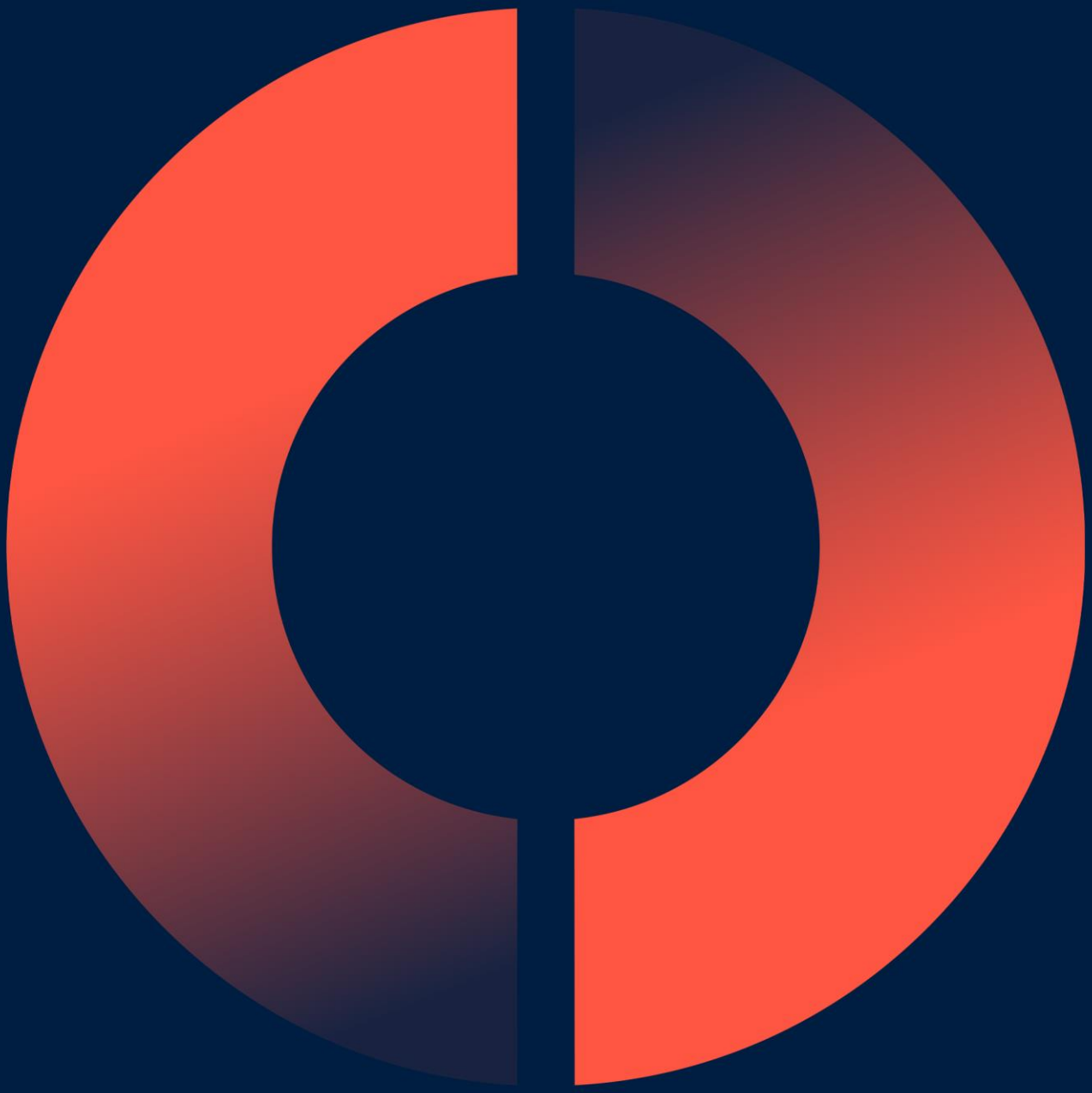
SCHRODERS CAPITAL UK REAL ESTATE FUND (SCREF)

Q2 2022



Schroders capital

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Investment objective

SCREF'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.

