# Standard Life Inv. Property Income Trust

## Diversified UK commercial property REIT

Investment trusts

**Standard Life Investments Property Income Trust (SLI) is an actively managed closed-ended company investing directly in UK commercial property. The trust has grown substantially since mid-2014 using share issues to fund asset purchases and the proposed acquisition of a c £165m portfolio provides the opportunity to make a step change in scale without materially altering the portfolio profile. Maintaining gearing at c 30% LTV, SLI has outperformed the IPD UK Monthly index over five years. The shares trade at a c 10% premium to NAV and yield an above average 5.4%.**

| 12 months ending | Total share price return (%) | Total NAV return (%) | IPD UK Monthly (%) | FTSE All-Share (%) | FTSE EPRA/ NAREIT UK (%) |
|---|---|---|---|---|---|
| 31/07/12 | 4.7 | 1.7 | 4.3 | 0.4 | (1.9) |
| 31/07/13 | 10.0 | 2.6 | 4.7 | 24.3 | 27.9 |
| 31/07/14 | 25.5 | 34.3 | 18.5 | 5.6 | 15.2 |
| 31/07/15 | 19.6 | 16.4 | 14.9 | 5.4 | 27.2 |

Note: 12-month rolling discrete £-adjusted total return performance.

### Investment strategy: Research-based approach

SLI aims to provide investors with a sustainable and attractive level of income by investing in good quality commercial real estate assets in the UK. The manager targets property assets that he believes will appeal to occupiers, where value can be added and rental growth generated by actively managing the assets. There is no set lot size restriction on purchases and properties range in value from £1m-20m. The manager's purchase philosophy is to acquire assets that offer an attractive income return and have good medium- or long-term prospects for capital growth. A research-based approach is taken to buying and selling property looking at where markets are likely to change in the following six months, with changes in infrastructure seen as a key driver of market developments.

### Market outlook: Favourable fundamentals

The manager sees potential for the current property cycle in the UK to run longer than some commentators expect due to the low level of supply and good level of demand. Rising interest rates are not seen as a particular threat as they are considered to reflect a stronger economic environment which supports demand growth. Coupled with low levels of supply, this should translate into rental growth. UK properties with relatively high yields should be less sensitive to rising interest rates given the current wide yield spread and the expectation for rates to rise gradually and peak significantly below historical levels.

### Valuation: Above-average premium and yield

SLI's share price premium to NAV is one of the highest among peers and sits slightly above its 9.7% three-year average. There is no active discount control mechanism but a substantial number of shares have been issued since mid-2014, taking advantage of the premium to grow the company without diluting existing shareholders. SLI's 5.4% dividend yield is one of the highest in the peer group of closed-ended funds directly investing in UK property with a market cap of over £100m and a track record of more than one year.

**19 October 2015**

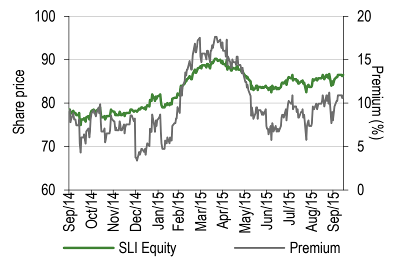
| | |
|---|---|
| **Price** | **85.75p** |
| **Market cap** | **£247m** |
| **AUM** | **£309m** |

| | |
|---|---|
| NAV* | 77.3p |
| Premium to NAV | 11.9% |
| NAV** | 78.0p |
| Premium to NAV | 10.9% |

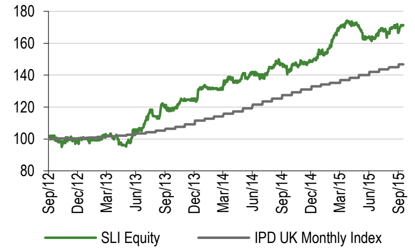
*IFRS NAV after dividend adjustment as at 30 June 2015.
**EPRA NAV after dividend adjustment as at 30 June 2015.

| | |
|---|---|
| Total dividend yield | 5.4% |
| Ordinary shares in issue | 288.4m |
| Code | SLI |
| Primary exchange | LSE |
| AIC sector | Property Direct - UK |

**Share price/premium performance**




**Three-year cumulative perf. graph**




| | | |
|---|---|---|
| 52-week high/low | 90.3p | 75.0p |
| NAV** high/low | 78.0p | 71.9p |

**EPRA NAV after dividend adjustment.

**Gearing**

| | |
|---|---|
| Gross loan to value* | 29.4% |
| Net loan to value* | 19.8% |

*As at 30 June 2015.

**Analysts**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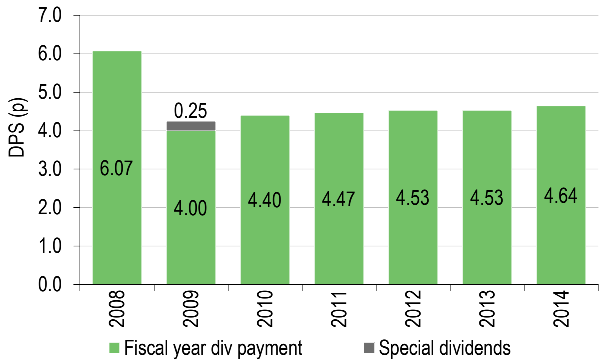
***Standard Life Inv. Property Income Trust Ltd is a research client of Edison Investment Research Limited***

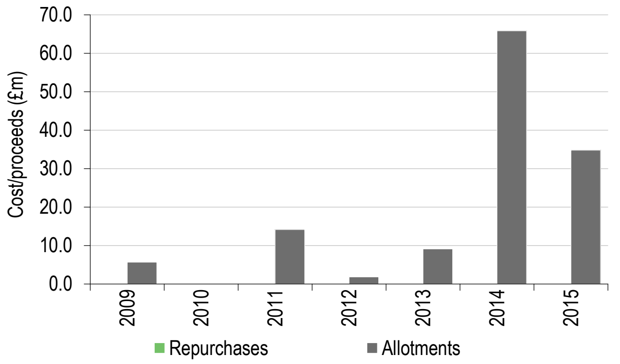
## Exhibit 1: Trust at a glance

| Investment objective and fund background | Recent developments |
|---|---|
| SLI'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 will be invested in direct holdings within the three main commercial property sectors of retail, office and industrial. | ■ 28 September 2015: £165m portfolio acquisition proposed, subject to a successful equity fundraising, shareholder approval and a new bank facility being put in place.<br>■ 22 September 2015: Significant asset management programme completed.<br>■ 27 August 2015: Interim results to 30 June 2015 – NAV total return +6.6%.<br>■ 12 August 2015: Sale of two assets for £9.6m (18.4% ahead of March 2015 valuation) and purchase of two assets for £7.9m completed. |

