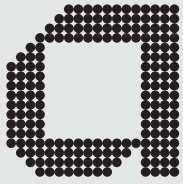
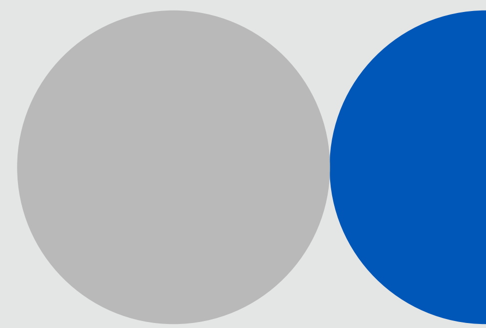


UK Commercial Property REIT

A diversified portfolio of high quality real estate, built for the future

Performance Data and Analytics for Quarter 4, 2022



Investment Objective

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.

Cumulative Performance (%)

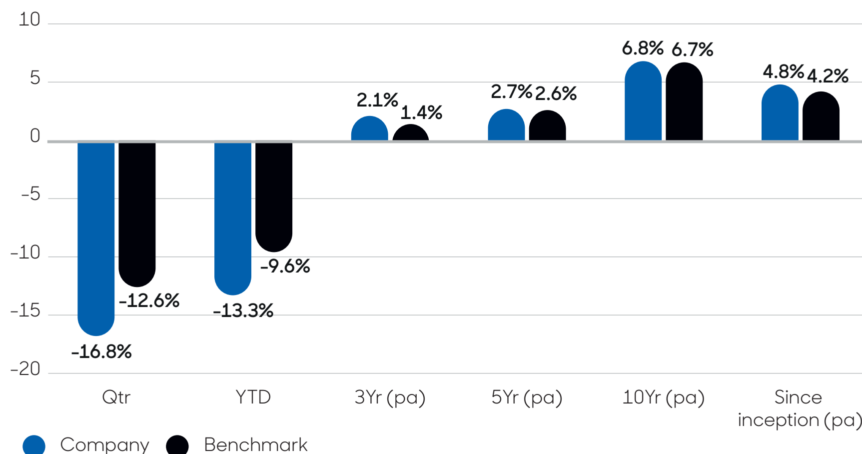
	Q4 2022	1 yr	3 yrs	5 yrs
NAV Total Return	(20.82)	(18.10)	(1.33)	3.29
Share Price Total Return	(1.76)	(16.20)	(24.30)	(17.42)
Direct Portfolio Total Return	(16.83)	(13.33)	2.07	2.69

Discrete Performance (%)

	31/12/22	31/12/21	31/12/20	31/12/19	31/12/18
NAV Total Return	(18.10)	(21.53)	(0.87)	0.13	4.54
Share Price Total return	(16.20)	12.51	(19.71)	11.34	(2.03)
Direct Portfolio Total Return	(13.33)	21.37	1.10	1.40	5.92
MSCI Benchmark	(9.63)	16.84	(1.16)	1.89	6.66

Source: abrdn as at 31/12/2022. MSCI Quarterly Benchmark Report to end December 2022.
Past performance is not a guide to future results.

Portfolio Total Returns – Annualised



Source: MSCI; Benchmark: UK Balanced Portfolios Quarterly Property Index.
Past performance is not a guide to future results.

