

UK Commercial Property Trust

Sustainable income with reversionary upside

UK Commercial Property Trust (UKCM) is one of the largest UK real estate investment companies and aims to be among the lowest risk in the sector, reflected by its low level of gearing. The portfolio was repositioned in 2015 and UKCM has outperformed its benchmark since March 2016. In recent months, UKCM has moved underweight the weaker shopping centre subsector, as well as making its first hotel investment, which increased the proportion of RPI-linked and long-dated income to 15.2%. The manager sees significant reversionary potential for the portfolio, with its estimated rental value (ERV), based on market rents, indicating c 20% upside to rental income, giving the prospect of near-term earnings growth and potentially providing scope for future dividend increases.

12 months ending	Share price (%)	NAV (%)	Benchmark (%)	IPD UK Monthly Index (%)	UK Real Estate Index (%)	FTSE All-Share (%)
31/12/13	25.7	13.1	10.7	11.0	23.8	20.8
31/12/14	20.4	19.5	17.4	19.5	21.3	1.2
31/12/15	0.8	9.0	12.8	13.9	12.1	1.0
31/12/16	3.8	3.8	3.6	2.6	(8.5)	16.8
31/12/17	9.4	12.1	10.6	11.2	12.7	13.1

Source: Thomson Datastream. Note: 12-month rolling discrete total return performance in sterling terms up to last reported NAV date.

Investment strategy: Sustainable income focus

UKCM aims to generate a sustainable income from a prime UK commercial property asset portfolio. The portfolio is constructed using a bottom-up approach, but broad sector and regional allocations are aligned with the property team's market views. The manager prefers to hold resilient assets, such as multi-let industrial properties, that reduce exposure to individual tenants, thus reducing void risk. Drawing on the local market knowledge of all managers in Aberdeen Standard Investments' property investment team, the manager seeks to add value by identifying market developments before they are reflected in pricing, and actively managing the portfolio to improve the rental value of properties.

Market outlook: Rental income key driver of returns

UK GDP growth is expected to slow modestly in 2018 and, with the uncertainty created by Brexit negotiations, the potential for the UK property market to see further capital gains over the next 12 months appears relatively limited. However, UK property assets currently offer a c 5% income return, which compares favourably with the c 1% yield on UK government bonds. Also, as a real asset with rental income subject to upward reviews, property can provide a measure of inflation protection, which may add to the appeal of the asset class to those income-seeking investors with particular concerns about capital preservation.

Valuation: Discount has recently widened

UKCM's shares have largely traded between a 10% premium to NAV and a 10% discount over three years and broadly within a narrower 5% premium to 5% discount range over one year. The share price has recently widened to a 6.7% discount to EPRA NAV, which compares with its 1.2% one-year average discount.

Investment companies

28 February 2018

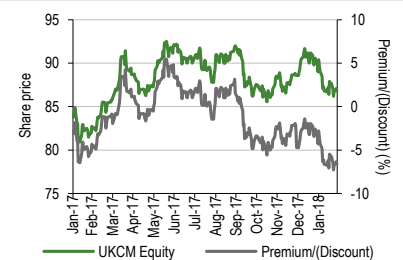
Price 86.8p
Market cap £1,128m
AUM £1,445m

NAV* 92.8p
Discount to NAV 6.5%
NAV** 93.0p
Discount to NAV 6.7%

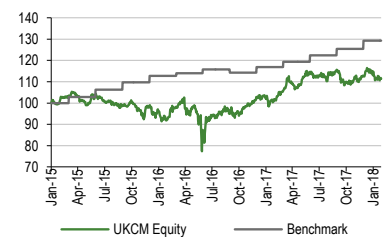
*IFRS NAV. **EPRA NAV. Including income as at 31 Dec 2017.

Yield 4.2%
Ordinary shares in issue 1,299.4m
Code UKCM
Primary exchange LSE
AIC sector Property Direct - UK
Benchmark MSCI IPD Balanced Monthly & Quarterly Funds Index

Share price/discount performance



Three-year performance vs index



52-week high/low 92.5p 82.3p
NAV* high/low 92.8p 87.4p

*Including income.