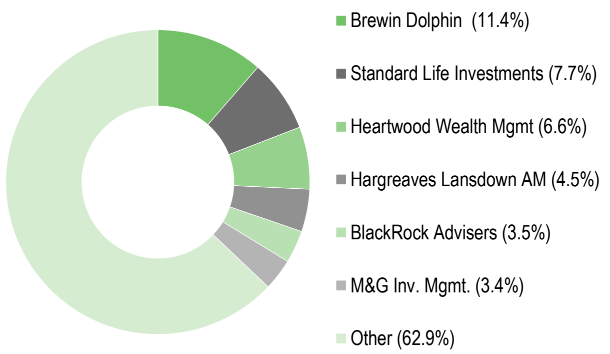
| Forthcoming | | Capital structure | | Fund details | |
|---|---|---|---|---|---|
| AGM | May 2016 | Ongoing charges | 1.4% of total assets (c 1.8% of NAV) | Group | Standard Life Investments |
| Final results | April 2016 | Net gearing | 19.8% LTV | Manager | Jason Baggaley |
| Year end | 31 December | Annual mgmt fee | Tiered: 0.75-0.65% total assets | Address | 1 George Street, Edinburgh EH2 2LL |
| Dividend paid | Feb, May, Aug, Nov | Performance fee | None | | |
| Launch date | 19 December 2003 | Trust life | Indefinite | Phone | 0845 60 60 062 |
| Continuation vote | No | Loan facilities | £84m fully drawn | Website | www.standardlifeinvestments.com |

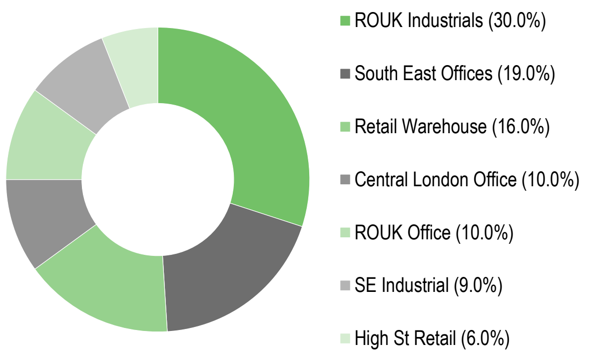
| Dividend policy and history | Share buyback policy and history |
|---|---|
| SLI pays dividends quarterly. A key objective is to provide an attractive, sustainable level of income to shareholders. | Renewed annually, SLI has authority to purchase up to 14.99% and allot up to 10% of its issued share capital. |




| Shareholder base (as at 14 August 2015) | Distribution of portfolio (as at 30 June 2015) |
|---|---|




**Top 10 holdings (as at 30 June 2015)**

| | | | % of portfolio | Value Band | |
|---|---|---|---|---|---|
| **Property** | **Location** | **Sector** | **30 June 2015** | **30 June 2015** | **30 June 2014** |
| White Bear Yard | London | Office | 6.2 | £16-18m | £12-14m |
| DSG, Blackpool Road | Preston | Retail | 5.5 | £14-16m | £15.8m* |
| Chester House | Farnborough | Office | 5.3 | £14-16m | £14-16m |
| Symphony | Rotherham | Industrial | 5.3 | £14-16m | £14.6m* |
| Denby 242 | Denby | Industrial | 5.1 | £14-16m | £12.9m* |
| Hertford Place | Rickmansworth | Office | 4.8 | £12-14m | £12-14m |
| St James's House | Cheltenham | Office | 4.4 | £12-14m | £10-12m |
| 3B-C Michigan Drive | Milton Keynes | Industrial | 4.0 | £10-12m | N/A* |
| Hollywood Green | London | Retail | 4.0 | £10-12m | £10-12m |
| Bourne House | Staines | Office | 3.6 | £10-12m | £8-10m |
| **Top 10** | | | **48.2** | | |

Source: Standard Life Investment Property Income Trust, Edison Investment Research. Note: *Purchase value shown where property was not in June 2014 portfolio, N/A where purchase value not available.

## Proposed portfolio acquisition and capital raising

On 28 September 2015, SLI announced the proposed acquisition of a portfolio of 22 UK commercial properties for c £165m subject to shareholder approval, raising up to £100m of additional equity and arranging new debt of up to £75m. The acquisition portfolio is diversified by sector, tenant and region and has a similar income and covenant profile to SLI's existing property portfolio. The manager believes that the acquisition portfolio is complementary to SLI's existing portfolio and sees it introducing a number of additional near-term asset management opportunities.

SLI raised £97m of additional capital over the 12 months to June 2015 through a number of smaller equity issues timed to take advantage of attractive acquisition opportunities. The current proposal represents a continuation of this approach while its scale reflects the specific opportunity to acquire an entire portfolio. Completion of this transaction would represent a major advance in SLI's strategy to increase the size of the trust that it has pursued since mid-2014 with the aim of improving the liquidity of the shares as well as reducing the percentage ongoing charge.

In Exhibit 2, we set out the key prospective changes to the profile of SLI's property portfolio assuming completion of the purchase. Points to note from this are that gearing is likely to increase temporarily, although remaining comfortably within SLI's permitted range; tenant exposure would be substantially diversified and the running yield slightly higher, which would enhance dividend cover.

