Standard Life Inv. Property Income Trust

Embracing the changing environment

Investment trusts

Standard Life Investments Property Income Trust (SLI) is managed by Jason Baggaley. He aims to deliver an attractive level of income with the potential for income and capital growth from a diversified portfolio of UK commercial property. The manager notes that the industry is in a period of change, such as in the office sector, where tenants are demanding a higher level of service from their landlords. Baggaley says that SLI is embracing and benefiting from the changing environment, continuing to forge strong relationships with its tenants. He is cautiously optimistic about future returns from UK property and is building on his positive long-term performance track record. SLI's NAV total return has outperformed its IPD Monthly Index Funds (quarterly version) benchmark over the last one, three, five and 10 years. The trust offers an attractive 5.0% dividend yield.

12 months ending	Share price (%)	NAV (%)	Benchmark (%)	FTSE All-Share (%)	UK real estate index (%)
31/03/14	32.9	33.7	12.8	8.8	28.0
31/03/15	25.8	20.6	17.1	6.6	25.3
31/03/16	2.9	13.4	11.1	(3.9)	(5.3)
31/03/17	7.6	4.9	3.4	22.0	(0.0)
31/03/18	7.7	16.0	10.5	1.2	6.6

Source: Thomson Datastream. Note: All % on a total return basis in pounds sterling, up to last reported NAV.

Investment strategy: Actively managed portfolio

Baggaley seeks "good properties, in good locations, with good tenants". SLI's portfolio is primarily invested in the three main UK commercial property sectors of industrial, office and retail. The manager actively manages SLI's properties, such as renegotiating mutually favourable leases and refurbishing units, which builds strong relationships with the trust's tenants. As a result, SLI has a current record of 100% rent collection within 21 days and a below-industry level of voids. The trust's loan-to-value ratio is currently very low versus history (14.3% at end-March 2018), as the manager has realised profits on some of its holdings and is patiently looking for attractive investment opportunities before reinvesting the proceeds.

Market outlook: Relatively attractive yields

Given that the UK commercial property cycle appears to be in a later stage, which is illustrated by pockets of declining capital values, investors considering exposure to the sector may wish to consider a fund that takes a well-considered approach to investment in selected individual properties. While future returns from property may be driven more by income than capital appreciation, in a continued low interest rate environment, property yields remain attractive versus other asset classes, such as bonds or cash.

Valuation: Regularly trading at a premium to NAV

SLI's current 6.8% premium to NAV is modestly lower than its average premiums over the last one, three and five years (range of 5.8% to 7.7%). The board issues shares aiming to limit the premium; so far in FY18, the share count has increased by 2.4%, raising gross proceeds of £8.9m.

12 June 2018

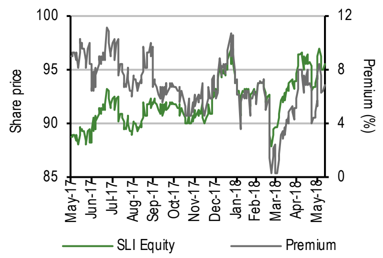
Price	**95.5p**
Market cap	**£386m**
AUM	**£486m**

NAV*	89.4p
Premium to NAV	6.8%

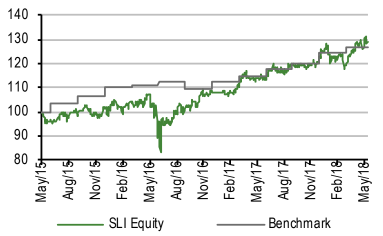
*IFRS NAV (including income) as at 31 March 2018.

Yield	5.0%
Ordinary shares in issue	404.4m
Code	SLI
Primary exchange	LSE
AIC sector	Property Direct – UK
Benchmark	IPD Monthly Index Funds (quarterly version)

Share price/premium performance



Three-year performance vs index



52-week high/low	97.0p	87.9p
NAV** high/low	89.4p	81.4p

**Including income.

Gearing

Loan to value*	14.3%

*Borrowings less cash divided by value of property portfolio. As at 31 March 2018.