Gearing

Gross loan to value* 17.2%
Net loan to value* 12.8%

*As at 31 December 2017.

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Exhibit 1: Company at a glance

Investment objective and fund background

UKCM's objective is to provide ordinary shareholders with an attractive level of income, together with the potential for capital and income growth, by investing in a diversified UK commercial property portfolio. Investments primarily comprise direct holdings in the industrial, retail and office sectors, and UKCM also has some exposure to the smaller leisure and hotel sectors. The preferred lot size range is £20m to £70m, with a focus on investments between £30m and £50m.

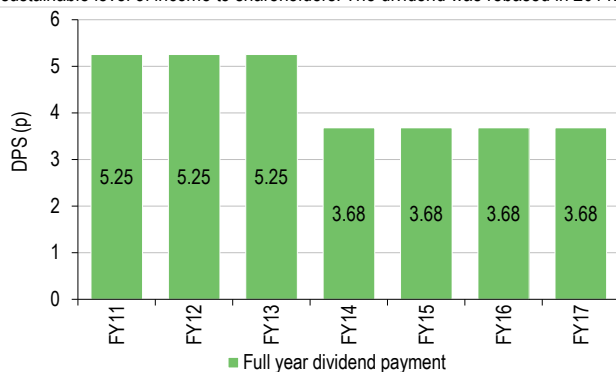
Recent developments

- 1 February 2018: Full-year results to 31 December 2017 – NAV total return +12.2% vs +10.7% benchmark return; 0.92p dividend announced for Q417 vs 0.92p for Q416.
- 1 February 2018: Robert Fowlds appointed to board, with effect from 1 April 2018.
- 24 January 2018: Sale of three Shrewsbury shopping centres for c £51m.
- 1 January 2018: Margaret Littlejohns joined the board as a director.
- 16 November 2017: £32m forward purchase of Maldron Hotel in Newcastle city centre, UKCM's first acquisition in the hotel sector.
- 26 October 2017: Quarterly results to 30 September 2017 – NAV total return +2.7% vs +2.5% benchmark return; 0.92p dividend announced for Q317 vs 0.92p for Q316.

Forthcoming		Capital structure		Fund details	
AGM	June 2018	Ongoing charges	1.4% (FY16)	Group	Aberdeen Standard Investments
Final results	April 2018	Gross gearing	17.2% loan to value	Manager	Will Fulton
Year end	31 December	Annual mgmt fee	0.65% of total assets	Address	1 George Street, Edinburgh EH2 2LL
Dividend paid	May, Aug, Nov, Feb	Performance fee	None	Phone	0345 600 2268
Launch date	20 September 2006	Company life	Indefinite	Website	www.ukcpt.co.uk
Continuation vote	2020 and seven-yearly	Loan facilities	£250m at 2.89%		

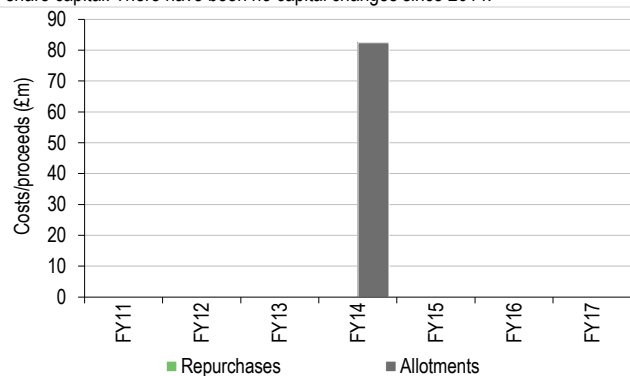
Dividend policy and history

UKCM pays dividends quarterly. A key objective is to provide an attractive sustainable level of income to shareholders. The dividend was rebased in 2014.

