



Standard Life Investments Property Income Trust

REITs | Update | 13 April 2021

Focus on tomorrow's world

With the roadmap out of lockdown and economic recovery in place, Standard Life Investments Property Income Trust (SLI) has turned its attention to future-proofing its portfolio. This has put ESG at the forefront of its decision-making on disposals and acquisitions, with longevity of income critical to the process. The manager says that identifying lasting trends that have developed and accelerated during the pandemic, such as the growth in online retailing and how the office will be used, and its impact on future demand for space, has become mission critical.

Rent collection figures of 93% for 2020 and a 3.3% valuation uplift in the final quarter of 2020 may reflect the resilient nature of its portfolio. The manager expects that further growth will come from savvy asset recycling.

Commercial UK property exposure

SLI aims to generate an attractive level of income, along with the prospect of both income and capital growth, by investing in a diversified portfolio of UK commercial property assets, primarily in three principal commercial property sectors: industrial, office and retail. SLI uses gearing with the aim of enhancing returns, with the current loan-to-value (LTV) ratio at 23.0%.

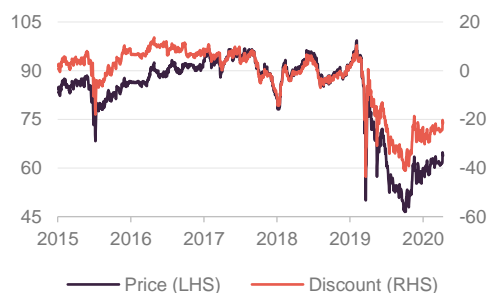
Year ended	Share price total return (%)	NAV total return (%)	Morning-star UK REIT total return (%)	Peer group NAV total return (%)	MSCI UK total return (%)
31/12/16	7.0	2.5	(7.4)	8.3	19.2
31/12/17	13.7	14.6	12.7	9.0	11.8
31/12/18	(8.3)	9.8	(13.3)	9.5	(8.8)
31/12/19	18.0	3.9	33.1	3.8	16.5
31/12/20	(29.8)	(4.5)	(16.9)	(9.9)	(13.2)

Source: Morningstar, Marten & Co

Sector	Property – UK Commercial
Ticker	SLI LN
Base currency	GBP
Price	63.8p
NAV	81.3p
Premium/(discount)	(21.5%)
Yield	4.5%

Share price and discount

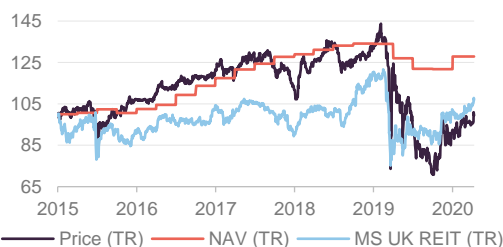
Time period 31/12/2015 to 09/04/2021



Source: Morningstar, Marten & Co

Performance over five years

Time period 31/12/2015 to 09/04/2021



Source: Morningstar, Marten & Co



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Domicile	Guernsey
Inception date	19 December 2003
Manager	Jason Baggaley
Market cap	£253.4m
Shares outstanding	396.9m
Daily vol. (1-yr. avg.)	1,101.6k
Net gearing	23.0%

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[Click here for SLI's peer group analysis](#)



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Future proofing the portfolio

The real estate sector has gone through profound change during the COVID-19 pandemic. Lockdown has highlighted the vulnerability of sectors such as non-essential retail and hospitality, has cast doubt on the future of the office and has emphasised the strength of the logistics sector. In truth, change had been underway for a number of years, but trends that developed and accelerated during the last year have held a huge magnifying glass up to the sector.

For SLI's manager Jason Baggaley, it has been about identifying and responding to future real estate requirements. SLI has always been on the front foot in this regard. For several years, pre-COVID, it had shifted its portfolio focus towards industrial and logistics – which it now has a 48.2% exposure to – and away from retail. This provided it with some resilience during the past year. It had also been focusing on providing more amenities, such as bike storage and shower facilities, at its offices, as employee wellness crept up the agenda.

These are perhaps changes that any forward-thinking property manager would have been making. The pandemic has moved the bar further. In light of that, SLI's focus now is on what impact this will have on demand for real estate space in the future.