Analysts

Mel Jenner	+44 (0)20 3077 5720
Gavin Wood	+44 (0)20 3681 2503

investmenttrusts@edisongroup.com

Edison profile page

Standard Life Investments Property Income Trust is a research client of Edison Investment Research Limited

Exhibit 1: Trust at a glance

Investment objective and fund background

Standard Life Investments Property Income Trust's objective is to provide shareholders with an attractive level of income together with the prospect of income and capital growth through investing in a diversified portfolio of UK commercial properties. The majority of the portfolio is invested in direct holdings within the three main commercial property sectors of retail, office and industrial.

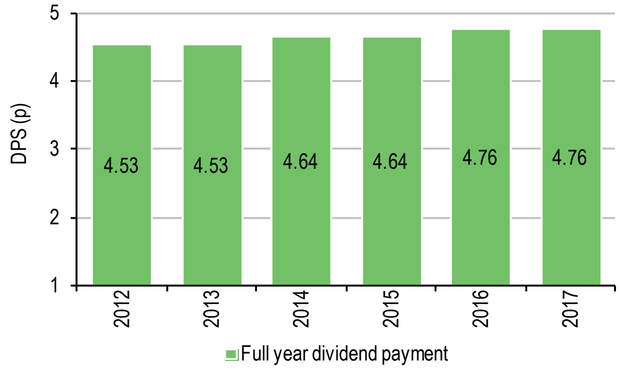
Recent developments

- 9 May 2018: Announcement of first interim dividend of 1.19p.
- 9 April 2018: Completion of sale of multi-let office in Slough for £13.3m; 9.6% ahead of end-December 2017 valuation.
- 8 March 2018: Announcement of fourth interim dividend of 1.19p.
- 5 March 2018: Completion of letting of 1 Marsh Way, Rainham, which was the trust's largest void.

Forthcoming		Capital structure		Fund details	
AGM	8 June 2018	Ongoing charges	1.7%	Group	Aberdeen Standard Investments
Interim results	August 2018	Loan to value	14.3%	Manager	Jason Baggaley
Year end	31 December	Annual mgmt fee	Tiered – 0.65% to 0.75% of total assets.	Address	1 George Street,
Dividend paid	Mar, May, Aug, Nov	Performance fee	None		Edinburgh EH2 2LL
Launch date	19 December 2003	Trust life	Indefinite	Phone	0845 60 60 062
Continuation vote	No	Loan facilities	£145m (£110m drawn)	Website	www.slipit.co.uk

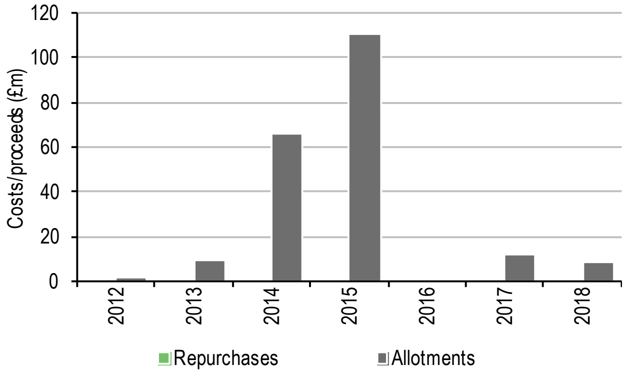
Dividend policy and history (financial years)

SLI pays dividends quarterly. A key objective is to provide an attractive sustainable level of income to shareholders.

