Schroders

Marketing material for professional investors or advisers only

Schroder UK Real Estate Fund (SREF) Q2 2020

30 June 2020

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	£2,255.3 million
Fund gross asset value	£2,286.2 million
Cash	£167.2 million
Number of holdings	53
Number of tenants	721
Void rate[1]	5.8%
Average unexpired lease term to break	8.7 years
Average unexpired lease term to expiry	10.0 years
Debt (% NAV)	0.4%
Net initial yield[1]	4.2%
Reversionary yield[1]	5.7%
Equivalent yield[1]	5.2%
Gross distribution yield[2]	3.0%
Investment parameters	Compliant

Source: Schroders, 30 June 2020

[1] Includes all directly held properties and joint ventures but excludes indirect funds. Includes agreements for lease but excludes land and development.

[2] Distributions payable in the twelve months to 30 June 2020 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 All Balanced Property Fund Index Weighted Average. Source: MSCI

Fund suspension

The subscription and redemption of shares was suspended on and from midday 18 March 2020, due to the material uncertainty of the March-end valuations and to ensure fair treatment of investors. Schroder Real Estate continues to monitor the situation closely in conjunction with the UK Financial Conduct Authority, the Fund's independent valuers and professional advisors.

Performance analysis

Performance (%)	3 months	12 months	3 yrs (p.a.)	5 yrs (p.a.)	10 yrs (p.a.)
SREF[3]	-0.5	-1.8	4.2	5.8	7.8
Benchmark[4]	-2.0	-2.6	3.4	4.6	6.6

Performance (%)	Q4 18 Q4 19	Q4 17 Q4 18	Q4 16 Q4 17	Q4 15 Q4 16	Q4 14 Q4 15
SREF[3]	2.1	7.3	11.1	4.7	14.2
Benchmark[4]	1.6	6.5	10.2	2.8	12.5

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, or because valuations may not be reliably determined in unusual market circumstances - 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

While the UK is experiencing a sharp recession as a result of lockdown measures imposed by the government in response to the Covid-19 pandemic, this is likely to be relatively short-lived. Schroders forecasts that GDP will grow by 16% in the second half of 2020, and by 6% in 2021. The economy is anticipated to rebound to its pre-virus level by mid-2022.

Strategy and portfolio activity

SREF's strategy continues to be underpinned by top-down, research-driven thematic investment, alongside stock selection and curation of our tenant base to ensure security and longevity of income. The Fund's proactive approach to both engaging with occupiers and active management of the portfolio to add value have been key to delivering performance in the current climate. Q2 2020 and the period since quarter end, saw the completion of 328,582 sq. ft. of letting transactions across the Fund's UK industrial assets, alongside new lettings in the office portfolio. The 24 industrial deals secured £2.1 million of income per annum in aggregate for the Fund, representing a 45% increase in annual passing rent on these units, while two new lettings at City Tower, Manchester will deliver a further £116,031 per annum for the Fund.

The deals demonstrate the Fund's ability to capitalise on the reversionary potential of its wider portfolio, and serve to enhance the Fund's Weighted Average Unexpired Lease Term and income resilience through high quality covenants.

Performance

For the quarter end 30 June 2020, SREF has returned to outperformance of the benchmark over 3 months, 1 year, 3 years p.a., 5 years p.a., and 10 years p.a. Please note that past performance is not a guide to future performance and may not be repeated. This outperformance is a result of the quality of SREF's portfolio, asset management achievements and the smoothing of the benchmark volatility seen in the month of March.

The market impact of Covid-19 and lockdown measures imposed by the government led to the Fund's independent valuers applying material uncertainty to the underlying property valuations for the month ending 31 March 2020, as well as subsequent months, and an associated widening dispersion between valuation movements across SREF's peer group. The recent alleviation of lockdown measures and slight uptick in transactional activity has led to more stability in the Fund's capital value movements, reflecting the quality of SREF's assets, alongside the security and relatively long tenure of its income.

Over the course of the quarter and since period end, the Fund completed 26 lease re-gears and new lettings growing income and adding value across the portfolio. Valuation declines remain most concentrated in the retail and leisure sectors, where the impact of Covid-19 is felt more acutely on tenant revenue.