**Exhibit 2: Summary of prospective changes to key portfolio characteristics**

| | Pre-transaction | Post-transaction | Comment |
|---|---|---|---|
| Portfolio value | £315m | £480m | £165m or c 50% increase |
| Net gearing (LTV) | 19.8% (24% currently) | Up to 30%, target 25% | Likely sale of one or two lower-yielding Std Retail properties |
| No. of properties | 43 | 65 | 22 new properties or c 50% increase |
| No. of tenants | 122 | 240 | 118 new tenants or c 100% increase |
| Annual rent | £19.6m | £32.0m | £12m or c 60% increase |
| Annual ERV | £22.4m | £34.2m | £12m or c 50% increase |
| Average lease length | 7.2 years | 6.1 years | More asset management opportunities in next 12 months |

Source: Standard Life Investment Property Income Trust, Edison Investment Research. Note: ERV = estimated rental value.

Emphasising the complementarity of the two portfolios, there is no difference in exposure to the three key commercial property sectors: office, industrial and retail. Exhibit 3 shows the prospective changes in sub-sector and regional exposure. The greatest prospective sub-sector change is a 5pp increase in exposure to south-east offices, largely offset by a 4pp reduction in exposure to central London (City, West End) offices. The more detailed regional analysis highlights that the increased south-east exposure relates primarily to outer London (9.5pp increase), which the manager favours, seeing rising demand driven by appreciably lower total occupational costs than central London.

**Exhibit 3: Prospective change in portfolio split by IPD sub-sector and by region**

| IPD sub-sector | Pre-transaction | Post-transaction | Change |
|---|---|---|---|
| Industrials - Rest of UK | 30.0 | 29.0 | (1.0) |
| Offices - South East | 19.0 | 24.0 | 5.0 |
| Retail Warehouses | 16.0 | 14.0 | (2.0) |
| Offices - Rest of UK | 10.0 | 9.0 | (1.0) |
| Industrials - South East | 9.0 | 10.0 | 1.0 |
| Std Retail - South East | 6.0 | 8.0 | 2.0 |
| Offices - City | 6.0 | 4.0 | (2.0) |
| Offices - West End | 4.0 | 2.0 | (2.0) |
| | **100.0** | **100.0** | |

| Region | Pre-transaction | Post-transaction | Change |
|---|---|---|---|
| South East | 27.7 | 27.7 | 0.0 |
| Outer London | 4.0 | 13.5 | 9.5 |
| North West | 12.8 | 12.5 | (0.3) |
| East Midlands | 18.0 | 12.1 | (5.9) |
| South West | 7.9 | 7.7 | (0.2) |
| West Midlands | 0.9 | 5.4 | 4.5 |
| Scotland | 8.8 | 5.3 | (3.5) |
| North East | 0.4 | 4.0 | 3.6 |
| London City | 6.2 | 3.7 | (2.5) |
| Other | 13.3 | 8.1 | (5.2) |
| | **100.0** | **100.0** | **0.0** |

Source: Standard Life Inv. Property Income Trust, Edison Investment Research

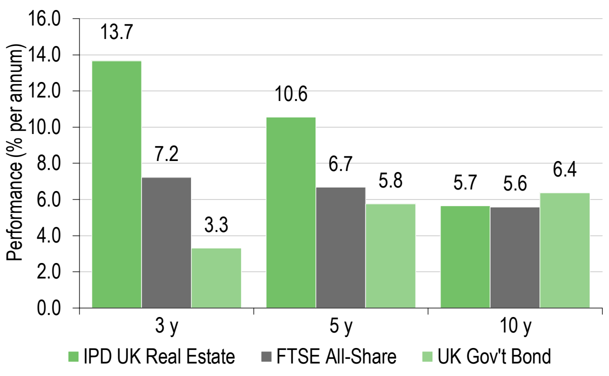
If the deal proceeds, the manager anticipates a pause in the flow of acquisitions, allowing time to focus on managing the newly-acquired assets.

## Market outlook: Favourable fundamentals

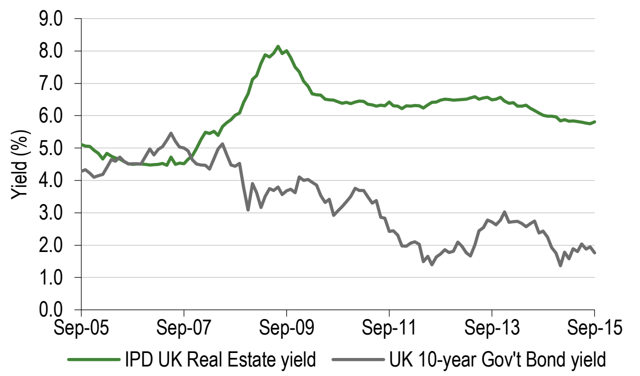
Investors may consider investment in property for a number of reasons. Within a portfolio it has the potential to provide diversification due to property asset values having a low correlation with equities and bonds over longer periods. Longer-term returns have tended to be at a similar level to equities and bonds (marginally higher than equities and modestly lower than bonds over 10 years – see Exhibit 4) and volatility has been below that of equities. Also, as a real asset with rental income subject to upward reviews, property can provide a measure of inflation protection.

**Exhibit 4: UK real estate returns vs equities and bonds over 10 years**

**UK real estate total returns vs equities and bonds to 30 September 2015**




**UK real estate yield vs 10-year government bond yield to 30 September 2015**




Source: Thomson Datastream, Bloomberg, Edison Investment Research

After a strong post-crisis period for property returns (+12.5% pa over six years for the IPD UK index) it is reasonable to question the likely level of prospective returns for the asset class. Yields have fallen as the hunt for returns has driven valuations up across asset classes (Exhibit 4 right-hand chart). While this suggests the longer-term potential for further capital gains may now be more limited, there is still a positive argument in terms of the relative level of income provided by property assets, with a yield spread between property income (IPD UK index) and government bonds standing at over 300bp currently. There could be concerns over the potential effect on asset values once UK monetary policy starts to normalise. However, property has recorded positive capital returns during previous periods of rate tightening and policy normalisation is itself a manifestation of increasing economic strength, also evidenced by rising employment, which itself is a key positive indicator for property markets.

## Fund profile: Diversified UK commercial property REIT

Launched in December 2003, SLI is a Guernsey-registered closed-ended investment company listed on the London Stock Exchange. On 1 January 2015, SLI became a UK REIT. SLI aims 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 portfolio principally invests in direct holdings within the three main commercial property sectors of retail, office and industrial, although investments may also be held in other commercial property such as hotels, nursing homes and student housing. Investment in property development and co-investment vehicles, where there is more than one investor, is permitted up to 10% of the portfolio. There are currently no holdings in this category or the other commercial property category (although one mixed-use leisure and retail development includes a Travelodge).