Performance analysis

Performance (%)	3 months	12 months	3 yrs (p.a.)	5 yrs (p.a.)	10 yrs (p.a.)	Q4 20 Q4 21	Q4 19 Q4 20	Q4 18 Q4 19	Q4 17 Q4 18	Q4 16 Q4 17
SCREF[1]	2.4	18.1	7.8	7.6	9.0	16.2	-0.4	2.1	7.3	11.1
Benchmark[2]	3.9	23.3	9.2	8.1	8.5	19.1	-1.0	1.6	6.5	10.2

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.

Source: MSCI. [1]Performance is calculated on a NAV to NAV price basis plus income distributed, compounded monthly, net of fees, gross of tax and based on an unrounded NAV per share. [2]MSCI/AREF UK Quarterly All Balanced Open-Ended Property Fund Index.

Key information

Fund net asset value
£2,667.9m

Fund gross asset value
£2,804.1

Average unexpired lease term to break
8.4 years

Average unexpired lease term to expiry
9.7 years

Cash
£95.1m

Investment parameters
Compliant

Number of holdings
52

Number of tenants
654

Void rate[3]
7.0%

Index-linked leases[5]
17.0%

Debt (% NAV)
4.1%

Net initial yield[3]
4.1%

Reversionary yield[3]
4.9%

Equivalent yield[3]
4.7%

Gross distribution yield[4]
2.9%

Quarter spot yield
3.0%

Source: Schroders, 30 June 2022. [3]Includes all directly held properties joint ventures and indirect funds. Includes agreements for lease but excludes land and development. [4]Distributions payable in the twelve months to 30 June 2022 as a percentage of the latest net asset value per share (NAV). [5]As a percentage of total contracted income.

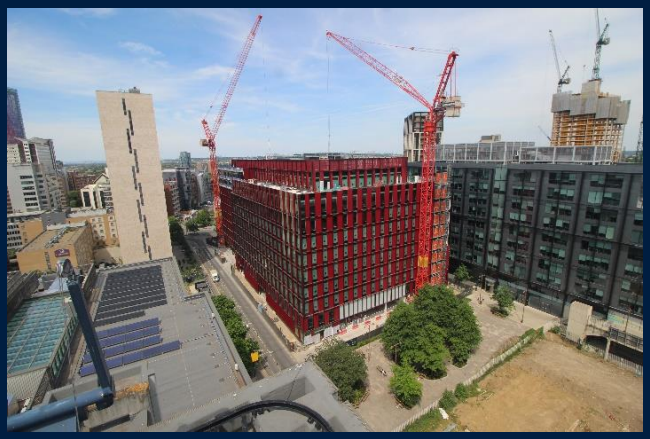
Risk factors

- 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

Strategy

SCREF's key strategic priorities for 2022 are:

- Building income and total returns through active asset management
- Investing in inherent opportunities within the Fund
- Crystalising profit on assets where the business plan has completed
- Recycling capital to deliver quality assets with defensive income and resilient sustainability credential
- Sustainability focused - SCREF is an SFDR[1] Article 8[2] equivalent fund, with three binding commitments to sustainability incorporated within it's stated investment objective



2 Ruskin Square, Croydon

One Cambridge Square, Cambridge

[1]Regulation (EU) 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector ("SFDR")
[2]A fund that has environmental and/or social characteristics within the meaning of Article 8 of SFDR

Performance

SCREF generated an absolute total return in Q2 of 2.4% and NAV growth of £46.8 million. Please note that past performance is not a guide to future performance and may not be repeated. SCREF's performance during the quarter was derived principally from:

- Capital value growth (net of capex) across the property portfolio of £42.8 million, primarily across industrial assets, retail warehousing, and a select number of offices following asset management activity.
- Active asset management: 30 new lettings, lease renewals and rent reviews completed generating an additional £2.3 million of contracted rent per annum.
- Practical completion achieved at Hartlebury 30, a 30,000 newly built, sustainable industrial warehouse at Hartlebury Trading Estate.
- Contracted rent increase of £1.14 million generated from an RPI linked rent review settled with the Secretary of State at 1 Ruskin Square.
- 12 leasing transactions being completed across the industrial portfolio generating an additional £0.67 million of contracted rent per annum.

