Schroders

Marketing material for professional investors or advisers only

Schroder UK Real Estate Fund (SREF) Q3 2019

30 September 2019

Investment objective

SREF's performance objective is to outperform its benchmark by 0.5% per annum, net of fees, over rolling three year periods although this is not guaranteed over this or any other period.

Key information

Fund net asset value	£2,471.0 million
Fund gross asset value	£2,501.4 million
Cash	£166.7 million
Number of holdings	57
Number of tenants	715
Void rate[1]	6.9%
Average unexpired lease term to break	8.2 years
Average unexpired lease term to expiry	9.4 years
Debt (% NAV)	0.3%
Net initial yield[1]	4.6%
Reversionary yield[1]	5.6%
Equivalent yield[1]	5.1%
Gross distribution yield[2]	3.0%
Investment parameters	Compliant

Source: Schroders, 30 September 2019

[1] Includes all directly held properties, all joint ventures plus the quoted initial yield on the indirect funds. Includes agreements for lease but excludes land and development.

[2] Distributions payable in the twelve months to 30 September 2019 as a percentage of the latest net asset value per share (NAV)

[3] Performance is calculated on a net asset value (NAV) to NAV price basis plus income distributed, compounded monthly, net of fees, gross of tax and based on an unrounded NAV per share.

[4] MSCI/AREF UK Quarterly Property Fund Index – All Balanced Property Fund Index Weighted Average. Source: MSCI

Performance analysis

Performance (%)	3 months	12 months	3 yrs (p.a.)	5 yrs (p.a.)	10 yrs (p.a.)
SREF[3]	0.6	2.7	7.6	8.6	9.9
Benchmark[4]	0.4	2.2	6.7	7.5	8.5

Performance (%)	Q4 17 Q4 18	Q4 16 Q4 17	Q4 15 Q4 16	Q4 14 Q4 15	Q4 13 Q4 14
SREF[3]	7.3	11.1	4.7	14.2	18.7
Benchmark[4]	6.5	10.2	2.8	12.5	17.2

Past performance is not a guide to future performance and may not be repeated. The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.

Risk factors

- Property-based pooled vehicles, such as the Fund, invest in real property, the value of which is generally a matter of an independent valuer's opinion.
- The price of shares and the income from them may fluctuate upwards or downwards and cannot be guaranteed.
- It may be difficult to deal in the shares of the Fund or to sell them at a reasonable price because the underlying property may not be readily saleable, thus creating liquidity risk. In addition, the payment of redemptions may be deferred for a maximum period of 24 months from the original Dealing Day for Redemption.
- There is no recognised market for shares in the Fund and, as a result, reliable information about the value of shares in the Fund or the extent of the risks to which they are exposed may not be readily available.
- A potential conflict with the Manager's duty to the shareholder may arise where an Associate of the Manager invests in shares in the Fund. The Manager will, however, ensure that such transactions are effected on terms which are not materially less favourable to the shareholder than if the potential conflict had not existed.

Executive summary

Market summary

Investors and occupiers continue to be influenced by uncertainty around Brexit and a slowdown in economic activity. Transaction volumes remain below last year, and polarised by sector, while occupiers are taking time to sign new lease deals. UK commercial real estate maintains its strong yield advantage over UK government bonds.

Strategy and portfolio activity

SREF maintains its cautious sector allocation while having a relatively long weighted average lease expiry profile. The Fund's diverse tenant base and properties are let at affordable rents which provide defensive investment characteristics and sustainable income, as well as the opportunity for capital growth.

During the third quarter of 2019, sales totalling £121 million were completed following the completion of asset business plans and for liquidity management purposes. The Fund sold its remaining core City assets along with Hythe Riverside Retail Park and all except one remaining car showroom.

