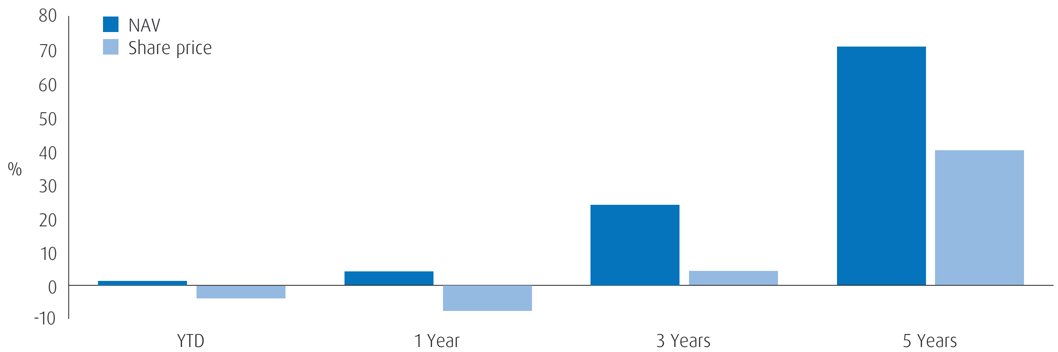
Currency: Sterling

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 31.03.19

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	1.2	1.2	4.0	23.8	70.7
Share price	-3.7	-3.7	-7.5	4.1	39.9

Discrete annual performance (%) as at 31.03.19

	2019	2018	2017	2016	2015
NAV	4.0	13.4	2.3	15.9	24.9
Share price	-7.5	3.3	9.0	0.5	33.7

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.

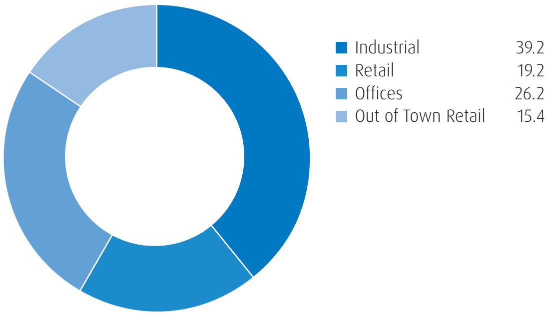
Trust codes

Sedol	
BREI - GBP	B012T52

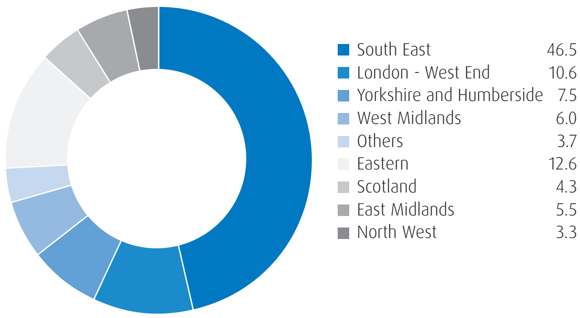
Top 10 property investments (%)

London W1, 14 Berkeley Street	8.2
Banbury, 3663 Unit, Echo Park	7.0
Colnbrook, Units 1-8 Lakeside Road	6.3
Eastleigh, Southampton International Park	5.6
Hemel Hempstead, Hemel Gateway	4.6
York,Clifton Moor Gate	3.8
Bracknell, 1/2 Network Bracknell, Eastern Rd	3.6
Theale, Maxi Centre	3.4
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.2
Eastleigh, Wide Lane	3.1
Total	48.8

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	
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	1.25

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 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 31.03.19 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. (05/19)