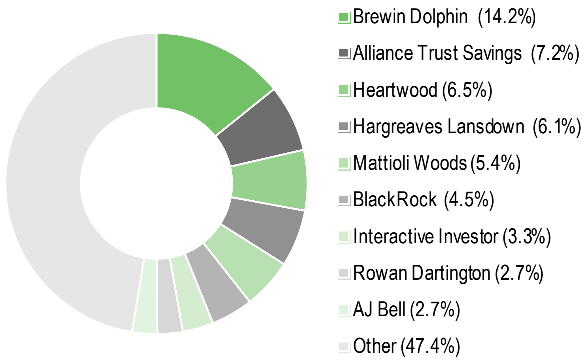


Share buyback policy and history (financial years)

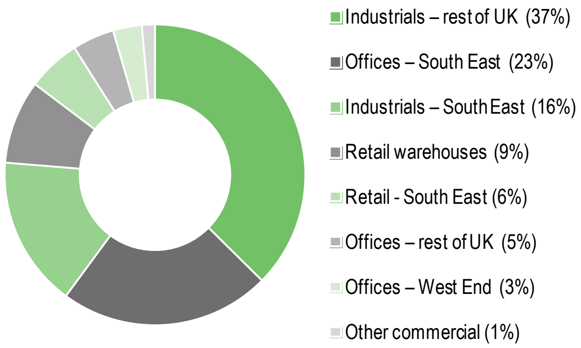
Renewed annually, SLI has authority to purchase up to 14.99% and allot up to 10% of its issued share capital.



Shareholder base (as at 31 March 2018)



Portfolio exposure by IPD subsector (as at 31 March 2018)



Top 10 holdings (as at 31 March 2018)

			Value band (£m)	
Property	Location	Sector	31 March 2018	31 March 2017*
Denby 242	Denby	Industrial	15–20	15–20
Symphony	Rotherham	Industrial	15–20	15–20
Chester House	Farnborough	Office	15–20	15–20
The Pinnacle	Reading	Office	10–15	N/A
New Palace Place	London	Office	10–15	10–15
Hollywood Green	London	Retail	10–15	10–15
Charter Court**	Slough	Office	10–15	10–15
Howard Town Retail Park	High Peak	Retail	10–15	10–15
Timbmet	Shellingford	Industrial	10–15	N/A
Marsh Way	Rainham	Industrial	10–15	N/A

Source: Standard Life Investments Property Income Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-March 2017 top 10. **Sold in April 2018.

Market outlook: Later cycle, but relatively good yields

While the UK commercial property market may appear late in the cycle, as evidenced by elevated capital values, with pockets of capital decline, the cycle may have further to run. The property upturn following the global financial crisis has been slow and steady, and any slowdown may also be gradual and prolonged. Interest rates remain low, and while commercial property total returns in coming years may be skewed to income rather than capital growth, the yields available are still relatively attractive compared to those available from other asset classes, such as bonds or cash.

Fund profile: Diversified UK commercial property fund

Launched in 2003, SLI is registered in Guernsey and listed on the London Stock Exchange. It is designated as a REIT, meaning it does not pay UK corporation tax on chargeable gains or rental profits, and must distribute at least 90% of its real estate profits. Since September 2006, SLI has been managed by Jason Baggaley, who aims to generate an attractive level of income with the prospect of income and capital growth from a diversified portfolio of UK commercial property. He is able to draw on the broad resources of Aberdeen Standard Investment's real estate team, and has recently recruited a new full-time portfolio manager as a dedicated resource for SLI – Oli Lord was hired as the trust's first deputy fund manager. Baggaley believes Lord will be a very good addition to the team, and will be fully involved in SLI's acquisition and asset management activities.

The trust is primarily directly invested in the three main commercial property sectors: industrial, office and retail; but alternative areas such as hotels, nursing homes and student housing are also considered. SLI is benchmarked against the IPD Monthly Index Funds (quarterly version). A maximum 10% of the portfolio may be invested in co-investments and property development. In normal market conditions, no single property may exceed 15% of total assets and a maximum 20% of the rent roll may be from a single tenant (excluding the government). Gearing of up to 65% of gross assets is permitted and the loan to value (borrowings minus cash as a percentage of property valuation) is capped at 45%. At end-March 2018, SLI's loan to value was 14.3%.