ESG at heart of investments

The manager believes that ESG compliant properties have greater prospects of longevity of income growth

The Environmental, Social and Governance (ESG) credentials of potential investment acquisitions have become the top priority for SLI as it looks to future-proof its property portfolio. Assets with high ESG credentials will have sustainable income that can be grown, Jason argues. It means future investments may not be quite as high-yielding, as assets with strong ESG gradings tend to come with a 'green premium'. But instead of thinking of it as a 'green premium', Jason believes that non-ESG conforming assets should be thought of as having a 'brown discount'. Properties with strong ESG credentials are often newly built and so come with less risk of future capital expenditure needs and also greater prospects of longevity of income growth. The quality of the buildings, and the sustainability features, are more appealing to prospective tenants, and with ESG continuing to move up the agenda of all businesses, they are expected to have greater income growth potential well into the future. Tenants are increasingly becoming more sensitive to the sustainability of the buildings they occupy and are often willing to pay a higher rent for them, Jason says. From an investment perspective, investors tend to be willing to pay more for property with higher ESG credentials, supporting long-term valuations.

Sustainability features that SLI are looking for in future acquisitions include top Energy Performance Certificate (EPC) ratings on energy efficiency, but also solar panel installations and rainwater harvesting facilities. On the 'social' element, SLI is focused on properties that provide employee amenities, mostly in offices. Amenities such as shower facilities, bike storage and studio space for events and classes all factor into social wellbeing and productivity of workers.

SLI has carried out a number of ESG initiatives on its existing portfolio, including office refurbishments to incorporate some of the features mentioned above. In June

2020 it also completed the installation of a major Photo Voltaic (PV) solar panel scheme on one of its assets, the largest undertaken by Aberdeen Standard Investments in the UK. The power is sold to the tenant, with SLI receiving a yield of around 7% from the £500,000 investment. The scheme is expected to save the equivalent of 229 tonnes of CO₂ in its first year of operation, and the power output is the equivalent of the yearly electricity usage of 230 homes. SLI is looking to roll out solar panel installations across its industrial portfolio. It is working with a number of tenants on further sustainability initiatives, including the adoption of a 'nil rubbish to landfill' policy.

Industrial versus logistics

Performance of industrial sub-sectors is expected to be polarised, with logistics outperforming multi-let industrial in the manager's view

SLI made a number of disposals from its portfolio towards the end of 2020 (more details on page 6), most notably four multi-let industrial assets for £37.75m. Jason believes that the future growth prospects of the multi-let industrial sector, which is comprised of smaller units usually let to SMEs, is limited as the risk of tenant failure is heightened due to the economic impact of COVID-19. He says that the sub-sector has not benefitted from the move to online retailing. This is not the case in single-let logistics properties, which are thriving due to a marked increase in online retailing and supply chain enhancements. This likely polarisation in performance has not yet been recognised by most investors, and the sales gave SLI the chance to crystallise profits on the assets.

Opportunities in other sectors

The manager thinks that negative investor sentiment towards certain sectors could throw up investment opportunities

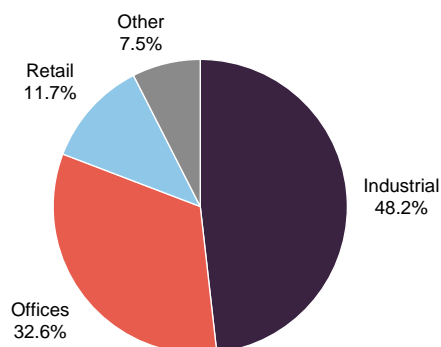
Just as he can take advantage of investment sentiment in the industrial sector, Jason believes the same can be said for other less-favourable property sectors, including the retail market, where there is a disconnect between price and quality of asset. Not all retail is bad, and some investment opportunities could exist for the right type of asset – namely retail warehouses. Units on retail parks that are let on low, sustainable rents and are operationally a strong performer for the essential retail tenant are the ideal proposition for SLI. That was the case with SLI's acquisition of a B&Q retail warehouse in Halesowen, West Midlands, in September 2020. Further investment opportunities that provide strong income growth potential could exist in this sector at the right price.

Asset allocation

SLI's portfolio of 50 assets was valued at £437.7m on 31 December 2020 and is primarily allocated across three sectors: industrials (48.2%), offices (32.6%) and retail (11.7%).