SCREF's performance outlook:

- High quality portfolio generating defensive income: 78.1% of SCREF's assets are located in London and the southeast, 32.5% of the office portfolio is let to government or higher education increasing to 44.9% (including the 2 Ruskin Square government pre-let), low void rate at 7.0%, long unexpired lease term of 8.4 years to earliest termination.
- Well hedged against inflation – 17.0% contracted income with index-linked reviews, increasing to 24.8% on completion of 2 Ruskin Square.
- Given the high quality of SCREF's office portfolio, the fund is set to benefit from the polarisation between demand for prime offices and more secondary offices. As a result, we expect the Fund's office sector performance to recover more quickly and more strongly than the benchmark.
- SCREF has proactively fitted-out space in four buildings to meet evolving tenant requirements and to provide greater flexibility in exchange for rent premiums and reduced incentives.
- Increasing exposure to the industrial sector and income via development of existing industrial assets and consideration of selective acquisitions.

PROFESSIONAL PENSIONS INVESTMENT AWARDS
WINNER
UK Core Property Manager of the Year
Schroders

CORPORATE GOVERNANCE QUALITY MARK 2021 AREF Code of Practice

3 Month Total Return

2.4%

12 Month Total Return Growth

18.1%

Q2 2022 NAV Growth

£46.8m

Total increase in contracted rent during Q2 2022

£2.3m

UK real estate market commentary

Hopes of a sharp slowdown in inflation over the next 12 months have evaporated. Schroders now expects inflation to average 9% in 2022 and 6% next year. In part this is due to a further spike in gas prices as Russia has reduced supplies to Europe in retaliation for sanctions. However, it also reflects an acceleration in the price of services, suggesting that faster inflation is no longer confined to imported energy and food. That is a red flag for the Bank of England which wishes to avoid a wage-price spiral and we forecast that it will raise the base rate to 2.25-2.5% by mid-2023. The combination of rising prices and interest rates means that economic growth is likely to be fairly modest over the next 18 months and there is a risk of a recession, if the squeeze on real household incomes intensifies.

The prospect of weak economic growth and higher interest rates has led to a sharp fall in both equity and bond prices. The yield on 10 year UK government bonds and the cost of long-term debt have increased by 1.25% since the start of 2022. As a result, the total cost of debt including banks' margins now exceeds prime office and industrial yields and the gap between 10 year gilt yields and the all property initial yield (4.0%) has shrunk to around 1.75%. That is the narrowest since 2008 and compares with an average of 1.9% over the last 30 years. Although the yield gap between bonds and real estate is not fixed and flexes according to rental growth prospects, the fact that the gap has shrunk at the same time as the outlook for the economy has deteriorated means that real estate yields are now likely to rise across the board.

Given the jump in finance costs and the increased risk of recession, we expect that many investors will now step back from the real estate market and wait for it to re-price. At this early stage it is It is difficult to know how far and how fast the adjustment will take, but our working assumption is that capital values will fall by 10% on average between now and end-2023. To put that in context, the peak to trough falls in capital values during the early 1990s recession and the GFC were 27% and 44%, respectively (source MSCI UK Monthly index). We think the fall in capital values will be smaller over the next 18 months, because there is less speculative development and because investors generally have lower levels of debt, so there is less risk of distressed sales depressing prices.

Which assets will be most defensive? While it is possible that yields rise by the same amount across the market, hitting prime assets harder, we think that investors will probably become more, not less discerning given the uncertain economic environment and that the spreads between prime and secondary yields will widen. That was the pattern in the early 1990s and again during the GFC.

We think the assets which are likely to be most defensive over the next 18 months are those with decent demand and supply fundamentals and good prospects for rental and income growth over the long-term. They include bulky goods retail parks, offices with strong energy efficiency and well-being features and multi-let industrial estates. We think that certain niche sectors benefitting from long-term structural changes will also be relatively defensive including life sciences, self storage, social supported housing and student halls.