Performance

SREF outperformed its benchmark in the third quarter of 2019. The Fund outperformed its benchmark over one, three, five and ten years. Please note that past performance is not a guide to future performance and may not be repeated. Performance during the quarter was primarily driven by income. The valuation of the Fund's retail assets fell while assets in other sectors were broadly unchanged.

UK real estate market commentary

While economic growth has slowed in most countries this year, the UK has seen a relatively sharp slowdown due to the uncertainty around Brexit. Our central forecast assumes that Parliament forces the Prime Minister to ask for a further delay beyond October, that the EU agrees and that there is then a general election where voters reject the option of a no-deal Brexit. In this scenario, Schroders expects that the UK economy will grow by 1% p.a. through 2019-2020, inflation will be around 2% and the Bank of England will raise the base rate to 1% by the end of next year. However, politics is fluid and the UK could leave without a deal, either on 31 October or after an election.

Office take-up was steady through the first nine months of 2019, with tech, media and serviced office providers making up for lower demand from banks and professional services. In general, office markets appear to be well placed to withstand a period of economic weakness. In most cities vacancy rates are close to their low point before the financial crisis and new building is limited, or in the City of London set to fall sharply in 2021. However, there are two caveats. First, Brexit will cut demand for London office space from financial services. The size of the impact will depend on the type of Brexit. Second, serviced office providers (e.g. WeWork) have recently been an important source of demand, particularly in London and Birmingham, but it is unclear how resilient they would be in a downturn.

Industrial rental growth has eased to 3% this year from 5% in 2018. In part this reflects weaker demand from manufacturers who account for roughly a quarter of space and in part it is due to an increase in vacant distribution warehouses. The last two years have seen an increase in speculative development of big distribution units and retailer insolvencies have added empty space. Moreover, there are signs that occupiers in London are starting to balk at further rent increases, following a 40% rise since 2014. We expect that distribution warehouse rents will be stable over the next 18 months. Rents on multi-let industrial estates will probably increase slowly, reflecting the continued growth of last-mile deliveries and low levels of new building.

The retail sector continues to be challenging. While this year has seen fewer administrations than in 2018, several retailers have announced store closures and retailers are increasingly asking for large cuts in rent, either at lease expiry or in exchange for lease extensions, or store improvements. We expect retail rents to fall by 20% on average over the next five years, as online sales increase from 19% of total retail sales today to between 25-30%. Lower rents will encourage some retailers (e.g. discounters) and leisure operators to expand, but they are unlikely to fill all the vacant space. The other part of the solution will be to redevelop and convert retail schemes to other uses, particularly residential. That should be viable in big city centres and affluent towns, but it will be more difficult elsewhere.

The investment market remains polarised. On the one hand, the insecurity of rental income makes it difficult to price many retail assets and the value of shopping centre deals has sunk to the depressed levels of 2008-2009. Yields on shopping centres and retail parks have risen by 0.6% over the last 12 months and we expect them to continue to rise through 2020. On the other hand, there is strong demand for supermarkets with long leases and index-linked rents, prime offices and prime industrials. A Brexit deal could trigger a new inflow of foreign capital, particularly into the London office market where yields are 0.5-1.0% higher than in Paris and Berlin, although UK finance costs are correspondingly higher. The weakness of sterling may also be an attraction for some overseas investors.

We forecast low single digit all property total returns in 2019, but the average will mask a huge variation across different types of real estate. For example, secondary shopping centre values could fall by 20% or more this year, whereas industrial and regional office capital values should be stable, assuming the economy avoids a recession. Our main focus for diversified portfolios is on industrial / logistics serving large population centres and offices in winning cities such as Bristol, Leeds and Manchester. We also like certain niche types such as retirement villages and social supported housing where demand is driven by long-term structural factors independent of the economy and where there is a shortage of good quality purpose-built accommodation.