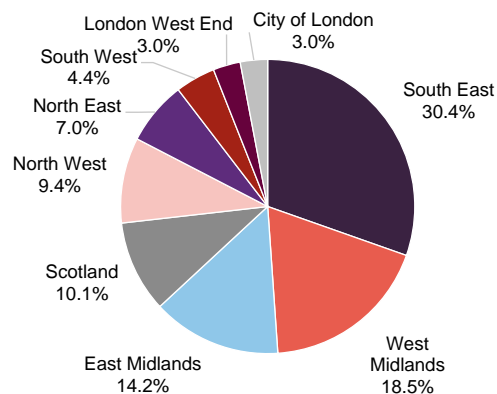
In the final quarter of 2020, SLI's portfolio increased in value on a like-for-like basis by 3.3%, with its weighting to industrial behind much of the increase with a 6.5% like-for-like rise. All sectors increased in value, with offices up by 0.3%, retail up by 0.4% and other (a data centre and two leisure assets) up by 1.7%.

Figure 1: Property sector exposure



Source: Standard Life Investments Property Income Trust

Figure 2: Geographic exposure



Source: Standard Life Investments Property Income Trust

Top 10 holdings and tenants

Figure 3: Top 10 properties at 31 December 2020

Property	Town/city	Sector	Value (£m)
Hagley Road	Birmingham	Office	25-30
B&Q	Halesowen	Retail	15-20
Symphony	Rotherham	Industrial	15-20
Marsh Way	Rainham	Industrial	15-20
The Pinnacle	Reading	Office	10-15
Timbmet	Shellingford	Industrial	10-15
Hollywood Green	London	Other	10-15
New Palace Place	London	Office	10-15
Atos Data Centre	Birmingham	Other	10-15
Badentoy	Aberdeen	Industrial	10-15

Source: Standard Life Investments Property Income Trust

The aforementioned acquisition of the B&Q retail warehouse in Halesowen was the only big change in the group's top 10 holdings, with the DIY retailer becoming SLI's top tenant by income, accounting for 5.6% of total passing rent, as shown in Figure 4.

Figure 4: Top 10 tenants at 31 December 2020

Tenant	Passing rent (£)	% of total passing rent
B&Q Plc	1,560,000	5.6
BAE Systems plc	1,257,640	4.5
The Symphony Group Plc	1,225,000	4.4
Public sector	1,158,858	4.1
Schlumberger Oilfield UK plc	1,138,402	4.1
Jenkins Shipping Co Ltd	843,390	3.0
Timbmet Group Limited	799,683	2.9
Atos IT Services UK Ltd	772,710	2.8
CEVA Logistics Limited	692,117	2.5
ThyssenKrupp Materials (UK) Ltd	643,565	2.3
Total	10,091,365	36.2

Source: Standard Life Investments Property Income Trust

SLI has collected 93% of rent for 2020

Rent collection figures

For the whole of 2020, SLI has collected 93.6% of rent due. SLI has supported its tenants that are struggling, through rent deferrals or rent-free periods, in exchange for amended lease terms (generally extensions) and, in a small number of cases, rental write-offs. It has made a provision of £2.58m for bad debts in its accounts. Some of SLI's tenants have abused government restrictions on landlords being able to enforce lease covenants, and chosen not to pay and not to engage with SLI even when they have the capacity to pay (these have generally been companies with private equity ownership). SLI has said it will chase those tenants with vigour as and when government restrictions allow (current restrictions have been extended to the end of June 2021).

For the first quarter of 2021, SLI has collected 84.4% as at 29 March 2021, which is likely to increase in the coming weeks and months.

Sales

SLI has disposed of £45.6m of assets that are not deemed future-proof

SLI completed a number of sales at the end of 2020 totalling £45.6m. The bulk of this was made up of four multi-let industrial assets, which were sold for a combined £37.75m. SLI also sold a retail warehouse in North Shields for £3.55m, on which it had recently concluded a lease regear, extending it to 15 years to expiry. The rent was reduced from £18 per square foot to £15 per square foot, and SLI believed the future rent prospects for the asset were only for further falls. The final disposal was an office building in Derby, which was sold for £4.3m. The capital expenditure required to bring it up to the standard to make it fit for the future of the office (i.e. with amenity space – as outlined earlier) was too great. A further two asset disposals are planned in the coming weeks.

Sales proceeds will be ploughed into logistics developments at superior yields

The proceeds were used to pay down the £35m drawn from the group's £55m revolving credit facility (RCF), while it assesses investment opportunities.