The board reviews SLI's property income and total return performance against the Investment Property Databank (IPD) Balanced Monthly Funds index and maintains a focus on the level of property voids and rent arrears across the portfolio.

During 2014, the board reassessed its strategy together with the investment manager and other advisers. The board's overall intention is to continue to distribute an attractive income return alongside growth in the NAV and to provide a good overall total return. It is intended that SLI remains primarily invested in office, industrial and retail properties, while monitoring other commercial property segments including student accommodation and care homes. In all segments, poor secondary and tertiary locations are regarded as high risk and will be avoided.

Standard Life Investments has been SLI's investment manager since its launch in 2003 with Jason Baggaley acting as lead fund manager since September 2006. Baggaley, a qualified chartered surveyor, joined Standard Life Investments in 1996 and has over 24 years of real estate fund management experience. In addition to managing SLI's portfolio, he also manages a major segregated corporate pension fund. Baggaley is supported by portfolio manager, Cameron MacKay and graduate portfolio manager Alex Thomason, and he also draws on the investment manager's wider real estate team. The manager anticipates that the larger portfolio that would result from the proposed acquisition would justify adding additional experienced resource to the team.

## The fund manager: Jason Baggaley

### The manager's view: Property sector remains attractive

Jason Baggaley sees strengthening UK economic fundamentals providing a positive backdrop for the UK property sector over the remainder of 2015 and into 2016, citing the rebound in GDP growth in the second quarter of 2015 with business sentiment and consumer confidence remaining buoyant. While rising interest rates present an emerging risk, the current yield spread between property and bonds is seen as providing a reasonable buffer to compensate for prospective rate rises. Together with an anticipated robust economic environment underpinning occupational demand, a limited pipeline of future new developments is seen as reinforcing property sector fundamentals. In addition, capital values are supported by healthy demand from a diverse source of investors from overseas, to private equity type buyers to UK institutions, attracted by the relative yields and improving fundamentals.

Total returns from UK property in the first half of 2015 lagged the same period in 2014, but Baggaley highlights that capital returns remained at an attractive level and rental growth continues to improve. Overall, he expects positive total returns for investors on a three-year view, although at a more normal 5-10% level driven by rental growth rather than the c 20% seen in 2014. As a positive indicator, he points to rental growth spreading out across the UK, having previously been limited to London and the South East. While the retail sector continues to face headwinds that may hold back recovery in weaker locations, the prospects for South East and Central London retail are expected to improve further as economic recovery gains more traction. Prime, good-quality secondary assets and selective poorer-quality secondary assets in stronger locations are seen to provide the best opportunities.

Baggaley sees the proposed acquisition portfolio as a good fit with SLI's existing portfolio in terms of both sector and geographic spread, noting in particular that it does not have exposure to Central London property where value is currently less apparent. Although the acquisition portfolio already has a slightly higher running yield than the current portfolio, he sees further potential from a number of asset management opportunities at properties where leases expire over the next 12 months. Baggaley notes that the properties in the acquisition portfolio were all relatively recently purchased following thorough due diligence and only one or two lower-yielding retail properties appear candidates for divestment.

# Asset allocation

## Investment process: Research-based approach

The manager is focused on providing investors with a sustainable and attractive level of income by investing in good-quality UK commercial real estate assets. Assets are targeted in good, but not necessarily prime locations, where it is perceived that there will be good continuing tenant demand. Properties are selected that the manager believes will appeal to occupiers, where value can be added and rental growth generated through active management. SLI targets a covered dividend over each year and the manager's purchase philosophy is to acquire assets that offer an attractive income return and have good medium- or long-term prospects for capital growth.

To manage risk, the following portfolio restrictions are applied in normal market conditions:

- No property will represent more than 15% of total assets.
- No tenant (excluding the government) will be responsible for more than 20% of the rent roll.
- Borrowings will not exceed 65% of gross assets. The board's current intention is that SLI's loan-to-value ratio (net borrowings as a proportion of property value) will not exceed 45%.

The proposed acquisition is not expected to move LTV above 30% and SLI has stated that it will not seek to cover any shortfall in equity funding by increasing the level of long-term borrowing.

### Asset management opportunities

Asset management opportunities are a key element of the manager's investment approach. These principally comprise negotiating new lease agreements with either new or existing tenants when an existing lease expires and can involve refurbishment prior to re-letting. Generally, lease expiries are seen as opportunities to negotiate a higher rent, potentially increasing the capital value of a property as well as income. The downside risk of a lease expiry is the potential for a void period.

During the first half of 2015, key asset management transactions included:

- Ocean Trade Centre Aberdeen: two leases extended with existing tenants; major refurbishment on seven units, five let on a 10-year lease to CCF and two let subject to legal commitment.
- Explorer Crawley: lease break with Amey removed to give a further five years certain term.
- Coal Rd Leeds: Five-year lease extension agreed on one unit.
- St James House Cheltenham: New 10-year lease agreed on part of third floor to existing tenant reinforced current ERVs and exceeded valuation assumptions.

In September 2015, SLI completed an asset management programme on its largest asset, an office property at White Bear Yard, Farringdon, in London. This comprised re-letting the ground floor following a lease expiry in August and renewing leases on the two upper floors. The new leases increased the property's rental value by c £215,000 pa, which the manager anticipates will increase the property's capital value by at least £2m (c 12%) in the September 2015 valuation.

### Voids

With SLI's void rate standing at 10.3% at end-June 2013, the elimination of voids was made a priority target in the second half of 2013. Through active management initiatives and the sale of the retail warehouse portfolio the void rate was reduced to 0.6% at end-June 2014. Maintaining low voids remains a key aim and although the headline void rate has increased over the year to end-June 2015 from 0.6% of ERV across two properties to 2.8% of ERV across seven properties, the rate remains low compared with average industry levels, with the IPD average void rate standing at 7.6% at end-June 2014 and 7.0% at end-December 2014. The manager notes that adjusting for lettings in solicitors hands reduced the void rate to under 2% and he highlights that the main void (1.5% of ERV) was a property in Bristol purchased during June 2015 where a refurbishment was planned prior to re-letting the property.