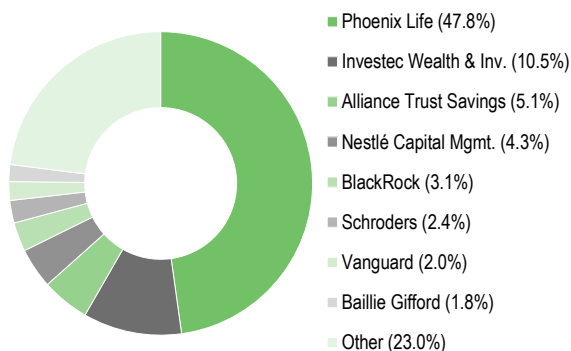


Share buyback policy and history

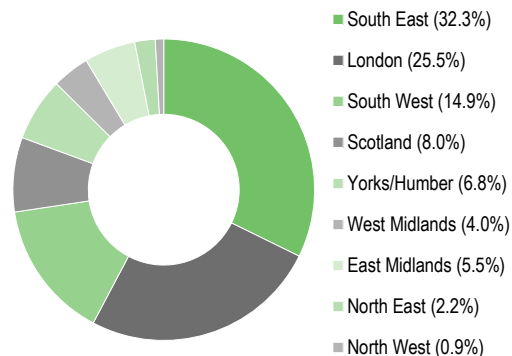
UKCM has authority to purchase up to 14.99% and allot up to 10% of its issued share capital. There have been no capital changes since 2014.



Shareholder base (as at 12 February 2018)



Portfolio exposure by region (as at 31 December 2017*)



Top 10 assets by market value (as at 31 December 2017)

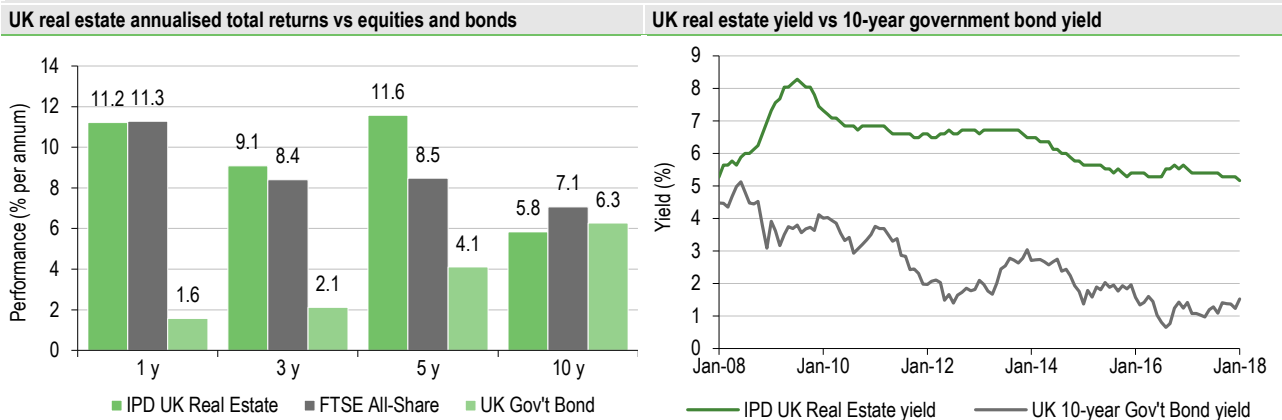
Company	Location	Sector	Value range (£m)	
			31 December 2017	31 December 2016
Ventura Park	Radlett (North M25)	Industrial	70-100	70-100
Junction 27 Retail Park	Birstall, Leeds	Retail warehouse	70-100	50-70
15 Great Marlborough Street	London	Office – West End	50-70	50-70
Great Lodge Retail Park	Tunbridge Wells	Retail warehouse	50-70	50-70
Ocado Distribution Unit	Hatfield	Distribution warehouse	50-70	50-70
The Rotunda Leisure Scheme	Kingston upon Thames	Leisure	50-70	50-70
Kew Retail Park	Richmond, London	Retail warehouse	50-70	50-70
The Parade	Swindon	Shopping centres	50-70	50-70
Dolphin Estate	Sunbury-on-Thames	Industrial	50-70	30-50
Hannah Close	Neasden	Industrial	30-50	30-50

Source: UK Commercial Property Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *Portfolio data as at end-December 2017, adjusted for sale of Shrewsbury shopping centres (c 3.3% of portfolio) in January 2018.

