Real estate quarterly report

Second quarter 2022 | July 2022

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Storm clouds gather

Fears that a perfect storm is brewing has weighed on the real estate sector. Central banks' move to raise interest rates to curb spiralling inflation has stoked concerns that investors will turn away from real estate to less risky alternatives, such as bonds. Meanwhile the cost of debt has also increased and is approaching the average property investment yield in some locations and markets, meaning a hit on earnings as interest payments balloon.

The share prices of property companies have almost indiscriminately been hit. Only a handful showed gains in the quarter, led by companies with long-dated inflation-linked income. The industrial and logistics sector, for so long the darling of the real estate sector, was the hardest hit following a bleak earnings update from Amazon that suggested its expansion was over. Some companies seem to have been oversold and now trade on attractive discounts to NAV.

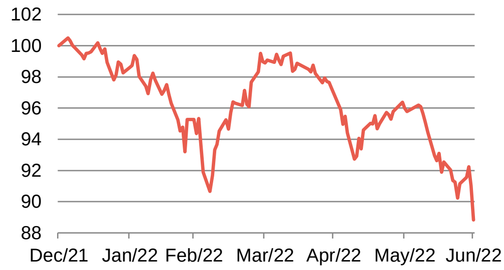
Merger and acquisition (M&A) activity continued during the quarter, with LXI REIT and Secure Income REIT finalising their merger and Capital & Counties and Shaftesbury progressing with their own union. M&A may continue to be a theme for the rest of the year, with many companies trading at significant discounts to NAV.

Best performing companies in price terms in Q2 2022

	Chg. on quarter (%)
Alternative Income REIT	5.8
Secure Income REIT	4.1
NewRiver REIT	3.2
Alpha Real Trust	1.0
CLS Holdings	0.7

Property sector performance*

Time period 31/12/2021 to 30/06/2022



Source: Bloomberg, Marten & Co. Note *: Average share price of listed property companies rebased to 100

Biggest property companies at end of Q2 2022

	Market cap (£m)	Chg. on quarter (%)
SEGRO	11,810	(27.0)
Land Securities	4,924	(15.5)
Unite Group	4,257	(7.9)
British Land	4,145	(15.7)
Tritax Big Box REIT	3,392	(24.9)

In this issue

- **Performance data** – A handful of companies saw share price gains, with index-linked funds performing strongly
- **Corporate activity** – Just under £600m was raised in the quarter, with the volume still supressed
- **Major news stories** – Various big ticket sales were struck as funds looked to shore up balance sheets

QuotedData
BY MARTEN & CO

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Performance data

Figure 1: Best performing companies in price terms in Q2

	%
Alternative Income REIT	5.8
Secure Income REIT	4.1
NewRiver REIT	3.2
Alpha Real Trust	1.0
CLS Holdings	0.7
Circle Property	0.4
Grit Real Estate Income Group	(1.4)
PRS REIT	(1.4)
Palace Capital	(1.8)
Custodian REIT	(2.1)

Source: Bloomberg, Marten & Co

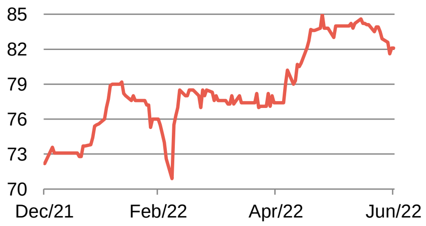
Figure 2: Worst performing companies in price terms in Q2

	%
Hammerson	(42.5)
Sirius Real Estate	(28.9)
SEGRO	(27.4)
Tritax Big Box REIT	(24.9)
Industrials REIT	(21.7)
Safestore Holdings	(20.8)
Capital & Counties	(19.9)
Great Portland Estates	(19.5)
TR Property Investment Trust	(18.8)
Workspace Group	(18.8)

Source: Bloomberg, Marten & Co

Best performing property companies

Figure 3: Alternative Income REIT YTD



Source: Bloomberg, Marten & Co

There were few real estate winners in the second quarter of 2022, as fears mounted for a recession. However, a handfuls of funds did post share price gains, led by long-income specialists Alternative Income REIT and Secure Income REIT. Both benefit from long inflation-linked leases, which offer some protection against soaring inflation. Secure Income REIT's share price was also boosted by its merger with fellow long-income fund LXI REIT (which became effective on 6 July – see page 7 for more detail).

Retail specialist NewRiver REIT continued its share price recovery after it said it had returned to positive capital value growth, suggesting valuations in the retail sector were stabilising after years of decline. Over the course of the quarter its share price was up 3.2%.

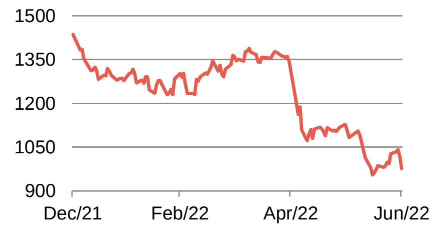
Micro-cap Alpha Real Trust, which has a portfolio of property and property loans, announced a tender offer for up to 10% of its share capital, to combat the group's shares trading at a significant discount to NAV.

Office landlord CLS Holdings announced a proposed tender offer of its shares if its discount persists. Following the news, its share price was up slightly in the quarter, however, its discount still languishes at around 35%.

Circle Property was the only other fund to see its share price rise in the quarter. It has previously announced that it would sell assets and return capital to shareholders after suffering a persistently wide discount.

Worst performing companies

Figure 4: SEGRO YTD



Source: Bloomberg, Marten & Co

Industrial and logistics specialists and office-focused funds dominated the share price fallers list; however, it was the retail-focused Hammerson that topped the list of worst performing funds, with 42.5% wiped off its market cap.

Amazon's bleak earnings update and admission that its warehouse expansion was over hit the share price of many of the logistics focused property companies. This coupled with an expected squeeze on retail spend and the tight margins involved in online retailing saw investors convey caution towards the sector that has for the past several years seen exponential growth. SEGRO, the largest listed property company, saw 27.4% wiped off its value during the quarter, while Tritax Big Box REIT was close behind with 24.9%. Both companies are now trading on wide discounts to NAV (see page 6 for details).

The uncertain outlook for the office sector – including working from home and hybrid trends depressing demand and halting rental growth, and rising interest rates curbing investors' appetite for real estate – impacted the office specialists. Sirius Real Estate, which owns business parks in Germany and the UK, was the most affected, with a 28.9% fall in its share price.

London office landlords were also heavily impacted, with Great Portland Estates (down 19.5%) and Workspace Group (down 18.8%) both suffering heavy losses.

Shareholder revolt over the possible merger of central London retail and hospitality landlords Capital & Counties and Shaftesbury (more detail on page 7) saw the share price of both fall by double-digits (19.9% and 15.5% respectively).

Significant rating changes

Figures 5 and 6 show how premiums and discounts to NAV have moved over the course of the quarter.

Figure 5: Biggest percentage point changes to ratings in Q2 2022 – the 10 greatest improvements

Company	Sector	Premium/(discount) at 31/03/2022 (%)	Premium/(discount) at 30/06/2022 (%)	Difference (percentage point)
Alternative Income REIT	Diversified	(8.6)	(3.3)	5.3
Secure Income REIT	Diversified	6.7	11.1	4.4
NewRiver REIT	Retail	(34.7)	(34.1)	0.6
CLS Holdings	Offices	(43.0)	(42.6)	0.4
Circle Property	Offices	(14.6)	(14.2)	0.4
Alpha Real Trust	Diversified	(27.6)	(29.4)	(1.8)
PRS REIT	Residential	3.1	1.3	(1.8)
Ground Rents Income Fund	Ground rents	(36.7)	(38.6)	(1.9)
Capital & Regional	Retail	(42.9)	(44.9)	(2.0)
Target Healthcare REIT	Healthcare	1.2	(2.2)	(3.4)

Source: Bloomberg, Marten & Co

Many of the positive rating changes were discussed in the previous section. Of the others, private rented sector residential developer PRS REIT saw a slight narrowing of its premium to NAV as its share price fell just 1.8% in the quarter (versus an average fall across listed real estate companies of 10.2%). Demand for rented accommodation could grow as interest rates rise, leaving homeownership out of reach for many would-be first-time buyers and forcing others in to renting.

The uncorrelated nature of the care home sector with the wider economy could be behind Target Healthcare REIT's share price performance (down 3.4% in the quarter) compared to the wider real estate sector.

Shopping centre owner Capital & Regional saw its share price stabilise somewhat (after months of heavy falls) as market indicators suggest mall values may have hit the bottom and investment levels pick up.

Figure 6: Biggest percentage point changes to ratings in Q1 2022 – the 10 biggest deteriorations

Company	Sector	Premium/(discount) at 31/03/2022 (%)	Premium/(discount) at 31/06/2022 (%)	Difference (percentage point)
Big Yellow Group	Self-storage	59.3	10.7	(48.6)
Sirius Real Estate	Offices	29.3	(16.8)	(46.1)
LondonMetric Property	Logistics	29.3	(12.5)	(41.8)
Industrials REIT	Industrial	25.3	(12.4)	(37.7)
SEGRO	Logistics	18.3	(14.1)	(32.4)
Urban Logistics REIT	Logistics	15.9	(14.5)	(30.4)
Warehouse REIT	Industrial	13.9	(15.2)	(29.1)
Picton Property	Diversified	1.3	(26.2)	(27.5)
Tritax Big Box REIT	Logistics	8.6	(18.5)	(27.1)
Shaftesbury	Retail	(0.2)	(23.1)	(22.9)

Source: Bloomberg, Marten & Co

Again, many of the funds mentioned in the biggest discount deteriorations during the quarter were covered earlier. Self-storage specialist Big Yellow Group topped the list after reporting a significant increase in its NAV (22.9%) while seeing its share price fall 14.6%.

Major corporate activity

Fundraises

Just under £600m was raised by property companies in the second quarter of 2022

The ongoing war in Ukraine and heightened fears for a recession meant that fundraises were again muted in the second quarter, with just three issues of shares. The total was up on the previous quarter, however, with just under £600m raised. Supermarket Income REIT let the way with a £300m substantially oversubscribed issue and a further £6.7m through a PrimaryBid offer. The total raised eclipses the original £175m target. The company will deploy the proceeds into a pipeline of investment opportunities.

Home REIT also smashed its fundraise target, raising £263m – significantly above its initial target of £150m. The proceeds of the raise will be used to tackle the ongoing critical need for homeless accommodation in the UK, with the company having a £300m acquisition pipeline.

Impact Healthcare REIT raised £22.3m in a placing and offer for subscription, which it will use with other financial resources to acquire from its pipeline of care home assets worth £169m.

Mergers and acquisitions

Shaftesbury and Capital & Counties Properties reached an agreement on a £3.5bn all-share merger. The merger would create a REIT, which would be called Shaftesbury Capital Plc, focused on the West End of London with a £5bn portfolio across Covent Garden, Carnaby, Chinatown and Soho.

Shareholders of both LXI REIT and Secure Income REIT voted in favour of a merger of the two trusts. Under the terms of the merger, each Secure Income shareholder received 3.32 new LXI shares per one Secure Income share. The merger became effective on 6 July. The combined company has a portfolio worth £3.9bn and net assets of £2.8bn.

The acquisition of McKay Securities by Workspace Group completed in May. Under the terms of the acquisition, each McKay shareholder received 209 pence per share in cash and 0.115 new Workspace shares.

Other major corporate activity

CLS Holdings proposed a tender offer of its shares due to its persistent and unjustified share price discount to net tangible assets. The size of the tender will be scaled to ensure the group's loan-to-value is within an acceptable level. The terms of the tender offer will be announced following the group's half year results on 10 August 2022.

Matthew Howard will succeed Peter Lowe as lead manager of CT Property Trust (formerly BMO Real Estate Investments) from 19 July 2022. Howard is currently the fund manager of the RSA Shareholders Real Estate Fund and deputy manager of BMO Commercial Property Trust. He joined BMO REP in July 2017, having spent the previous six years at Hermes Investment Management (now Federated Hermes). He is a member of BMO REP's Investment Committee.