## Tenant profile

The tenant profile of the property portfolio is closely monitored as tenant failure is seen as a key potential risk. Thorough due diligence is undertaken on prospective tenants before entering into new lease arrangements and tenants are kept under constant review through regular direct contact (seen as an important feature of SLI's management approach) and monitoring the credit and risk ranking of tenants and income streams in comparison to the UK real estate market. The manager seeks to be proactive in identifying signs that a tenant's financial situation may be deteriorating and will initiate discussions relating to potentially renegotiating lease terms ahead of a default occurring. Exhibit 5 highlights the change in SLI's top 10 tenants over the year to end-June 2015 with lower exposure to individual tenants largely reflecting the increase in the number of portfolio properties.

**Exhibit 5: Top 10 tenants**

| | Passing rent, £m | % of total rent | |
|---|---|---|---|
| **Tenant** | **30 June 2015** | **30 June 2015** | **30 June 2014** |
| BAE Systems | 1.258 | 7.1 | 8.8 |
| Trebor Bassett | 1.157 | 6.5 | 8.1 |
| The Symphony Group | 1.080 | 6.1 | N/A |
| DSG | 1.041 | 5.9 | N/A |
| Bong UK | 0.713 | 4.0 | N/A |
| Matalan | 0.697 | 3.9 | 4.9 |
| Grant Thornton | 0.680 | 3.8 | 4.8 |
| Banner Business Services | 0.467 | 2.6 | N/A |
| Yusen Logistics | 0.450 | 2.5 | N/A |
| Mendeley | 0.417 | 2.3 | N/A |
| **Top 10** | **7.959** | **44.7** | **45.6** |

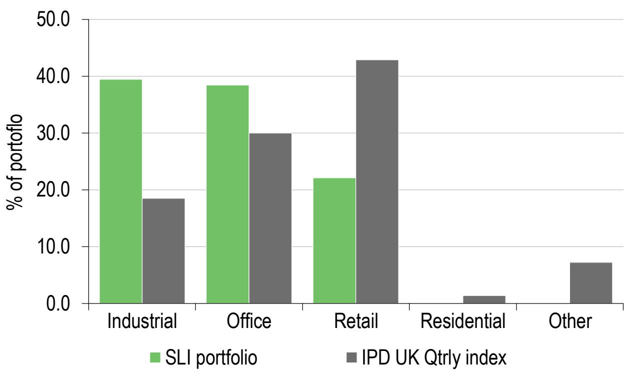
Source: Standard Life Investment Property Income Trust, Edison Investment Research

## Current portfolio positioning

SLI maintains a relatively concentrated portfolio of directly-owned freehold and leasehold property investments in the UK. At 30 June 2015, SLI held 39 property assets valued at £288.4m, which compares to 31 property assets valued at £178.8m a year earlier. The increase in the number of investments was driven by the fund increasing in size over the year while the average value per property also increased from £5.8m to £7.4m.

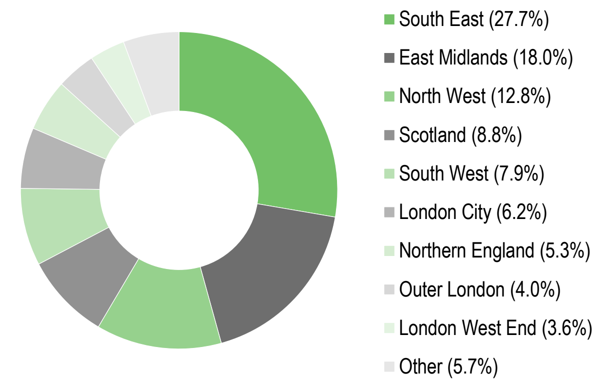
As shown in Exhibit 6, SLI's portfolio provides a differentiated exposure to the UK property market, as represented by the IPD UK Quarterly index, which comprises c 9,600 properties. This can be largely attributed to the manager's property selection as the three main commercial property sectors of retail, office and industrial in which SLI is primarily invested represent over 90% of the index by value. From a regional perspective, SLI's income focus leads it to invest principally outside of London where recent strong capital appreciation has reduced average yields to below the level that SLI requires to maintain a covered dividend.

**Exhibit 6: Portfolio sector allocation at 30 June 2015**




Source: SLI, Edison Investment Research

**Exhibit 7: Portfolio split by region at 30 June 2015**




Source: SLI, Edison Investment Research

As shown in Exhibit 8, over the 12 months to 30 June, there has been a marked shift in the portfolio's exposure with a 20pp reduction in the office sector largely balanced by a 17pp increase in the industrial sector. Similar to a year earlier, the majority of SLI's retail sector exposure is through retail warehouses rather than high street retail premises.

**Exhibit 8: Portfolio exposure by IPD sub-sector as at 30 June 2015**

| | End-June 2015 | End-June 2014 | Change |
|---|---|---|---|
| Industrials - Rest of UK | 30.5 | 17.0 | 13.5 |
| Offices - South East | 18.8 | 30.0 | (11.2) |
| Retail Warehouses | 16.4 | 14.0 | 2.4 |
| Offices - Rest of UK | 9.9 | 15.0 | (5.1) |
| Industrials - South East | 8.9 | 5.0 | 3.9 |
| Offices - Central London | 9.8 | 13.0 | (3.2) |
| Std Retail - South East | 5.7 | 6.0 | (0.3) |
| | **100.0** | **100.0** | |

Source: Standard Life Investment Property Income Trust, Edison Investment Research

## Recent investment activity

The manager has sought to grow the trust since mid-2014 through making attractive purchases funded by capital raisings but has also remained active in managing the overall portfolio, selling a number of assets expected to see lower returns or where there was an opportunity to realise a capital gain. During 2014, 12 properties were purchased for a total £94.2m while five properties were sold for £30.5m including SLI's largest investment, a logistics unit in Bolton let to Tesco with a lease expiry in 2016, to avoid expiry risk and capture profit.