Market outlook: Rental income likely to drive returns

As shown in Exhibit 2 (left-hand chart), UK real estate generated a strong return over one year to end-January 2018, closely matching the performance of UK equities, as capital values recovered from the weakness in the second half of 2016 following the UK's vote to exit the EU, with both asset classes substantially outperforming UK government bonds.

Exhibit 2: UK real estate returns vs equities and bonds over 10 years



Source: UKCM, Thomson Datastream, Bloomberg, Edison Investment Research. Note: Data to 31 January 2018.

With five-year real estate returns significantly higher than 10-year returns and UK GDP growth expected to slow modestly in 2018, against a backdrop of rising global economic growth and the uncertainty created by Brexit negotiations, the potential for the UK property market to see further capital gains over the next 12 months appears more limited. However, as illustrated in Exhibit 2 (right-hand chart), UK property assets currently offer a materially higher income return than UK government bonds and property can also provide a certain degree of inflation protection, given that it is a real asset which generates an income stream that is generally subject to regular upward reviews. This is likely to increase the appeal of property as an asset class for income-seeking investors who have a particular focus on capital preservation.

Fund profile: Diversified fund focused on prime assets

Launched in September 2006, UKCM is a Guernsey-registered, LSE-listed, closed-ended investment company that aims to provide an attractive level of income to shareholders with the potential for capital and income growth from a diversified UK commercial property portfolio. UKCM invests directly, primarily in the industrial, retail and office sectors, but also has exposure to the leisure and hotel sectors. The portfolio is relatively concentrated (42 properties at end-December 2017), with a £20m to £70m preferred lot size range and a focus on investments between £30m and £50m. Performance is benchmarked against the MSCI Investment Property Databank (IPD) Balanced Monthly & Quarterly Funds index, a direct property fund peer group index, with the IPD Monthly index also referenced as a measure of the underlying UK commercial property market.

UKCM has been managed by Aberdeen Standard Investments (formerly Standard Life Investments) since July 2014, when it acquired Ignis Asset Management, UKCM's former investment manager. After Will Fulton's appointment as lead manager in 2015, UKCM's portfolio was aligned with the new manager's investment strategy, resulting in c 25% of the portfolio by value being sold and the proceeds reinvested. The main effect was an increase in industrial sector exposure and a reduction in retail sector exposure. The manager focuses on property assets considered as prime due to their location, build quality or tenant profile, and aims to acquire properties at attractive prices, often when they are not viewed as prime assets by the wider market.

A final decision on converting UKCM to a UK REIT (real estate investment trust) is expected in the second quarter of 2018, with conversion likely to be in the summer. This reflects proposed changes to tax legislation, which would limit interest deductions for non-UK registered property companies, and likely result in UKCM paying corporation tax (currently 19%) on net rental profits from 2020.

The fund manager: Will Fulton

The manager's view: Prime assets provide best opportunities

Will Fulton acknowledges the heightened macro uncertainty, which is leading to investors becoming more risk averse, but points out that lending to the property sector is at a lower level than before the 2008 financial crisis, liquidity remains reasonable, development is relatively restrained by historical standards and vacancy rates are below average levels in most markets. These factors support a positive outlook for the sector, but he sees rental income as the key driver of near-term returns and believes that prime/good-quality assets, with stronger tenants on longer leases, should provide the best opportunities in the anticipated weaker economic environment in 2018. Fulton emphasises his aim to hold resilient properties, such as multi-let industrial assets, which lowers tenant and void risk. He highlights that the portfolio's current 7.6% void rate mainly relates to higher-quality, sought-after industrial assets at Ventura Park in Radlett and Magna Park in Lutterworth, which he is confident of re-letting. The retail sector saw the weakest growth in 2017 and Fulton's view that it continues to face oversupply and structural headwinds in less strong locations was reflected by UKCM moving underweight via the sale of three Shrewsbury shopping centres to the borough council.