UK Commercial Property REIT

Key Statistics as at 31 December 2022

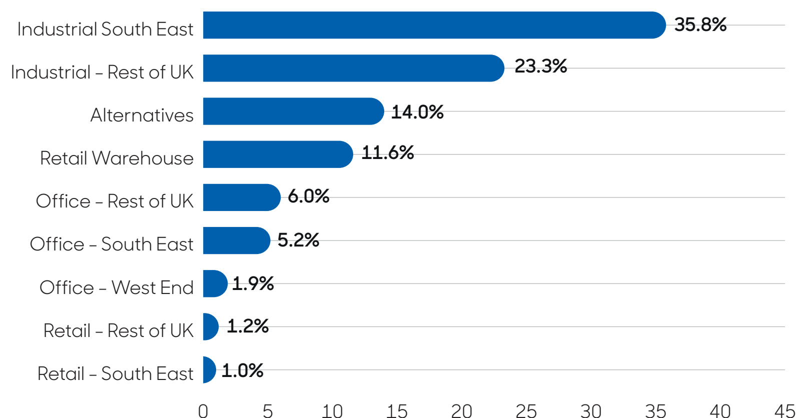
Launch date	20 Sep 2006
Lead Fund Manager	Will Fulton
Total Assets	£1.3bn
Net Asset Value	£1.0bn
Share price (per closing LSE price)	58.4p
NAV per share	79.7p
Premium/(Discount) to NAV	(26.7)%
Occupancy levels	98.0%
Average lease length	8.3 years
Gearing	20.0%[A]
Gross dividend yield	8.9%[B]
Annualised dividend yield	5.8%
Dividend pay dates	Feb, May, Aug, Nov
Management fees	From 1 April 2022, 0.525% on gross assets up to £1.75 billion, (excluding any cash held over £50 million) 0.475% on gross assets over £1.75billion
Stock code	UKCM
Sedol	B19Z2J5

[A] Gearing is calculated as gross borrowings less cash divided by portfolio value.
[B] Based on last 12 months dividends (settled Nov-22, Feb-22, May-22 and Aug-22 including special dividend settled Aug-22).

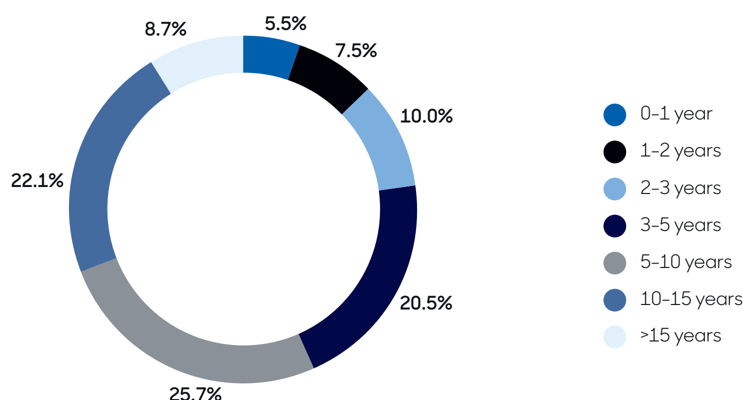
All sources (unless indicated): abrdn plc: 31 December 2022.

UK Commercial Property REIT

Sub Sector Weightings



Lease Expiry Profile (% of Portfolio Income)



Market Commentary

Asset management delivering rental growth potential and high occupancy

The Company has maintained a very low void rate of 2.0% which provides good visibility of future income and clearly demonstrates both the quality of the Company's portfolio and the asset management team's ability to retain income while focusing on capturing reversionary potential.

Strong leasing momentum in the investment portfolio during the last quarter including:

- An Agreement for Lease at Emerald Park Industrial Estate in Bristol has been signed with Northgate Vehicle Hire Ltd over Unit 101 at 25% above passing rent and 16% ahead of the previous rental value. The 10 year lease, which includes a tenant break at year five and is subject to the completion of landlord refurbishment works which will improve the unit's EPC rating from C to A, is at an annual rent of £251,000 pa, equating to £11 per sq ft.
- A six year lease extension at 10% above the previous passing rent and a 3% premium to ERV was also agreed at Emerald Park with MedaCo Ltd, a supplier of equipment for care homes, schools and hospitals. Running to 2030, with a tenant break in 2027, the new rent of £96,200 pa, equates to £9.75 per sq ft.
- At Gatwick Gate Industrial Estate in Crawley a short term extension was agreed with Airbase, the tenant at unit 2B. The tenant's lease has been extended by 12 months and the annual rent increased by 17% to £330,000 pa.

Strong leasing momentum continues into 2023:

- The Company has recently signed two new lettings at its largest asset, Ventura Park, Radlett, at a collective new rent of £2.0 million pa, £800,000 pa above the previous rent. This equates to a 69% increase and is 63% ahead of ERV 12 months ago.

Progress continues to be made in the Company's development pipeline:

- The larger first phase of the Company's student development at Exeter was completed and its 131 beds are now fully occupied. Phase 2 is scheduled for completion in Q1 2023 and will provide a further 83 beds with the Company benefitting from a minimum guaranteed total annual income of £1.65 million for the 2022/23 academic year. Homes for Students has been appointed to manage the asset and interest from students in Phase 2 has been strong.
- The industrial developments at Sussex Junction, Bolney, and Precision Park, Leamington Spa, are expected to complete in early February and April 2023 respectively.
- Work on site has started for the Company's Hyatt Hotel in Leeds which is expected to complete in Q2 2024.

Top 10 holdings

	Location	Value Band
Ventura Park	Radlett	Over £100m
Hannah Close	London	£50-£100m
Dolphin Industrial Estate	London	£50-£100m
Ocado warehouse	Hatfield	£50-£100m
Newton's Court	Dartford	£50-£100m
Junction 27 Retail Park	Leeds	£50-£100m
XDock 377	Lutterworth	£25-£50m
Emerald Park	Bristol	£25-£50m
The Rotunda	Kingston-on-Thames	£25-£50m
The White Building	Reading	£25-£50m

Factsheet

Receive the factsheet by email as soon as it is available by registering at www.invtrusts.co.uk/#signup
www.ukcpreit.com

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UK Commercial Property REIT

Strong balance sheet with significant covenant headroom and flexibility
Robust balance sheet with low gearing and financial resources of £42.5 million available after allowing for future capital commitments and the February 2023 dividend.

The Company has three debt facilities in place with all covenants well covered and an additional £431 million of unencumbered property which provides further significant headroom and flexibility with respect to the Company's covenant package. The current blended interest rate is 3.61% per annum on drawn debt of which 68% is at a fixed rate.

On 10 January 2023, the Company extended its £180 million revolving credit facility with Barclays, of which £93 million is drawn, to January 2026 with a new margin of 1.90%. The new overall blended interest rate is 3.68% per annum with a weighted maturity of 5.2 years.

Economy and Investment Outlook
Perhaps an over-used phrase but never more true - it was a year of two halves in 2022. The positive performance that UK real estate recorded at the start of the year was unwound with a notable acceleration in the final quarter, as capital value declines weighed on performance. UK real estate recorded a total return of -10.1% in 2022, according to the MSCI monthly index data, having returned 9.6% in the first half of 2022 and -17.9% in the second half of the year. Regardless of the continued strength of many operational markets, there was a broad repricing of UK real estate, driven by a weaker macroeconomic environment and, primarily, rising debt costs. Value declines for All Property were 13.3% over the year and -15.6% in Q4 alone.

Yields moved out across all real estate sectors, with lower yielding areas of the market, such as the industrial sector and long income which have experienced the biggest value gains in recent years, experiencing greater outward yield movements than the wider market. Indeed, given the magnitude and speed of correction we have seen in the supermarket, industrial and logistics, and areas of the long-income market, we think that market pricing for these areas of UK real estate will find a floor much quicker than we have seen in previous cycles. As such, our outlook and forecasts for these areas of the market have improved materially, given the level of correction these sectors experienced in the latter part of the year.

The UK economy has faced a period of significant volatility over the second half of 2022, as the macroeconomic environment weakened and political turmoil rocked financial markets. While greater political stability has returned to the UK, the economy is facing headwinds as we enter 2023. Although UK GDP edged up in November the ONS attributed this to a World Cup-related services boost and it seems likely to be an upwards blip rather than evidence of a stronger underlying rate. We currently forecast UK GDP to decline by 1.3% in 2023, before recovering in 2024 with modest growth of 0.6%.

Headline inflation looks to have peaked with the Consumer Price Index falling in December from 10.7% to 10.5%. Powerful base effects combining with global goods disinflation are expected to pull inflation down in 2023. However costs remain high and underlying inflation pressures are still apparent, leading us to expect headline inflation to only moderate through 2023, not fall to pre-2022 levels. We expect 6.2% by the end of the year, before falling to 2.4% in 2024.

The real estate investment market reacted quickly to expanding interest rates and, as expected, the Bank of England continued its monetary policy tightening cycle in February 2023, with a further 50bps rise in response to the rate of UK inflation, taking the base rate to 4.0%. Further hikes are expected in early 2023, with the base rate expected to peak between 4.25% and 4.5% before a sharp rate-cutting cycle begins towards the end of 2023 as the Bank of England attempts to stimulate the UK economy out of recession.

Due to the recessionary pressures, we expect our view is more bullish than some for an earlier rate-cutting, which we expect being towards the end of 2023. While there is considerable uncertainty around the speed and trajectory of monetary policy easing, we expect the base rate to be cut to 2.5% by the end of 2023, before stabilising between 1-2% during 2024. The risk of the base rate returning to even lower bounds is skewed to the upside.

This has significant, and potentially very positive, implications for real estate. During H2 2022 the combination of an uncertain economic environment and rising cost of debt financing hit markets hard with significant negative repricing. The prospect of an earlier than anticipated rate cutting cycle, combined with a repriced market, offers the prospect of a far more positive real estate yield margin over a 10-year Gilt risk free rate, providing the potential for renewed interest and appetite for the real estate sector.

Higher costs in this inflationary environment are naturally having a significant impact on UK consumers who are experiencing a deepening cost-of-living crisis and are expected to face further pressure from a weakening employment market in the face of recession. The most obvious implication for real estate is likely to be further depressed retail sales as household discretionary spend drops but this weaker economic environment is likely to weigh on occupational sentiment across the entire real estate sector as we move through 2023. The relative strength of income and occupier covenant therefore will grow in importance as will asset quality and location, in addition to simple sector selection.

On a brighter note, and unlike previous market cycles, we enter this period of market turbulence with supply levels remaining tight across many sectors. This is particularly the case for those sectors benefitting from longer-term structural growth drivers, such as residential asset classes and industrial and logistics. In the latter sectors, tenant demand has remained robust and the UK vacancy rate remains near an all-time low of 3.4%* [*CoStar], on top of which supply is expected to remain limited by the fact that development pipelines have been constrained by higher construction costs. We expect this to contain availability rates, albeit partly offset by rising occupational costs including an expected 2023 rise in business rates. It is hard to imagine that business sentiment will not be weakened which will temper occupational demand but rental growth in the industrial sector is still anticipated to remain positive, at more normalised levels rather than the high-growth levels experienced over the last few years. As with the wider real estate market, asset location and specification will be important to secure this.

The question around the future occupation of offices and how this sector reacts is perhaps the hardest to decipher. There is a historic correlation between office take-up and GDP growth, with poorer business sentiment and a weakening economic environment expected to add further pressure to a sector already facing structural headwinds as businesses and employees re-evaluate working practices. And so, as we enter a recessionary environment in 2023, we anticipate demand for good-quality accommodation will prove more resilient but secondary accommodation will progressively face tougher conditions. ESG adds another layer of complexity to the office equation as owners face mounting costs to repurpose offices to a 'B' energy rating, the expected legal occupational and trading requirement by 2030 and that increasingly demanded by many tenants. It is fair to assume not all will succeed and a reduced national office demand, a response to agile working practices, is likely to lead to a concentration of that demand, and so rental growth, in only the very best offices.

Retail will continue to feel the impact of the cost-of-living crisis and the subsequent squeeze on household disposable incomes. Retail sales volumes have continued to decline and occupier sentiment, particularly in the discretionary end of the market, has weakened. The sector remains structurally oversupplied and further retailer failures are likely in this environment, adding further space to an already saturated market. Discount-led retailers and budget supermarkets have enjoyed more robust trading conditions, particularly in the run up to Christmas, but the prospect of rental value growth in the sector is more limited in the near term.

Turning to residential, fundamentals in the private rented sector (PRS) remain supportive reflected in very strong levels of rental value growth. We expect the limited availability of good-quality rental accommodation across much of the UK, and increasing demand, to offset consumer cost pressures and allow rents to moderate to more normalised levels of growth for PRS and the Build to Rent sector.

All in all a weaker economic environment is expected to weigh on occupational sentiment across real estate as a whole, as we move through 2023, with the relative strength of income, occupier covenant, location and asset quality growing in importance to tenants and so investors.

Quality will prevail across all sectors, with prime assets remaining far more resilient. The 2022 repricing of real estate and the likelihood of a positive recalibration of its historic attractive margin over a risk-free investment yield later in 2023 and into 2024 as interest rates fall is likely to enhance general investment appetite.