Although the overall portfolio has increased in value over the last 12 months, there has been no clear trend of increasing lot size for new investments with the manager preferring to focus on prospective returns. While 2015 started with a £15.8m investment, subsequent purchases have ranged from £2.9m to £13.2m, with seven purchases made in 2015 for a total of £49.5m. Recent sales have generally been lower-value assets with eight properties sold for between £1.3m and £5.5m in 2015, totalling £24.8m.

## Lease expiry/break profile

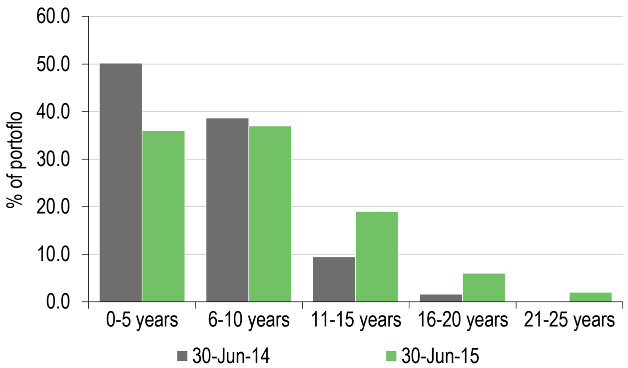
SLI's property portfolio has an average lease length to earliest of lease end or break option of 7.1 years, which the manager reports as similar to the IPD index (excluding leases over 35 years). An active approach is taken to managing lease expiries, and as at end-June 2015, 73% of 2015 income at risk through lease expiry or break had been secured and 68% of the income at risk in 2016 had also been secured. As the occupational market improves and supply though development remains limited, the manager sees increasing opportunity to add value through lease events – either renewing existing leases, or taking accommodation back to refurbish and then re-let.

**Exhibit 9: Portfolio yield characteristics**

| | 30 June 2015 | 30 June 2014 |
|---|---|---|
| ERV pa (£m) | 20.9 | 14.0 |
| Area sq ft (m) | 2.65 | 1.45 |
| Average ERV per sq ft | 7.88 | 9.63 |
| Initial yield | 5.78% | 7.50% |
| Reversionary yield | 5.02% | 5.33% |

Source: SLI, Edison Investment Research

**Exhibit 10: Portfolio lease expiry/break profile**



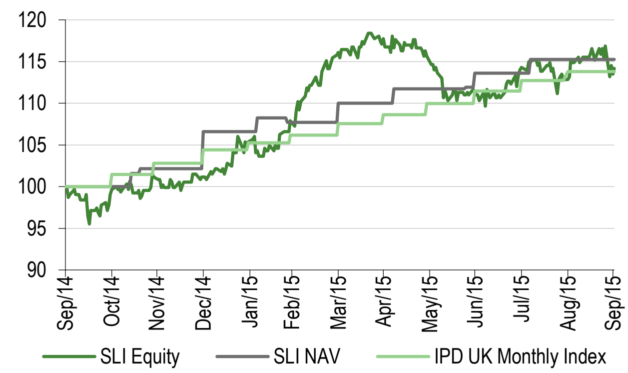

Source: SLI, Edison Investment Research

## Performance: Outperforming over five years

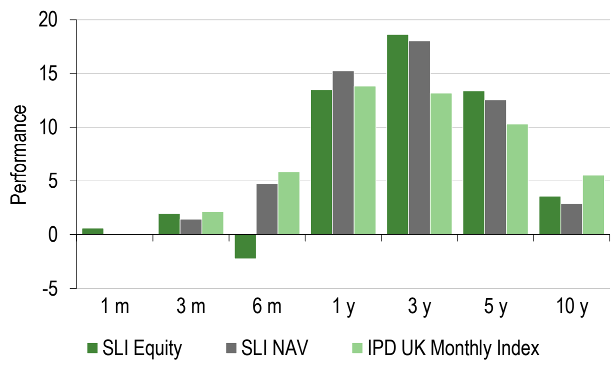
As shown in Exhibit 12, SLI's share price and NAV total return performance have been ahead of the IPD UK Monthly index over one, three and five years, although somewhat lower over 10 years. Exhibit 11 shows that SLI's NAV has followed a steady upward path over the last 12 months, similar to that of the IPD UK Monthly index, while SLI's share price has followed a more variable path to deliver a similar return over the period. Exhibit 13 illustrates SLI's considerable underperformance of the IPD UK Monthly index during the 2008 global financial crisis largely resulting from the effect of gearing as well as the revaluation of an interest rate swap due to the fall in interest rates. Investment style was also a contributory factor with secondary underperforming prime property during the period. Subsequent performance has diverged more modestly from the index with SLI recording 17% outperformance of the index since the post-crisis low. SLI's most recent period of sustained outperformance from May 2013 to date has been its strongest during the last 10 years.

**Exhibit 11: Investment trust performance to 30 September 2015**

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




Price, NAV and benchmark total return performance (%)



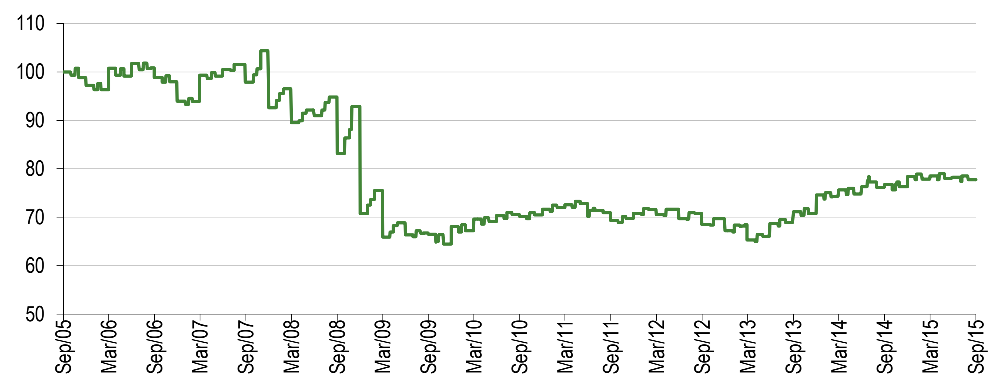

Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Index performance is sterling adjusted. Three, five and 10-year performance figures annualised.

