F&C UK Real Estate Investments

BMO

Q3 2018

Manager Commentary
Peter Lowe

Total returns for the UK property market, as measured by the Investment Property Databank (IPD) Quarterly Universe, were 1.5% in the third quarter of 2018. The annual total return was 8.4%, with capital values up 0.4% over the quarter and 3.7% over the year.

Performance eased further in the third quarter of 2018, with both yield impact and rental growth moderating at the all-property level. Investment activity improved during the quarter, mainly due to higher transactions in non-traditional sectors. Net investment by overseas investors remained substantial, reflecting both higher buying and lower sales. Institutions were net investors during the quarter, but at a lower level than in the second quarter. Property funds recorded positive inflows from retail investors, but this was front-loaded and has since weakened. Sentiment towards the retail sector has become increasingly negative, especially for regional shops, shopping centres and department stores, but also towards retail warehousing as administrations and store rationalisations continue.

The economy continued to deliver positive GDP growth, with some improvement evident in the third quarter. Inflation stayed above target, although the rate moderated towards the end of the quarter. There were also some concerns about a slowing of growth globally, the impact of higher tariffs and the potential effect on the UK economy. The official interest rate was raised in August 2018 to 0.75%, but the asset-purchase programme remained in place, keeping monetary policy fairly relaxed. The chancellor introduced his budget after quarter-end, but acknowledged that a further budget might be necessary should Brexit warrant it. The Brexit negotiations remained fraught, both within parliament and with the EU. The market consensus is still for some sort of deal by the 29 March deadline, but the odds are moving against a smooth transition, both politically and economically. The markets are becoming more nervous as the deadline approaches.

On a sector basis, the property market remained polarised. Industrials were again the top performer among the three main segments over the quarter, delivering a 3.3% total return, but this represents a loss of momentum compared with the previous quarter's 4.8%. The South East again outperformed the rest of the UK, and standard industrials outperformed distribution warehouses. However, all elements were well ahead of the all-property average. Offices slightly outperformed the all-property average at 1.7%, with strength in the City largely off-setting underperformance in the West End. Offices outside Central London delivered a 1.8% total return. The retail sector delivered a marginal 0.1% quarterly total return. Total returns for shopping centres and retail warehousing were negative over the quarter. Regional standard retail was flat, with the South East segment supported by the Central London component. The alternatives market, at 1.8%, was above the all-property average. Open market rental value growth eased further to 0.1% at the all-property level, led by industrials but impacted by a negative performance from retail.

The Company portfolio returned 0.6% over the quarter, with total returns of 8.8% over the year (outperforming the IPD Quarterly Index of 8.4% over the same period), driven by an above-index annual income return of 5.3%.

The portfolio continues to derive structural benefit from its overweight to the industrial sector, which is now 38% by value. The initial yield on the portfolio is 5.0%, with a 60% weighting by geography to the South East. The void rate at quarter-end was 4.2% by rental value with post-period lettings having reduced this further.

The September quarter saw a further moderation in performance with the market likely to be moving into a mature phase of the cycle. Though the asset class is generally expected to be supported by its attractive income return, we anticipate a softening of values in certain subsectors. The next few months are likely to be dominated by Brexit – the impact will also be felt over the medium and longer term. We expect both occupiers and investors to delay decisions until the outlook becomes clearer. We believe that a hard/no deal Brexit would adversely affect all parts of the property market and that any bounce-back from a deal could be limited. To date, overseas investors have been supportive, although the mix of buyers by nationality has changed since the referendum. There could be some softening of sentiment as capital taxation changes come into effect in 2019, though the direction of travel for sterling could also be an offsetting factor. We anticipate further trials in the retail sector as structural problems persist and the legacy of older leases is addressed. Investors are still expecting interest rates to rise, but the Bank of England's announcement that the neutral interest rate for monetary policy may be lower than in the past may limit the extent of the increase. The banking system is in better order than at the time of the last market peak. Relatively low vacancy rates and constrained new supply of development stock should provide further protection on the downside. With that in mind, we continue to expect a period of single-digit positive total returns over the medium term, driven by income. However, we are alert to the potential for some near-term volatility in capital values.

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: £367.69 million

Share price: 95.60p

NAV*: 107.31p

Discount/Premium (-/+): -10.91%

Dividend payment dates: Mar, Jun, Sep, Dec

Net dividend yield †: 5.23%

Net gearing:** 26.33%

Vacant property: 4.20%

Weighted average lease length: 6.42 years

Management fee rate*:** 0.60%

Ongoing charges**:** 1.20%

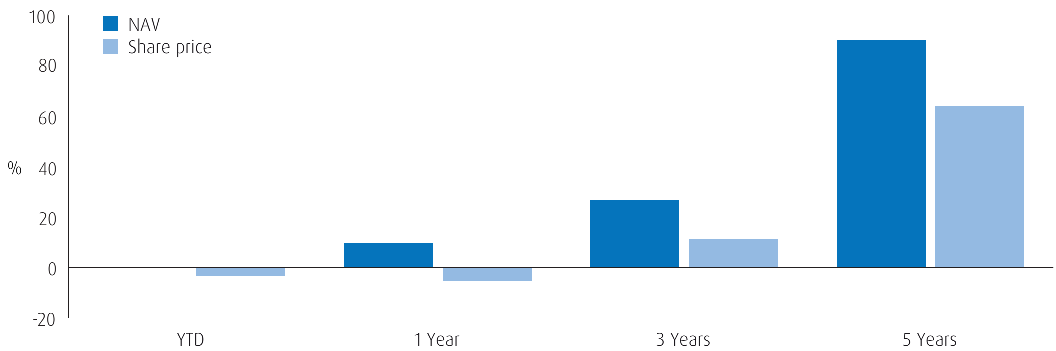
Year end: 30 June

Sector: Property Direct - UK

Currency: Sterling

Website:
www.fcre.co.uk
www.fcre.gg

Fund performance



Cumulative performance (%) as at 30.09.18

	3 Months	Year to date	1 Year	3 Years	5 Years
NAV	0.1	0.1	9.5	26.6	90.0
Share price	-3.0	-3.0	-5.3	11.0	64.0

Discrete annual performance (%) as at 30.09.18

	2018	2017	2016	2015	2014
NAV	9.5	12.7	2.6	18.8	26.4
Share price	-5.3	16.8	0.3	15.9	27.5

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

0800 136420

info@bmogam.com **www.bmogam.com**

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.

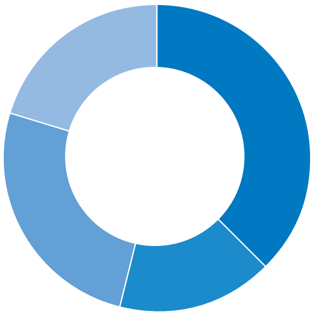
Trust codes

Sedol	
FCRE - GBP	B012T52

Top 10 property investments (%)

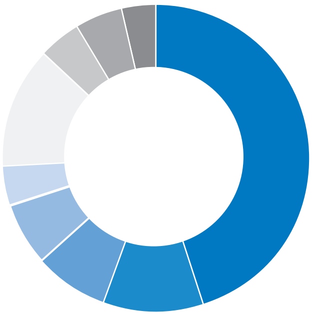
London W1, 14 Berkeley Street	8.0
Banbury, 3663 Unit, Echo Park	7.0
Colnbrook, Units 1-8 Lakeside Road	6.0
Eastleigh, Southampton International Park	5.1
Hemel Hempstead, Hemel Gateway	4.6
York,Clifton Moor Gate	3.7
Bracknell, 1/2 Network Bracknell, Eastern Rd	3.6
Edinburgh, 1-2 Lochside Way, Edinburgh Park	3.1
Theale, Maxi Centre	3.0
Eastleigh, Wide Lane	2.9
Total	47.0

Sector breakdown



Industrial	37.6
Retail	16.5
Offices	25.7
Out of Town Retail	20.2

Geographical breakdown



South East	45.2
London - West End	10.5
Yorkshire and Humberside	7.8
West Midlands	6.5
Others	4.3
Eastern	12.8
Scotland	4.3
East Midlands	5.1
North West	3.5

Net dividend distributions pence per share

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
March	1.8	1.8	1.8	1.8	1.8	1.8	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	
Total	7.2	7.2	7.2	7.2	7.2	6.1	5	5	5	5	3.75

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 September 2018, borrowings consisted of loans drawn down of £103 million: £90 million fixed term facility from Canada Life due to expire in November 2026 and £13 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 30.09.18 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. 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. (12/18)