SREF's inherent opportunities across its portfolio, the resilience of its income profile with affordable rents and potential for future growth, mean the Fund is well-positioned to deliver performance over the second half of this year.

UK real estate market commentary

The lockdown in response to Covid-19 has pushed the UK economy into a sharp recession. GDP fell by a fifth in April and unemployment is rising as companies make redundancies. In addition, 12 million people have a job, but are not working and are relying on temporary income support from the government. The increase in public spending and drop in tax revenues meant that government borrowing jumped to £104 billion in April-May 2020, although the simultaneous fall in bond yields has helped limit the cost of servicing this debt.

Schroders forecasts that GDP will grow by 16% in the second half of 2020 and by 6% in 2021, as people who are in work start to spend more on discretionary items and as the government increases investment in infrastructure, in order to reduce regional inequalities. The economy should get back to its pre-virus level by mid-2022. The main upside scenario is that scientists succeed in developing a vaccine, or effective treatment for Covid-19 before the end of this year. There are three downside risks. First, a national second spike in infections. A lot will depend on the quality of the government's testing and tracing systems. Second, a wave of insolvencies, as weak companies fail and there is then a domino effect, as well capitalised businesses being sunk by bad debts. Third, the UK and EU could fail to reach a trade deal before the end of 2020, leading to a hard Brexit.

The lockdown and collapse in revenues has meant that some businesses have not paid rent and service charges. The government's decision to place a moratorium on the eviction of tenants until the end of September may also be a factor. Retailers have been most likely to defer rent and service charge payments, while most office occupiers have paid in full. Industrial tenants fall somewhere in the middle. In total most balanced funds collected between 65-80% of the rent due on the March quarter day, including agreements to pay rent monthly, rather than quarterly in advance. In addition, some rent was written off, because tenants agreed to extend their lease, or remove a forthcoming break clause. We expect a similar pattern for the June quarter day.

Covid-19 has accelerated the growth in on-line retailing and increase in structural vacancy. The market share of on-line sales jumped to 33% in May 2020 from 19% in 2019 and while some of that will unwind as non-essential shops re-open, some people will remain hesitant about visiting stores. Footfall in the second half of June was 30-40% lower than in the same period of last year. The last month has seen several retailer insolvencies, particularly in the fashion sector and we expect that to continue over the next six months, leading to more empty units and a further big fall in open market rental values. Bulky good retail parks will probably be more defensive than shopping centres, partly because they have little exposure to fashion retailers, partly because they are open air rather than enclosed and partly because rents and service charges are more affordable. Whilst underweight to the

retail sector at 13%, Bracknell Town Centre is SREF's largest exposure to retail where the majority of the scheme is open air with modern, fit for purpose retailing at affordable rents. In the long-term we are likely to see more turnover based rents, but that will require retailers to share sales figures and agreement on how to treat goods which were bought on line, but returned in store.

The surge in internet sales during lockdown helped support demand for warehouses, both from supermarkets and pure online retailers. Amazon committed to two large fulfilment centres and seven smaller delivery warehouses in the first half of 2020, more space than it took in 2019. The NHS was also very active taking temporary warehouse space to store medical supplies. However, on the downside, manufacturers who account for around 30% of industrial space have been hit hard by the lockdown and Brexit presents them with further uncertainty. The last 12 months have also seen a limited increase in vacant industrial space, mainly in the South West and Midlands, as occupiers have moved into brand new logistics units and their old warehouses stand empty. As a result, we expect industrial rental growth to pause in the short term, before resuming in 2022.

In the office sector, the immediate question is how many people can a building accommodate safely and how many people need to continue working from home? While the answer varies according to design (e.g. towers require people to use lifts), most offices can probably only safely accommodate between 25%-40% of staff. The other constraint is how reliant are people on public transport to travel to work? That is likely to be more of an issue in central London where around 80% of commuters use public transport than in regional cities where public transport is more limited and the majority of people either drive to the office (e.g. Cardiff), or cycle (e.g. Cambridge).