UKCM acquired its first hotel asset in November 2017, via £32m (net of finance) forward funding to develop the Maldron Hotel in Newcastle. Fulton highlights the investment manager's extensive experience in this subsector and the particular appeal of this investment, which increases the proportion of UKCM's income that is RPI-linked and long-dated from 13.3% to 15.2%, with a 5.4% yield on cost. The hotel has been pre-let to Dalata, Ireland's largest hotel operator, on a 35-year lease, extending the portfolio's weighted average lease length from 8.3 years to 8.6 years.

Fulton is keen to emphasise UKCM's significant reversionary potential, with the portfolio's estimated rental value (ERV) reflecting market rents being received across all portfolio properties, equating to a reversionary yield of 5.6%, which compares with the portfolio's 4.5% net initial yield. He sees this as latent upside to the portfolio's rental income, which should be realised over time, giving the prospect of earnings growth and potentially providing enhanced dividend cover.

Asset allocation

Investment process: Active portfolio and property management

The manager focuses on institutional-grade, income-producing commercial property assets. There is no restriction on regional exposures within the UK or property sector weightings but, to manage risk, the following investment limits apply:

- No single property shall at the time of acquisition exceed 15% of gross assets.
- Borrowings will not exceed 65% of gross assets – the board sets the gearing range within which the manager may operate and maximum gearing is currently set at 25% of gross assets.

Broad sector and regional allocations are influenced by the top-down market views of Aberdeen Standard Investments' property research and strategy team. Individual property investment decisions take into account future capital and income growth potential, sector and geographic prospects, yield, lease length, covenant strength and asset management opportunities, drawing on the local market knowledge of all managers in the wider property investment team. Portfolio turnover has historically been relatively low and the manager does not see this changing.

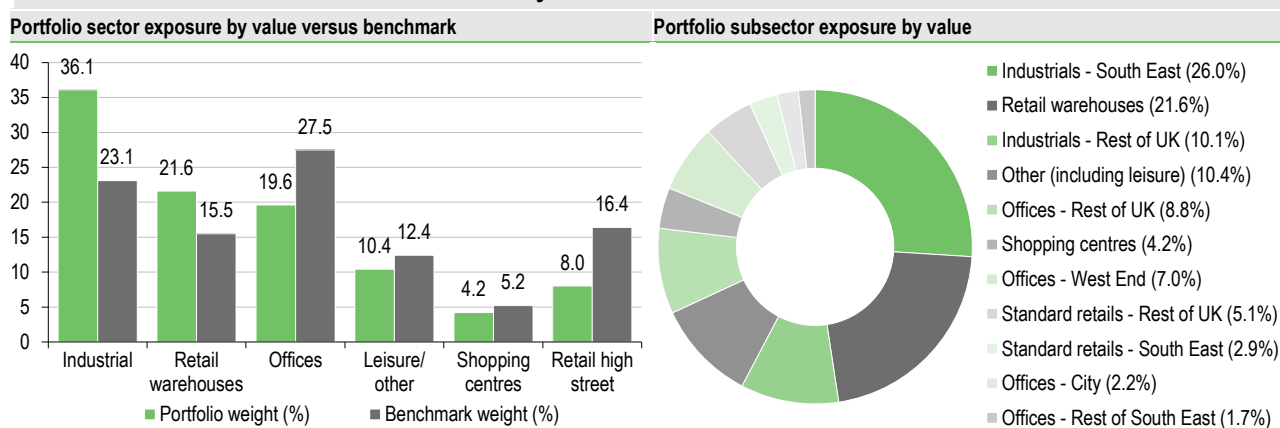
Regular contact is maintained with property agents to stay aware of investment opportunities and potential buying interest in UKCM's existing portfolio properties. Due to the investment manager's size and reputation, the team is regularly presented with private, off-market deals. When any new property is considered of interest, the manager conducts an initial assessment of the building, its location and potential returns, followed by a site visit if the preliminary screening is positive.

The manager seeks to identify market developments before they are reflected in pricing, when acquiring and selling assets, and asset management activity to improve the rental value of properties is also a key focus. This can involve regearing/extending a lease early or refurbishment.