**Exhibit 12: Share price and NAV total return performance, versus indices (percentage points)**

| | One month | Three months | Six months | One year | Three years | Five years | 10 years |
|---|---|---|---|---|---|---|---|
| Price relative to IPD UK Monthly | 0.6 | (0.1) | (7.6) | (0.3) | 15.2 | 14.8 | (17.0) |
| NAV relative to IPD UK Monthly | 0.0 | (0.7) | (1.0) | 1.3 | 13.4 | 10.8 | (22.3) |
| Price relative to FTSE All-Share | 3.4 | 8.1 | 5.3 | 16.2 | 35.5 | 35.5 | (17.5) |
| NAV relative to FTSE All-Share | 2.8 | 7.6 | 12.9 | 18.0 | 33.4 | 30.7 | (22.7) |
| Price relative to FTSE EPRA/NAREIT UK | (0.8) | (3.3) | (5.4) | (9.3) | (9.5) | (14.9) | 2.8 |
| NAV relative to FTSE EPRA/NAREIT UK | (1.4) | (3.8) | 1.3 | (7.9) | (10.8) | (17.9) | (3.7) |

Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Data to end-September 2015. Geometric calculation.

**Exhibit 13: NAV total return performance relative to IPD UK Monthly index over 10 years**



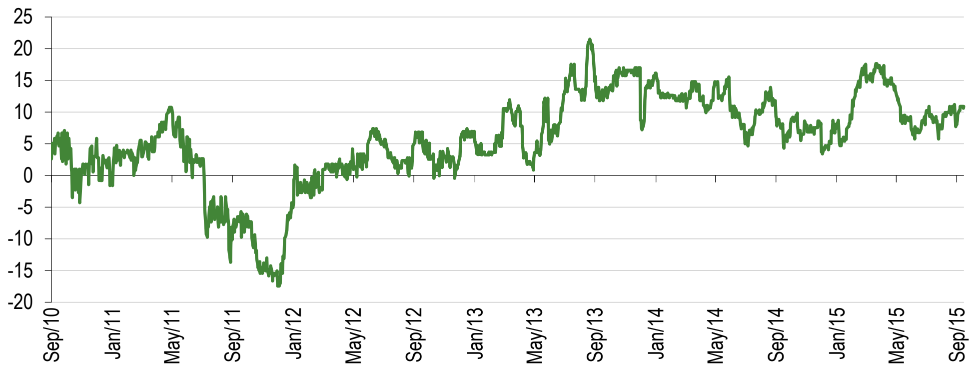

Source: Standard Life Investment Property Income Trust, Thomson Datastream, Bloomberg, Edison Investment Research

## Discount: Shares continue to trade at a premium

As illustrated in Exhibit 14, SLI's share price has ranged between a 17% discount to NAV and a 21% premium to NAV over the last five years averaging at a 5.7% premium. During the period from August 2011 to February 2012, which followed the news that one of SLI's tenants, Focus DIY group, was entering administration, the shares traded at a discount to NAV. Apart from this period, SLI's shares have mostly traded at a premium to NAV and have not traded at a discount since December 2012. The premium currently sits slightly higher than the 9.7% three-year average.

The board believes that long-term investment performance is a key driver to the level of the premium or discount. While SLI has annually renewed authority to issue or buy back shares with a view to trying to limit short-term volatility in the premium or discount, no shares have been repurchased during the last 10 years and allotments have been sporadic with new share issues primarily to raise capital (see Exhibit 1).

**Exhibit 14: Share price premium / discount to NAV over five years (%)**




Source: Thomson Datastream, Edison Investment Research. Note: Positive values indicate a premium, negative values a discount.

## Capital structure and fees

SLI has 288.4m shares outstanding following the issue of a total 127.7m shares, representing a 79% increase in issued share capital, since June 2014.

In early 2014, the board indicated that it intended to seek opportunities to increase the size of the trust, provided that it was in the long-term interests of existing shareholders, and a prospectus for the issue of up to 100m shares was published in July 2014. £36.5m of capital was raised in an initial placing with a further £25.3m raised through subsequent issues during 2014 and £34.8m in the first half of 2015. In each case, the shares were issued at a 5% premium to NAV. These share issues fully utilised SLI's capacity to raise equity under both the prospectus and disapplication of pre-emption rights authorities. The current portfolio acquisition proposal includes an equity raising of up to £100m (equivalent to c 40% of the current issued share capital) subject to shareholder approval at EGM.

The board places importance on raising new equity at a reasonable premium to NAV so that purchase costs do not negatively affect returns for existing shareholders. It is also considered important when raising equity in a rising market to minimise the potential for performance dilution that may occur if the scale of the raising leads to capital remaining uninvested for an extended period. As well as the potential dilution of capital returns, this could affect the trust's ability to maintain a covered dividend.

Research by the manager suggests that at c 30% loan to value (LTV), gearing is accretive through the property cycle whereas at 40-50% LTV, gearing is only accretive during an upswing. As the manager is not seeking to call the property cycle, gearing is maintained at around the 30% LTV level while the limit imposed by the board is 45% LTV. SLI has a fully drawn £84m debt facility with RBS, expiring in December 2018. The maximum LTV under the facility is 65% (reducing to 60% after December 2016), which compares to SLI's 29.2% gross LTV at 30 June 2015. SLI has taken out an interest rate swap over the full amount, with an all-in cost of debt of 3.8%.

A new tiered management fee structure was introduced in 2014, replacing the flat fee of 0.75% of total assets (with a reduced 0.20% fee on cash holdings above 10% of total assets) that had applied since the end of 2008. From 1 August 2014, the fees changed to 0.75% of total assets up to £200m, 0.70% of total assets between £200m and £300m and 0.65% of total assets in excess of £300m. No performance fees are paid. For FY14, ongoing charges were 1.6% of total assets (c 2.1% of net assets) and reduced to 1.4% of total assets (c 1.8% of net assets) in H115 due to the combined benefit of a lower fee structure and increased assets.

## Dividend policy

A key objective for SLI is to provide an attractive, sustainable level of income to shareholders. The board seeks to pay a covered dividend, thus rental income received in each period directly drives SLI's ability to make a dividend payment and the portfolio income yield has to be maintained at a level sufficient to ensure the dividend is covered. Over the five years to end-December 2014, SLI's portfolio has a consistently delivered a higher income yield than the wider property market as reflected by the IPD monthly index.