The fund manager: Jason Baggaley

The manager's view: Cautiously optimistic outlook

Baggaley says that historically there has been a very strong correlation between UK real estate returns and GDP. Higher economic activity means that companies expand, requiring more space for an increased workforce; more manufacturing drives demand for logistics space; and improving consumer confidence drives a higher level of spending, further supporting expansion. While higher interest rates may be viewed negatively for property returns, the manager says that this should not be the case if rates are rising due to more robust economic growth. He would consider it a greater risk if interest rates were rising in an attempt to combat a weak currency or a spike in commodity prices, such as oil. Baggaley notes that the UK economy was relatively weak in Q118, and he expects muted economic activity for the balance of the year. While he considers that Brexit is a risk to growth, he does not expect a recession or a collapse in real estate values. While the property market is slowing down, and there may be some reduction in capital values, such as Central London offices, he still expects property to generate positive total returns for investors.

While there appears to be a lot of buildings under construction in the City of London, Baggaley believes there is not an undue amount of stock. He says that historically the industry has tended to overbuild, but this is not evident currently, with a lot of new capacity already pre-let. On a wider scale within the office sector, there has been significant change, with many older properties changed to residential usage. The manager says that this has been a major contributor to keeping office supply in check, and he believes is a factor that is generally underestimated. Also, he notes that 20 to 25 years ago, companies were taking up long office leases, which are now up for renewal, and the existing facilities do not meet current tenant requirements; hence new capacity is required. Baggaley says that unemployment levels are very low currently and companies often refer to their workforces as their most valuable asset. Nowadays, people want to work in buildings that hold appeal. Baggaley says that for millennials, a company's ethics and the feel of the organisation is important, and this will continue to drive demand for efficient office accommodation. Individual companies now tend to require less space, given smaller desks, fewer meeting rooms, more flexible working (hot-desks) and digital rather than physical storage. The use of space has changed, with the addition of breakout and kitchen areas, which create a more informal environment.

Baggaley believes that we are currently in the latter part of the property cycle as prices are high; although he notes that other asset classes such as bonds and equities are also expensive. He does, however, feel that the property cycle has longer to run, unless there is a rapid increase in interest rates. Just as the recovery following the global financial crisis was muted and slow, he expects the slowdown to be protracted, ie lower for longer. Baggaley believes that property can continue to deliver a positive total return, led by income rather than further capital appreciation.

Asset allocation

Investment process: Selective property investment

Baggaley focuses on quality assets in good – but not necessarily prime – locations, with good current and future tenant demand. He seeks properties where there is potential to add value through asset management activities such as rent reviews and refurbishments. Properties are sold when they have a higher than desired void or capex risk; where the asset is not expected to outperform; or if it has become fully valued. The manager notes the importance of making selective investments. While industrial has been the darling of the real estate sector, delivering strong performance, he says that in general it is better to be an owner than a buyer of industrial property at current prices. If there is an economic slowdown, there will be parts of the industrial sector that are affected and Baggaley wonders if some buyers of UK industrial property are being discerning enough. He says that properties can have flaws, such as the yard size, access and quality of loading. The manager says that some industrial properties are being priced at levels that imply they will be 100% let indefinitely, which will not happen, and that property flaws will be exposed.

Baggaley prefers to invest contra-cyclically, buying properties that will be in high demand in the future rather than now. He notes that during the last recession, cinemas proved to be very resilient. However, he doubts that they will be so in the next downturn, due to the high cost of the experience and the rise of streaming services including Amazon Video and Netflix. The manager tries to avoid too much competition when purchasing properties. As an example, he cites the purchase of 1 Station Square, an office property in Bracknell. The town was out of favour with tenants, but following regeneration of the town centre, demand has picked up. SLI has refurbished the property and it is in a very good location, adjacent to the station, so the manager is confident of achieving rental growth. In terms of lot size, Baggaley historically found value in the £5m to £6m range, as institutions were looking at larger lot sizes. However, he says that there is now demand for smaller lots from family trusts, and SLI has found value in a couple of c £20m properties, where there is less competition. Each property investment is judged on its own merits.