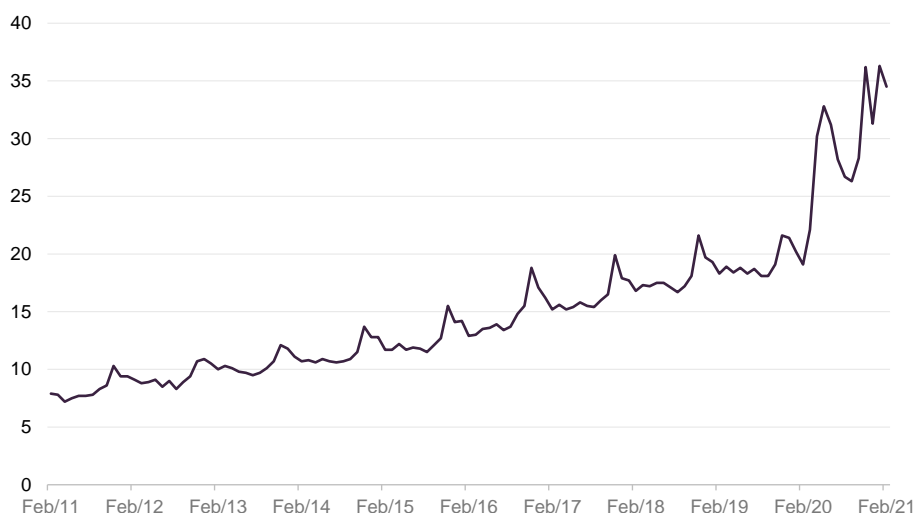
Acquisition pipeline

SLI will look to redeploy £35m to £45m from the RCF on a number of investments in its acquisition pipeline. The most significant being the acquisition of speculatively built logistics facilities. The group is in negotiations with several logistics developers to acquire mid-box (80,000 sq ft to 160,000 sq ft) logistics buildings on completion of construction. SLI is not taking development risk but is taking letting risk.

The sites all have planning permission in place and construction (which usually takes between nine to 12 months) is ready to start once terms are agreed. The yield on cost is expected to be in the region of 5.25% and 5.5%, which compares favourably to investment yields in the prime mid-box logistics market of around 4.0%.

Tenant demand for logistics space is at an all-time high for several reasons. Online retail sales had been increasing for a number of years, as shown in Figure 5, but the rate accelerated hugely during the pandemic as non-essential retail was locked down for large periods of the year. Online retailing accounted for 34.5% of all retail sales in February 2021 compared to 19.1% in February 2020. Online retailers and parcel carriers have been scrambling for space to cope with the surge in demand for home deliveries. Mid-box logistics units are a vital link in the distribution network, as goods are transported from national and regional distribution centres to the front door.

Figure 5: Internet sales as a percentage of total retail sales



Source: Office for National Statistics, Marten & Co

The COVID-19 pandemic laid bare how quickly supply chains can be disrupted when they span many different countries and continents. It has led to a 'reshoring' of supply chains, the result of which has been an increase in demand for logistics space in the UK. The future trading relationship with the EU, following the Brexit

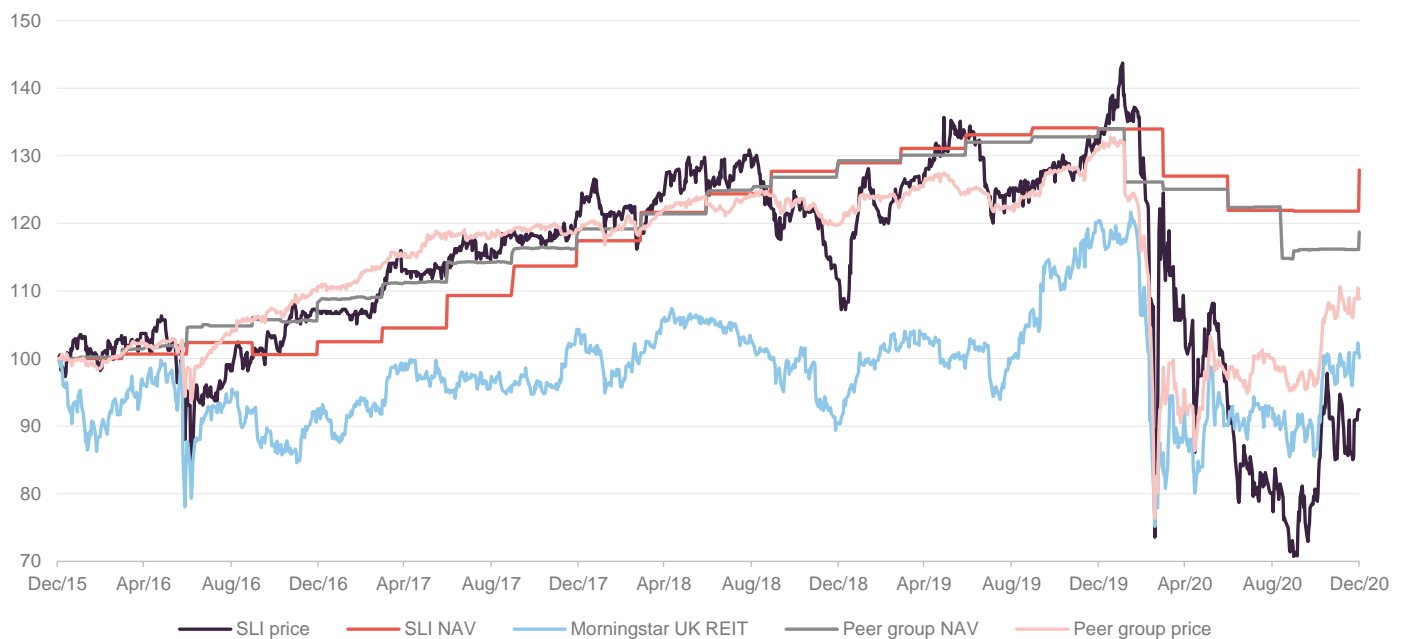
deal, has created barriers to trade and it is expected companies will look to restructure their supply chains further to gain greater operational efficiencies.

SLI is looking at investment opportunities in other property sectors, including self-storage and aparthotels, as well as being open-minded to opportunities in the retail warehouse sector.

Performance

SLI's NAV total return has, for all periods (from three months to 10 years), beaten that of the Property – UK Commercial peer group average, as illustrated in Figures 6 and 7.

Figure 6: SLI NAV total return and share price total return versus various benchmarks (rebased to 100) over five years



Source: Morningstar, Marten & Co

Despite SLI's superior NAV recovery over the last six months, its share price recovery has lagged that of its peer group and the Morningstar UK REIT index.

Figure 7: Cumulative total return performance to 31 December 2020

	3 months (%)	6 months (%)	1 year (%)	3 year (%)	5 year (%)	10 year (%)
SLI NAV	5.0	4.9	(4.5)	8.9	27.9	135.8
SLI share price	30.7	1.5	(29.8)	(24.0)	(7.6)	70.3
Peer group NAV	2.2	(2.2)	(9.9)	2.4	20.9	100.5
Peer group share price	13.9	12.3	(15.2)	(6.2)	11.8	81.4
Morningstar UK REIT Index	14.5	11.2	(16.9)	(4.0)	0.1	92.8
MSCI UK	10.6	5.5	(13.2)	(7.8)	22.9	55.1
RPI	0.3	0.6	1.9	8.9	14.6	35.0
RPI +2%	0.8	1.6	3.9	15.4	26.2	63.6
CPI +3%	0.9	1.9	4.2	15.9	26.7	66.2
Libor +5%	1.2	2.5	5.3	17.8	31.0	72.5

Source: Morningstar, Bloomberg, Marten & Co

[Click here](#) for an up-to-date comparison of SLI and its Property – UK Commercial peer group

We have used the Morningstar UK REIT Index and the MSCI UK Index as comparators to SLI's short- and long-term performance. From an inflation comparison, SLI's NAV total return has been markedly ahead of inflation (as measured by both RPI and CPI) over five- and 10-year periods. In Figure 7, we have used RPI, RPI + 2%, CPI + 3% and Libor + 5%.