Investors continue to narrow their focus on prime and best-in-class assets, and particularly within those sectors that benefit from structural and demographic growth drivers. Secondary assets, and those that do not meet current environmental and occupier criteria, are expected to see much weaker demand from investors. Pricing is likely to recalibrate, as a result. While prime and secondary pricing moved out in tandem during 2022, prime pricing is expected to stabilise in 2023 while secondary pricing sees greater capital value declines. While this trend has occurred in previous market cycles, we expect the divergence in pricing in some sectors to be more pronounced during this cycle as occupier and investor demand narrows.

The pace of repricing for UK real estate will mean opportunities will arise over the course of 2023, particularly as the path of monetary policy turns more accommodative. Those sectors that benefit from longer-term growth drivers, such as the industrial and living sectors, will see greater demand return and at more attractive pricing levels. The repricing of long-income real estate investments will also provide an attractive opportunity to investors, particularly as yields for gilts and inflation linked bonds are expected to move lower in line with the expected policy rate cuts from the Bank of England. Despite seeing significant capital value declines during 2022, the industrial sector will grow in favour once again. Investors are attracted by re-based yields and rental value growth prospects, driven by a very positive supply/demand dynamic in the sector. Investors will focus on assets with good fundamental attributes, location and specification.

Important information

Risk factors you should consider prior to investing:

- The value of investments and the income from them can go down as well as up and investors may get back less than the amount invested.
- Past performance is not a guide to future returns.
- The value of property and property-related assets is inherently subjective due to the individual nature of each property. As a result, valuations are subject to substantial uncertainty. There is no assurance that the valuations of Properties will correspond exactly with the actual sale price even where such sales occur shortly after the relevant valuation date.
- Prospective investors should be aware that, whilst the use of borrowings should enhance the net asset value of the Ordinary Shares where the value of the Company's underlying assets is rising, it will have the opposite effect where the underlying asset value is falling. In addition, in the event that the rental income of the falls for whatever reason, including tenant defaults, the use of borrowings will increase the impact of such fall on the net revenue of the Company and, accordingly, will have an adverse effect on the Company's ability to pay dividends to Shareholders.
- The performance of the Company would be adversely affected by a downturn in the property market in terms of market value or a weakening of rental yields. In the event of default by a tenant, or during any other void period, the Company will suffer a rental shortfall and incur additional expenses until the property is re-let. These expenses could include legal and surveying costs in re-letting, maintenance costs, insurance costs, rates and marketing costs.
- Returns from an investment in property depend largely upon the amount of rental income generated from the property and the expenses incurred in the development or redevelopment and management of the property, as well as upon changes in its market value.
- Any change to the laws and regulations relating to the UK commercial property market may have an adverse effect on the market value of the Property Portfolio and/or the rental income of the Property Portfolio.
- Where there are lease expiries within the Property Portfolio, there is a risk that a significant proportion of leases may be re-let at rental values lower than those prevailing under the current leases, or that void periods may be experienced on a significant proportion of the Property Portfolio.
- The Company may undertake development (including redevelopment) of property or invest in property that requires refurbishment prior to renting the property. The risks of development or refurbishment include, but are not limited to, delays in timely completion of the project, cost overruns, poor quality workmanship, and inability to rent or inability to rent at a rental level sufficient to generate profits.
- The Company may face significant competition from UK or other foreign property companies or funds. Competition in the property market may lead to prices for existing properties or land for development being driven up through competing bids by potential purchasers.
- Accordingly, the existence of such competition may have a material adverse impact on the Company's ability to acquire properties or development land at satisfactory prices.
- As the owner of UK commercial property, the Company is subject to environmental regulations that can impose liability for cleaning up contaminated land, watercourses or groundwater on the person causing or knowingly permitting the contamination. If the Company owns or acquires contaminated land, it could also be liable to third parties for harm caused to them or their property as a result of the contamination. If the Company is found to be in violation of environmental regulations, it could face reputational damage, regulatory compliance penalties, reduced letting income and reduced asset valuation, which could have a material adverse effect on the Company's business, financial condition, results of operations, future prospects and/or the price of the Shares.

Other important information:

The Company is a Closed-ended investment scheme registered pursuant to the Protection of Investors (Bailiwick of Guernsey) Law 2020, as amended and the Registered Collective Investment Scheme Rules 2021 issued by the Guernsey Financial Services Commission.

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