Palace Capital's chief executive Neil Sinclair stepped down from the board. Sinclair co-founded Palace Capital in 2010 and helped grow the business through a combination of corporate and property acquisitions, with the company moving up from AIM to the Main Market in 2018 and converting to a REIT in 2019. Steven Owen, currently non-executive chairman, has assumed the role of interim executive chairman.

Warehouse REIT announced its proposed admission to the premium segment of the main market and the cancellation of its trading on AIM, which should happen in July. The move should open up its shares to a wider pool of investors and improve their liquidity.

Target Healthcare REIT and Supermarket Income REIT both moved up into the FTSE 250 Index.

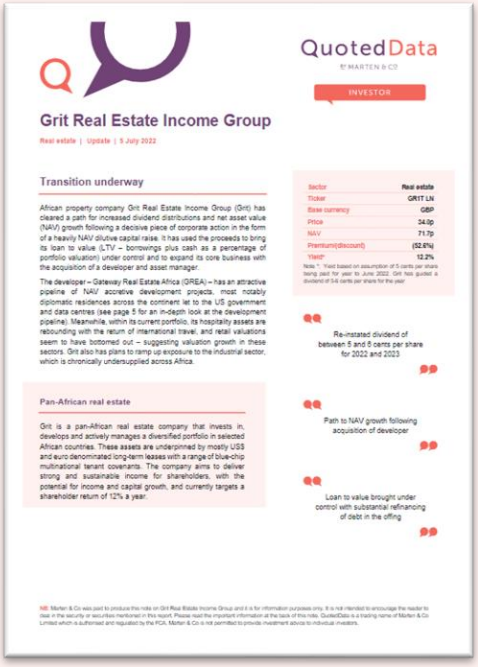
Major news stories

- **Tritax Big Box REIT** let 1m sq ft across four buildings at its Symmetry Park Rugby development site to a global leader in storage and information management services. Two of the buildings are from the company's speculative development programme, and the other two are being pre-let and will be constructed on a built-to-suit basis.
- **Life Science REIT** completed the acquisition of Oxford Technology Park, a 20-acre science and technology park, for £120.3m, meaning it has now fully deployed the proceeds from its IPO in November 2021.
- **Derwent London** exchanged contracts to acquire the Moorfields Eye Hospital and the UCL Institute of Ophthalmology, for £239m. The site is being sold by Moorfields Eye Hospital NHS Foundation Trust and UCL and is subject to final Treasury approval, which is expected by the end of 2022. Derwent plans to redevelop the 2.5-acre site into a 750,000 sq ft campus.
- **Land Securities** agreed a deal to sell 32-50 Strand, in London, for £195m, representing a net initial yield of 4.2%, to Sinarmas Land Limited, a real estate company listed on the Singapore Exchange. The disposal is in line with Landsec's strategy to recycle capital into higher return opportunities.
- **Workspace** will look to sell a light industrial portfolio that was acquired as part of its takeover of McKay Securities earlier in May. It said that it received several unsolicited approaches for the acquisition of the entire portfolio, last valued at £137m at 30 September 2021.
- **UK Commercial Property REIT** acquired a hotel development site in Leeds for £62.7m. The group will fund the development of the 305-room hotel, which is scheduled to complete in 2024 and will have a 25-year franchise agreement in place with Hyatt Hotels. The hotel will be operated under a lease by Interstate Hotels & Resorts, with UKCM's rental income based on the income generated from the operation of the hotel.
- **Regional REIT** acquired three offices for a total of £26.5m, reflecting an overall blended net initial yield of 8.0%. It has bought 1 North Bank, in Sheffield for £8.5m, Thorpe Park, in Leeds for £8.6m, and Albion Street, also in Leeds for £9.4m.
- **British Land** agreed a deal to sell a 75% stake in its Paddington Central assets to GIC for £694m, representing a 1% discount to September 2021 book value and a net initial yield of 4.5%.
- **BMO Commercial Property Trust** and BMO Real Estate Investments have both changed their name, to Balanced Commercial Property Trust and CT Property Trust respectively, following the acquisition of BMO by Columbia Threadneedle. CT Property Trust's new ticker is CTPT, while Balanced Commercial Property Trust remains BCPT.
- **Standard Life Investments Property Income Trust** also changed its name – to abrdn Property Income Trust Limited, with a new ticker of API.

Selected QuotedData views

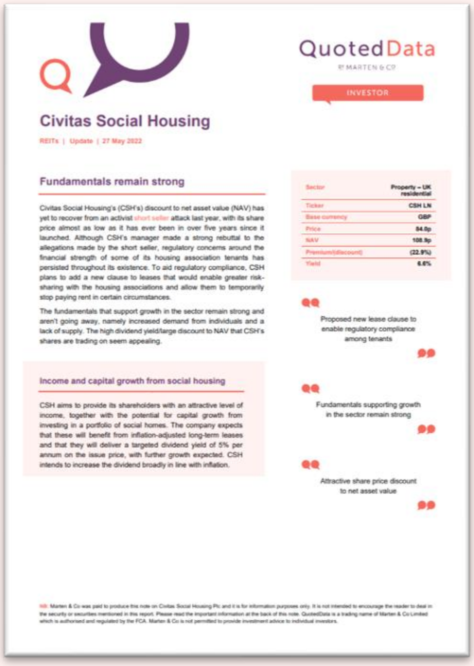
- **Is logistics a house of cards?**
- **To B or not to B**

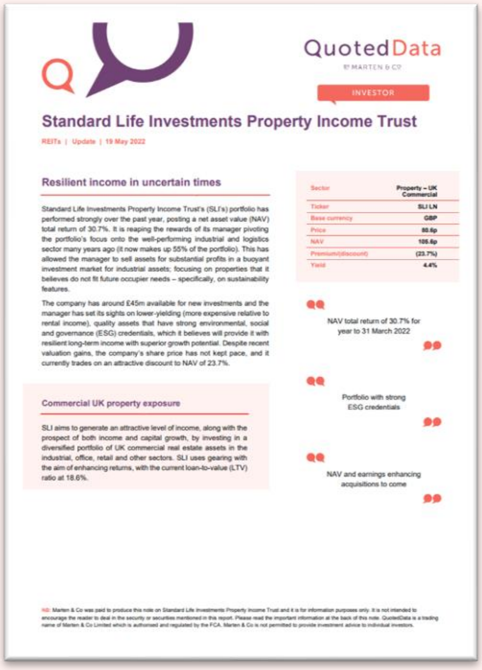
Real estate research notes



An update note on Grit Real Estate Income Group (GR1T). After its capital raise, the company has cleared a path for an increased, sustainable dividend and NAV growth following the acquisition of a developer.

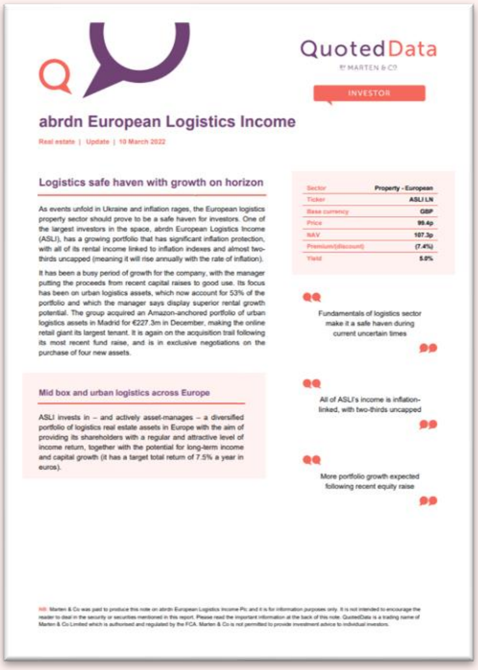
An update note on Civitas Social Housing (CSH). The fundamentals of the social housing sector remain strong and the wide discount that the group's share price trades may make it attractive.





An update note on Standard Life Investments Property Income Trust (SLI). The trust has proved resilient during the pandemic and is capturing capital value growth as the economy bounces back.

An update note on abrdn European Logistics Income (ASLI). The fundamentals of the European logistics sector make it a safe haven in times of uncertainty and the group's income displays substantial inflation protection.



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