SLI's level of voids at end-March 2018 was 5.8%, which was lower than the industry level of c 7%. The manager says that "voids generally do not worry me", highlighting that several of the trust's voids are under offer and most vacancies have occurred within the past six to nine months. Baggaley is confident that all of SLI's vacant properties can be let. For the let properties, the trust continues to achieve 100% rent collection within 21 days, which is helped by collecting its own rents. While it has a couple of retail tenants that are under pressure, they are both currently fully paid up.

Current portfolio positioning

During 2017, SLI purchased six assets for £48.9m, providing diverse exposure by type, location and tenant. They are all expected to generate strong current and future tenant demand, providing a reliable future income stream. Nine assets were sold in 2017, raising £71.4m in order to reduce future void and capex risk. The manager was also keen to reduce exposure to two areas that he believes will generate lower-than-average returns: weaker retail warehousing and central London offices. So far in 2018, SLI has announced three new purchases (£23.7m) and one sale (£13.3m):

Timbmet (Shellingford) – a single-let warehouse unit on the route from Oxford to Swindon. The purchase price of £11.5m reflects an initial yield of 6.5%. The lease is a 25-year sale and leaseback, without a break clause, with five-yearly, upward-only rent reviews of 2.5% pa. Timbmet has been in-situ for many years and has recently spent money on the property; bringing its headquarters onto the site. Baggaley comments that there is strong population growth in the area, so longer-term the property could potentially be converted to residential use.

Grand National Retail Park (Aintree) – the purchase price of £6.13m reflects an initial yield of 6.85%. The park is adjacent to Aintree racecourse and has four units with the following tenants: Premier Inn, Pure Gym, Mitchells and Butler, and KFC. It is also adjacent to the Jockey Club, whose property is on a long lease. There is scope for asset management activities; SLI has already negotiated a break in Pure Gym's lease in exchange for an additional five-year lease term.

Flamingo Flowers (Sandy) – an industrial unit used for the processing and distribution of cut flowers. While Brexit is a risk to Flamingo's business, the company has access to home-grown as well as imported flowers. The property was purchased for £6.02m, reflecting an initial yield of 6.25%. There is a 19-year lease with five-year indexation. SLI gained low-cost entry to a large site, which is just 35 miles north of the M25 junction with the A1. The manager sees very limited downside risk, saying that he could knock every building down and let the hard standing at a similar rate, while believing that in 10–20 years time, this "will be a cracking piece of real estate".

Charter Court (Slough) – a multi-let office sold for £13.25m, which was 9.6% higher than the end-December 2017 valuation. The sale not only generated a profit, but was also undertaken to reduce risk. There was a vacant floor and other leases due to expire in 2020 and 2021, by which time a major refurbishment would be required. The sale ensures that SLI avoids the necessary capex and loss of income during the refurbishment programme.

Exhibit 2: Top 10 tenants

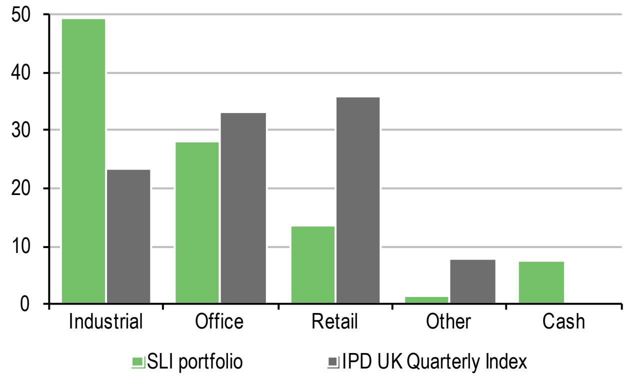
	Passing rent (£m)	% of total rent	
	31 March 2018	31 March 2018	31 March 2017*
BAE Systems	1.258	4.8	4.5
TechnoCargo Logistics	1.242	4.8	4.5
The Symphony Group	1.080	4.1	3.9
Hadleigh PVT	0.800	3.1	N/A
Bong UK	0.757	2.9	2.7
Euro Car Parts	0.736	2.8	2.5
Ricoh UK	0.697	2.7	2.5
CEVA Logistics	0.633	2.4	N/A
thyssenkrupp Materials (UK)	0.590	2.3	N/A
Public sector	0.559	2.1	N/A
Top 10	**8.352**	**32.0**	**34.6**