Taking a longer term view, we doubt whether the current experiment with remote working will lead to a step change in office demand after the virus. While it will be more common for people to work from home occasionally, we do not expect it to become the norm. The office is the best place to communicate with colleagues, spark new ideas, train staff and meet with clients. Many occupiers including big tech (e.g. Amazon, Apple, Google) have invested heavily in new offices in order to attract and retain staff. We anticipate that the demand for offices in city centres and close to universities will increase once the virus is brought under control, driven by the growth in tech, life sciences, professional services and public administration.

Investment transactions fell sharply during the lockdown, given the uncertainty over the economy and the difficulties of conducting site visits and other due diligence. In April and May there were just 50-60 investment deals per month, compared with over 200 in a normal month. The lack of transactions coupled with some tenants deferring rent meant that valuers decided to apply material uncertainty clauses. That in turn forced open-ended funds to suspend dealing of primary shares. We are now starting to see a recovery in transactions, at least where the tenant has a strong covenant and paid rent through the lockdown. Consequently, valuers have lifted the material uncertainty clause on industrial assets and we expect that office and retail will follow over the next two to three months.

We expect that real estate yields will now rise despite the low level of bond yields, as investors price-in potential falls in rental income - albeit they should be short-lived in the office and industrial sectors. Given the uncertainty over the economy it is difficult to know how far capital values will fall, but our working assumption is that after a 7% drop in the first half of 2020, they will decline by around 5% in the second half and then stabilise in 2021. Industrial and regional office are likely to be the most defensive sectors, assuming rents are broadly flat, while retail and leisure will probably be the weakest. Looking forward to 2021, London offices could be one of the best performing sectors, if foreign investors start to bid down yields, assuming there is then greater clarity on Brexit.

Manager's commentary

Portfolio activity in Q2 2020 focused on growing and diversifying SREF's income through new lettings and lease re-gear activity across the Fund's industrial portfolio.

The completion of 24 letting transactions across the Fund's industrial portfolio took place during the quarter and since period end, securing £2.1 million of income per annum in aggregate. The new lettings highlight the continued demand for high-quality space in the right locations, despite the ongoing market disruption caused by Covid-19. Hartlebury Trading Estate witnessed the most activity with £1.2 million of completions, across 247,432 sq ft, representing 18% of the total space at the estate.

Two new 10-year leases at City Tower, Manchester were completed in Q2 generating income of £116,031 per annum for the Fund. Ashfield Healthcare's letting will see the medical service provider lease 9,059 sq ft of space across the entire seventh floor as the business carries out expansion plans. A pre-emption deal has also been signed to allow for further expansion in the building in the future, with the 10-year lease including a five-year break. Sonoco Limited, an existing tenant at City Tower, is upsizing to a 1,979 sq ft suite on a 10-year lease with a tenant break at year five.

These lettings are in line with SREF's business plan to grow income at existing assets across the Fund, capitalising on the reversionary nature of the portfolio, whilst further reducing SREF's low void rate. As at end June, the void rate is 5.8%.

The Fund continues to maintain a structural underweight position to retail and core Central London offices to enhance the portfolio's defensive quality, with strategic focus on London sub-market offices, pro-active management of the Fund's current industrial allocations, and sustainable investment to support outperformance. We expect SREF's resilient income profile, our active engagement with tenants and proactive management of the portfolio to continue to drive returns over the second half of the year.

Liquidity management and redemptions

The material uncertainty clause applied to the valuations as at the end of March led to the suspension of new issuance and redemptions of shares in the Fund and its Feeder Trust on and from midday 18 March 2020. The suspension was required in order to treat all customers fairly, and not as result of liquidity pressure. Schroder Real Estate is monitoring the situation closely in conjunction with the UK Financial Conduct Authority, the Fund's independent valuers and professional advisors, to ensure we continue to act in the best interests of all investors. The

suspension will be reviewed in light of further statements from the independent valuers.

The promotion of an active secondary market in SREF remains an important tool to enhance liquidity for investors, and help maintain a stable capital base to enable asset management activities. Q2 2020 saw similar secondary market transaction volumes relative to Q1, with £24.2 million of transactions completed (versus £24.4 million in Q1).