Current portfolio positioning

UKCM's portfolio comprised 42 properties at end-2017, well-diversified by geography, sector and tenant, with a significant overweight in the industrial sector (Exhibit 3 left-hand chart). The sale of three Shrewsbury shopping centres, agreed in December 2017 and completed in January 2018, moves UKCM's shopping centre subsector exposure below that of the benchmark, while it remains overweight in retail warehouses. Similar to the benchmark index, UKCM's largest regional exposures are the South East and London, which together account for over 50% of the portfolio value (see Exhibit 1), but London is UKCM's greatest underweight, 7.2pp below the benchmark. UKCM's largest overweight exposure is to the South West (+8.2pp), while it has a significant 6.2pp underweight to the North West and 4.8pp overweight to the South East. Exhibit 3 (right-hand chart) shows an analysis of portfolio exposure by subsector.

Exhibit 3: Portfolio sector and subsector analysis as at 31 December 2017*



Source: UK Commercial Property Trust, Edison Investment Research. Note: *Portfolio data as at end-December 2017, adjusted for sale of Shrewsbury shopping centres (c 3.3% of portfolio) in January 2018. Latest available benchmark data as at 30 September 2017.

Exhibit 4: Top 10 tenants by annual rent

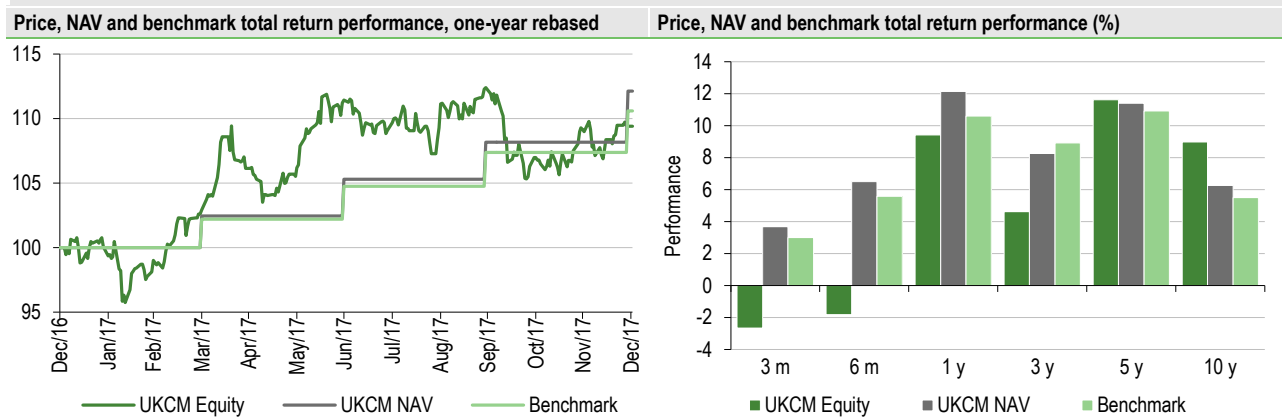
Tenant group	IPD risk band	% of income		
		31 Dec 2017	31 Dec 2016	Change (pp)
B&Q	Negligible	5.8	5.8	0.0
Public sector	Negligible	4.7	4.8	(0.1)
Ocado Retail	Low	3.9	3.9	0.0
Sainsbury's (incl Argos)	Negligible	3.8	3.8	0.0
Sony Centre Entertainment	Negligible	3.1	4.6	(1.5)
Marks & Spencer	Negligible	3.1	3.1	0.0
DSG Retail	Negligible	2.9	2.9	0.0
Odeon Cinemas	Low/medium	2.7	2.7	0.0
Total E&P UK	Negligible	2.7	2.7	0.0
Cineworld Group	Negligible	2.6	2.5	0.1
		35.3	36.8	

Source: UK Commercial Property Trust, Edison Investment Research

UKCM's portfolio included 343 tenancies at end-December 2017, with the top 10 tenants providing 35.3% of rental income and only one tenant accounting for more than 5% of income, as shown in Exhibit 4. The majority of UKCM's tenants are classified as negligible to low risk.