Conversely, we think that the sectors and assets which are most exposed to rising interest rates are those with relatively fixed, or insecure income streams. They include secondary shops and shopping centres, dedicated conference hotels, offices in secondary locations and in general, any building with poor energy efficiency. The jump in construction costs and tightening in bank loan terms is also likely to depress prices for land and re-development projects. We are also cautious on distribution warehouses given the high level of new building over the last three years and their high exposure to retail. In the short-term consumers are likely to cut back on-line, as well as in-store. The war in Ukraine has added to the inflation caused by the combination of pent up demand and supply disruptions due to Covid-19. While the drop in real incomes means that consumer spending will be weak in 2022, we expect that the UK economy will avoid a recession thanks to higher government spending and an increase in investment. Next year should see a recovery in consumption as inflation slows to 3% from 8% this year. That assumes that oil and gas prices stabilise at current high levels and that wage increases do not accelerate, generating second round inflation. In this scenario we expect the Bank of England to raise the base rate to 1.5% by end-2022.

"We think the assets which are likely to be most defensive over the next 18 months are those with decent demand and supply fundamentals and good prospects for rental and income growth over the long-term" Mark Callender, Head of Real Estate Research

Fund commentary and key activity

Transaction update

As announced in the Q1 update, SCREF exchanged an agreement to sell Jubilee House, Stratford in Q1 2022 for £72.35 million, conditional on securing planning permission and vacant possession. Significant progress was made during Q2 with the proposed scheme successfully receiving formal planning approval.

Key asset management initiatives

The fund experienced strong levels of leasing activity across the portfolio during Q2 2022, completing a total of sixteen new lettings, ten lease renewals and four rent reviews during the quarter, generating an additional £2.3m per annum in contracted rent.

Industrial

Within SCREF's industrial portfolio, 12 leasing and rent review transactions were completed across 121,579 sq ft of floorspace, resulting in a net uplift in contracted rent of £673,589 per annum, at a combined 3.9% ahead of ERV.

At Hartlebury Trading Estate, practical completion was achieved at Hartlebury 30, a high specification and sustainable industrial warehouse. The 30,000 sq ft warehouse was 100% pre-let to Etac Limited on a new 15 year lease at a rent of £195,916 per annum, with the lease expected to complete in Q3 2022.

Offices

The office sector also saw good levels of activity. At Battersea Studios, five new leasing transactions took place in Q2, securing a combined £170,631 per annum of income at the scheme, 5.5% ahead of the total valuation ERV for the five office suites.

At 1 Ruskin Square, Croydon, SCREF secured a significant rental uplift of £1.14 million per annum, following the settlement of an RPI-linked rent review with the Secretary of State. The revised rent of £7.3 million per annum increases the SCREF total contracted rent generated by the Secretary of State to 9.5%.

Retail & Leisure

At Bracknell, three lease renewals and two new lettings were completed across 37,834 sq ft. Major national retailers Footlocker and Poundland both renewed leases at the scheme.

At Chatham Waterside, two vacant restaurant units of a combined 3,100 sq ft were successfully let to franchisees of Costa Coffee and Kaspas Desserts on 10 year leases. These lettings will generate an additional £78,050 of contracted rent per annum. The scheme now has only one vacant unit remaining, where there is strong interest from national restaurant operators.

Occupier engagement and Covid-19

CBRE rent collection as at 24 June for the March Quarter Day totalled 92.0% in aggregate for properties they manage on behalf of SCREF.

Fund updates

- **Liquidity management**– Promoting an active secondary market remains an important tool when managing the Fund's liquidity. Over the quarter, SCREF completed £65 million of secondary trades bringing the year to date total to £81 million.
- **Redemptions -**As at quarter end, the Fund received redemption requests totalling £65 million which are due to be paid on 3 October. The management of SCREF's liquidity will, at all times, comply with the binding terms included in the Fund's Prospectus and Instrument of Incorporation,
- The SCREF **Q2 webinar** will take place on 11th August from **09.00am to 10.15am GMT**. Investors would have received an invitation to register via email. If you have any queries related to attendance or registration please contact realestate@schroders.com

Team changes

With effect from 2 September 2022 Jessica Berney, SCREF Fund Manager, will be taking maternity leave. As a result, Rob Cosslett, current Deputy Fund Manager, will become SCREF Fund Manager. Rob joined Schroders in 2015, is a Chartered Surveyor and was appointed Deputy Fund Manager in 2019. Rob has been supporting Jessica across all aspects of the SCREF fund management role, and assumed the role of Fund Manager during Jessica's maternity leave in 2021. Rob will report to Nick Montgomery, Head of UK Real Estate Investment, who will provide oversight and support to the team.

To further boost dedicated resources for SCREF, Eleanor Jukes also joins the team on 1 August as a dedicated, senior Portfolio Manager, reporting to Rob. Eleanor joins from Legal & General Capital ("LGC") where she was Head of Transactions within the Urban Regeneration team, leading complex investment transactions that often involved public/private stakeholders across the commercial and residential asset classes. Prior to LGC, Eleanor was a Senior Strategist at Legal & General IM Real Assets and, prior to that, Eleanor was an analyst at Schroders. Eleanor has 15 years real estate experience.

We have also been able to secure a Senior Product Specialist starting 16 September as a replacement for Freya Petty who left the company to pursue other

career opportunities. Until her arrival, Nikki Keys and Maisie Donati will be your point persons for answering any queries you might have.

Alongside the dedicated new SCREF hires, Schroders Capital Real Estate has made a number of key new hires at its offices in both London and Manchester. This includes Rebecca Gates as Head of UK Asset Management, who joins with over 30 years experience from LaSalle where she was member of the UK Investment Committee as well as the UK management board. Alongside Rebecca, four new UK asset managers have been hired with specialist expertise in industrial, offices retail and healthcare. Finally, to support our sustainability programme, and SCREFs Article 8 equivalent binding commitments, new hires are being made in the real estate sustainability team.

Sustainability

Strategy

To deliver a high quality portfolio benefitting from resilient sustainability credentials and which will remain fit-for-purpose as tenant requirements continue to evolve.

SCREF is an SFDR Article 8 equivalent fund, with three binding commitments to sustainability incorporated within it's stated investment objective.

Progress against targets

- We continue to work closely with our appointed EPC advisor, WSP in order to work towards 100% portfolio EPC coverage and ensure 100% EPC compliance by the April 2023 MEES deadline
- Our investment and sustainability team continues to work towards establishing Net Zero Carbon pathways for all assets within SCREF
- Progressing the Fitwel feasibility study with CBRE at Hartlebury Trading Estate with a target for certification during 2022
- 2021/2022 GRESB submission completed
- Accreditation: 36.2% of the standing property portfolio (excluding development sites at Croydon and Cambridge) and 70.9% of the current office portfolio benefits from BREEAM good or better, NABERS and/or Fitwel accreditation
- Sustainability linked loan – The current RCF has been converted to a sustainability linked loan with three KPI's during Q2 2022

Edmonton, London

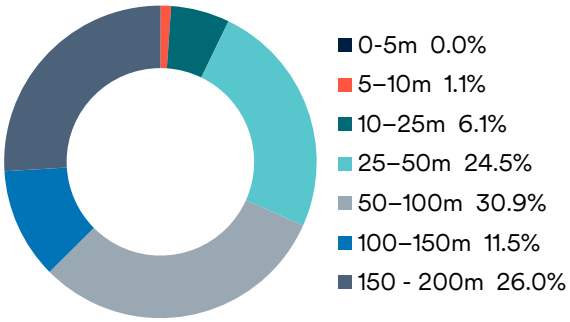
Mermaid Quay, Cardiff

One Lyric, Hammersmith

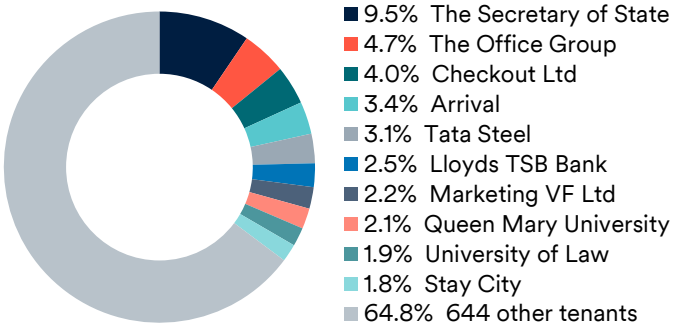
Portfolio analysis

Segment	Absolute segment positions, %		Relative segment positions, %	
	SCREF	Benchmark	Underweight	Overweight
Offices – Central London	9.9	10.5	-0.6%	
Offices – South East[2]	30.8	8.6		22.2%
Offices – Rest of UK	3.9	4.9	-1.0%	
Industrial – South East	22.2	28.4	-6.2%	
Industrial – Rest of UK	8.5	14.6	-6.1%	
Standard retail – South East	3.3	4.3	-1.0%	
Standard retail – Rest of UK	1.6	1.6	0.0%	
Shopping centres	0.5	0.8	-0.3%	
Retail warehouses	7.7	10.8	-3.1%	
Other	8.2	10.1	-1.9%	
Cash	3.4	5.4	-2.0%	

Lot size bands, by GPV



Tenant profile, % contracted rent



X2, Heathrow

Hartlebury 30, Hartlebury Trading Estate

Top Ten Holdings	Sector	ESG Credentials	Key attributes	% of NAV
1 Ruskin Square, Croydon	Offices	BREEAM Excellent	19.3years WAULT to break, 98% let to UK Government	8.5%
Acorn Industrial Estate, Crayford	Industrial		Highly reversionary, dominant southeast estate	6.6%
Wenlock Works, Shepherdess Walk, London	Offices	BREEAM Excellent	61% of passing rent index-linked to RPI	6.1%
2 Ruskin Square, Croydon	Offices	BREEAM Outstanding (target), NABERS Pioneering Project	25 year pre-let to UK Government, rent index-linked to RPI	6.1%
Bracknell Town Centre, Bracknell	Retail and Office		Fit for purpose, modern retail at affordable rents	4.0%
Hartlebury Trading Estate, Worcestershire	Industrial		Reversionary estate, with pipeline of development sites	3.9%
One Lyric, Hammersmith, London	Offices	BREAAM Very Good	16.0 year AWULT	3.8%
X2, London	Industrial		Unique location adjacent to Heathrow Airport, fully let	3.6%
The Brewery, Romford	Retail Warehousing		34% contracted income to Sainsburys supermarket	2.5%
Woking Business Park, Woking	Mixed Use		Reversionary estate with low void	3.4%

Source: Schroders, 30 June 2022, figures subject to rounding.

[1]Positions relative to AREF/MSCI UK Quarterly Property Fund Index – All Balanced Open-Ended Property Fund Index. Absolute deviation vs. benchmark is 49.2%. [2]Of SCREF's 30.8% allocation to South East offices, 44.9% comprises offices let or pre-let to the UK Government in Croydon (including 2 Ruskin Square, Croydon). [3]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.

Wenlock Works, London

Meadows Retail Park, Chelmsford

Shareholder information

Minimum investment	£100,000
Total expense ratio (TER)[1]	0.75%
Annual management charge (AMC)	Tiered structure with discounts for scale Headline rate of 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)[2]	2.9%

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 Maisie Donati on +44 (0)207 658 4894
Number of shares in issue	48,767,653
NAV per share	£54.71
Offer price per share	£57.12
Bid price per share	£53.91
Pricing methodology	Dual priced
Offer spread[3]	NAV +4.4%
Bid spread[3]	NAV -1.5%
Number of new shares issued – Q2 2022	94,344
Number of shares redeemed – Q2 2022	0
Number of shares matched – Q2 2022	1,239,201

Related party holdings

Related party	Shareholding
None	

Fund literature

Sustainable Investment	https://www.schroders.com/en/uk/realestate/products--services/sustainability/
SCREF 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%	8.5%
Commitment to development[4]	20%	5.4%
Borrowing[4]	25%	4.1%
Shorter/medium term leaseholds (< 50 years)[4]	20%	0.0%
Speculative development	15%	1.0%

Fund codes

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

[1]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. [2]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. [3]Offer and bid spreads are reviewed monthly and are subject to change. [4]On/off balance sheet.

Source: Schroders, 30 June 2022.

Further information

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For all fund servicing queries

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Important information

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