Schroders capital

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SCHRODERS CAPITAL UK REAL ESTATE FUND (SCREF)

Q1 2022

31 March 2022

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.

Key information

Fund net asset value	£2,621.1 million
Fund gross asset value	£2,699.7 million
Cash	£98.4 million
Number of holdings	53
Number of tenants	644
Void rate[1]	7.0%
Average unexpired lease term to break	8.5 years
Average unexpired lease term to expiry	9.8 years
Index-linked leases	16.1%
Debt (% NAV)	3.3%
Net initial yield[1]	4.0%
Reversionary yield[1]	4.9%
Equivalent yield[1]	4.7%
Gross distribution yield[2]	2.8%
Quarter Spot Yield	3.0%
Investment parameters	Compliant

Source: Schroders, 31 March 2022.

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

[2]Distributions payable in the twelve months to 31 March 2022 as a percentage of the latest net asset value per share (NAV).

Performance analysis

Performance (%)	3 months	12 months	3 yrs (p.a.)	5 yrs (p.a.)	10 yrs (p.a.)
SCREF[3]	4.9	18.8	7.2	7.6	8.8
Benchmark[4]	5.6	23.1	8.1	7.8	8.1

Performance (%)	Q4 20 Q4 21	Q4 19 Q4 20	Q4 18 Q4 19	Q4 17 Q4 18	Q4 16 Q4 17
SCREF[3]	16.2	-0.4	2.1	7.3	11.1
Benchmark[4]	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. [3]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.

[4]MSCI/AREF UK Quarterly All Balanced Open-Ended Property Fund Index.

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

Strategy

SCREF's key strategic priorities for 2022 are:

- Building income and total returns through active asset management.
- Capitalising on inherent opportunities within the Fund.
- Crystalising profit and selectively recycling low yielding capital.
- Focus on asset quality with defensive income and resilient sustainability credentials.

Market summary

Schroders forecasts for GDP growth has decreased by 1% since end 2021 to 4% in 2022, and by 2% in 2023. The change is primarily driven by the Ukraine war adding to inflation caused by pent up demand and Covid-19 supply disruptions. We expect the UK economy to avoid a recession and for consumption to recover in 2023 as inflation slows to 3% from 8% in 2022. Polarisation in the overall sector performance remains especially with industrials peaking and retail warehousing yields sharpening, with further subsector polarisation – supermarket and bulky goods retail parks rental growth and high quality office sector demand against declining rents for secondary offices.

Performance

SCREF had a strong absolute quarterly total return of 4.9% and NAV growth of £108.8 million. This performance is despite £4.7 million of transaction cost associated with the acquisition of The Brewery in Romford.

SCREF's performance during the quarter was derived principally from:

- Capital value growth of £90.2 million mainly driven by yield compression in retail warehousing, industrial assets, and long leased office assets.
- Active asset management: 32 new lettings, lease renewals and rent reviews completed.
- Agreement for lease also exchanged with DPD for a new 58,320 sq ft industrial unit at Wolverhampton for a 25 year lease at £0.96 million per annum.
- Contracted rent increase of £1.92 million from completed leasing activity and the exchanged agreement with DPD.
- BREEAM in use certification achieved at the University of Law campus.

Detractors to SCREF's quarterly performance were:

- £4.7 million of transactions costs associated with the acquisition of Romford.
- 11.4% underweight in industrials (against Q1 benchmark).
- 3.1% underweight in retail warehousing (against Q1 benchmark).

SCREF's performance outlook:

- Defensive income characteristics and high quality portfolio with 47.3% in London and the southeast, 31.7% let to government or higher education, low void rate at 7.0%, long unexpired lease term of 8.5 years to break.
- Well hedged against inflation – 16.1% contracted income with index-linked reviews, increasing to 25.4% on completion of 2 Ruskin Square.
- SCREF's office exposure is set to benefit from the polarisation between demand for prime offices and more secondary offices with 95.7% of SCREF's offices located in winning cities and 9.4 years unexpired to earliest termination. 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.
- SCREF is progressing several industrial development sites within the existing portfolio, we continue to look at selective industrial acquisitions and remain business plan led.

UK real estate market commentary

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 base rate to 1.5% by end-2022.

Retail

The outlook for town centre retail remains difficult. While vacancy is stabilising as empty units are converted to other uses, footfall is still 15% below pre-pandemic levels and many retailers continue to shrink their store network and shift more of their business on-line. As a result, we expect that high street shop and shopping centre rents will fall by a further 5-10% through 2022-2023. By contrast, supermarket and bulky goods retail park rents will probably increase by 1-2% per annum. Both types are relatively insulated from on-line competition and footfall is back to pre-pandemic levels. The big grocery chains have ambitious plans to open more small supermarkets and there is steady demand for retail park units from discount retailers and gyms.

Office

Although the office market is still adapting to hybrid working, some patterns are emerging. First, occupiers continue to be drawn to city centres, rather than moving to the suburbs. Second, whereas some companies are cutting space, other firms are either maintaining, or adding to their footprint and vacancy in central London and major regional cities has stabilised at 10% and 8%, respectively. Third, occupiers have a strong preference for high quality offices, as companies look to cut carbon emissions and attract staff back to the office. Offices rated either BREEAM Excellent, or Very Good accounted for 70% of take-up in the City of London in 2021 and 50% in Manchester. Given this polarisation in demand, we expect prime office rents in London, Cambridge and major regional cities to continue to rise through 2022-23. Secondary office rents are likely to decline, or at best be flat.

Industrial

Industrial rents have risen by 5% per annum over the last five years, fuelled by the growth in on-line retail. In addition, the disruption of supply chains during the pandemic has prompted manufacturers and retailers to dial down on just-in-time deliveries and hold more stock. Looking ahead over the next 2-3 years, industrial rental growth is likely to slow to 3-4% per annum, partly as the growth in on-line sales moderates and partly because of a big increase in construction of distribution warehouses.

Summary

We expect all property total returns to average 5-7% per annum over the three years to end-2024. If we view the market in terms of sectors, then we expect the range in returns to narrow because most of the favourable decline in industrial yields and unfavourable rise in town centre retail yields has now happened. Industrial is still likely to be one of the strongest parts of the market, but largely because of superior rental growth. Retail parks and prime offices should also out-perform. However, while the sector range in returns is likely to narrow, the gap between buildings with strong and weak sustainability features is likely to widen. “Green” buildings currently command a price premium of around 20% and we expect that to grow in future. The recent sharp increase in construction costs means that some buildings with poor energy efficiency risk becoming stranded assets.

The downside risk is that higher inflation becomes entrenched and the Bank of England is forced into a sharper rise in base rate than markets are anticipating. That would hurt economic growth and although rental growth might be faster in nominal terms, it is likely that the impact on capital values and total returns would be more than out-weighed by an increase in real estate yields.

Fund commentary and key activity

Acquisitions

£81 million acquisition leading to £6.2 million per annum increase in contracted income.

The Brewery, Romford

- During the quarter SCREF completed the acquisition of "The Brewery" in Romford for £162 million in a 50:50 joint venture with a Schroders Capital managed fund.
- Attractive net initial yield of 7.3%, it is located adjacent to the new Romford Crossrail station and comprises of a 21-acre freehold site anchored by a Sainsbury's superstore, car park and Nuffield Health.
- The asset produces a total passing rent of £12.43 million per annum (SCREF share is £6.2 million per annum), representing a low average rent of £19.72 per sq. ft, excluding car park income.
- The asset has a low void rate of 2.1% and a weighted average unexpired lease term to expiry of 6.25 years.
- BREEAM in-use accreditation and the business plan will enhance sustainability performance.
- Despite transaction costs of £4.7m, The Brewery has contributed 3% to SCREF's total return of the period.
- In addition, three units are under offer to food and beverage operators at terms in excess of the acquisition underwrite.

Self Storage

- In line with SCREF's strategy to expand its self storage portfolio, SCREF is under offer on a single asset which will be incorporated into the existing platform and managed by the current operator Flexiss.

Disposals

Jubilee House, Stratford

- SCREF has conditionally exchanged a sale of Jubilee House in Stratford for £72.35 million. The sale of the site is conditional on successful securing planning for a 38 storey tower scheme, consisting of a 5-storey local academy and 33 storeys of student housing accommodation above. Completion of the sale is targeted for Q2 2023, with the proceeds expected to be recycled into projects elsewhere in the portfolio and selective new investment opportunities.

Hackbridge, South London

- SCREF has completed the sale of a small plot of development land at Hackbridge in the London Borough of Sutton to Capital Industrial for £2.35 million. The site offered very limited development potential to SCREF given planning constraints and the exit pricing reflects a 17.5% premium to valuation.

Monks Cross Drive, York

- SCREF completed the sale of Units 1,2 and 3 Monks Cross Drive, York to Lidl GB Limited for £3.9 million. SCREF owns a 25% share of Monks Cross Shopping Park, resulting in net sale proceeds after costs from the sale of £0.96 million. The site became vacant in Q1 2020. Lidl intend to owner occupy the site, which will provide a strong footfall driver to the wider scheme still within SCREF ownership whilst the sale price reflects an 5.4% premium to valuation.

Key asset management initiatives

32 leasing deals completed and one agreement for lease exchanged generating a combined increase in contracted rent of £1.92 million per annum.

Industrial

- Eight deals completed in the quarter and one agreement for lease exchanged, totalling an increase in annual contracted rent of £1,437,100 per annum. The eight completed transactions were 17% ahead of valuation ERV.
- Wolverhampton, Steel park – Pre-let exchanged with DPD for development of 58,320 sq ft at £962,280 per annum. Construction of the building is expected to complete in Q3 2024, built to a Net Zero Carbon and BREEAM Excellent specification.

Offices

- 3 Ruskin Square, Croydon – planning permission for 290,000 sq ft of prime office space received. The building is currently being marketed for a pre-let and will target BREEAM outstanding and NABERS accreditation on completion.
- 2 Ruskin Square Croydon – pre-let development now topped out, is on time with target completion in June 2023 and on budget.
- Battersea Studios, London - Five leasing deals totalling £206,085 per annum either completed or in legals, reducing the current void rate at the asset by 6%.

Retail & Leisure

- 1 Ruskin Square, Croydon – ground floor retail unit totalling 4,298 sq ft completed to major new convenience store occupier.
- Norwich – 5 year lease extension with Hughes completed, extending lease expiry to August 2032. Pump Gyms currently on-site progressing their fit out ahead of anticipated store opening in August 2022.
- Chatham – Following the completion of new leases to Ninja Warrior UK, Gymfinity Kids and KFC in Q4 2021, a new 10 year lease has also been completed with a Costa Coffee franchisee. Strong interest in the final vacant unit.

Occupier engagement and Covid-19

The fund's rent collection for the December Quarter Day (rent for Q1) totals 90.0% in aggregate.

Fund updates

- **Marketing passports** - SCREF has successfully re-applied for select European marketing passports, during the quarter permissions have been received from Korea and Japan.
- **Prospectus updates** – On 3 March 2022, SCREF's Prospectus was updated to incorporate the following three amends:
- 1. The inclusion of binding environmental, social and governance ("ESG") commitments into the PAIF's investment policy;
- 2. Updating the name of the Fund in line with the new 'Schroders Capital' brand which is being rolled out across Schroders' private assets product range; and
- 3. Amending Appendix V of each of the PAIF and Feeder Fund Prospectus to reflect the revised leverage limits, effective 9 July 2021, which enable the Fund to draw on its Revolving Credit Facility ('RCF') to fund further development at Ruskin Square, Croydon, where Building 2 has been pre-let to the UK Government.
- **Liquidity management** – SCREF has completed £70 million of secondary market transactions over the year to date.
- The SCREF **Q1 webinar** will take place on 11th May from **09.00am to 10.15am GMT on line as well as in person** at the Schroder London offices. 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.

2 Ruskin Square, Croydon

The Brewery, Romford

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.

Progress against targets

- BREEAM in-use accreditation awarded at University of Law, Bloomsbury (50% SCREF ownership).
- 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.
- Accreditation: 83% of the office portfolio benefits from BREEAM good or better, NABERS and/or Fitwell accreditation, benefitting from the polarisation between quality and secondary.
- Article 8 - Achieved Article 8 classification during the period with new binding ESG commitments.
- Green loans – current RCF to be amended to include green loan KPI's during Q2 2022.

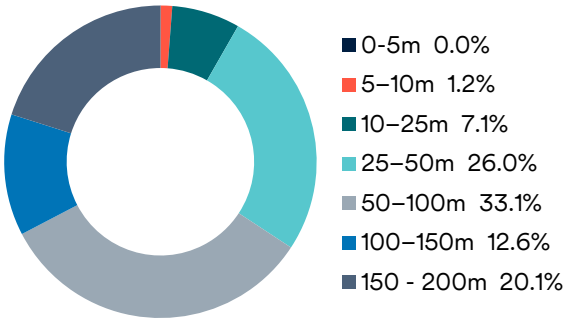
Monks Cross Retail Park, York

DPD CGI, Wolverhampton

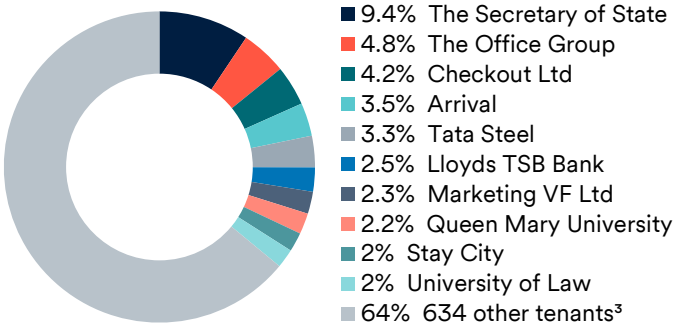
Portfolio analysis

Segment	Absolute segment positions, %		Relative segment positions, %[1]	
	SCREF	Benchmark	Underweight	Overweight
Offices – Central London	10.2	10.9	-0.7%	
Offices – South East[2]	29.4	8.7		20.7%
Offices – Rest of UK	4.1	5.0	-0.9%	
Industrial – South East	22.5	27.5	-5.0%	
Industrial – Rest of UK	8.2	14.6	-6.4%	
Standard retail – South East	3.4	4.4	-1.0%	
Standard retail – Rest of UK	1.7	1.8	-0.1%	
Shopping centres	0.5	0.9	-0.4%	
Retail warehouses	7.9	10.9	-3.0%	
Other	8.4	9.9	-1.5%	
Cash	3.6	5.4	-1.8%	

Lot size bands, by GPV[2]



Tenant profile, % contracted rent



Battersea Studios, London

Crossways, Hartlebury

Top Ten Holdings	Sector	ESG Credentials	Key attributes	% of NAV
Building 1, Ruskin Square, Croydon	Offices	BREEAM Excellent	19.4 year AWULT, 98% let to UK Govt	8.3%
Acorn Industrial Estate, Crayford	Industrial		Highly reversionary, dominant south London estate	6.6%
Wenlock Works, Shepherdess Walk, London	Offices	BREEAM Excellent	62% of passing rent index-linked to RPI	6.2%
Building 2, Ruskin Square, Croydon	Offices	BREEAM Outstanding (target), NABERS Pioneering Project	25 year pre-let to UK Govt with RPI indexation	5.4%
Bracknell Town Centre	Retail and Office		Low retail void at 7.3%	4.1%
One Lyric, Hammersmith, London	Offices	BREAAM Very Good	16.2 year AWULT	3.9%
Hartlebury Trading Estate, Worcestershire	Industrial		Reversionary estate, with pipeline of development sites	3.8%
X2	Industrial		Unique location adjacent to Heathrow Airport, fully let.	3.5%
The Brewery, Romford	Retail Warehouse	BREEAM In-use Good		3.4%
Woking Business Park, Woking	Industrial		Reversionary estate, with low void.	3.3%

Source: Schroders, 31 March 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 41.5%; [2]Of SCREF's 29.4% allocation to South East offices, 45.2% comprises offices let or pre-let to the UK Government in Croydon; [3]GPV: gross property value; [4]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.

Shareholder information

Minimum investment	£100,000
Total expense ratio (TER)[1]	0.88%
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]	2.8%

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	48,673,310
NAV per share	£53.85
Offer price per share	£56.19
Bid price per share	£53.07
Pricing methodology	Dual priced
Offer spread[3]	NAV +4.3%
Bid spread[3]	NAV -1.4%
Number of new shares issued – Q1 2022	105,087
Number of shares redeemed – Q1 2022	0
Number of shares matched – Q1 2022	310,139

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%	8.3%
Commitment to development[4]	20%	5.5%
Borrowing[4]	25%	3.3%
Shorter/medium term leaseholds (< 50 years)[4]	20%	0.0%
Speculative development	15%	0.9%

[4]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

[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.

Source: Schroders, 31 March 2022.

Further information

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Important information

For professional clients only.

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 Schroders Capital 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 Schroders Capital 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
- 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.

This fund does not have the objective of sustainable investment or binding environmental or social characteristics as defined by Regulation (EU) 2019/2088 on Sustainability-related Disclosures in the Financial Services Sector (the "SFDR"). Any references to the integration of sustainability considerations are made in relation to the processes of the investment manager or the Schroders Group and are not specific to the fund.

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.

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