Performance: Outperforming over long and short term

Exhibit 5: Investment company performance to 31 December 2017



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

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

	Three months	Six months	One year	Three years	Five years	10 years
Price relative to benchmark	(5.5)	(7.0)	(1.1)	(11.4)	3.2	38.3
NAV relative to benchmark	0.7	0.9	1.4	(1.8)	2.2	7.6
Price relative to IPD UK Monthly Index	(5.8)	(7.5)	(1.6)	(11.9)	0.5	36.9
NAV relative to IPD UK Monthly Index	0.3	0.4	0.8	(2.4)	(0.5)	6.5
Price relative to UK Real Estate Index	(10.1)	(9.3)	(2.9)	(0.9)	(0.2)	75.1
NAV relative to UK Real Estate Index	(4.2)	(1.7)	(0.5)	9.8	(1.1)	36.2
Price relative to FTSE All-Share	(7.3)	(8.4)	(3.3)	(14.1)	6.3	28.0
NAV relative to FTSE All-Share	(1.2)	(0.7)	(0.9)	(4.9)	5.3	(0.5)

Source: Thomson Datastream, Bloomberg, Edison Investment Research. Note: Data to end-September 2017. Geometric calculation.

As shown in Exhibit 6, UKCM's NAV total return has outperformed its MSCI IPD Balanced Monthly & Quarterly Funds Index benchmark over one, five and 10 years to end-December 2017, while underperforming over three years. Although relatively weak more recently, UKCM's share price total return is markedly stronger than the benchmark over 10 years, corresponding with the discount narrowing from c 24% to c 5% over the period. Exhibit 5 illustrates the relative weakness of the share price performance since September 2017, while the NAV has progressed higher at a faster pace than the benchmark. UKCM has delivered relatively steady outperformance of its benchmark since March 2016, following the portfolio repositioning in 2015.

Discount: Recent widening

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



Source: Thomson Datastream, Edison Investment Research

As illustrated in Exhibit 7, other than a brief sharp widening of the discount around the time of the UK's EU referendum in June 2016, UKCM's shares have largely traded between a 10% premium to NAV and a 10% discount over the last three years. The discount steadily narrowed and moved to a 5% premium over the 12 months to June 2017, with the share price moving decisively back below NAV in October 2017, and the shares are currently trading at a 6.7% discount to NAV.

Capital structure and fees

UKCM has a single share class, with 1,299.4m ordinary shares in issue. UKCM has annually renewed authority to purchase up to 14.99% and allot up to 10% of its issued share capital, but has not repurchased or issued any shares since 2014, when 61m new shares and 41m treasury shares were issued, with the £82m proceeds funding a number of acquisitions.

The trust has two fully utilised debt facilities: £150m expiring in 2020, and £100m expiring in 2027, with a 2.89% pa blended cost. It also has an undrawn £50m revolving credit facility to provide short-term investment flexibility. The £250m debt equates to 17.2% gross loan to value at end-December 2017, while net loan to value was 12.8%. The £150m facility has an associated interest rate swap (swapping the facility's variable rate for a fixed rate of 1.30% pa), which had a fair value liability of £2.1m as at end-December 2017.

UKCM pays a quarterly management fee at a rate of 0.65% pa of total assets and the investment manager is also entitled to a £0.1m pa administration fee. No performance fee is payable. Including direct property costs, the FY16 ongoing charge was 1.4% of average net assets, slightly lower than the 1.5% ongoing charge in FY15. Excluding direct property costs, FY16 and FY15 ongoing charges were both 0.9% of average net assets.

Dividend policy and record

UKCM's initial dividend policy was set by the board in 2006 based on an outlook for strong rental growth. However, the 2008 economic downturn lowered rental growth prospects, particularly outside central London, and the quarterly dividend was rebased to a more sustainable level in 2014 (see Exhibit 1). Subsequently, the dividend has been held steady, with 0.92p paid quarterly through to Q417 (to be paid on 28 February 2018), and the 3.68p total annual dividend was 94% covered by revenue earnings in FY15 and FY16. Looking forward, the manager's analysis of UKCM's current portfolio rental income shows significant near- and medium-term reversionary potential (market rents are higher than those being received under current lease terms, in aggregate), which would improve the trust's revenue earnings and provide scope for higher dividend payments.

Peer group comparison

Exhibit 8 shows trusts from the AIC Property Direct – UK sector that have a market cap in excess of £100m and a performance history of at least one year. UKCM is one of the largest trusts in the peer group by market cap and has one of the lowest levels of net gearing. While lower gearing acts to dampen UKCM's performance relative to more highly geared peers in a strong market, which is reflected in its NAV total returns ranking in the lower half of the peer group over three and five years, its performance is similar to the peer group average over one year and it ranks third out of seven trusts over 10 years, which includes the 2008 financial crisis. UKCM's 4.2% yield ranks at the lower end of the peer group, possibly reflecting its focus on prime properties as well as its lower gearing. However, as noted above, UKCM's portfolio has significant reversionary potential, which suggests scope for higher dividend payments over the near and medium term. UKCM's share price

moved from a premium to a discount to NAV in October 2017 and its current discount ranks as the widest in the peer group. UKCM's ongoing charge is one of the lowest in the peer group and no performance fee is payable.

Exhibit 8: Selected UK direct property fund peer group as at 27 February 2018*											
% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR 10 year	Premium/ (discount)	Ongoing charge	Perf. fee	Net gearing	Dividend yield (%)	
UK Commercial Property Trust	1,127.9	12.1	26.9	71.6	83.6	(6.5)	1.4	No	115	4.2	
AEW UK REIT	150.3	11.9					2.8	No	99	8.8	
Custodian REIT	431.7	10.0	24.1				10.9	1.7	No	123	5.6
Ediston Property Investment	236.6	9.1	32.2				0.5	1.7	No	117	5.1
F&C Commercial Property	1,138.3	10.5	32.8	83.2	90.9	0.8	1.0	No	123	4.2	
F&C UK Real Estate Investments	247.9	13.6	24.9	72.7	55.1	(0.6)	1.7	Yes	139	4.9	
Picton Property Income	465.0	14.9	53.3	124.9	40.4	(1.9)	2.5	No	136	4.0	
Primary Health Properties	719.0	17.1	48.9	77.1	98.5	16.6	1.6	Yes	208	4.7	
Regional REIT	372.4	7.5				(4.2)	4.4	Yes	183	7.9	
Schroder Real Estate Investment	324.6	13.4	34.3	63.6	(2.3)	(5.1)	2.5	No	143	4.0	
Secure Income REIT	820.7	14.4	44.6			1.1	1.6	Yes	210	3.9	
Standard Life Inv. Property Income	371.8	14.4	37.8	111.4	55.8	6.2	1.7	No	122	5.1	
Average	533.9	12.4	36.0	86.3	60.3	1.7	1.9		143	5.2	
UKCM rank in peer group	2	7	8	6	3	12	11		11	8	

Source: Morningstar, Datastream, Edison Investment Research. Note: *Performance data to 31 December 2017. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

The board

UKCM has six independent non-executive directors, following the appointment to the board on 1 January 2018 of Margaret Littlejohns, who brings many years' experience in investment and commercial banking, with specific expertise in risk management. She worked for nearly 20 years at Citigroup and is currently chair of Henderson High Income Trust and a director of JPMorgan Mid Cap Investment Trust. Continuing the phased succession of long-serving directors initiated in 2016, John Robertson, who has served on the board since UKCM's launch in 2006, will retire in April 2018. Robert Fowlds, who will join the board on 1 April 2018, brings 35 years' property sector experience, most recently working at J.P. Morgan Cazenove where he led the real estate investment banking team. These changes will be followed by Andrew Wilson standing down from the board at the 2019 AGM, after close to 12 years as a director and two years as chairman, with a new chairman to be selected in due course. The other board members (and dates of appointment) are Ken McCullagh (February 2013), who is CEO of LNC Property Group; Sandra Platts (December 2013), former MD of Kleinwort Benson in Guernsey; and Michael Ayre (February 2016), a Guernsey resident and qualified accountant with a focus on taxation.

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