Source: Standard Life Investments Property Income Trust, Edison Investment Research. Note: *N/A where not in March 2017 top 10.

SLI's top 10 tenants are shown in Exhibit 2. Over the 12 months to end-March 2018 there was a decrease in concentration in the largest tenants – 32.0% of total rent compared with 34.6% at end-

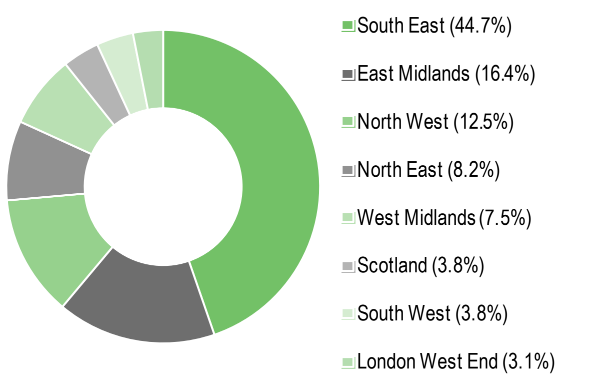
March 2017. In aggregate, SLI's clients are low credit risks; just 3.5% of gross income was designated as coming from high or maximum credit risk customers (based on the IPD risk bands) as at 31 March 2018. As shown in Exhibit 3, compared with the benchmark, SLI continues to be overweight the industrial sector, modestly underweight the office sector and underweight the retail sector. The trust is diversified by region, with less than 50% invested in London and the South East of England (Exhibit 4).

Exhibit 3: Sector allocation at 31 March 2018 (%)



Source: SLI, Edison Investment Research

Exhibit 4: Portfolio split by region at 31 March 2018

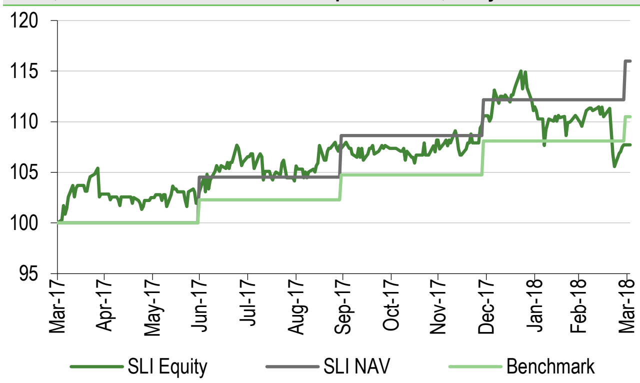


Source: SLI, Edison Investment Research

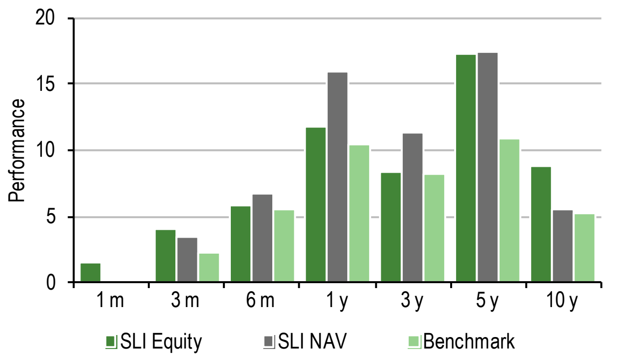
Performance: Outperformance versus benchmark

Exhibit 5: Investment trust performance to 31 March 2018

Price, NAV and benchmark total return performance, one-year rebased



Price, NAV and benchmark total return performance (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three, five and 10-year performance figures annualised.