On 1 January 2015, SLI became resident in the UK for tax purposes and will comply with the UK REIT regime. REITs do not pay UK corporation tax in respect of rental profits and chargeable gains relating to the property rental business and must distribute at least 90% of their real estate profits as property income distributions (PIDs). Certain categories of shareholder may be able to receive the PID element of their dividends gross, without deduction of withholding tax, including UK companies, charities, local authorities, UK pension schemes and managers of PEPs, ISAs and Child Trust Funds. Where SLI pays an ordinary dividend, in addition to the PID, this will be treated in the same way as dividends from non-REIT companies.

Having maintained a flat quarterly dividend since the third quarter of 2011, the board increased the payment by 2.5% to 1.161p per share in the first quarter of 2014 to reflect a combination of lower interest costs, improving outlook for rents and lower void rates. While the quarterly dividend remains at this level, the first three payments in 2015 were treated as PIDs and paid net or gross of UK tax dependent on whether the registered shareholder had completed an HMRC declaration.

## Peer group comparison

Exhibit 15 shows a comparison of SLI with a selected peer group of closed-ended funds directly investing in UK property with a market cap of over £100m and a track record of more than one year. SLI's NAV total return is ahead of the peer group average over three and five years, while lower than the average over one and 10 years. SLI's Sharpe ratios over one and three years are lower than the peer group average but above one indicating positive risk-adjusted returns. The majority of the peer group's shares are trading at a premium to NAV and SLI's premium is towards the higher end of the range. Even though it is one of the smaller funds in the peer group, SLI's ongoing charge is only slightly above the peer group average and should reduce in 2015 due to the growth of the fund. Excluding GCP Student Living, which is highly leveraged, SLI's gearing is above average for the peer group but not exceptional. SLI's income focus is reflected in its 5.4% dividend yield, which is one of the highest in the peer group.

**Exhibit 15: UK direct property closed-ended sector selected peer group as at 14 October 2015**

| % unless stated | Market Cap £m | NAV TR 1 Year | NAV TR 3 Year | NAV TR 5 Year | NAV TR 10 Year | Sharpe 1y (NAV) | Sharpe 3y (NAV) | Discount (ex-par) | Ongoing Charge | Perf Fee | Net Gearing | Dividend yield (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Standard Life Inv. Prop. Inc. | 249.5 | 8.1 | 48.3 | 59.2 | 31.4 | 1.6 | 1.4 | 10.8 | 2.38 | No | 135 | 5.4 |
| Custodian REIT Plc | 201.4 | 9.2 | | | | 2.3 | | 3.9 | 2.03 | No | 112 | 5.8 |
| Empiric Student Property | 327.3 | 8.7 | | | | 1.6 | | 4.7 | | No | 104 | 5.6 |
| F&C Commercial Property | 1,131.9 | 13.5 | 52.6 | 81.5 | 107.6 | 2.9 | 2.7 | 10.4 | 1.14 | Yes | 124 | 4.3 |
| F&C UK Real Estate Investments | 238.6 | 12.1 | 46.7 | 50.4 | 57.0 | 1.8 | 1.7 | 2.0 | 1.99 | Yes | 142 | 4.9 |
| GCP Student Living | 151.7 | 25.0 | | | | 2.5 | | 9.6 | 4.13 | No | 375 | 4.1 |
| LXB Retail Properties | 165.7 | 3.9 | 24.8 | 48.3 | | 1.3 | 1.0 | (4.6) | 2.51 | Yes | 101 | |
| Picton Property Income | 387.5 | 19.0 | 59.9 | 50.9 | | 2.6 | 2.0 | 2.7 | 4.30 | No | 145 | 4.6 |
| Primary Health Properties | 467.6 | 17.3 | 28.7 | 51.5 | | 2.1 | 1.2 | 28.3 | 1.89 | Yes | 105 | 4.8 |
| Schroder Real Estate Invest | 305.9 | 12.2 | 27.1 | 36.9 | (0.4) | 2.6 | 0.8 | (0.6) | 2.73 | No | 128 | 4.2 |
| Tritax Big Box | 842.9 | 22.3 | | | | 2.2 | | 6.3 | 1.10 | No | 138 | 4.9 |
| UK Commercial Property | 1,114.8 | 10.7 | 45.9 | 59.6 | | 3.0 | 2.4 | 1.5 | 1.48 | No | 120 | 4.3 |
| **Average** | **465.4** | **13.5** | **41.7** | **54.8** | **48.9** | **2.2** | **1.7** | **6.3** | **2.33** | | **144** | **4.8** |
| **Median** | **316.6** | **12.1** | **46.3** | **51.2** | **44.2** | **2.2** | **1.5** | **4.3** | **2.03** | | **126** | **4.8** |

Source: Morningstar, Edison Investment Research. Note: TR=total return. Sharpe ratio is a measure of risk-adjusted return. The ratios shown are calculated by Morningstar for the past 12- and 36-month periods by dividing a fund's annualised excess returns over the risk-free rate by its annualised standard deviation. Net gearing is total assets less cash and equivalents as a percentage of net assets.

## The board

SLI's board comprises four independent non-executive directors. Former chief investment manager of Standard Life, Richard Barfield (appointed November 2003) took over as chairman in May 2014 following the retirement of Paul Orchard-Lisle after more than 10 years' service. Barfield has stated his intention to retire from the board at the June 2016 AGM and Robert Peto has accepted the board's invitation to succeed him as chairman. A search has also been started for a new UK-based non-executive director. Appointed a director in May 2014, Peto is a former member of the Bank of England Property Advisory Group and is currently chairman of DTZ Investment Management and GCP Student Living as well as a director of Lend Lease Europe GP. Senior independent director, Sally-Ann Farnon (appointed July 2010) is a former KPMG partner and is currently a director of Ravenscroft, Breedon Aggregates, Dexion Absolute, HICL Infrastructure and Threadneedle UK Select Trust. Huw Evans (appointed April 2013) is a chartered accountant with extensive financial advisory experience and has served on the board of a number of Guernsey-based funds. A director since November 2003, Shelagh Mason retired from the board in December 2014.