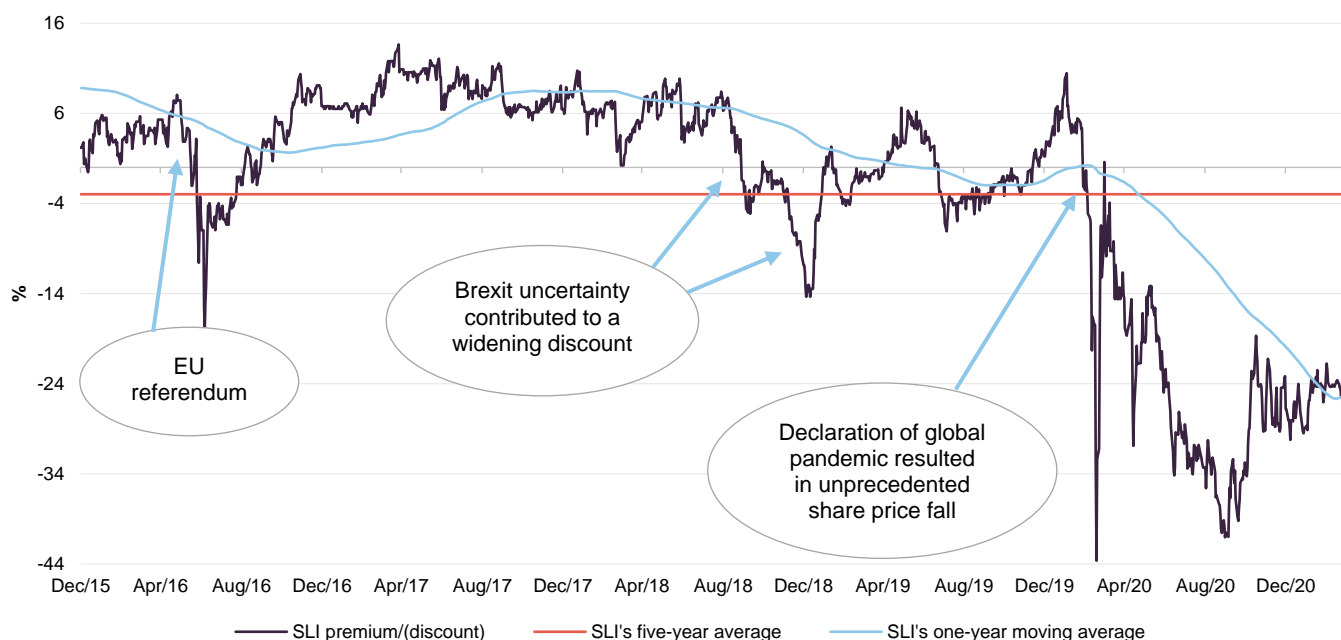
Premium/(discount)

The outbreak of COVID-19 saw SLI's rating fall from a 9.8% premium to a 43.6% discount in a matter of days, with a mass stock market sell-off. Its rating has been up and down since as successive lockdowns impacted its share price. The news of vaccine success in November 2020 saw its discount narrow and it is currently trading at a discount of 21.5% (as at 9 April 2021).

SLI is authorised to repurchase up to 14.99% and issue up to 10% of its issued share capital (renewal of these authorities is sought annually at the company's AGM). Purchase of shares will only be made at prices below the prevailing NAV to enhance shareholder value.

Since November 2020, SLI has repurchased 9.9m shares for just under £6m at an average price of 60.1p in an ongoing share buyback programme. These shares are held in treasury.

Figure 8: SLI's discount over five years



Source: Morningstar, Marten & Co

Fund profile

Further information about the trust is available at its website www.slipit.co.uk

SLI launched on 19 December 2003. It is domiciled in Guernsey, has a premium main market listing on the London Stock Exchange and, to maintain a tax-efficient structure, migrated its tax residence to the UK on 1 January 2015, when it also became a UK Real Estate Investment Trust (REIT).

SLI aims to provide investors with an attractive level of income, together with the prospect of income and capital growth. It aims to achieve this by investing in a diversified portfolio of UK commercial property. These are principally direct holdings within the three main commercial property sectors: office, industrial and retail, although it can also hold assets in the alternatives sector.

The board's and manager's preference is towards properties that are in good, but not necessarily prime, locations, where it is perceived that there will be good continuing tenant demand. The manager also looks for properties where it can add value using asset management initiatives. There is a focus on tenant quality, and as part of SLI's strategy, tenants are treated as key stakeholders and the manager works closely to understand their needs. The aim is to achieve greater tenant satisfaction and retention, and hence lower voids, higher rental values and stronger returns.

SLI has full use of the wider Aberdeen Standard Investments (ASI) team, which has 270 people globally working on property. This provides access to specialist transactions, ESG, debt and research teams, as well as providing a risk management framework.

Previous publications

QuotedData has published three previous notes on SLI. You can read these by clicking the links in the table below or by visiting our website.

Figure 9: QuotedData's previously published notes on SLI

Title	Note type	Date
KYT (know your tenant)	Initiation	8 July 2019
Adding value in cautious times	Update	13 February 2020
Building for a new normal	Annual overview	25 September 2020

Source: Marten & Co



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