SLI's relative returns are shown in Exhibit 6. Its NAV total return has outperformed the benchmark over all periods shown. The trust's share price total return has also outperformed over five and 10 years, while underperforming over shorter time periods, which has led to a smaller premium to NAV. The manager attributes the outperformance to his flexible investment approach. He seeks to invest in areas of the commercial property market where there is less competition, and he actively manages the portfolio, being willing to take profits and reinvest in more attractive opportunities.

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

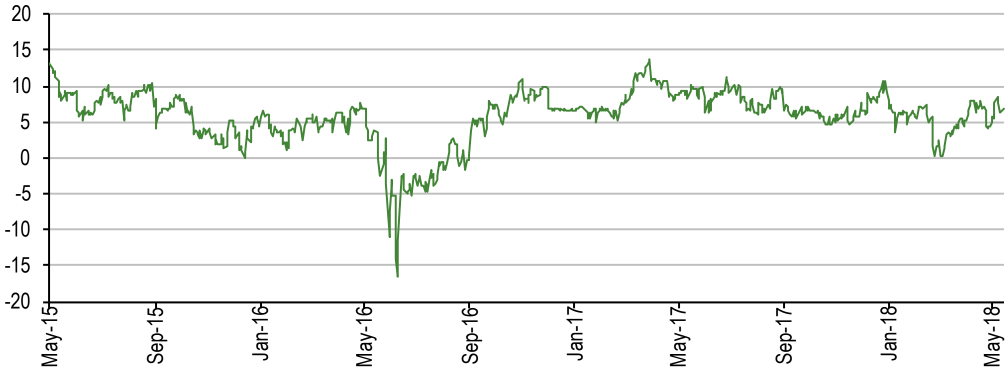
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to benchmark	(4.3)	(4.7)	(4.9)	(2.5)	(6.0)	19.0	35.2
NAV relative to benchmark	1.2	1.2	1.2	5.0	8.8	32.8	2.8
Price relative to FTSE All-Share	(0.4)	4.6	2.6	6.4	0.6	44.9	18.8
NAV relative to FTSE All-Share	5.3	11.0	9.2	14.6	16.3	61.7	(9.6)
Price relative to UK real estate index	(6.2)	1.3	(3.7)	1.1	18.2	23.3	76.7
NAV relative to UK real estate index	(0.8)	7.5	2.5	8.8	36.7	37.5	34.4

Source: Thomson Datastream, Edison Investment Research. Note: Data to end-March 2018. Geometric calculation.

Valuation: Generally trading at a premium

As shown in Exhibit 7, apart from a period following the UK's EU referendum, when there was widespread selling of risk assets, SLI has regularly traded at a premium to NAV over the last three years. The trust's current 6.8% premium compares with the averages over the last one, three, five and 10 years of 6.8%, 5.8%, 7.7% and 1.6%, respectively. SLI issues shares in response to investor demand, aiming to limit the premium. So far in FY18, 9.5m shares have been issued (2.4% of the share count at end-FY17), raising gross proceeds of £8.9m. In FY17, the share count was increased by 3.4%, raising gross proceeds of £12.0m.

Exhibit 7: Share price premium/discount to NAV (including income) over three years (%)



Source: Thomson Datastream, Edison Investment Research

Capital structure and fees

SLI is a conventional investment trust with one class of share; there are currently 404.4m shares in issue. The trust has a £145m debt facility with Royal Bank of Scotland – a £110m, 2.725% (including the cost of a hedge to fix the interest rate) term loan, which expires in April 2023, and a £35m revolving credit facility (RCF). The RCF has just been extended by a further two years, aligning its expiry with the term loan, with the interest rate increasing from Libor +1.20% to Libor +1.45%. This increases SLI's certainty regarding both the availability and cost of financing until April 2023. The RCF is currently undrawn and SLI's loan to value at end-March was 14.3%, which is very low versus history, due to recent asset sales resulting in a higher-than-average level of cash. Once this cash is reinvested, Baggaley says that the loan to value will increase to c 20%, which he considers a comfortable level. Given the advanced stage of the property cycle, he would not want to significantly increase the trust's level of gearing.