Manager's commentary

SREF's portfolio is defensively positioned with an underweight to the retail sector relative to benchmark, a low weight to core central London offices and a relatively long weighted unexpired lease profile. The Fund has a diverse tenant base, with the UK government as the largest occupier. This supports the Fund's security of income at a time of relatively weak economic growth, while the general affordability of rents should enable us to grow rents as the economy improves.

Our business plan-led approach is at the heart of our investment process and sets out risks and opportunities, asset-by-asset, with the overall aim of meeting SREF's investment objectives. Once a property's business plan has been completed it will be considered for sale with the proceeds reinvested in the portfolio in line with strategy, or used for liquidity management purposes.

We have identified a number of opportunities in the portfolio to enhance value through lease regears, refurbishments and selected redevelopments. We therefore believe that the Fund is well placed to continue to meet its performance objective. On page four of this report we discuss the progress made to date.

Liquidity management and redemptions

Promoting an active secondary market remains an important tool when managing the Fund's liquidity. SREF has seen strong demand from new and existing investors, and secondary market transactions totalling £86 million were completed during the third quarter of 2019. In the year to date SREF has received redemption requests from investors which have been met from existing cash balances and the proceeds of selected asset disposals. As advised in previous investment reports, we seek to balance the interests of long term investors with those seeking to exit. The management of SREF's liquidity will at all times comply with the binding terms included in the Fund's prospectus and Instrument of Incorporation.

Please note that the payment of redemptions accepted at the end of June 2019 are payable in early October and will therefore be reflected in the Fund's October month end NAV.

GRESB

In the annual GRESB survey of global real estate funds, SREF was awarded 'Green Star' status for the fifth year in succession. SREF achieved a GRESB rating of 3-stars and ranked in the top ten of its peer group of 79 UK non-listed funds. Please see www.gresb.com for further information.

Bracknell Town Centre


CGI of Wenlock Works, London N1

Key activities

Transactions

No purchases were made during the third quarter.

Sales

Sales totalling £121 million were completed during the third quarter. This includes the sale of 11/12 Appold Street, EC2 which was unconditionally exchanged for sale in June for £22.2 million, as reported in last quarter's report. Properties were transacted following the completion of their asset business plans.

4 Chiswell Street, London, EC1

4 Chiswell Street was sold for a net £35.8 million. Following the comprehensive refurbishment of the common parts and 50% of the space in 2016, rents in this multi-let office building of around £60 psf were achieved. Lease re-gears were subsequently agreed with existing tenants to increase the income and weighted unexpired term. Following completion of the asset management and business plan, the building was fully let when sold.

Bracknell Beeches

The sale of Bracknell Beeches generated net sale proceeds of £13.8 million. This small business park is adjacent to the railway station in Bracknell and was sold with the benefit of residential use to a developer at a premium to its prior valuation. Had the property been retained, it would have required significant capital expenditure to generate an equivalent valuation.

Hythe Riverside Park, Colchester

This retail warehouse was sold for a net £28.8 million during the third quarter. The disposal follows the completion of the restructure of the lease to Sainsbury's and a reduction of the surrender premium payable to B&Q to permit B&Q to remain in occupation. As a result, all asset management has been completed and we judged that best value could be achieved by disposing of the property.

Car showrooms

A further 10 car showrooms were sold during the third quarter, realising net proceeds to the Fund totalling £18.9 million. Following these disposals the Fund has one remaining car showroom where we are seeking to extend the lease prior to its disposal. Since first acquisition in 2011, the total return achieved on the car showroom portfolios have achieved their target return objective of in excess of 8% p.a.

Asset management update

New lettings

19 new lettings were completed during the third quarter across SREF's office, industrial, retail and leisure assets, adding £681,000 p.a. of rental income. These lettings were completed collectively at rents above ERV and demonstrate the quality, affordability, sustainability and relevance of the Fund's assets to occupiers.

At **Kensington Village, W14,** CACI, a leading specialist in providing integrated marketing, location planning consultancy, network services and technology solutions, has taken a 4,771 sq ft letting on a 10-year lease at a rent of £38 psf.

Four lettings have been secured at **Battersea Studios, SW8** with a fifth occupier having newly renewed its lease to remain at the south-west London asset. Brand Agency, the company behind beauty company Ciate London, has let a 4,329 sq ft unit on a new three-year lease at a headline rent of £50 per sq ft.

We are in advanced discussions with the prospective tenant on a pre-let of a new c.330,000 sq ft office building at **Ruskin Square, Croydon**.

Rent reviews and lease renewals

Rent reviews totalling £1.9 million p.a. were agreed during the quarter at rents which were an average of 24% above the passing rent. Notable rent reviews were achieved at **Electra Industrial Estate, E16** where Bloomberg LP will pay a new rent of £879,000 p.a., an uplift of 38%, and at **Arenson Centre, Dunstable** where Sopra Group Solutions have agreed a new rent of £223,000 p.a., significantly above the ERV.

13 new lease renewals were agreed during the quarter, totalling £858,000 p.a., in line with ERV.

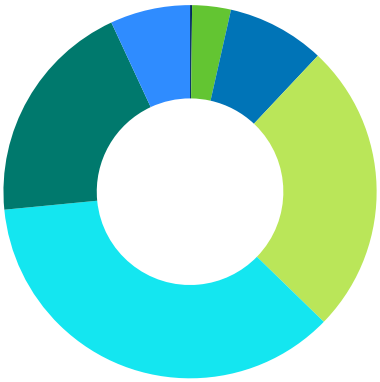
Sustainability

One Lyric, Hammersmith, W6 has achieved a BREEAM Excellent rating following the refurbishment completed last year. The offices are fully let to The Office Group. Sustainability is incorporated into all aspects of SREF's investment process with the aim of enhancing long term returns for our clients, contributing to our tenants' business performance and delivering positive impacts to communities, the environment and society for the long term. This certification is evidence of our commitment.

Portfolio analysis

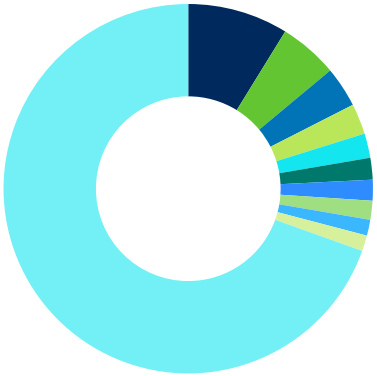
Segment	Absolute segment positions, %		Relative segment positions, %*	
	SREF	Benchmark	Underweight	Overweight
Offices – Central London	8.3	11.8	-3.5%	
Offices – South East	25.4	10.7		14.7%
Offices – Rest of UK	4.9	5.7	-0.8%	
Industrial – South East	18.4	19.7	-1.3%	
Industrial – Rest of UK	4.9	10.2	-5.3%	
Standard retail – South East	5.9	7.0	-1.1%	
Standard retail – Rest of UK	2.4	3.2	-0.8%	
Shopping centres	5.0	2.4		2.6%
Retail warehouses	5.7	13.1	-7.4%	
Other	12.6	10.2		2.4%
Cash	6.7	6.0		0.7%

Lot size bands, by GPV**



- 0-5m 0.2%
- 5–10m 3.4%
- 10–25m 8.5%
- 25–50m 25.3%
- 50–100m 36.2%
- 100–150m 19.6%
- 150 - 200m 6.9%

Tenant profile, % contracted rent



- 8.8% The Secretary of State
- 5.2% The Office Group
- 3.5% Tata Steel
- 2.7% Lloyds TSB Bank
- 2.1% Care UK
- 1.9% Stay City
- 1.8% Reading Forbury Sq.
- 1.7% University of Law
- 1.4% M&S
- 1.4% Cable & Wireless
- 69.5% 705 other tenants***

Source: Schroders, 30 September 2019, figures subject to rounding.*Positions relative to AREF MSCI UK Quarterly Property Fund Index – All Balanced Property Fund Index Weighted Average. Absolute deviation vs. benchmark is 40.6%. **GPV: gross property value. ***look through analysis. The sectors, securities, regions and countries shown above are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Top Ten Holdings	Sector	% of NAV
Building 1, Ruskin Square, Croydon	Offices	6.5%
Bracknell Town Centre	Retail and Office	6.0%
King's Mall, Hammersmith, London, W6	Shopping Centre	4.3%
One Lyric, Hammersmith, London, W6	Offices	4.2%
Wenlock Works, Shepherdess Walk, London, N1	Offices	4.1%
Acorn Industrial Estate, Crayford	Industrial	3.9%
Matrix, Park Royal, London, NW10	Industrial	3.7%
Electra Industrial Estate, London, E16	Industrial	3.7%
City Tower, Manchester	Mixed Use	3.5%
Hartlebury Trading Estate, Worcs	Industrial	3.0%

The sectors, securities, regions and countries shown above are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

One Lyric, Hammersmith, London W6

Electra Industrial Estate, London E16

Shareholder information

Minimum investment	£100,000
Total expense ratio (TER)[5]	0.83%
Annual management charge (AMC)	0.70% per annum
Frequency of pricing	Monthly
Valuation point	8am on the first business day of each calendar month
Distribution frequency	Monthly paid last business day
Distribution yield (% NAV)[6]	3.0%

Shareholder dealing

Subscriptions	Monthly
Redemptions	Quarterly, subject to 3 months' notice at quarter end
Dealing cut off	12 noon on the last Business Day of the calendar month
Secondary market dealing	Please phone Tom Dorey on +44 (0)207 658 3020
Number of shares in issue	51,894,687
NAV per share	£47.62
Offer price per share	£49.43
Bid price per share	£46.82
Pricing methodology	Dual priced
Offer spread[7]	NAV +3.8%
Bid spread[7]	NAV -1.7%
Number of new shares issued – Q3 2019	74,030
Number of shares redeemed – Q3 2019	2,525,167
Number of shares matched – Q3 2019	1,870,079

[5]Calculated in accordance with industry standard Association of Real Estate Fund guidelines which include fees charged by the Investment Manager, Property Adviser, Depositary, Registrar, Auditor, Legal Adviser and Valuation Agent.
[6]Calculated gross of tax, net of fees and expenses. Distributions are paid monthly on the last business day of each calendar month.
[7]Offer and bid spreads are reviewed monthly and are subject to change.
Source: Schroders, 30 September 2019.

Related party holdings

Related party	Shareholding
The Schroder Indirect Real Estate Fund	551,604 shares

Fund literature

Sustainable Investment	https://www.schroders.com/en/uk/realestate/products--services/sustainability/
SREF Prospectus	http://www.schroders.com/sref
Audited Annual Report and Accounts	http://www.schroders.com/sref
Dealing forms	http://www.schroders.com/sref

Investment parameters

Legal limits	PAIF Limit (%)	Current status (%)
Minimum % of assets (NAV) forming Property Investment Business	60%	100%
Minimum % of income from Property Investment Business	60%	100%
Aggregate exposure to indirect investment	40%	0.4%
Investment in a single asset	15%	6.5%
Commitment to development*	20%	4.1%
Borrowing*	25%	0.3%
Shorter/medium term leaseholds (< 50 years)*	20%	0.0%
Speculative development	15%	4.1%

*(on/off balance sheet).

Fund codes

	ISIN	SEDOL
Schroder UK Real Estate Fund (gross)	GB00B8215Z66	B8215Z6
Schroder UK Real Estate Fund (net)	GB00B8FPXR30	B8FPXR3
Schroder UK Real Estate Fund Feeder Trust	GB00B8206385	B820638

Further information

Tom Dorey
Head of Real Estate Product
For general enquires and placing trades
Phone: +44 (0)207 658 3020
tom.dorey@schroders.com
www.schroders.com/realestate
For your security, communications may be taped or monitored.

Northern Trust
Registrar
For all fund servicing queries
Phone: +44 (0)870 870 5059
schrodersenquiries@ntrs.com

Important information

For professional investors only. This material is not suitable for retail clients.
Past performance is not a guide to future performance and may not be repeated.
The value of investments and the income from them may go down as well as up and investors may not get back the amount originally invested.
The Schroder UK Real Estate Fund is authorised by the Financial Conduct Authority (the "FCA") as a Qualified Investor Scheme ("QIS"). Only investors to whom a QIS can be promoted, as specified in COBS 4.12.4R of the FCA's Handbook, may invest in Schroder UK Real Estate Fund. A QIS may not be promoted to a member of the general public. Investors and potential investors should be aware that past performance is not a guide to future returns. No warranty is given, in whole or in part, regarding the performance of the Fund and there is no guarantee that the investment objectives of the Fund will be achieved.
This information is not an offer, solicitation or recommendation to buy or sell any financial instrument or to adopt any investment strategy. Information herein is believed to be reliable but we do not warrant its completeness or accuracy. Any data has been sourced by us and is provided without any warranties of any kind. It should be independently verified before further publication or use. Third party data is owned or licenced by the data provider and may not be reproduced, extracted or used for any other purpose without the data provider's consent. Neither we, nor the data provider, will have any liability in connection with the third party data.

The material is not intended to provide, and should not be relied on for accounting, legal or tax advice. Reliance should not be placed on any views or information in the material when taking individual investment and/or strategic decisions. No responsibility can be accepted for error of fact or opinion. Any references to securities, sectors, regions and/or countries are for illustrative purposes only. Any investment in the Fund must be based solely on the prospectus, or any other document issued from time to time by the Manager of the Fund in accordance with applicable laws. Schroders has expressed its own views and opinions in this document and these may change.

Risk factors

- Property-based pooled vehicles, such as the Fund, invest in real property, the value of which is generally a matter of a valuer's opinion.
- The price of shares and the income from them may fluctuate upwards or downwards and cannot be guaranteed.
- It may be difficult to deal in the shares of the Fund or to sell them at a reasonable price because the underlying property may not be readily saleable, thus creating liquidity risk.
- There is no recognised market for shares in the Fund and, as a result, reliable information about the value of shares in the Fund or the extent of the risks to which they are exposed may not be readily available
- A potential conflict with the Manager's duty to the shareholder may arise where an Associate of the Manager invests in shares in the Fund. The Manager will, however, ensure that such transactions are effected on terms which are not materially less favourable to the shareholder than if the potential conflict had not existed.

The forecasts included should not be relied upon, are not guaranteed and are provided only as at the date of issue. Our forecasts are based on our own assumptions which may change. We accept no responsibility for any errors of fact or opinion and assume no obligation to provide you with any changes to our assumptions or forecasts. Forecasts and assumptions may be affected by external economic or other factors.
The Company is generally exempt from UK tax on capital gains realised on the disposal of its investments (including interest paying securities and derivatives). Overseas investors, depending on their tax status, may be liable to capital gains tax (or corporation tax) upon disposal of their holding. Investors who qualify as exempt (including overseas qualifying pension funds, charities and sovereign wealth funds) will benefit from full exemption. Schroders does not provide tax advice and investors should seek advice from professional advisers.
Schroders will be a data controller in respect of your personal data. For information on how Schroders might process your personal data, please view our Privacy Policy available at www.schroders.com/en/privacy-policy or on request should you not have access to this webpage.
Issued by Schroder Unit Trusts Limited, 1 London Wall Place, London EC2Y 5AU. Registration No. 4191730 England. Authorised and regulated by the Financial Conduct Authority. PRO01459