Redemption requests received during Q4 2019 and Q1 2020 (prior to the suspension date on 18 March) are affected by the suspension of dealing, and will become payable once the suspension is lifted.

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.

Key activities

Transactions and asset management update

No purchases or sales were made during Q2 2020.

New lettings

Five new lettings and 19 lease renewals were completed over the course of Q2 across the Fund's industrial portfolio. These transactions secured £2.1 million of rental income per annum in aggregate. The lease renewals undertaken across four estates accounted for £1.7 million of this total. Philip Scott joined the SREF team from the agency Gerald Eve in March as an Investment Manager, with primary focus on the Fund's industrial portfolio and strengthening occupier relationships across these assets.

Hartlebury Trading Estate in the West Midlands witnessed the most lettings transactions over the past two months with £1.2 million of transactions taking place across 247,432 sq ft, representing 18% of the total space at the 1.4 million sq ft estate. The transactions included a new 10-year lease for 55,101 sq ft of space was also completed with Concept Furniture International at a rent of £250,000 per annum, representing a 43.7% increase on the previous rent and 30% ahead of ERV. ARCC Communications also signed a new six-year lease for a 16,755 sq ft unit. The 220-acre estate is now 99% let by ERV following these transactions, with only one unit still vacant.

SREF also completed significant lettings at its **Arenson Way, Dunstable** with the arrival of Signature Flatbreads, who signed a new five-year lease for 40,775 sq ft. The rent was agreed at £265,000 per annum, 37% ahead of ERV.

At **Woking Business Park**, Sally Salon Services Ltd has signed a 10-year lease renewal on its unit of 2,517 sq ft at a rent of £37,750 per annum, 36.5% ahead of the previous rent and 1.8% ahead of ERV. Both estates are now 100% let following these lettings.

Acorn Industrial Estate, Crayford saw three transactions take place, across 19,095 sq ft. This included a 15-year lease renewal by Gase Marine & General Engineering Services Ltd for two units at the site totalling 13,358 sq ft. Meanwhile, a new 10-year lease was signed by specialist manufacture and distributor of Pipeline Inspection Systems, Mini-Cam LTD, for 1,887 sq ft of space. Contracted rent at the scheme has increased by 5.5% over the past 12 months.

In addition to the above industrial lettings, new 10-year office lettings with medical service provider Ashfield Healthcare and US packaging firm Sonoco Limited were completed at City Tower, Manchester. The two lettings will generate income of £116,031 per annum for SREF.

Occupier engagement on the impact of Covid-19

The Fund's rent collection for the March Quarter Day (pertaining to Q2 2020) totalled 75% in aggregate, which represented the upper end of a peer group collecting between 65-80% of rents on average, and reflected the impact of Covid-19 on occupier revenues. The Fund's rent collection for Q3 to date (the June Quarter Day) is 71.5% as at 17 July, adjusted for monthly rents.

SREF is undertaking discussions with all tenants who have requested rent concessions – the Manager's position is to deal with each occupier on a case-by-case basis with negotiations ranging to suit individual circumstances from monthly rents to rent deferrals, to offering rent free in return for re-gears or removing break options.

Sustainability and Impact Investing

The Fund has recently published a new Sustainability Guide, which is available on the Fund's website here. The Guide provides a comprehensive overview of Schroder Real Estate's approach to responsible and sustainable investment.

In tandem with the recent lettings completed at **City Tower, Manchester**, the Fund is implementing a Health and Wellbeing Framework at the building. Works are currently on site to enhance its occupier offering to create best in class amenities for our tenants, with works currently on-site to deliver a brand new cycle store and shower facility for tenants. The asset recently achieved a Wiredscore Platinum accreditation for connectivity and, following refurbishment, two of the floors were awarded a BREEAM Very Good rating. Occupiers regularly attend sustainability meetings and the success of 'Environmental Week' in February highlighted increasing tenant engagement on impact and sustainability. This is encouraging and, as we continue to develop our understanding of tenants' needs, we expect the asset's sustainability credentials to grow.

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. Please refer to the Sustainability Guide for full information.

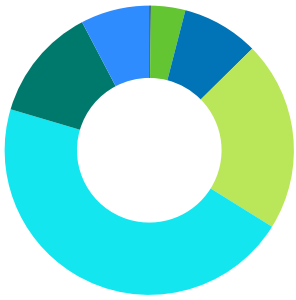
Hartlebury Trading Estate, Worcester


City Tower, Manchester

Portfolio analysis

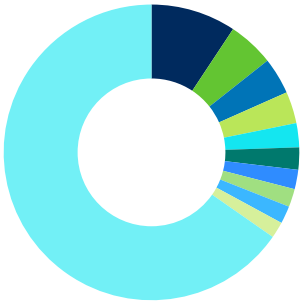
Segment	Absolute segment positions, %		Relative segment positions, %*
	SREF	Benchmark	Underweight / Overweight
Offices – Central London	10.9	12.3	-1.4%
Offices – South East	27.1	10.9	16.2%
Offices – Rest of UK	4.9	5.9	-1.0%
Industrial – South East	20.1	20.9	-0.8%
Industrial – Rest of UK	5.1	10.7	-5.6%
Standard retail – South East	5.0	6.1	-1.1%
Standard retail – Rest of UK	2.2	2.9	-0.7%
Shopping centres	0.6	1.7	-1.1%
Retail warehouses	5.1	11.1	-6.0%
Other	11.6	10.6	1.0%
Cash	7.3	6.8	0.5%

Lot size bands, by GPV**



- 0-5m 0.2%
- 5–10m 3.9%
- 10–25m 8.6%
- 25–50m 21.3%
- 50–100m 45.7%
- 100–150m 12.7%
- 150 - 200m 7.7%

Tenant profile, % contracted rent



- 9.3% The Secretary of State
- 5% The Office Group
- 4% Checkout Ltd
- 3.5% Tata Steel
- 2.6% Lloyds TSB Bank
- 2.4% Marketing VF Ltd
- 2.1% Care UK
- 2% Stay City
- 1.9% Royal Mail Group
- 1.8% Reading Forbury Sq.
- 65.3% 711 other tenants***

Source: Schroders, 30 June 2020, 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 35.4%. **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	7.3%
Wenlock Works, Shepherdess Walk, London, N1	Offices	6.4%
Bracknell Town Centre	Retail and Office	5.7%
One Lyric, Hammersmith, London, W6	Offices	4.4%
Acorn Industrial Estate, Crayford	Industrial	4.4%
Electra Industrial Estate, London, E16	Industrial	4.1%
Matrix, Park Royal, London, NW10	Industrial	4.0%
City Tower, Manchester	Mixed Use	3.5%
Hartlebury Trading Estate, Worcs	Industrial	3.2%
Kensington Village, London W14	Offices	2.7%

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Wenlock Works, Shepherdess Walk, London N1

Woking Business Park

Shareholder information

Minimum investment	£100,000
Total expense ratio (TER)[5]	0.80%
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 Freya Petty on +44 (0)207 658 7904
Number of shares in issue	49,584,922
NAV per share	£45.48
Offer price per share	£47.23
Bid price per share	£44.79
Pricing methodology	Dual priced
Offer spread[7]	NAV +3.8%
Bid spread[7]	NAV -1.5%
Number of new shares issued – Q2 2020	0
Number of shares redeemed – Q2 2020	0
Number of shares matched – Q2 2020	588,288

[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. Yield presented is annualised backwards-looking distribution yield.
[7]Offer and bid spreads are reviewed monthly and are subject to change.
Source: Schroders, 30 June 2020.

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%	0.3%
Investment in a single asset	15%	7.3%
Commitment to development*	20%	0.1%
Borrowing*	25%	0.4%
Shorter/medium term leaseholds (< 50 years)*	20%	0.0%
Speculative development	15%	0.1%

*(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

Freya Petty
Manager, Real Esate Capital
For general enquires and placing trades
Phone: +44 (0)207 658 7904
freya.petty@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

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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.
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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.
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- 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.
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