Since 2014, SLI has had a tiered management fee – 0.75% of total assets up to £200m, 0.70% between £200m and £300m, and 0.65% above £300m. No performance fee is payable. In FY17, the ongoing charge was 1.7%, which was in line with the prior financial year.

Dividend policy and record

The 4.76p total dividend paid for FY17 was in line with FY16, and was 104% covered by income. The 1.19p Q118 dividend was only 84% covered, which Baggaley explains is as a result of recent asset sales and the trust holding cash awaiting attractive reinvestment opportunities. The manager says that he will only invest in assets that he believes will deliver good long-term returns. He will not jeopardise his positive long-term performance record by hastily investing cash to ensure short-term dividend cover. Baggaley also notes that voids are modestly higher than the historical average and he has also sold some of SLI's higher-yielding properties, which has affected the level of income. However, he views the uncovered dividend as a blip rather than a longer-term trend. Based on its current share price, SLI has a dividend yield of 5.0%, which compares favourably with the 3.9% yield on the FTSE All-Share index, but is modestly lower than the 5.7% yield on the FTSE All-Share REIT index (source: Bloomberg).

Peer group comparison

SLI is a member of the AIC Property Direct – UK sector. In Exhibit 8, we highlight the eight sector peers with a market cap above £300m that have been trading for more than one year. SLI's NAV total returns are above average over one, three, five and 10 years. It ranks second out of eight funds over one year, third out of seven over three years, second out of five over five years, and third out of five over 10 years. SLI is one of five trusts in the selected peer group that is trading at a premium. Its ongoing charge is below average and no performance fee is payable. SLI has a below-average level of gearing and an above-average dividend yield, which ranks third-highest in the selected peer group.

Exhibit 8: Selected peer group as at 11 June 2018*

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Discount (ex-par)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Standard Life Inv. Prop. Inc.	386.2	16.0	38.0	122.4	72.2	6.8	1.7	No	131	5.0
Custodian REIT	453.4	8.3	27.4			14.3	1.7	No	123	5.3
F&C Commercial Property	1,170.3	9.3	32.2	85.8	111.2	1.7	1.2	No	122	4.1
Picton Property Income	488.3	14.4	49.9	134.3	52.4	1.6	2.5	No	135	3.8
Regional REIT	354.9	6.5				(7.8)	4.4	Yes	186	8.4
Schroder Real Estate Invest	316.8	10.6	33.5	74.8	7.5	(9.6)	2.2	No	142	4.1
Secure Income REIT	1,257.3	18.9	51.8			6.8	3.9	Yes	128	4.0
UK Commercial Property	1,120.1	11.2	25.9	73.6	90.6	(7.7)	1.5	No	121	4.3
Average (8 funds)	**693.4**	**11.9**	**36.9**	**98.2**	**66.8**	**0.8**	**2.4**		**136**	**4.9**
SLI rank in peer group	**6**	**2**	**3**	**2**	**3**	**2**	**6**		**4**	**3**

Source: Morningstar, Edison Investment Research. Note: *Performance to 31 March 2018. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

The board

SLI's board has five directors; all are non-executive and independent of the manager. The chairman is Robert Peto; he was appointed on 28 May 2014 and assumed his current role following the June 2016 AGM. The other four directors are: Sally-Ann Farnon (appointed on 1 July 2010); Huw Evans (11 April 2013); Mike Balfour (10 March 2016); and James Clifton-Brown (17 August 2016).

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
295 Madison Avenue, 18th Floor
10017, New York
US

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia