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Safer harbour REITS: an update

REITs to back as investors come out of lockdown

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Safer harbour REITs: an update

REITs to back as investors come out of lockdown

A number of REITs have the ability to thrive in current market conditions and thereafter. Not only do they hold assets that will remain in strong demand, but they have focus and transparency. The leases and underlying rents are structured in a manner to provide long visibility, growth and security. Hardman & Co defined an investment universe of REITs that we considered provided security and "safer harbours". We introduced this universe with our report published in March 2019: *"Secure income" REITs – Safe Harbour Available*. Here, we take forward the investment case and story. We point to six REITs, in particular, where we believe the risk/reward is the most attractive.

- **2018 and 2019 saw outperformance:** Past-year outperformance in the selected universe is 11.4% (12.9% unweighted), vs. the sector, after 5.7% outperformance over the year to our 2019 report. Despite this and previous outperformance, 5%-6% yields on sustainable dividends remain available, which we consider attractive.

- **Income and transparency:** The REITs' strategies are transparent and geared to sustainable income. 42% of the UK's top 100 quoted shares have announced dividend cuts, and this may well rise to ca.50%. At worst, 20% of the market capitalisation of the REITs listed in this report will cut 2020 dividends. For most, we believe they will rise.

- **Designed for the retail, as well as institutional, investors:** Recent conditions benefit corporates, which provide personal investors with income, and such investors are even more active in the market. Search for income will not abate, and yields available here are at a premium to the wider market.

- **Risks:** COVID-19 conditions generally play to these particular REITs' strengths. They are not GDP-exposed, other than on the margin. Quoted sector (and banking system) gearing is lower, so REITs are far less exposed to treasury management mistakes. There is a solid base, albeit some are having to cut dividends.

- **Investment case:** Investors have rightly been sceptical of real estate during a crisis. In the April share price bounces, there was an initial differentiation favouring defensiveness. Our view is that this will continue, fuelled by the need for income in a world where long interest rates will be "lower for longer". With the right exposure, investors have every reason to expect attractive, positive total returns.

Financial ratings summary of selected REITs

At current prices*	Share price (p)	Change year to date	Historical dividend yield	Price to historical EPRA NAV (x)
Impact Healthcare (IHR)	96	-11.2%	6.5%	0.90
LXi (LXI)	100	-28.6%	5.8%	0.83
Primary Health Properties (PHP)**	158	-0.0%	3.6%	1.47
Residential Secure Income (RESI)	91	-7.1%	5.5%	0.83
Urban Logistics (SHED)**	122	-15.8%	6.3%	0.84
Warehouse REIT (WHR)	103	-6.4%	5.9%	0.97

This table highlights certain REITs we see as of interest. We remain positive on others, outlined in this report.
**Priced as at 18 May 2020; **Hardman & Co client. Source: Hardman & Co Research*

Executive summary

Revisiting "Secure income" REITs

Modest rents, cash transparency – attracting investor inflows

Updating our previous publication

In March 2019, we published an Insight entitled *"Secure income" REITs*, highlighting the safety that some REITs could provide to investors focused on income. It would seem appropriate to revisit the issue today, with volatile markets and scepticism in many investors' minds about the future demand for property.

We believe that some specialist REITs continue to offer comfort to income investors, and recent weakness adds to their attractions.

The investment case

A price dip in a successful cohort

2020 has confirmed "secure" status of many of the REITs we cover

The REITs covered (see page 11) have been designed to provide stable, rising income. Not all have succeeded, but 11 out of the 16 covered are set to avoid a cut (either announced by the Board or as per consensus forecasts), which is a much more resilient situation than that in the wider market or the wider real estate sector, in this most difficult year.

Market background has impacted share prices of successful ones…

We consider ratings attractive. Stock markets and, particularly, the real estate doyens have been weak, and cuts have hit, even in the universe in this report. This has resulted in a valuation landscape that we find particularly attractive, namely:

…which yield 5.4% on progressive dividends

- The average (unweighted) historical dividend yield stands at 5.6%, and the prospective dividend yield is just over 5% after forecasting ca.10% dividend cuts. Those REITs (11 out of the 16 in our secure income basket) where dividends are not expected to be cut yield 5.4% on historical dividends – a surprisingly modest discount to that for the entire basket.

Temporary share price weakness belies ongoing outperformance…

Although share prices have fallen recently and dividend yields are attractive, investors backing this sector are investing in long-term outperformers. This applies to both their operational performance and their stock market performance over past years. Longer-term share price trends in these REITs are strong, absolute and relative:

- The average REIT in this report has generated positive total shareholder returns (TSR) in the past year. These REITS also outperformed in the year ahead of our March 2019 report, rising more than the rise in the wider sector.

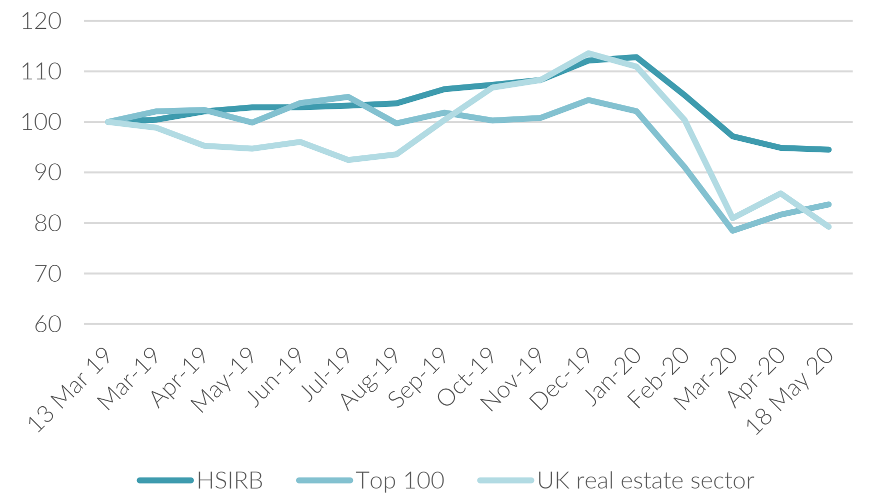
…11.4% (12.9% unweighted) 12-month outperformance

- The 11.4% (weighted), 12.9% (unweighted) outperformance vs. the UK real estate sector in the past year is based on the price moves above, versus a sector down 16.8%. Share prices in our "universe" have therefore fallen slightly.

The Hardman & Co Secure Income REIT Basket (HSIRB)

To help readers understand the resilience of the stocks we have identified, we have created a basket of them and compared this basket's performance to the 100 largest stocks on the London market, and the Real Estate sector. We chart, below, the basket of REITs created in our previous publication, which was priced on 13 March 2019. The basket is weighted and price trends to the pricing of this report, on 18 May 2020, are compared, rebased at 100.

Price performances since previous Hardman & Co sector research



HSIRB: Hardman Secure Income Real Estate Basket
Source: London Stock Exchange, Hardman & Co Research

The chart clearly demonstrates that, although the basket has fallen a little in absolute terms since we published a year ago, it has substantially outperformed both the 100 largest stocks in the market as a whole and the UK real estate sector.

For more detail on how we constructed this chart, please see the section later in this report, entitled *Methodologies, definitions and clarifications*.

The REITs' investment strategy

How do they operate and invest?

While even the successful REITs (those not cutting their dividends) here yield far more than the stock market as a whole, their prospects are resilient. We outline in this report how the REITs' portfolios are successfully constructed for secure growth:

- This is achieved through a transparent, focused strategy.
- Most REITs offer end-tenants clear value-for-money rent levels.
- The 14.1-year average WAULT (weighted average unexpired lease term) is lengthy.
- The value inherent in the rents and the overall strong lessee covenants mean the rent progression should be predictable, affordable and consistently positive.
- Excluding the student accommodation REITs, ca.75% of the leases are indexed to CPI, RPI or fixed uplifts, and this rises to 90%, including other upwards-only contracts.
- The result is that £2.2bn has been raised, or 22% of market capitalisation, as new equity in the past 24 months, in 18 fund raises.

"Safer harbour" REITs deliver on multiple attractions

Investment case for "safer harbour" or "secure income" REITs well established, and COVID-19 only accentuates their attractions further

This investment case is not about finding pockets of resilience. This report seeks a universe that is structurally better-placed than the whole equity market. COVID-19 has only highlighted the relative success of (most of) the REITs in this report.

Resilient leases and dividends

Cash, dividends and trends that were already in place

Dividends

- "Safer harbour" REITs pay the dividends. Of the 16 listed here, five (maybe in the end four) in 2020 will likely cut, but total weighted £ reduction is likely to fall by no more than 10% of the total across the 16. See page 12. The unweighted might approach 20%, dragged down principally by PBSA (purpose-built student accommodation), which – arguably – is a sector that should not qualify for this report. Dividend income in the wider market is now under permanent constraint. The broader equity-market dividend payment situation has been made much worse, permanently, by COVID-19.

Cash

- Cash is king, and much of the real estate sector remains illiquid. This applies to assets that have poor forward income visibility and very much also to the "open-ended funds" (also known as PAIFs). Again, COVID-19 simply reminds investors of existing tensions. UK all-property rents were already growing much more slowly than "safer harbour" REITs.
- While there may be concerns elsewhere in the property sector, most "safer harbour" or "secure income" REITs are collecting rent fully on time – the contrast with the broader market is quite stark. See page 35.

Assets tenants delighted with

- This is not easy, plain sailing. Several REITs in this report have reported 97%-100% rent payment on time for the quarter day end-March, but not all have. (See individual commentaries in this report.)
- The "safer harbour" REITs generally provide assets that society needs in increasing numbers, just as they generally provide income streams that investors need – a happy coincidence. One important indicator of likely success is "value-for-money."

Modest rents, and the majority is CPI/RPI-indexed

Really important that leases are not treated just as financial structures

One of the most important supports to the investment case of the REITs in this report is "value-for-money." We have referred to modest rents – the definition varies by sector – and this is an important plank in the investment case. They are a hallmark of most of the REITs in this report. We would include all "secure income" REITs, bar the PBSA REITs.

High exposure to CPI/RPI linkage

We estimate – based on results announcements, company-issued Fact Sheets and presentations – that nearly 50% weighted and nearly 60% unweighted income from these 16 "secure income" REITs is linked to CPI or RPI.

Some examples of value

Demand dynamics and rents on our six REIT highlights

REIT	Does COVID-19 boost demand?	Rents
Impact Healthcare (IHR)	Neutral	ca.10% fees
LXi (LXI)	Neutral	e.g. budget hotels
Primary Health Properties (PHP)	Yes	Value proposition
Residential Secure Income (RESI)	Yes	All rents below market
Urban Logistics (SHED)	Yes	Typical ca.£5-£6 sq. ft. p.a.
Warehouse REIT (WHR)	Yes	Typical ca.£5 -£6 sq. ft. p.a.

This table highlights certain REITs of interest. We remain positive on others, outlined in this report.
Source: Hardman & Co Research

"Modest" rents may, for example, mean that they enhance labour retention or that they are a low portion of operators' gross profits. While the rents of Primary Health Properties (PHP) are above those typical for older, smaller, converted properties, i) this is comparing "apples with bananas" in terms of quality and sustainability for both patients and GPs, ii) it is also comparing "apples with bananas" in terms of the opportunity to save the NHS money, and also improve outcomes. Purpose-built new primary medical assets offer more services, taking pressure off hospitals in areas such as testing.

A good destination for new equity

Significant, undimmed, growth momentum

With £1bn p.a. or more of new equity issuance, these 16 REITs have channelled significant new equity into growing real estate asset classes. There is still plenty of potential to deploy new equity. Even in niche sectors (e.g. supermarkets), these REITs' acquisitions have accounted for less than 10% of the asset class transaction flow.

The majority of REITs covered here are set to grow dividends

We have already seen many companies deferring, reducing or even cancelling dividend payments. These include some of the staple constituents of income portfolios, such as Shell; the past month has taught investors that owning shares in the largest 100 companies does not shield you from this risk. Statements have made it clear that the economic uncertainty ahead also casts a shadow over the immediate prospects for dividend growth.

In contrast, although the REITs covered here are likely, in aggregate, to cut dividends by up to 10% this year, we believe the majority will immediately return to dividend growth. Thus, these REITs should stand out as a much safer option than the broader market. This report seeks to verify how robust these particular REITs are, and to support our conclusion that they offer value.

New issuance

£2.2bn raise over two years – often over-subscribed

- We calculate that the REITs covered in this report have raised £2.2bn new growth equity in the past two years alone. Their market capitalisation totals £11.5bn, well up on the total as of the date of our previous report. The majority of secondary issues have raised more than the original intention.
- REITs with the attribute of strong transparency, have, understandably, a solid appeal to a broad range of shareholder classes, including direct retail investors and wealth managers.

We estimate ca.50% weighted and ca.60% unweighted income linked to CPI or RPI

Since the 2008 global financial crisis, most UK REIT equity issuance has been aimed at seekers of stable, progressive income, which hits the "bottom line" in a predictable, transparent manner. In our report published in March 2019: *"Secure income" REITs – Safe Harbour Available*, 17 such REITs were identified, whose mission was secure income, which was benefiting primarily from long-term indexed or fixed uplift income. We estimate that ca.50% of weighted and ca.60% of unweighted income is linked to CPI or RPI. Note: much is capped and collared with a 4% ceiling,. It is also to be noted that, out of the 17, one small REIT (AEW Long) was delisted at a loss.

Rebuilding the UK: retail investor, as well as institutional attraction

Retail investors are increasingly important to the market, as identified by Hardman & Co's work with the Office for National Statistics, *Share ownership: for the many, not the few*, published earlier this year. The REITs highlighted here are mostly designed to fit their requirements far better than is the case for the broader market

These REITs have an advantage regarding secondary fund raises – designed with private investors and wealth managers in mind

These REITs are designed for transparency and are simple to understand. They fulfil investors' need for trusted and regular income. Many indicate their affinity by paying dividends quarterly. Indeed, our client PHP's move from bi-annual to quarterly dividend payments was well received. Retail investors have been an increasing part of the UK investor universe in recent years.

Retail investment provides new money and drives share prices

A London Stock Exchange-hosted webinar, on 7 May (which Hardman & Co co-sponsored), illustrated that, while ca.5% of transaction cash volume (a far higher number of individual transactions) is normally retail, the recent markets have frequently seen 20%. Account openings at large private investor platforms have almost trebled (as per the presentation), and the balance is ca.75% of retail orders having been buys recently. Investors and the REITs have the appetite to engage, and the "simple" REIT structure encourages this. Wealth managers feature strongly in the shareholder lists of the REITs listed here. See page 24.

In exactly right space for retail and institutional investment

We dwell on the importance of the retail investor market here, as we consider it to be particularly supportive of many of the REITs listed in this report: they are designed for the visibility towards which the current climate is leaning. We are confident that more retail interest will come – as a result of the attributes illustrated on pages 3 to 5.

Overview of ratings and performance

16 REITs in this report have outperformed sector, but large majority still seen share price falls

Hardman & Co identifies 16 quoted REITs in the UK investing in assets that target lower-risk characteristics. This report is a sequel to our sector report of 19 March 2019. We summarise some key investment characteristics. As was stated in the 2019 report, "not all should yet be considered fully safe harbour". Indeed, this has proven to be the case. Some – particularly the student, PBSA, sector – have performed badly, related to COVID-19. Further, the last report included AEW Long REIT, which acquired assets with long leases. The covenants proved to be poor, and the stock market listing was cancelled. We have included the negative effect from this in the statistics in the table below.

The table below shows the current valuation ratings and share price performances in the 12 months to date.

Share price-related data (12 months to date)	
Wider quoted real estate sector index change in past year	**-16.8%**
16 REITs in this report	
Unweighted share price change in past year *	-6.0%
Weighted share price change in past year*	-7.0%
Unweighted average historical dividend yield	5.64%
Weighted average historical dividend yield	4.99%
Unweighted average share price/NAV	90%
Weighted average share price/NAV	104%
Market capitalisation	£11.5bn

**Data for 16 REITs in this report, plus the AEW REIT featured in the last report but since de-listed.*
Share prices as at 18 May 2020 compared with 17 May 2019
Source: Companies, Bloomberg, Hardman & Co calculations

Ratings and performance as of our 2019 report

From our last report just over a year ago

Here, for comparison, are the valuation ratings as at our March 2019 report on this REIT universe, and share performance for the year to 13 March 2019.

Outperformance and positive capital returns

Share price-related data (12 months to March 2019)	
Wider quoted real estate sector index change in year to 13 March 2019	**-3.0%**
17 REITs in the Hardman & Co report of 19 March 2019	
Unweighted share price change in previous year*	+2.3%
Weighted share price change in previous year*	+2.7%
Unweighted average historical dividend yield	5.1%
Unweighted average share price/NAV	99.4%
Market capitalisation	£10.9bn

**Data for 17 REITs in Hardman & Co report, priced on 13 March 2019*
Source: Companies, Bloomberg, Hardman & Co calculations

This 13 March 2019-based data also listed the performance of the wider quoted sector and compared this with the performance of the 17 REITs listed.

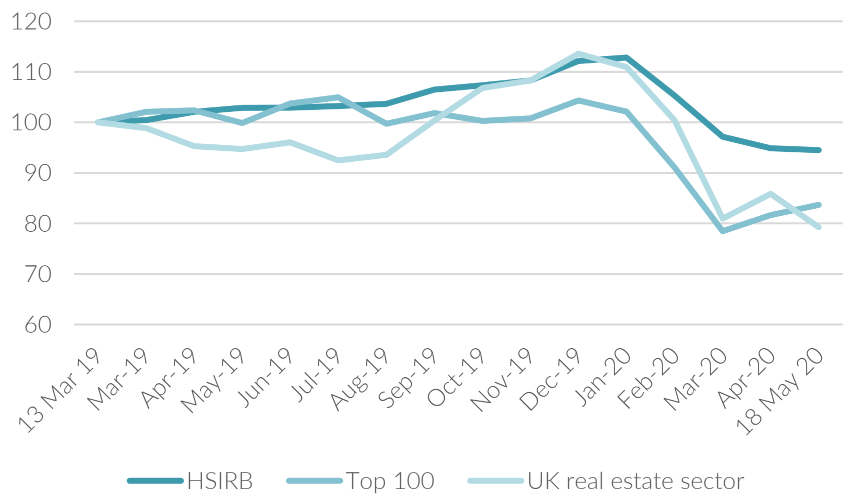
Note that a number of these REITs have been floated in the past three years, and are therefore in asset deployment phase. Sector issuance continues, reflecting investor propositions that we consider to be realistic and compelling.

Note also that, going forward, we will be excluding PBSA from this sector and will be planning to include LondonMetric, as it refocuses ever more away from retail and into logistics.

The Hardman & Co secure income basket

The chart below shows the weighted share price performance of the 16 REITs in this report.

Price performances since previous Hardman & Co sector research



Source: London Stock Exchange, Hardman & Co Research

Methodologies, definitions and clarifications

This is not a total return, being based solely on share prices, without reinvesting dividends. It should be recalled that the dividend yield on the "basket" is above that of both the top 100 UK shares and also the wider UK real estate sector.

Calculations are rebased to 100 and commenced on 13 March 2019, the date of the previous Hardman & Co research into this "basket" of REITs. The end date is as of the pricing of the REITs in this report. Data points illustrate that monthly movements are shown based on month-end prices. Weightings are not adjusted monthly. They do not reflect the weighting effect of new issues of stock, so as to recreate the investment performance of an investor at the origin of the basket, and they are not influenced by changes in relative sizes that come about as a result of new issues of stock. Were such adjustments to be made, the difference in the basket-weighted price movement would be *de minimis*.

The real estate comparator comprises a weighted price chart for the UK real estate stocks that are among the largest 350 UK quoted stocks by market capitalisation.

Ratings, financial ratios and investment missions

We turn now from the overview of the Hardman & Co universe of REITs and look at each one.

Where the REITS invest

REIT	Commentary and selected statistics overview
Assura (AGR)	AGR invests in UK primary medical assets; it is of a slightly smaller lot size than PHP and includes an element of development.
Civitas Social Housing (CSH)	CSH invests in higher-acuity adult care and in supported housing, providing life-time secure, bespoke configured buildings, each with 5-10 flatlets.
Empiric Student (ESP)	ESP invests in PBSA focused on the mid-market across a wide range of institutions. COVID-19 stretches university finances.
GCP Student Living (DIGS)	DIGS invests in PBSA, involving an element of development and at the middle-/upper-end cost range, in South East UK. 14% of students are EU, 23% UK, 63% other overseas students. 30% are postgraduates.
Impact Healthcare (IHR)	IHR invests in care homes, with a focus on funding the expansion of existing, successful operators' businesses.
LXi (LXI)	LXI invests in various "secure income" sectors. It has one of the strongest NAV uplifts of the more recent IPOs. The larger sectoral exposures include budget hotels, logistics and others. Over 95% income is RPI-linked.
Primary Health Properties (PHP)	PHP invests in UK primary medical assets, expanding into RoI. Its 23-year track record is the longest of its peer group, and each year has seen a dividend rise. In March 2019, it completed an all-share merger with the listed MedicX Fund.
The PRS REIT (PRSR)	PRSR invests in new-build open-market houses to rent – almost exclusively to families. Rent is typically ca.35% of household income or less. Assets are bought at below vacant possession values.
Residential Secure Income (RESI)	ReSI invests in UK social housing, with a focus on shared ownership, local authority housing and retirement housing. Its overarching characteristic is high covenant strength.
Secure Income (SIR)	SIR invests in budget hotels, leisure and other assets with long leases. It is 90% UK-exposed. To end-2019, its TSR was ca.20% (since IPO).
Supermarket Income (SUPR)	SUPR invests in supermarkets. Asset ranges of NIYs are wider in this "secure income" type than others. Supermarkets such as Tesco have, in the past three years, successfully coped with changes in the competitive landscape.
Target Healthcare (THRL)	THRL invests in care homes, exclusively purpose-built, modern, and all with en-suite wet rooms.
Triple Point Social Housing (SOHO)	SOHO invests in supported housing: life-time secure, bespoke configured buildings, each with 5-10 flatlets. It is similar to CSH, but focused somewhat more on purpose-built as new.
Tritax Big Box (BBOX)	BBOX invests in large-scale logistics hubs. It holds an amount of development land (ca.7.5% yield on development cost).
Urban Logistics (SHED)	SHED invests in "last-mile" logistics assets. Hands-on management and good purchase yields have delivered one of the strongest NAV uplifts of the more recent IPOs. Forward-funding is undertaken. It is growing well, post its recent equity raise.
Warehouse REIT (WHR)	WHR invests in "last-mile" warehouses/multi-lets: hands-on asset management and crystallising value uplifts.

Source: Hardman & Co Research

Dividend yields and price/NAV per stock

Price performance and ratings

Ticker	Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)*	Price to historical EPRA NAV (x)*
AGR	77	78	61	3.6	1.44
CSH	102	91	84	5.3	0.94
ESP	60	97	94	7.4	0.55
DIGS	125	198	162	5.5	0.65
IHR	96	108	107	6.5	0.90
LXI	100	140	125	5.8	0.82
PHP	158	158	133	3.6	1.47
PRSR	70	92	97	5.7	0.72
RESI	91	98	97	5.5	0.83
SIR	250	430	401	6.5	0.58
SUPR	106	109	102	5.3	1.09
THRL	94	117	115	7.1	0.87
SOHO	97	92	94	5.3	0.92
BBOX	130	148	147	4.8	0.86
SHED	122	145	126	6.3	0.84
WHR	103	110	103	5.9	0.97

**Priced as at 18 May 2020*

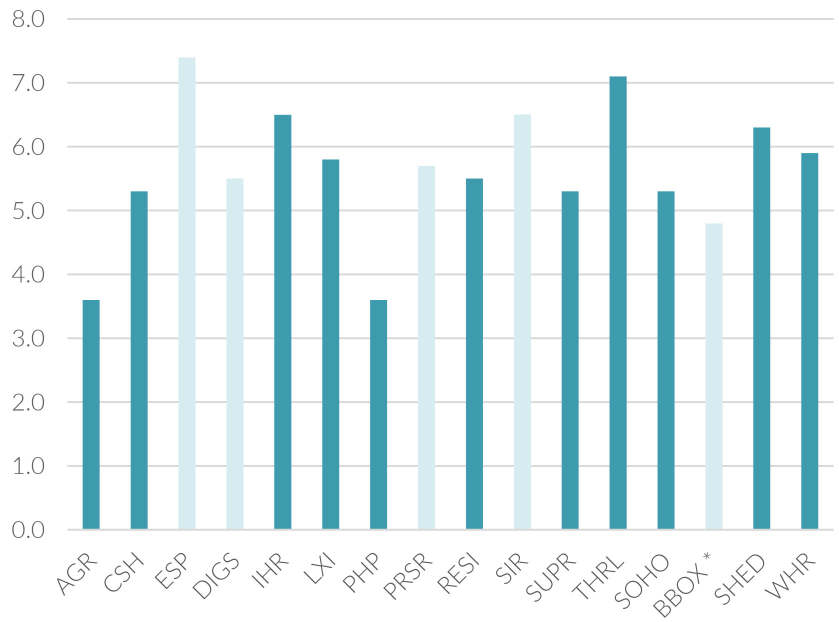
Source: Companies, Bloomberg, Hardman & Co calculations

Historical dividend yield ratings

Both generally and in specific sectors, yields appear anomalously high

The chart below illustrates dividend yields that are nearly all at a premium to the historical 4.4% dividend yield on the UK's largest stocks. It also quantifies how the care home REITs and the "last-mile" logistics REITs offer among the highest dividend yields. The analysis in this report points to solid growth prospects and high visibility in both these sub-sectors. In the chart, REITs where dividends are cut are shaded and show the historical dividend.

Historical dividend yields



**For BBOX, we emphasise that the likely cut will be modest, and is reflected in the historical figures*

Source: Company announcements, Hardman & Co Research

As to prospective dividends, we anticipate the historical payout of £573m p.a. (this includes dividends taken as scrip) will fall to ca.£515m this year. This takes into account assumptions on the REITs cutting or likely to cut dividends, and reflects dividends announced (as opposed to paid) in 2020. We anticipate a level of payout in 2021 similar to that seen for the REITs that have cut dividends. After a full year of cuts, we anticipate Tritax Big Box will grow its dividend again in 2021. For 2022, we anticipate overall growth resuming at ca.2.5%.

High levels of growth for PHs, Assura, Warehouse REIT and Urban Logistics

Among the higher levels of 2020 dividend growth, we estimate that Assura and PHP are well placed, as the underlying rents are accelerating, and PHP has further drivers to growth. We anticipate good growth from Warehouse REIT as it builds on 2019's prompt deployment of the equity raise. Urban Logistics is deploying its 2020 equity raise, and is well placed, with a 100% historical dividend cover on a significantly raised historical dividend.

Although most share prices have outperformed, they have fallen in absolute terms

The share prices of a number of the REITs covered in this report have been dragged down by negative sentiment: since year-end 2019, median prices are down 11.9% – down 14.9% unweighted average, down 10.2% weighted.

However, the REITs in this report have outperformed the broader UK real estate sector.

- 11.4% outperformance of the UK real estate sector in the past year.
- 5.7% outperformance in the year to 13 March 2019 – our previous sector publication.

In a very difficult period, REITs seeking secure income continue to outperform, but several have seen share price falls where no economic damage has been done

Outperformance is entrenched. In the year to 13 March 2019, the weighted share prices of REITs covered rose 2.7%, versus a 3.0% fall in the UK real estate sector. Note that this data covers the 17 REITs listed in our previous report, as opposed to the 16 REITS in this report. One REIT de-listed, at a loss. 11 out of the 16 REITs' share prices are down vs. a year ago, and 14 down on end-2019.

We consider the shorter-term weakness to represent an opportunity, evidenced by the longer-term outperformance.

The dividend yield anomaly is dramatic

Really appears anomalous, unless wider market dividends bounce back hugely in 2021

For the REITs in this report, our investment conclusion is that they offer better prospects than the UK top 100 quoted shares and also the wider UK quoted property sector. Not only is the potential and the visibility better, but the rating is dramatic.

Current dividend yields

Index or cohort	Dividend yield at 18 May share prices
UK top 100 based on 2020 dividends pre any dividend cuts	4.4%
UK top 100 based on likely 2020 dividends	2.4%
16 REITs listed in this report pre any dividend cuts (weighted)	5.0%
16 REITs listed in this report based on estimated dividends	4.5%
16 REITs listed in this report pre any dividend cuts (unweighted)	5.6%
16 REITs listed in this report based on estimated dividends	4.9%

Source: Companies, Bloomberg, Hardman & Co estimates and calculations

The dividend yields indicated for 17 REITS listed in our previous report are significantly different from the 16 REITs listed here. Their historical dividend yield (weighted) is 5.0%, albeit we estimate a ca.10% (weighted average) cut in 2020, followed by bounce-back in 2021.

We are surprised by many of the dividend yields

There seems to us to be little discernment, judging by the dividend yields.

REIT description, share prices and dividends

REIT	Ticker	Investment focus	Share price, 13 March 2019 (p)*	Current share price (p)**	Historical year (or half-year annualised) dividend (p)*	Historical dividend yield (%)	Prospective dividend position
Assura	AGR	Primary medical	57	77	2.80	3.6	Growth***
Civitas Social Housing	CSH	Social housing	98	102	5.30	5.3	Growth
Empiric Student	ESP	Student accomm.	95	60	4.45	7.4	Cut
GCP Student Living	DIGS	Student accomm.	154	125	6.25	5.5	Cut
Impact Healthcare	IHR	Residential care	104	96	6.17	6.5	Growth***
LXi	LXI	Managed property	123	100	5.75	5.8	Growth***
Primary Health Properties	PHP	Primary medical	123	158	5.60	3.6	Growth***
The PRS REIT	PRSR	Open-market housing	102	70	4.00	5.7	Cut
Residential Secure Income	RESI	Social housing	93	91	5.00	5.5	Growth
Secure Income	SIR	Hospitals, leisure	405	250	16.30	6.5	Cut
Supermarket Income	SUPR	Supermarket grocers	102	106	5.70	5.3	Growth
Target Healthcare	THRL	Residential care	116	94	6.65	7.1	Unchanged
Triple Point Social Housing	SOHO	Social housing	101	97	5.10	5.3	Growth
Tritax Big Box	BBOX	Distribution centres	141	130	6.25	4.8	Modest cut
Urban Logistics	SHED	Urban warehouses	120	122	7.75	6.3	Growth***
Warehouse REIT	WHR	Urban warehouses	101	103	6.10	5.9	Growth***

All EPS figures are on diluted shares
**As of 19 March 2019 Hardman Sector Publication, priced 13 March 2019*
***As of 18 May 2020*
****Historical dividends 100% or more covered by EPRA EPS*
Source: Company reports & accounts, company forward guidance on dividends, Hardman & Co Research estimates

Many of the REITs that have not cut dividends, and that we see as unlikely to do so, are trading on yields of over 6%. This is a higher dividend yield than the average for the wider UK real estate sector, and, particularly, it is higher than the weighted average for the UK sector. We would also point to the table on dividend cover, below.

It is important to note that most REITs in this report are issuing growth equity. This impacts dividend cover in the years during which investment takes place. Therefore, as such, there may be times when funds have been raised but not yet deployed into the pipeline that management has identified – known as "cash drag". A number of REITs where we anticipate growth in dividend per share have raised new equity over 2020 to date and, as such, the initial period post issue will see earnings diluted.

REIT recent financial track record

Ticker	Historical dividend per share (p)	REIT historical dividend cover (%)	Historical loan to value ratio (%)	Historical EPRA NAV/share (p)	Share price 12-month high (p)	Current share price (p)	Current market capitalisation (£m)
AGR*	2.80	100	36	53.5	84	77	2,044
CSH*	5.30	100	27	107.9	102	102	598
ESP	4.45	88	33	110.2	104	60	361
DIGS	6.25	92	19	174.7	212	125	598
IHR*	6.17	112	7	106.8	115	96	303
LXI	5.75	102	20	124.3	140	100	521
PHP	5.60	100	44	107.9	165	158	1,910
PRSR*	4.00	110	21	95.0	100	70	346
RESI	5.00	54	36	108.6	100	91	154
SIR	16.30	94	32	431.1	470	250	809
SUPR*	5.70	86	32	97.0	109	106	502
THRL*	6.65	83	18	108.1	123	94	429
SOHO	5.10	67	31	105.4	105	97	339
BBOX*	6.25	96	30	151.1	160	130	2,218
SHED*	7.75	104	34	145.2	150	122	230
WHR	6.10	100	40	105.2	117	103	248

*Prices as of 18 May 2020; *See Company earnings adjustments below*
Source: Company reports & accounts, Bloomberg

Notes

- **Dividend and cover:** The historical dividend comprises the sum of the past two halves or four quarters.
- **Historical ratio:** EPRA EPS as a percentage of dividend declared per share.
- **Market capitalisation:** On the basis of shares issued, not diluted shares.
- For the purposes of dividend cover calculations, all EPS figures are on diluted shares and on an EPRA basis, pre-revaluations.

Company adjustments

- **AGR:** LTV stated as historical figure, prior to 2020 equity raise.
- **CSH:** 87% last full year, 100% run rate last quarter.
- **IHR:** Dividend cover 82% on a cash basis; LTV 18%, including post-balance sheet asset purchases.
- **PRSR:** Dividend cover based on IFRS accounting. EPRA 2019 EPS 0.02p. Note the statement by the company at the recent results: "The interim dividend in respect of Q3 will be deferred for review in Q4 when the outlook is likely to be clearer."
- **SUPR:** LTV stated as historical figure, prior to 2020 equity raise.
- **THRL:** 95% dividend cover in most recent half year.
- **BBOX:** Latest quarter dividend cut to 1.5625p. A year prior, it was 1.675p. The historical dividend stated in the table above is four times the last declared dividend. The dividend in the last full year was higher, at 6.85p. The 6.85p was covered 96%.
- **SHED:** LTV stated as historical figure, prior to 2020 equity raise.

Dividend covers

Above, we itemise dividend covers. Two points should be made:

- Overall, we attempt to calculate the share-weighted cover, i.e. when shares have been issued during the year, the dividends paid in certain quarters may be payable only on the shares in issue prior to the new shares. An example would include PHP.

- Further, on dividend cover, the PRS REIT statistic is given on the basis of IFRS EPS cover, and, were EPRA EPS to be used, the cover would be almost nil. Impact Healthcare's cover is based on the appropriate accounting, but Impact Healthcare itself highlights that the cash dividend cover is lower. It is still near 100% on that basis, and the cash drag effect of investing new equity is working through.

Tritax Big Box has cut the quarterly dividend that it announced in April 2020. We believe the balance of probable outcomes in future quarterly dividends will be at least maintained at prior-year levels, with a reasonable opportunity to see the full-year dividend outcome as unchanged on the prior year. It is too early to estimate anything other than a modest cut in total 2020 declared dividends, we believe. The management track record in the quoted arena is a long and largely successful one.

Some appealing investment cases

What is the detail driving some of the appealing investment cases?

Whole new world?

Over the past two months, it has become commonplace to assert that these are unprecedented times. A typical quote is "We are really in a totally unprecedented set of circumstances where there is no previous playbook."

Investors still hold by the "previous playbook" – transparency (in both the types of assets held and the cashflows they will generate), consistency and value-for-money rents.

For the real estate sector, the same kinds of REITs – those with a good chance of security of steady income growth – were outperforming in 2019 (and, indeed, before) and are outperforming now. The view strongly remains that they have the attributes to imply outperformance will continue.

- Yields on assets are attractive and, in most cases (see the detail in this report), the income is safe. The average NIY (net initial yield) for REITs here (non-weighted) is 100 bps above the All-Property index.
- Dividend yields, again, are typically 100 bps, or more, above the top 100 shares' historical 4.4% dividend yield. In many cases (again, see detail in this report), the dividend prospects (for modest growth) are safe. For the leading 100 shares in the UK, 2020 could well see a halving.
- Most REITs here should not be trading below NAV, on the bases above. Our valuation yardstick is, however, sustainable income and covenant strength, rather than NAV. The NAV rating accorded to such a relative "haven" is a reassurance. Dividend yields seem attractive, even before cuts to broader UK equity dividends.

Better prospects on higher dividend yields

For more context, we outline investor drivers on all REITs covered in subsequent sections of this report.

All these REITs, bar LXi and Warehouse REIT, have reported that 97% or more of the March quarter (in advance) rent was paid on time. LXi's exposure to hospitality is unfortunate, but budget hotels will be among early "unlockers", and at least one of the two tenants is engaging positively in the situation. Budget hotels are facing a hit that is likely to be temporary, but the LXi share price performance indicates deeper-seated worries, which should prove unwarranted. LXi's income and NAV performance since flotation are strong.

REIT description, share prices and dividends

REIT	Ticker	Investment focus	Current share price (p)*	% rent collected at** last quarter day	NAV growth over past two years (% p.a.)	Historical dividend yield (%)	Prospective dividend position
Impact Healthcare	IHR	Residential care	96	100	3.5	6.5	Growth
LXi	LXI	Managed property	100	67	6.7	5.8	Growth
Primary Health Properties	PHP	Primary medical	158	97	3.6	3.6	Growth
Residential Secure Income	RESI	Housing of social benefit	91	99***	5.2	5.5	Growth
Urban Logistics	SHED	Urban warehouses	122	93	11.8	6.3	Growth
Warehouse REIT	WHR	Urban warehouses	103	82	3.5	5.9	Growth

**As at 18 May 2020*
***at or within a week*
****Hardman & Co estimate*
Source: Company reports & accounts, company forward guidance on dividends, Hardman & Co Research estimates

Outperformance and positive prospects

We published on these "safer harbour" REITs in March 2019

This report follows our March 2019 report: "Secure income" REITs – Safe Harbour Available. This listed 17 REITs that sought security of income. Of course, this is far from all plain-sailing.

Here, we follow up on evolving story

Three of the REITs listed in last year's report have, unfortunately, not found that desired security. AEW Long relied too much on the length of leases, and covenant strength disappointed. It is no longer listed. The two student REITs (and Unite) have fallen foul of the pressures created by COVID-19, and they have foregone significant rent, while strengthening their relationships with universities. They have sought to do the right thing – cancelling typically three or four months' rent. This indeed is "the right thing", but it is exceptionally painful to investors seeking income, and also seeking clarity about the relationships with counterpart institutions and tenants. Our main problem is the lack of evident clarity.

Other REITs have seen some element of their income delayed or in doubt. The most notable – for us – is Secure Income REIT, with significant blue-chip leisure exposure. Some uncertainty remains.

LXi's share price fall of interest, we consider

LXi has some exposure to leisure via blue-chip budget hotels. Here, we consider that medium-term damage is seen as very limited, and it will, in due course, continue to be seen as such. This tenant profile, which has seen delays in rent collection, has resulted in a weak share price. LXi has a disciplined focus on investment characteristics, as opposed to backing a specific physical asset class. Immediately following, we list six REITs that we consider offer appealing investment cases at current price levels. These six are not the exclusive list of appealing opportunities.

Target Healthcare and Tritax Big Box in UK…

We see Target Healthcare and Tritax Big Box as noteworthy, and would point readers towards our description of the positioning and prospects for all 16 in the section below this one.

…and Tritax EuroBox and Yew Grove in Europe (but outside scope of this report)

Non-UK, European stocks, Tritax EuroBox and Yew Grove, are interesting long-income stocks, but are outside the scope of this report, which is analysing Sterling income stocks.

Impact Healthcare

Impact Healthcare invests in care homes. We like the sector dynamics and ratings. The shares offer an above-average yield and a discount to NAV. The dividend is covered in accounting, if not cash, terms, and the REIT has the benefit of low gearing and long RPI-linked leases.

Investing in care homes, 19.7-year WAULT, upwards-only RPI rents

The primary source of acquisitions is through the operators themselves – so the REIT starts off and retains a close, detailed, regular operational and financial watching brief. Many operators are effectively partnering with the REIT in order to expand the quantum and range of services in their estate. Leases are long-term, with a WAULT (weighted average unexpired lease term) of 19.7 years.

Strong cashflow

The 6.7% to 8.6% NIYs achieved on assets purchased do not reflect compromised quality. Rather, they reflect the detailed knowledge of, and constant contact with, the tenant base required. There has been no trend of rising or falling acquisition NIYs over time since the 2017 float. The NIYs do mean that financial gearing plays a small part in total returns, and we anticipate ongoing gearing will remain low. During COVID-19, rent payments have been almost faultless.

Strong operators who benefit from the REIT's financing

Counterparty risk appears low, and this asset class is likely to be supported further by demographic and market trends. Clearly, 2020 has brought operational, human and financial strain. Counterparties are strong, and the general "tone" coming out of the first crisis does help prospects. 95% of staff are UK-originated. Rent is a fraction of the fee income, and is well-funded. Modern assets play a part in staff retention, as does expansion of specialist facilities (e.g. dementia-specific areas).

It is the care home operator that pays the rent, not the elderly resident. Impact Healthcare is in constant contact with the operators; they are strong participants, well-resourced financially, with modern homes. Rent cover has been 1.8 times, on average. There remains high tenant concentration. 51% of the current roll derives from two tenants. However, the figure was 77% in 2018, and we anticipate further diversification. Tenant contact is very important – so we would not anticipate a mass-expansion in tenant numbers – rather, we would expect steady, constrained growth.

Equity issuance, but no greater cash drag than 2019, so strong dividend cover a feature

Impact Healthcare is growing significantly, deploying equity raised last year. For example, it is forward-funding the development of a new 94-bed care home to be operated by Prestige, one of the group's tenants. Growth assists specialisms, making the care home owner more resilient and attractive to occupiers and families. 2019 saw 39% growth in rental income (net). Notably, there was 7% growth in all (non-debt-related) expenses, so operational gearing is clear. In 2019, before the full benefit of capital deployment, the dividend was over 100% covered. This is a strong, cash- generative REIT.

Private-funded care home fees have risen faster than RPI in recent years. In many cases, these fees will be supported by the release of home equity or other savings. With asset-price turmoil, it may be wise to assume moderated rises in privately funded fees – roughly a third of the portfolio. This should prove readily surmountable by Impact Healthcare. We also believe it will cause no meaningful problems for Target Healthcare. However, Target Healthcare's extent of uncovered dividend means that a likely dividend progression for Target Healthcare will be sideways in 2020, rather than the (modest) growth we estimate for Impact Healthcare. For the moment, this quite likely lack of all-important dividend progression – for just one year, 2020, – takes the edge off a strong investment story at Target Healthcare.

LXi

Since float in February 2017, LXi has achieved a 12.8% (to September 2019) annual accounting return. There has been a total 19.6% rise in NAV since float in February 2017. Note that this figure is calculated at 18%, excluding secondary share- issuance benefits. Regular asset recycling has proven the validity of NAVs. LXi has acquired at 5.8% NIYs, on average, and valuations now (historical) are 5.06%. Occupancy is 100%, and WAULT is 22 years to first break option. 77% income is RPI- or CPI-linked; all bar 4% of this has upwards-only escalators. We note that the 16.3% historical year EPRA cost ratio is modest, given the variety of sectors and forward-funding, and we anticipate lower ratios going forward, post the significant fund raise in 2019. COVID-19 has been a bump in the road.

It is most important that all the portfolio charges relatively low rents. The largest sector is industrial, at 28%, for example. BCA, Bombardier and Stobart (not Eddie Stobart) comprise 7%, 7% and 4%, respectively. There are some smaller industrial tenants, but these are institutional-grade, e.g. Johnson Matthey and Brenntag, the German distributor. Other sectors comprise budget hotels (24%), healthcare (14%) and discount foodstores (10%), with small amounts in other areas, including car parks and care homes, in addition to a small exposure to coffee shops and pubs. Clearly, the hospitality exposure poses risks.

Budget hotels are well placed for 2021, and LXi share price fall offers opportunity

Only 67% of rent due at end-March was received on time. LXi is the exception to the cohort of the six REITs we have selected, in that 2020 is a difficult year. Hospitality exposure may result in NAV reduction, but this would be seen as very much a one-off six (or so) months' missed income. Other tenants with smaller LXi exposure in "vulnerable" sectors comprise Greene King, Costa Coffee and Starbucks – all financially robust, with strong balance sheets and material cash holdings.

As stated by the company on 6 April: "The final dividend is scheduled to be announced in May 2020, along with the Company's annual results, and paid in June 2020. This will meet the Company's dividend per share target of 5.75 pence for the year."

Primary Health Properties

Primary Health Properties (PHP) has increased its dividend in each of the 23 years since float. Its entire exposure is in primary medical assets, which are modern and purpose-built as the local health "hub". Income is 90% government-backed, with the remainder very secure. There is security, but there are also a number of drivers to financial returns improving further. That says it all, but to expand, five factors are highlighted:

Rents accelerating – almost only sub-sector in market

- Rents are all upwards-only and effectively paid by governments in the UK or Republic of Ireland (RoI). RoI comprises 8% of the assets. Recent announcements state that rent rises now exceed 2% p.a., and the figure is set to remain at that level or – more likely – grow modestly. The drivers to that are technical, on an asset-by- asset basis, but the driver is a combination of catch-up and rising build costs, allied to "incremental specification increases."

RoI boosts returns, and is ca.30% incremental investment

- In recent years, ca.30% of asset purchases (or forward-funded developments, where no redevelopment risk is taken) have been in RoI. Returns here are modestly higher than in the UK, and this skew to RoI growth is a driver of EPRA EPS growth.

Reducing cost of debt, further

- Interest costs fell from 4.0% to 3.5% in 2019. There is clear scope for further falls, as facilities renew, because PHP has grown and the interest rate environment favours borrower refinancing, as does PHP.

The most efficient REIT in UK, and getting better

- The EPRA cost ratio, at 12% (including performance fee), is the lowest in the UK sector, and this efficiency flows through to dividend-paying ability. Incremental purchases are on a significantly lower fee-basis than the average in the portfolio, so EPRA cost ratios should likely fall in the future.

- Put together, this gives clarity to DPS growth drivers and provides investors with a covenant strength that reasonably could be called near-gilt in quality.

Residential Secure Income

All private sector rents are below-market, and all covenants are high. The blended 5.0% NIY is "in the pack", but there are clear drivers to rental growth.

Housing with sub-market rents and high covenants

Since IPO, Residential Secure Income (ReSI) has assembled a portfolio of 2,677 homes, comprising 166 (22.3% by value) shared ownership homes, 289 (10.8% by value) local authority housing units and 2,222 (66.8% by value) retirement rental homes. The portfolio is in the south east of England. The blended NIY is 5.0%, with shared ownership homes below the average. Shared ownership rents receive specific subsidies from the government, but, over the long term, these taper off. Local authority housing is sub-open-market. Retirement housing per sq. ft. like-for-like location rents at usefully below open (non-age-restricted) housing. This is despite the demographics boosting demand and supply being constrained. The portfolio rent continues to be secure amid COVID-19, with 98% of April rent collected by 27 April 2020, in line with normal performance, with further rent to be received from Local Authorities who pay at the end of the month.

2019 and 2020 ramp-up – fully visible and understood by market

2019 (full-year to September) reported significant growth in operating earnings per share, to 2.9p (30 September 2018: 0.9p), reflecting the ongoing ramp-up of rental income through 2018 and 1H'19. 1H'20 has seen small purchases of shared ownership properties, but COVID-19 has delayed 2H'20. Profit growth is set to resume, with deployment. This makes a minimal dent in 2020 earnings. Given the prospects of ReSI and its achievements to date, we believe investors will rightly see through to 2021, when fuller deployment will have been achieved through the year.

Operational gearing coming through and significantly more to come

The REIT is very much still in acquisition mode, so returns have a built-in escalator into 2020 and beyond. Historical dividend cover was only 54%, but this belies the current and following year potential. For instance, in the 2019 fiscal period, property operating expenses amounted to 16% of gross rents, down from 24% in the previous year, which illustrates the operational gearing coming with capital deployment. We consider the mix of asset classes, below-market rents, affordability of rents and diverse but long-dated leases to give high visibility to rent collection, earnings growth and asset appreciation.

Variety of benefits from affordability and high covenants

ReSI's rental income is supported primarily by residents' pensions or housing welfare subsidy systems, including leases to local authorities. Rents are below-market in shared ownership and are affordable in the retirement segment, where pensioner income is unfluctuating and the desire stay *in situ* is high. Local authority housing rents are around market level, providing a saving to the local authority versus other emergency accommodation, such as hotels and bed & breakfast accommodation. While the historical LTV is 36.3%, the asset quality warrants higher levels. The eventual overall target stands at 50% LTV. 90% of ReSI's debt is very long-term in nature, with only £14.5m needing to be refinanced before 2043. Crucially, there is significant social value added in at least four ways; we expand on this in a later section of this report providing ReSI details.

Retirement assets currently dominate the portfolio, and deliver a leveraged yield of 6.9%. On balance, there is no COVID-19 effect.

The local authority housing portfolio produces a leveraged yield of 7.2%, and an unleveraged yield near 5%. A lease with a 7.0-year WAULT is in place to Luton Borough Council.

Major opportunity in shared ownership: for both capital increase and de minimis-risk rent

Shared ownership is a part buy, part rent product, with a below-market rent. The possibility of non-payment of rent is effectively obviated, as such non-payment has serious consequences. It would void the shared ownership tenant's stake in the asset. As to growth, there are several partnerships in place, including Metropolitan Thames Valley, Places for People, Crest Nicholson and other developers. COVID-19 is delaying completion of ReSI's acquisition of the remaining homes at Clapham Park, but delivery of its existing 93 units continues to progress.

Urban Logistics

Rent collection up with last year's ratio

Urban Logistics invests in modern "last-mile" logistics assets across the UK, with a slight bias to the Midlands. These assets are in high and increasing demand, not just as a result of internet shopping, but also because businesses and health service providers require that end-consumer hub. Supply is shrinking as other uses compete. Asset prices typically are still below replacement cost and down on a decade ago.

Trading is robust. As of an 8 April announcement, 93% of rents for the quarter to June 2020 had been collected, and more has come in since. The rate has also risen since, with the 8 April rate of 93% comparing with 91% at the same time last year. This is one of the best performances in the sector and in the 16 REITs covered in this report. Results are due to be published on 29 May.

1H'20, an 8.1% return in just six months

Sector rent growth stood at 3.1% for 1H'20 (September 2019) and averages 3.2% since March 2017 year-end

1H'20's excellent performance was strong, which is simply in line with experience since IPO. Urban Logistics reported a total accounting return of 8.1% for 1H'20, putting it again in the top 10% of all REITS. The dividend was raised by 25% to 3.75p. The 25% interim dividend rise for 1H'20 matched EPS, driven by rent reviews, new letting and acquisitions. Asset disposals in the period made total (ungeared) property returns of 50.0%. EPRA NAV per share rose 12.4%. WAULT rose to 6.1 years from 5.5. Urban Logistics' like-for-like rent growth stood at 3.1% for 1H'20 (September 2019), and has averaged 3.2% since the March 2017 year-end.

Urban Logistics is successfully deploying its March 2020 equity raise. NIYs achieved have been 6.3% and 7.0% so far. A recent example achieved a passing rent of £4.96 sq. ft. The capital value was £68 sq. ft.

4.4-year WAULT: shorter is good in a rising rent environment

Excluding one 20-year lease asset, the (end-1H'20) WAULT stood at 4.4 years. In an in-demand market, this is a good thing. Rents are likely to rise when leases are renewed. We estimate that there is 9% reversionary upside on the current rent of £4.90 sq. ft., as demonstrated by its ability to sell assets at premiums to their current valuations. Assets are modern, typically with low (sub-25%) site cover, and tenants are 89% rated low or low-moderate risk by Dun & Bradstreet. Urban Logistics' average tenant has stayed for more than 10 years.

Urban Logistics' total accounting returns

Year-end Mar	Annual return
FY'17	19.1%
FY'18	10.9%
FY'19	17.7%
1H'20	16.4%*

**Annualised return*
Source: Urban Logistics accounts

More than 14% of initial portfolio been sold and capital reinvested

More than 14% of the initial portfolio has been sold and the capital reinvested. There have been seven asset sales, including three in the first half of FY'20. The disposals generated a total property return, including income of 58% in a little more than two years, excluding one non-core sale.

1H'20 disposals are indicative of market appetite in that they were at 4.7% and 5.3% NIYs. These are interesting yields, as they compare with acquisition NIYs of 7.1% across the 45 assets acquired into the portfolio, historically. Management states that 75% value-added derives from asset management initiatives and transaction value-capture, as opposed to simple market moves. Since the April 2016 flotation, total (share price plus dividends) returns were +70% for SHED. This compares with +11% for the largest UK real estate sector shares. Year to date, the largest real estate sector shares' capital values have fallen 26%. The SHED share price has fallen 12%.

Warehouse REIT

Investment case

Results are due in one week. The urban warehouse market comprises facilities that are essential to the delivery chain, not just of internet shopping fulfilment, but also a wide range of parcel distribution and the logistics support of a wide range of customers. The assets are let to multiple tenants and are located within the urban environment, typically 50,000 to 100,000 sq. ft. in size. There is strong occupier demand; supply is constrained and rents are rising at around 3% p.a. consistently. Despite this, the rents are at such a moderate level (typically below £5 sq. ft.) that asset values (typically £70 sq. ft.) are below build costs. The REIT is in expansion phase – principally acquisitions – but there is a small element of non-speculative new build. Equity issuance and acquisition costs have, in prior periods, had an impact on costs and EPS, but EPRA EPS expansion from here should be exciting.

Rents have risen strongly, yet assets trade below replacement cost

Average rent per sq. ft. is £5.47, which is an NIY of 6.5%. Rent was £4.72 at float and £5.26 at end-March 2019. Warehouse REIT states the reversionary yield at 7.3%, as market rents are above levels at which the portfolio is currently let. Given the long- term, consistent drivers to demand and the current low valuations, we anticipate rents to continue rising on top of the "built-in" rises to catch up with the current market rates.

Warehouse REIT has an attractive pipeline of potential asset purchases. Its current portfolio stands at 6.2m sq. ft. The April 2019 fund raise was fully invested, at 7.0% NIY, within six months. This is a niche market compared with the size of some of the more "mainstream" markets. This is one of the reasons that the NIYs are still at a premium to the broader market: 100 bps or more.

A multi-tenant strategy brings risk but also reward

Reflecting the management skill and the strong market, occupancy runs at 96.8% (excluding assets under refurbishment). There are 638 tenants in the portfolio, up from 129 at time of flotation. The portfolio value is driven by the positive market dynamics we have summarised, but there is significant scope by detailed asset management. In a number of cases, value has been created by lengthening leases on assets with strong tenants, but disposed of by motivated sellers. One example is the Boots distribution centre, two miles from the M3, where a 42% rent uplift to £8.19 sq. ft. was agreed in 2019. Other examples include the reconfiguring and refurbishment of multi-let assets.

Shareholders

£2.2bn equity raised in past two years

The asset split for new money

Retail investors, including wealth managers, are a major component of shareholder support

We have assessed the REITs – what about the investors?

These REITs appeal to a broad range of investor categories. This may be one factor behind share price resilience (excluding the worst two weeks of market turbulence and the PBSA REITs). It is also a source of diverse new-equity funding.

In the past two years, £2.186bn of new equity has been raised (gross),by 10 of the 16 REITs covered. This includes the £393m all-equity merger of PHP with MedicX Fund (MedicX). Excluding this, the minor buy-backs and estimated issuance costs, a net £1.73bn, or more, has been raised.

32% of the gross amount (16% excluding MedicX) has been invested in primary health assets, 14% into supermarkets, 13% into care homes, 12% into "big-box" logistics and just under 10% into "last-mile" logistics assets.

As noted earlier, a London Stock Exchange-hosted webinar on 7 May (which Hardman & Co sponsored) illustrated that, while ca.5% of transaction cash volume is normally retail, the figure has frequently reached 20% in recent markets. Account openings at large private investor platforms have almost trebled (as per the presentation), and the balance is ca.75% to buy orders among retail recently. Investors and the REITs have the appetite to engage, and the "straightforward" REIT structure encourages this. Wealth managers feature strongly in the shareholder lists of the REITs listed here.

Shareholders and new equity

REIT	£m equity raise* in last two years, and shareholders over 3% holding
Assura	185; Artemis; Resolution Capital; Aberdeen; Norges; Vanguard; Troy
Civitas Social Housing	0: Investec Wealth; East Riding Yorkshire; MFS; Aberdeen; Massachusetts Financial Services; FIL Investment
Empiric Student	0; Investec Wealth; CCLA; East Riding Yorkshire; Premier Fund Managers; SG Kleinwort Hambros
GCP Student Living	120; Allianz; Rathbone; Premier; Franklin Templeton**; Henderson**
Impact Healthcare	135; Quilter; Premier; Valu-Trac; Royal London; Baillie Gifford; Schroder
LXi	375; BMO; JM Finn; Brooks MacDonald*; BlackRock**
Primary Health Properties	493; CCLA; Investec Wealth; Vanguard; Troy
The PRS REIT	0; Invesco; Aviva; AXA; Jarvis Investment management; Aberdeen; Liontrust; BMO; Thames River
Residential Secure Income	0; Close; Schroder; CG Asset Management; Valu-Trac; Premier; Aberdeen
Secure Income	0; Artemis; Kames Capital; Invesco; Troy; Investec Wealth; Smith & Williamson; Raymond James; Quilter
Supermarket Income	285; Premier; Thames River; Quilter; Schroder; BMO; River Mercantile; West Yorks Pension; Hargreave Hale
Target Healthcare	130; Premier, Investec Wealth; BMO; Valu-Trac; CCLA; Rathbones
Triple Point Social Housing	0; East Riding Yorkshire; CCLA; BlackRock; Investec Wealth; Nottinghamshire Council; Schroder; Brewin Dolphin; Tilney; South Yorkshire Pension
Tritax Big Box	250; Aviva; Brewin Dolphin; Vanguard; BlackRock; State Street Global; Legal & General
Urban Logistics	136; Allianz; Rathbone; Premier; Franklin Templeton*; Henderson*
Warehouse REIT	77; Investec Wealth; M&G; Smith & Williamson; BMO; Rathbone; Hawksmoor; Premier

** Excludes issuance to managers; scrip dividends and (for ReSI) share buyback*
***Among largest shareholders, but under 3%*
Source: Company announcements, FactSet, FT

UK "safer harbour" REITs

The main drivers to investor value

Simple

Transparent

In demand

A bit battered by broader bear market

- A sector where dividend prospects are predominantly strong and can be simply assessed.
- A sector where strategies are simple and transparent.
- A sector where many REITs have ca.90% CPI or RPI-linked long leases (most capped at ca.4%).
- A sector that is growing and undertaking significant equity raises, the majority of which have raised more than the original intention.
- A sector that has outperformed operationally and in share price terms.
- A sector where most share prices are down on the year to date, but are down only slightly in the past 12 months, indicating – we believe – an underlying resilience.

These are our selection criteria

Beware of the surprise

No "mission-creep" or "mission-leap"

Or: why these REITs make a better case than sector-agnostic REITs. These latter bring more surprises, in both Boards' evolving strategy and in financial outcomes achieved. This is a negative, and particularly so in weakened economic macro conditions.

Investors have grown to seek certainty of the Boards' mission

REITs in our index have better yields and more focus

For real estate companies without a specific brief, managements seek to create "alpha" by backing their professional judgement. The history of real estate companies encourages this. Post-war inflation, and the resulting boom in nominal values, made it tempting for many to diversify, borrow and grow. Land Securities began with £20,000 capital in 1944, and grew opportunistically, as did the much longer-established British Land.

During this time of real estate investment growth, the concept of a REIT – a real estate investment trust – was born. Legislation was put in place in 1960 in the USA. The concept of a REIT as a convenient investment "wrapper" meant that legislation was adopted globally. From January 2007, the UK brought in mechanisms where existing property companies could convert – at a minor percentage cost of asset value, which was later waived – and many took advantage of the opportunity.

Boards of older-established real estate vehicles, which converted to REITs, make their decisions about sector exposure

Without the benefits – and the allied dangers – of high inflation and gearing, specialism has been much more in favour since the UK REIT regime began. There were two camps – two investment philosophies. New REITs launched usually had a specialism, a tight focus by asset class. REITs formed from existing real estate companies also had a specialism, but this specialism consisted of giving management *carte blanche* to seek to add value. In a number of cases, management did just that, but, more often than not, the returns disappointed.

Specialism

New REITs created since the 2007 UK legislation are more specialist

"New" REITs correctly identified investors' concerns and executed strategies in line with investor needs

Investors' decisions on sector allocation can be executed by investing in management teams best suited to optimise those sector returns. The preponderance of REIT issuance has been in specialist vehicles. These REITs focus on one asset class. The earliest were into primary health assets. PHP launched on the stock market in 1997. Other early sectors included PBSA – Unite floated in 1999 – and self-storage – Big Yellow came to the AIM market in 2000. Unite undertook development, and thus did not fit within the REIT legislation. Big Yellow is a REIT, but is an operating company – so we consider its leases to be particularly exposed to short-term changes and macroeconomic fluctuations. As investment conditions recovered from the 2008 financial crash and investors sought to raise real estate exposure, many more specialists were launched.

We favour index-linked income streams

The "universe" of these 16 REITs has eight where over 90% of lease income (all of which is over 10 years' duration) is CPI- or RPI-linked. Two more (Assura and PHP) are a mix that is effectively likely to track CPI plus and is upwards- only. The three logistics REITs are in addition, and, here, the market supply/demand is likely to lead to upwards-only rent moves, although with market risk.

Well over 50% of the "universe" income is CPI- or RPI-linked (usually capped at a 4% p.a. rise).

Bond-like security can be a false friend

Many go for long leases, but take care

Always pitfalls

The specialists focused often – not exclusively – on long leases. For example, the specialist, PHP, benefits from a WAULT of 12.7 years. There can be risks with long leases. They can seduce management and investors to gloss over covenant strength, which always remains essential. AEW Long was one of 17 REITs covered in our 2019 report. While AEW Long benefited from a WAULT of over 20 years, the covenants were poor, and it proved difficult to secure new tenants in assets that were over-rented in some cases. Nonetheless, many of the new, post 2007-founded REITs, focused on sectors offering long-term visibility.

A change vs. our previous research

Hardman & Co defines the relevant REITs as having long occupancy and either a focus on an individual asset class, which remains constant over time, or a strictly defined criterion for long-income investment. Annual direct-let PBSA REITs do not fit into these categories, so, in future, we will exclude them.

Certain REITs' missions based on asset characteristics vs. strict type

Of note: LXi

By this, we mean, for example, LXi, which has been touched on above. This targets long-dated income with built-in uplifts in leases written by tenants offering strong covenants. It is a REIT whose mandate is not asset-class specific. These REITs (Secure Income REIT would be another example) have the opportunity – by their mission – to recycle capital (after a number of years and rent reviews) from one sector "type" into another.

Mid-sized logistics specialists, e.g. Urban Logistics and Warehouse REIT

Another way in which the character of asset selection may vary from the long-income security is within asset classes in structural under-supply. Mid-sized logistics assets (Urban Logistics, Warehouse REIT and others) are a particular example. Mid-sized logistics' good NIYs come with strong rent growth, driven by under-supply. Leases typically are five years or longer, but this indicates an average term below many of the 16 REITs in this report. Here, under-supply and ongoing strong demand (omnichannel retail growth being just one driver) mean that reversionary potential outweighs the benefits of 10-20-year-long leases, we believe. This facet is essential regarding our inclusion of these REITs in a secure income research report.

Certain other specialists excluded

This may beg the question as to why this report and the March 2019 predecessor do not include specialists such as New River, Hansteen or the growing Stenprop in their research. These REITs focus on retail and industrial assets. Simply put, we considered retail – New River – to be specialising in assets where absence of long leases was not made up for by benefits of secure asset-class drivers to rising rents and reversions. Retail – even convenience retail – cannot be seen as secure. We look at "security" or stability from the point of view of a UK investor. This rules out overseas markets, we believe. Exclusion of Hansteen and Stenprop, due to exposure to overseas markets (Germany, principally), thus follows in an inescapable, straightforward manner.

Tritax Eurobox noteworthy

Tritax Eurobox is also excluded, simply because it is non-UK in its specialism. It is considered that Tritax Eurobox offers strong security and growth, but its mandate is outside the remit of this report.

Yew Grove noteworthy

Yew Grove is excluded because it is a vehicle for investment into RoI, exclusively. Its focus is interesting, being a high-quality covenant that is foreign direct investment (FDI)-led. Its investments are outside Dublin's central business district. We consider this a secure and growing income play, but it is outside the remit of this report. Rent collection in the recent quarter has been just shy of 100% on time.

Exceptions and why we include them

The REITs listed in this report – which replicate the universe in our March 2019 report – offer characteristics of long-term security of steadily growing income. We should reiterate the proviso that the PBSA REITs have questions to answer before continuing to be seen as secure. A major characteristic (not present in PBSA) is the length of the actual leases. Nearly all REITs listed benefit from WAULTs of 10 years or more. There are exceptions to the long WAULT element of investment characteristics.

Shorter leases make sense where reversion uplifts abound

Certain sectors have particularly compelling prospects

Within the asset-class specialists, a significant exception to the long-lease REIT focus is the investors in mid-sized logistics assets (Urban Logistics, Warehouse REIT and others). Mid-sized logistics' returns are strong, with good NIYs and strong rent growth, driven by under-supply. The under-supply is built in through the multiple growth drivers; these do not just include internet shopping, which is consistently over 20% of the total, now. They also comprise expansion in parcel logistics generally (including NHS distribution centres owned by REITs in this segment).

The inclusion of other short leases has disappointed in 2020

2020 exposed some, perhaps surprising, weaknesses in pricing power

Other exposures to shorter leases are far less robust, as the investors into PBSA, such as Unite, Empiric and GCP Student, have discovered. Student accommodation NIYs are significantly lower, new supply (into an under-supplied market) is high, and the relationship with the tenants is articulated through the universities themselves, giving the tenant-channels (the universities) significant leverage over the actions of the PBSA providers. They do not really fulfil the criteria for inclusion here.

This has resulted in a very difficult 2020 for this sector's rent collection. There may be longer-term questions, and confidence in how these are being addressed is not yet high.

A different definition of "focus"

Conundrum at LXi

Then there are those among the "new" REITs, which seek to create "alpha" by picking sectors within the guidelines of a strict investment philosophy. The "new" REITs do include some that invest across sectors selected by the Board. One example is LXi. There is a strong mission: inflation-linked, long-lease income (the "L" and the "i" in the title). That is the focus. The focus is not the specific asset class. The fund-raise history and the recent share price movements, we believe, give interesting insights to the stock market sentiment towards such management-driven strategies (within strict guidelines). Recent weakness at LXi and the relatively slow initial fund raises indicate to us that investors are not as supportive of such a philosophy versus the sector-focus one. In the case of LXI, we believe this currently offers a good opportunity to look at its track record and prospects, which seem encouraging.

We turn briefly to LondonMetric (LMP). This REIT is "on the cusp" of being included in the REITs covered in this report.

Nearly 70% of income is from logistics assets, the majority being in our favoured asset class of "mid-box" urban logistics assets. However, almost 30% of income is in retail stores, convenience and leisure. There are some "roadside" assets. Six of the top 10 tenants comprise large stores or cinema. The report may perhaps be too backward- looking here. LondonMetric is a growth REIT, deploying proceeds of equity raises (the most recent on 7 May 2020) into the logistics arena. Its leases' WAULTs are longer than those of Urban Logistics or Warehouse REIT.

A word on capital deployment

Speed of deployment: certainly, this is an important factor, but is top speed always best counsel?

Separately, investment into private rented accommodation, for example PRS REIT, offers shorter leases. The challenges here are more to do with speed of deployment and upfront costs. This should be surmountable, but the minor deviation from the timings outlined at flotation have affected DPS progression and, understandably, put this REIT on the back foot, initially at least.

Interestingly, another residential-based REIT was slightly slower in deploying, and this too put sentiment against it initially: Residential Secure Income. Performance since year one has fully illustrated why the speed of deployment was, in fact, appropriate and, ultimately, positive. Residential Secure Income has come out as having a strong call to being the best selection of residential assets in UK REITs. It combines (generally, although not invariably) longer leases – typically five to 10 years, although length is not typically contractually fixed – with high-quality covenants. On these bases, it clearly qualifies as a secure income REIT.

In residential, ultra-long leases not always worry-free

Residential Secure Income combines security, high-quality covenants and reasonably long leases. This appears to us a good combination, and contrasts with the totally different residential model of the ultra-long leases of the supported housing REITs, Civitas and Triple Point Social. Here, capital was deployed more rapidly. The models are driven by long leases, but issues with the counterparts have proven challenging, and, indeed, the Regulator has become involved on several occasions.

A word on geography

This report's remit does not include UK-quoted REITs investing predominantly in non-UK assets. It is considered that Tritax Eurobox offers all the characteristics of security of long-term progressive income that might be sought in a REIT investment. It is not included for the simple geographical reason listed above.

How these REITs fit into "new normal"

Summary

Safer rent streams seem to bring higher rental growth –pleasant double win

- UK all-property rents were already set to grow significantly slower than "safer harbour" REITs. COVID-19 only accentuates trends already in place.
- Real estate relies on debt, but the 2008 crisis resulted in much lower debt ratios – ones we consider sustainable and modest.
- Consumer spending has attracted much more debt than business investment. This drives security for "safer harbour" REITs, and also keeps long-term interest rates damped down, supporting the rating of low-risk income streams.
- There might even be (some) stagflation. If there is, it will benefit carefully selected REIT investments.

Both in assets themselves and at level of the vehicle (in this case a quoted REIT) – liquidity is good

- Cash is king, and parts of the real estate sector are dangerously illiquid. "Safe harbour" REITs tend to support liquidity.
- Liquidity is a key plank for dividends, and the dividend payment situation for the market in general has been made much worse, permanently, by COVID-19.

Most have passed test on rent collection in difficult times

- However, it has not been made notably more difficult for the "safer harbour" REITs – the contrast with the broader market is quite stark.
- The "safer harbour" REITs generally provide assets that society needs in increasing numbers, just as they generally provide income streams that investors need to an increasing degree – a happy co-indicator.

Some myths deflecting investors from appreciation of this specific REIT universe

Some myths: GDP downgrades drive real estate prospects

What drives them more is "are the assets fit for the future?"

Not really about GDP or business confidence gearing any more

The UK property market was already heading for minimal rental growth in 2019 and 2020, and that was before the recession hit. The problem was much more to do with obsolescence than GDP. That the COVID-19 crisis has accentuated and accelerated the obsolescence is more important than the recession. Our report – and our previous report, published in March 2019 – seeks REITs that are not "obsolescent".

Some myths: real estate relies overly on debt

It does make use of debt. But not excessively.

Apart from immediately after fund raises and excluding *de minimis* elements of specialist alternative sectors, all REITs take on debt. The issue is more i) is debt an overly emphasised element in gearing returns on equity, and ii) is the debt sustainable?

Difficult to find seriously over-geared quoted REIT – unless its asset values have collapsed

Since 2008's shock, all quoted (and most non-quoted) real estate investment has de-geared. Debt remains a part of the equation, but in sustainable moderation. And there are no longer the assumptions that it will be automatically "rolled over" in effortless re-financing. We genuinely believe lessons were learnt.

Central banks around the world haven repeatedly used quantitative easing since 2008. This has kept interest rates low. However, although it has also meant debt is readily accessible, it has not meant debt is as plentifully used as it was before 2008. Debt ratios for real estate – certainly commercial real estate, including even buy-to-let – are consistently below where they were pre-2008, across the board, by sector, by type of investor and globally. 2008 and subsequent quantitative easing, if anything, provided abundant equity, even more than debt. It kept the economy going, in both consumer and public infrastructure, generating equity.

One major area that was not boosted by the post-2008 environment was business investment. Some of the UK statistics on this are addressed on page 90, but this is a global phenomenon, at least in the developed world.

For these reasons, and because UK is in a recession and entering a prolonged period of generally lower growth, long-term rates are seen as staying "lower for longer". We are not concerned by the types of loan to value (LTV) and interest cover in the REITs in this report.

However, issuance of debt has, of course, ballooned since March 2020, i.e. government debt. This has taken place across the globe. "We are all in it together", issuing government liquidity through debt. In addition, there are global imbalances. The Fed expanded its swap lines to a range of new countries to help ease a global squeeze on the dollar. While this may be a near-term solution, it bodes badly for all "risk" countries and countries relying on short-term capital from abroad. That was what tanked central Europe in 2008, and it is a real risk now, unfortunately, for other geographies. In as much as this hits risk assets' funding lines, an investor would view this as an additional reason not to be overly geared to assets whose cashflow, both short- and long-term, is not assured. Again, the REITs in this report are not – we consider – in this category (with the possible exception of Secure Income REIT).

Stag-flation?

A "what-if" – the sector looks good here too

One thought, and a speculative one at that – If the COVID-19 economic shock is relatively short-lived, one scenario is faced, but it may well prove longer if no vaccine is found this year. In that case, globally, governments might find that their debt issuance has become onerous. Might they be tempted to allow RPI inflation to drift to upper ends of ranges, while keeping interest rates low? We certainly would not write off the possibility of an element of "stag-flation" returning in a worse-case scenario post COVID-19.

In "stag-flation", it might be the case that bonds would not perform so well, but real estate would fare better, the clue being the name "real estate", whereby ultimately income derives from the real economy. This is the case for both public and private sector tenant-driven investments.

There are numerous risks, but the overall picture is of as many upside opportunities as pitfalls. If investors can skew towards the former, they should – in real estate – emerge well. We believe the former consists of secure, long-term accretive income streams, and we explore the opportunities in this report.

Real estate is illiquid and "cash is king"

Open-ended funds – investors will switch out and may move into secure income REITs

£10bn lockdown, or, oops I did it again

Since 18 March, more than £10bn of investors' money has been locked in open-ended UK property funds. This comes in the wake of the exercise of a specific mechanism: the Material Uncertainty Clauses (MUC) by property valuers, which indicate the inability to ascribe a value to physical property. This is very much a case of "here we go again", with the open-ended funds suspended over Brexit, later on last year driven by retail, and earlier driven, of course, by 2008 and subsequent events, and even, at times, earlier, when there were benign economic conditions.

Open-ended funds that purport to be valued every day surely have had their day. Similar retail-orientated funds in other countries are not valued every day. The interstices can be up to a year in major European countries. Open-ended funds are not liquid.

Lockdown ends earlier for different types of population

We are where we are on MUC clauses and, just as physical "lockdown" looks likely to be lifted differentially, the case is the same in real estate. Charles Smith, chairman of valuation and advisory UK at Cushman & Wakefield, has commented (*Investment Week*) that different asset classes will have the MUC lifted at different times: central London offices, annuity-style investments and logistics are likely to see the earliest removals[1].

The Hardman & Co view is that those sectors are indeed the ones, but the first is there by dint of liquidity, whereas the others are there because they are the beneficiaries of the new environment, just as much as they are (more) beneficiaries of the recent environment. They feature heavily in this report.

Investment Week, in the same article of 29 April 2020, quotes CBRE's Knight, explaining that clauses would be removed when a greater level of investment trading returns, providing empirical evidence to benchmark valuations. However, he suggested that there is a growing indication that a healthy level of long-income investments will trade over the course of the next few weeks. The removal of the MUC could follow for this sector. Also referenced was QuotedData's Richard Williams. The article references the acceleration in online retail sales, which could be negative for bricks-and-mortar retailers but positive for investors in warehouses. Another sub-sector that has fared well during the crisis is the healthcare property sector, where income is backed by the government.

REITs can, and do, avoid the illiquidity trap

In summary, the REITs in this report circumvent the illiquidity trap. They focus on sectors that are attracting new inbound investment. Also, the REITs (bar the exceptions highlighted) provide good dividend income. This is a crucial element in the mix. This can only be made more attractive – permanently – by COVID-19.

Dividends – it just got permanently harder, but not for these REITs

UK top 100 quoted dividends halved: REITs in this report cut 10%

Some drama for 2020, but any recovery will be only very partial

Whoever says REITs are more exposed to GDP is not looking at the 16 REITs in this report. Yet all bar two have share prices that have gone down this year.

UK top-quoted 100 dividends for 2020 have been cut by 42%, and this may well rise to ca.50%. See data as per *Investment Week* and *Financial Times*. At worst, 20% of the 16 REITs listed in this report will cut dividends in 2020 to the tune of 50%, we believe.

Partly economic, partly (rightly) political

Dividend cuts are big news. Of course, it is likely that many of the 2020 cuts will be partially reversed in 2021, but the reversal will be partial. This is a permanent, major change. When COVID-19 subsides, dividends will stay well below 2019 levels in the UK market in particular, but in global markets generally. Post 2008, dividend cuts were a sign of distress. Now they are more a sign of prudence (both financial and political).

[1] *https://www.investmentweek.co.uk/analysis/4014390/house-cards-crumble-recession-uk-property-market-underway/page/1*

REITs legally mandated to pay out…

However, REITs are mandated to pay out income as dividends. As ever, life is slightly more complex than the "headline", as the REIT "Property Income Distribution" has to be 90% of income after certain deductions – notably capital allowances. But the thrust of the argument is that REITs will continue to pay out the large majority of cash income profits as dividends. This puts them well ahead compared with total market prospects.

…these corporates are not

On 30 April, Royal Dutch Shell announced that it would be cutting its dividend by two thirds. It has been a solid, progressive dividend payer since the Second World War. It may be a sign of the decline in the carbon economy, but then Sainsbury's too has announced a dividend cut. It is calculated that 38 out of the top 100 UK quoted corporates have passed, cut or deferred £18bn of dividends for 2020. These had been paying £42bn p.a. dividends (Source: AJ Bell, and see also *Financial Times* of 9 May 2020).

The 10 highest dividend payers, UK, as of April 2020

Corporate	2020 dividends (£bn estimated as at Apr'20)
Royal Dutch Shell	11.9
BP	6.6
BAT	5.1
GlaxoSmithKline	4.0
Rio Tinto	3.2
AstraZeneca	2.9
Vodafone	2.4
BHP	2.1
Imperial	1.9
Diageo	1.8

Source: Sharecast, Refinitiv, Investment Week

The UK, with its preponderance of income funds, has espoused the dividend culture in recent years. After all, dividends are cash and cash is king. Research by Kepler has pointed to the AIC (Association of Investment Companies) trusts' discount volatility. This has been undertaken by sector, where sector is defined as an investment "style" or "strategy" mandate. UK quoted trusts with a high level of unquoted investments exhibit volatility, but so too – maybe counter-intuitively – have income sectors. These exhibit higher discount volatility than the "income-agnostic" cohort in each geographical area. Dividends were already seen as less reliable. Now, this forward-looking scepticism exhibited in the volatility has come to pass.

£52bn gap. This sub-sector can help a little.

As at 6 April 2020, 15% of the FTSE All-Share companies by weight (24% by number) had already confirmed their intention to cut their dividends. According to *Link*, more than £52bn of dividends are now allegedly at risk under worst-case scenarios; with ca.£110bn of dividends having been paid out in 2019, this would represent a fall in dividends of ca.47%. This is "at risk", not a quantum of cut; nonetheless, it is a dramatic figure, which is impossible to ignore, even if it is a one-off.

George Lagarias, chief economist at Mazaras, is of the view – quoted in *Investment Week*, May 2020 – that companies that have received state aid will feel constrained in paying full dividends.

It may well not be a one-off. Governments have funded the economy.

A new source of equity has been found

Stakeholder equity in growth market

Stakeholder equity, CSG, government intervention – all these have seen a major boost since COVID-19 hit, and none are going away. This may be a good thing. It concentrates the mind as regards real estate. Dividends come via a Board decision within a legal framework. It also, increasingly and permanently, comes courtesy of a social contract framework. Rent comes via a legal contract. It also, increasingly and permanently, comes courtesy of a social contract.

The stakeholder

UK banks have already abandoned dividends in the face of political pressure and Bank of England warnings. Some companies, such as Tesco, remain committed to paying out dividends; Sainsbury's does not.

Getting tougher still for landlords who were finding it tough already

The government does not want landlords to pursue commercial tenants unless they owe more than three months' rent. When did the government start taking a view – and enforcing it – on tenant delinquencies? Since it passed a law, that is when. The clear intention is to support valid business models undergoing short-term extreme strain. The law is, however, a blanket one. This may well be a good thing. It plays to the same audience as the entreaties of the Bank of England overpaying dividends.

Significant proportions of corporate America – and the UK – found it difficult to demonstrate that they were doing the right thing post the 2008 bailouts. This damaged trust, but things muddled on. It was noted by the corporates as much as by the public, employees and government; so corporate decisions have rapidly recognised that there are important issues here. A number of corporates have undertaken charitable giving, linked to their product or their geographical spheres. This report points to how student accommodation has, in many cases, written off three months' rent income or more. It seems that corporates recognise that the manner in which they treat employees and customers today will have a big impact right now and for future years.

Examining how companies assess and address their ESG risks in light of this crisis, and its potential aftermath, is particularly important as we consider preparations for a restart of the economy.

Sustainable investing lies not only in delivering solid financial performance, but in advancing a more stakeholder-centric model of corporate behaviour.

Many REITs will not find dividend payment more difficult

Many REITs in this report own assets of real use – they are "key worker" REITs

Economic positioning can seem unfair. It is less difficult for some than for others. Investors in sectors that are of real, tangible, visible value to the way in which post-2020 society functions will find life much easier. To a degree, it was always thus. Investors should invest in things society needs.

Many of the REITs in this report have "key worker" characteristics

REITs investing in assets that are clearly essential services – medical, logistical, staple – achieve "key worker" style status. These REITs are the equivalent of people able to go to the supermarket to shop before any others are allowed in. Which are these REITs and is their valuation by investors in line with their valuation by the broader society – a broader society that has a permanently clearer and louder voice than it did two months ago?

REITs legally have to pay dividends

In this report, we lay emphasis on sustainability of income. After all, cash is indeed king.

REITs' mandate is to pay out income via dividends. They are therefore not tied to the political difficulties of making payments while receiving – directly or indirectly – government/public money. Maybe there is an overarching risk here. Could COVID-19 mean that private investment will not be allowed to support public requirements? Would that imply that the government would stop paying housing benefit, stop paying (this is already seen as under-paying) for care homes, refuse to pay rent to get medical premises built? The answer is "no", simply because, post COVID-19, all these sorts of things will be needed more, not less, no matter how stretched the government finances might be.

"Key worker" REITs

Finding solutions to life's questions

Care homes, GPs, logistics, supermarkets – the "staff of life"

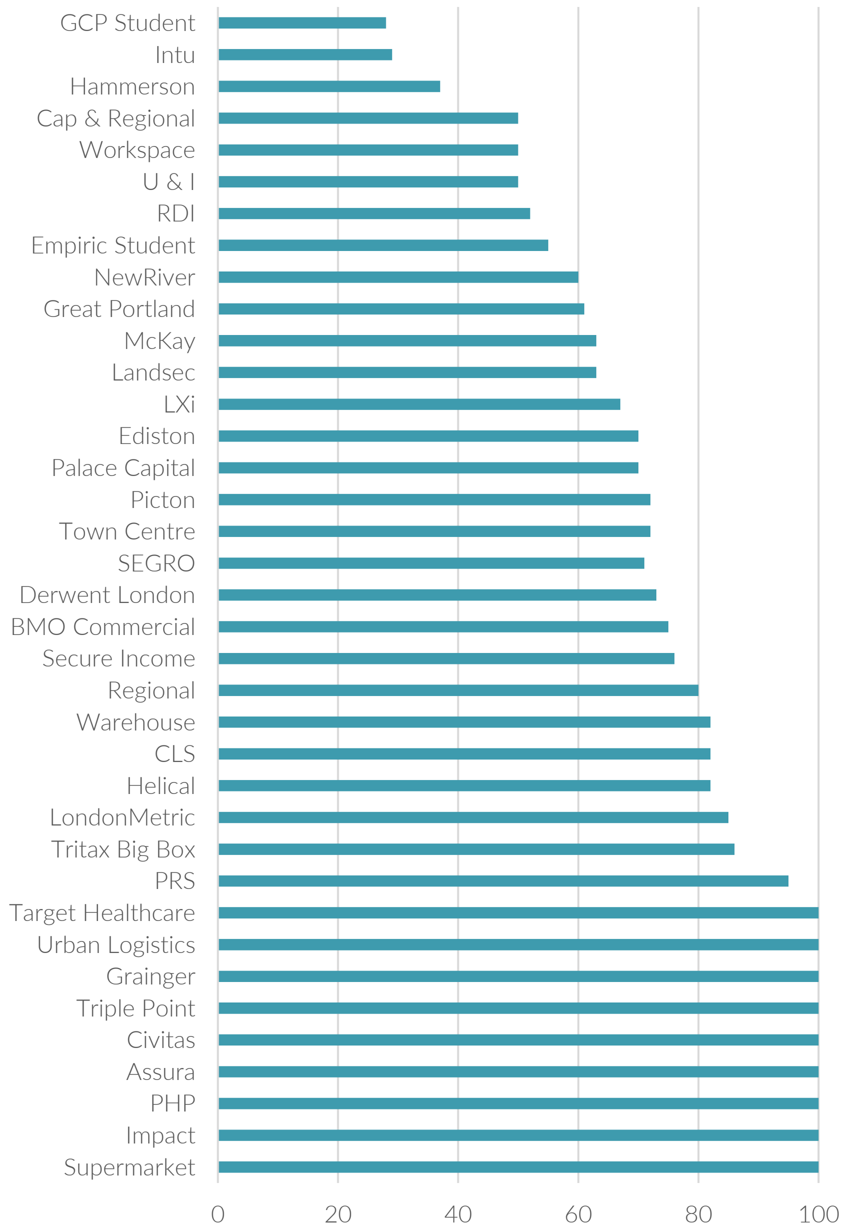
More real estate investors provide the "staff of life" than might be immediately imagined. We find it surprising that REITs providing care homes' logistics assets trade at discounts to net asset value (NAV). There is a clue here, we believe. We consider this to be an anomaly and to illustrate that investors still lump all real estate as too dangerous to be involved with. Where the case is crystal clear, for example in primary medical assets, investors are almost forced to pay premium prices. They have consistently subscribed to new equity at a premium to NAVs. PHP and Assura trade at over a 40% premium to historical NAV, for example.

Second-quarter rent collection

COVID-19 has placed a strain on the commercial arrangements of many corporate entities across sectors and across the globe. One measure is the timeliness of contractual payment terms. Effectively, all commercial real estate benefits from rents paid quarterly in advance. We summarise recent announcements made by REITs in this publication and leading REITs across the UK market.

Rent received (or firm agreements) as % of rents due end March 2020

See important notes, overleaf



Source: Company announcements

We note market announcements of the recent performance of REITs' rent collection for the quarter due end-March 2020. This has naturally been of significant interest to investors, as well as other stakeholders, such as lenders, tenants and others. The table above excludes British Land, which is about to report as we go to press. We would be pleasantly surprised if it were to report much above the average ratio achieved by the REITs listed here.

We allow investors to reach their own conclusions, but, apart from the two student accommodation REITs, all bar LXi and Secure Income REIT (see commentaries in this report)have performed well into the top half or have achieved effectively 100% collection.

Important notes on the chart above

In the chart above, the figure stated is a mix of rent received late and rent written off – often weighted to the former. Analysis must be made of the individual REIT and the extent of risks of i) writeoff vs. delay and ii) potential shortfalls in future quarters.

We do not want to encourage investors to see 100% collection as the only measure of success. An important example here would be Tritax Big Box, at 86%. Tritax Big Box's tenants are nearly all of the highest covenant. Some made arrangements for payment in April and May, Tritax Big Box announcing that it confidently expected 96% of rent to be collected by the end of May. Similarly, LondonMetric has announced an equivalent 92% by end-April.

We also must put in context a number of the 100% ratios in the chart. Even the most high-quality covenants (e.g. H M Government) may, from time to time, pay a week or two late. A number of the 100% figures stated in the chart above represent actual end-March 2020 payment received of 93%-98%, if this figure is at least as high as the March 2019 figure and if 100% receipt is realistically anticipated as the figure to be received shortly. Furthermore, some of the figures include rent not paid at end-March 2020 (these are quarterly, in-advance payments), but where an agreement has been reached by both landlords and tenants to defer the quarter in-advance method and alter this to monthly payments over the coming quarter. Target Healthcare and Palace Capital are two of several examples where this set of arrangements has been contractually agreed.

PBSA REITs have made announcements regarding their rent payments for the academic year 2019/2020. In rental contracts, PBSA will be paid monthly, not quarterly. Late payments, and payments where the landlord has agreed to forego the rent, will be almost exclusively related to periods where students have vacated the premises early and not returned. Our methodology is to take the figure of the percentage of the total academic year rent foregone and multiply this by four. This may be considered a conservative way for us to track the rent, but we certainly do not wish to mislead. As this cash effect will all be in the future, if judged by an end-March 2020 cut-off, the chart above should strictly show 100% collection for GCP Student and Empiric. However, in a large majority of individual tenant contracts, this is now almost entirely rent that has been written off. In almost all other cases in the chart, the figure is a mix of rent late and rent written off – often weighted to the former.

REITs' individual prospects

Hardman & Co does not provide share price targets, and this report does not include forward estimates, other than commentary on prospects for sustainability of DPS growth. This commentary is based on Hardman & Co analysis and on statements made by REITs regarding dividends in their recent COVID-19-related regulatory news announcements.

As noted, PHP and Urban Logistics are clients of Hardman & Co.

REIT summary commentary

Quoted REIT	Description
Assura	Well-placed to deliver low-risk DPS growth, as rents are set to continue to rise in this sector.
Civitas Social Housing	No COVID-19 impact. Certain lessee problems in 1H'19, but their leases have been novated. Model evolves.
Empiric Student	COVID-19 has hit hard. On the face of it, rents should grow, but the 2Q'20 shock is not fully resolved.
GCP Student Living	Same sector-macro issues apply to GCP Student as to Empiric. Overseas exposure.
Impact Healthcare	Well-placed: good asset yields and opportunities to grow collaboratively with high-covenant tenants.
LXi	Strong track record. Share weakness relates to blue-chip budget hotel exposure: this is overdone.
Primary Health Properties	Rents are continuing to accelerate. RoI expansion and falling costs of debt boost EPS too.
The PRS REIT	Undertakes no development, but DPS prospects are related to growth, and some delay may occur.
Residential Secure Income	COVID-19 events are neutral to positive. On balance sheltered housing rental benefits.
Secure Income	Excellent track record is under rather a shadow, given the (blue-chip long-lease) leisure assets.
Supermarket Income	Investors recognise COVID-19 as neutral to positive. Long term, there are also negatives at play .
Target Healthcare	Well-placed, securing good NIYs. The care sector has done well under historical funding restrictions.
Triple Point Social Housing	The same sector as Civitas. We prefer the asset mix: more purpose-built. No COVID-19 issues.
Tritax Big Box	COVID-19 has accelerated occupier demand. However, NIYs are relatively modest, and is supply rising.
Urban Logistics	COVID-19 accelerates demand. Excellent NIYs. Single-tenant letting. Chronic supply constraints.
Warehouse REIT	The same sector as Urban Logistics, WHR's assets are leased on a multi-tenant basis.

Source: Hardman & Co, based on company announcements, presentations and report and accounts

Assura

www.assuragroup.co.uk

Ticker: AHR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
77	78	61	3.6	1.44

** Priced as at 18 May 2020*

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Finsbury.
- **Next anticipated announcement:** AGM 2 July last year – similar date anticipated this year.
- Assura owns a UK portfolio of primary medical assets. These assets are local community health hubs. Leases, contractually, are upwards-only, paid by the government, effectively. Primary health assets benefit from 100% government income. 15% of income is from allied assets with a strong income backing (much of it pharmacies).

Performance

Primary health assets benefit from 100% government income. 15% of income is from allied assets with as strong income backing (much of it pharmacies). Successful fund raise

Assura owns and develops modern primary medical facilities, which provide community hub medical services – GP surgeries, pharmacies and allied services. This is a growing market, as non-purpose-built stock – still the majority – becomes an increasingly less appropriate medium to deliver community health. Assura reported a solid set of figures on 21 May. All rent was collected on time, and good progress was shown on the investment pipeline, which will be executed through taking development sites through the build process, as well as acquisitions of standing stock from third parties. As modern, larger facilities have been shown to deliver, this is a sector with much lower – though not nil – risks to development than any other. All are pre-let. The only real risk of relevance is the cost of the development team itself. Assura raised £185m in new equity at 77p in April 2020 – so there is a modest cash drag to the 2020 EPS.

Growing rent escalation, and large and growing development pipeline

Assura reported advancing profits, with valuations stable at an NIY of 4.68% (4.74%) and rental levels rising. WAULT stood at 11.7 years. Open-market value-based rents rose 1.2% like-for-like, slightly up from the 1.15% reported previously. The rise is modest, but the direction of travel is important, and is highly likely to continue. Two thirds are open-market, but the advances at the rest were higher – so the total advance like-for-like was 1.8%. EPRA cost ratios were almost the lowest in the sector, at 12.6%, and would be not far above 11%, excluding the development team. Growth is an important issue, with the recent equity raise in mind. £67m of standing stock, at a minimum, is set to be acquired in the next six-month period. There is also £20m of capital being invested in asset-enhancement projects on the existing estate. This is over the next two years, although the figure may grow. As to new development, the large majority is on-risk, with a small amount of forward-funding also undertaken for third-party developers. NIYs are ca.100 bps for such self-development. Assura is on site on 15 projects for £81m gross development value. A similar further amount will be on site in a year. Assura stated the forward development pipeline, and the figures for the 67 schemes identified a total £357m development value.

The financing of the business is an important element of economic value-added. These assets are of a low volatility, and Assura is a strong covenant. Recent debt funding has been secured at a 2.3% interest rate; the average on the total debt is 3.03%, down from 3.24%. From this level, there may be a little scope for further falls in the average cost of debt, but it is a modest element to the potential growth in EPRA EPS.

Commentary

High-quality assets – NIY under 5%, reflecting asset class's attractions, but assets are hardly more expensive than market average

Growth from here should be deliverable, with modest risk. The pipeline will grow the rent roll ca.15% (half that being on site or short-term). Assura is an experienced developer. In 2019, it purchased a long-established developer partner, GPI. All is pre-let. There is an element of developer uplift but, at the last results announcement, it owned 560 medical centres, compared with a total UK market of ca.9,000.

Excellent asset track record over cycle

Assura is a relatively low-risk growing REIT, barring any totally unexpected development problem. This growth is more the combination of portfolio expansion and developer profit on an expanding development pipeline than rental increases, which are accelerating slightly. As an illustration, the yield pick-up on developer cost vs. valuation, on an eventual £357m of developments, equates to over 5% of the equity value of Assura, although this uplift is only, at this stage, illustrative, and will take some years to deliver.

As the portfolio NIY is 4.68%, among the lowest in the REITs covered in this report, the accelerating rent profile is an essential element to a positive investment case. It is not much below the latest All-Property MSCI, which stands at 5.1%. The risk premium seems too low, and particularly so with recent market developments.

It is noteworthy that, in the 12 years since the MSCI instigated sub-sector returns and volatility measurement, all-property has risen 4.9% annually, vs. 7.9% for primary healthcare. Standard deviation of risk was 4.1 and 10.5, respectively. For equities, the figures are 4.5 and 15.0.

Civitas Social Housing

www.civitasreit.com

Ticker: CSH				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
102	91	84	5.3	0.94

*Priced as at 18 May 2020
Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Buchanan.
- **Next anticipated announcement:** Final results, in the prior year, were announced on 24 June.
- Civitas invests in purpose-built or significantly adapted properties for the delivery of mid- to higher-acuity care. Leases are upwards-only, paid by housing associations who, typically, will have been the former owners of the assets. Income ultimately is derived from government housing benefit. More than one third of the portfolio by rent roll is supported by back-to-back 25-year leases, written by care providers to Civitas housing association partners in higher-acuity stock.
- There is a significant strategy evolution – now, one third of assets are in mid- to higher-acuity care assets. A year ago, all assets were supported housing

Leases all 20 to 25 years, upwards-only, CPI-inked

Performance

Portfolio has evolved but long lease structure remains fully in place

Less a residential investment generating ultra-long income streams from tenants, some of whom are small

We make three overarching comments on investor strategy. On one level, this REIT is invested in a sector with 20-year-plus leases, all CPI-linked and where – crucially – the life outcomes on its occupiers are quantifiably enhanced. There is growing demand, and income is government-backed. On another level, the Civitas strategy has evolved significantly in the past year. This is increasingly less a specialist residential investment and more a care/clinical outcome-driven asset class. A third of the portfolio is higher-acuity stock. On 7 May 2020, the name of the company's investment adviser was changed from Civitas Housing Advisors Limited to Civitas Investment Management Limited, to better reflect the scope of activities now undertaken. Housing is de-emphasised

More a higher-acuity clinical setting, so more to be valued as upper-end care facility

The third of the portfolio, with care providers who have been contracted to step in to take all the occupancy risk obligations of the housing associations, constitutes a significant two-fold change. First, the care providers are now directly relevant operationally and financially. Civitas tends to work with the largest and most credit-worthy. Second, this is a step into a different "level" of the market, which has always been addressed by Civitas, but one related to the provision of care – where Civitas has expertise. For the care providers, this secures access to this higher-acuity stock for the long term.

But difficulties of 2019 left a mark. Problem absolutely not replicated in one third of portfolio, which is the new-style higher-acuity stock.

On a third level, 2019 – pre the higher-acuity roll-out – was a bumpy year for the business model. The regulator in the housing association sector became involved and certain weaker tenants (smaller housing associations) had to let go of the leases, and, fortunately, they were all novated across to stronger housing associations, with *de minimis* rent loss. Civitas – and the wider sector – has worked through this. It is worth noting that two thirds of the portfolio is in the new higher-acuity sector with the new-style back-to-back leases. The outcome of the difficult 2019 is that rental income has performed as per contract, rising steadily with long CPI-linked leases. COVID-19 is a challenge for the operators and tenants but has no financial impact on the lessees.

Commentary

The scope for valuation upside on higher-acuity facilities is clear. Care/nursing facilities' valuations come in a very wide range. Dependent on quality and sustainability of a facility's ability to keep up with potential future changes, the NIY valuation can go as far as 4%. There are risks, but the transition risks are reduced by Civitas's expertise gained with the care providers within its supported housing assets.

On 19 March 2020, Civitas announced: "The Company has noted previously an ambition to own freehold properties that facilitate not just the delivery of care for long-term conditions such as learning disability, autism and mental health but also in respect of other urgent needs with significant unmet demand including homelessness and step-down accommodation for the NHS….. This would, in due course, enable Civitas to enter into long-term leases with the NHS which may be structured in the form of specific joint venture arrangements and also with registered charities operating within areas of investment interest to the Company. Accordingly, it is intended that the Company will in due course seek to convene an EGM with the purpose of seeking shareholder approval to amend the Company's investment policy." As per the 11 May update: "The Company's portfolio is specifically focused on properties that are suitable for the delivery of mid-to-higher acuity care and these services remain in high demand as usual."

Scope for re-rating but this would be some way into future

Nonetheless, we value REITs on quantum and sustainability of dividends. It is yet to be proven that the higher-acuity stock is worth more through its better prospects (i.e. rated highly on NIYs) or if it brings more rent per £ invested. After the re-rating, more information is needed before the market fundamentally reviews its long-term DPS growth rate. The first moves are encouraging.

The higher-acuity situation is a very different one. We understand the market's initial enthusiasm.

Problems of 2019 Regulator's involvement may very well not return, but they did highlight some issues

Rent losses were de minimis and lessees have been strengthened

However, it cannot be ignored that, in April 2019, a Regulatory report highlighted strengthening needed in a number of the smaller lessees. A number of housing association lease counterparts have encountered difficulties. These have not resulted in any material rent losses, but covenant strengths are variable and have been associated also with Regulatory intervention. This is still the recent past and remains relevant. So, we were pleased that all leases successfully novated across to new counterparts and that Regulator involvement resulted in strengthened business models. Civitas's financial resilience in the face of COVID-19 is impressive, and the sector has weathered a difficult 2019. Nonetheless, latent risks remain, with positives and negatives finely balanced. On balance, we consider the risks of even partial income default some way into the future as being low, but we do wonder if new rents on new contracts – which should not affect Civitas or its peer group – might be at levels (slightly) lower than those in place currently.

Relatively early days, as such, but we like move to assets for a new level of care provision

On many REITs listed in this report, we comment on the attractiveness of the rents to occupiers. The same cannot necessarily be said in this sector: it is nuanced. The properties of the type acquired from flotation to earlier in 2019 needed significant and expensive re-configuration. Nonetheless, the outcome is that rents seem quite high in that sector and – growing with CPI – will stay that way. Being a newer sector, a number of the housing association lessees are very small specialists. The trend is for Civitas's lessees to gravitate towards medium-sized, rather than smaller, associations.

We do not now expect Civitas to buy portfolios of supported housing from aggregators. The significantly evolved strategy is initially being proven by a 70-bed development in Swansea jointly with an experienced developer. There are a number of factors de-risking the big change. Civitas's strategy is founded on expertise with the care providers. It is also in a joint venture with Schroder on a ca.175 new building development portfolio. Civitas has interesting partners supporting its as-yet limited track record of new-build, and it seems to Hardman & Co that purpose-built is the way forward, as opposed to buying converted stock. In any case, the valuations on the newly converted stock seem to Hardman & Co to be quite toppy. Valuations on care homes and nursing facilities have much more scope to rise to reflect the value-added potential derived from the clinical outcomes.

Empiric

www.espreit.com

Ticker: ESP				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
60	97	94	7.4	0.55

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** Maitland.
- **Next anticipated announcement:** Trading update; prior year was 9 July.
- The portfolio is PBSA blocks, across the UK. Tenants are principally UK-domiciled. This is a direct-let model (i.e. marketed annually to the students, not to universities' multi-year block allocations).

Performance

2018 dividend was cut

Through 2018 and 2019, Empiric has been rolling out its new management platform, which has two benefits

This is a stock that had already cut its 2018 dividend, and it instigated a proactive self-help programme. The latter is doing well. Empiric has progressed a good way, tightening its cost base and asset-management efficiencies. The new operating platform also delivers better service to the students. Operational costs are a significant element in the whole PBSA sector. The 2019 gross margin rose impressively: to 67.1%, from 61.8%. This drove a 38% EPS rise, but the dividend remained uncovered (albeit many REITs in this report pay uncovered dividends).

Autumn 2020 the very big problem

The worry is when campuses will re-open. If this is not until January 2021, the impact will be hard, and will be operationally geared. However, on 6 May, Empiric provided a reassuring trading update. 55% of the student accommodation remains occupied – so the reduction to income for the academic year is 12%. This is well below initial fears, and below the GCP Student REIT experience with its more international student base. It should put a base under the share price. £47m cash plus undrawn bank facilities are available.

Financing secure, but uncertainties remain for 2020/21

Empiric is continuing to receive bookings for the forthcoming academic year 2020/21, with 47% of rooms now reserved, compared with 54% at the same point last year, but the ratio is struggling, and there is a real risk. However, we point to Hardman & Co research indicating that placement year off-campus may be much lower in 2020/2021, which would boost demand for Empiric rooms just at the right time.

2021 visibility very poor, but could turn out well – with dividend returned to 50%, with scope for good future progression

2020 will be an exceptionally difficult year for the sector as a whole. If things go well, there will be a modest further rise in operating margins in 2021 vs. 2019, and the government could support the universities, which will, as of now, be in financial strain. Nonetheless, the uncertainty in this asset class is the highest in this report. It is lower than many other sectors but, still, it warrants care, ahead of significantly more details on the security of the university sector. However, Empiric is well placed to continue to improve efficiencies. The new, better, lower-cost platform comes onstream on 1 November 2020.

The more efficient "Direct-led model" continues to drive efficiencies and should bring Empiric closer in its tenant relations. It led to recent rental growth across the portfolio on a like-for-like basis of ca.3%. Empiric has been doing all the right things, operationally, in terms of repositioning in the past two years. Then COVID-19 hit the sector exceptionally hard. Rent of three months or more has been cancelled. With students going home and finding their sources of income constrained – many relying on short-term work in hospitality – student landlords have "done the right thing." Hardman & Co research indicates that a number of placement years have been cancelled by prospective employers – sadly – and so there may be a "last-minute" flurry of PBSA enquiries from May to August this year. However, late-opening campuses would see a bigger move the other way: first-year student cancellations, and postgraduates too – exactly the PBSA market.

Commentary

There is a balance among tenants, the universities themselves (which are both competitors and, effectively, agents for PBSA owners), shareholders and lenders. Three or more months' straight rent cancellation seems less of a balance. The trading update indicates that this may not have been so much of a risk (see above), but the initial shock to investor confidence may well be difficult, even partly, to overcome.

A risk it could get a lot worse

How bad could it get? There may be concern that certain institutions may not survive. Only two assets appear, by our analysis, to be in the lower half of UK rankings. Ranking does not constitute direct financial risk but – while most Empiric assets are mid-ranking, not global star – mid-rank's demise would be a devastating blow to the UK. We do not see institutional failure as a realistic risk beyond a ca.5% hit to NAV.

Or could operational gearing hurt Empiric?

Locations selected are robust, but…

Empiric clearly will not need fresh equity, but prospects are overshadowed. More time is needed to hear the full dialogue and rationale behind the decision to forego rent. Also, at a broader level, some higher education institutions now rely on government emergency support. Their finances may lead – theoretically at least – to closure, but this is unlikely. Absent any clarity, many students will defer courses by a year. This will be worse in certain locations, and may well lead to some voids in 2021/22, we fear. This sector always was a year-by-year rent decision – not the long leases typical elsewhere.

…rents have been rising ahead of inflation and ahead of wider lettings market –not much, but compounds up

Rental levels are a quandary. Inevitably, student accommodation is going to be more expensive than the general market, but it may be considered not outside the realms of possibility that non-London student rents could fall 25% (see the sectoral analysis later in this report). This is a hypothesis, not an expectation. This report assesses the downside, and the theme within it is that COVID-19 shocks risk bringing prior-existing concerns to the fore. Student accommodation is likely to see continuing demand, and supply remains reasonably constrained.

Bear case sees 15% rent cut, but this is heavily operationally, as well as financially, geared. Gearing has helped in good times, but, even then, dividend payout was reduced.

The market may turn out to continue on previous, more positive trajectories, after a very difficult 2020. However, the illustrative (progressive over time) 15% price-based revenue cut would have reduced, pro-forma, the historical results to the tune of £10.8m at the revenue and profit lines. EPRA profit would have fallen from £25.6m to £14.8m, or 2.5p EPRA EPS. It could have cut valuations by 15%-25% too. A 25% fall in gross asset value would cut NAV to £405m, from £665m; this is 67p per share. There is quite a disparity between 67p per share and 2.5p EPS. We believe Empiric's success in raising gross margins would mean it could, through its own hard work, achieve usefully more than 2.5p EPS. We would very much see the 67p – and a modest discount from that – as the benchmark. We do not see it going into loss, and such a – entirely theoretical, illustrative – reduction in asset value would leave the balance sheet geared 44%, a level that would be liveable with. Empiric, under a harsh and entirely illustrative scenario, would not need an equity raise. The combination of operational gearing and a still-significant hole in calendar 2020, and fears about value-for-money in the rents, make for a difficult share price rating environment.

Quoted stocks not talking about bigger picture, because picture entirely in hands of "lockdown" timetable

As Empiric stated in its latest results: "Analysis carried out by Knight Frank shows that the type of stock in the pipeline is also changing, with a shift towards the delivery of en-suite rooms arranged in cluster flats. This trend highlights a reduction in the delivery of studio bed spaces, which was at 32% of stock in 2018. This change in unit composition is partly a reaction to affordability pressures. A recent survey of students identified value for money as a key factor when deciding where to live. It also highlights the importance of quality and convenience (Source: Knight Frank Research)." Might there be a move to less than one for one en-suite? After all, far from all mid-level care home rooms have en-suites.

It all adds up to a share price inevitably under a large cloud. We think the cloud might be overstated in the case of Empiric, but 2020 is a testing experiment. In any case, Empiric is a clear survivor, and is continuing to apply efficiencies and cost-cutting "self-help".

GCP Student Living

www.gcpstudent.com

Ticker: DIGS				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
125	198	162	5.5	0.65

**Priced as at 18 May 2020*

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Buchanan.
- **Next anticipated announcement:** Investor report; prior year was 1 August.
- The portfolio is significantly London-weighted and comprises PBSA. Most tenants are non-EU overseas students.

Performance

Well-managed business with series of major uncertainties thrust upon it

GCP's NAV progression is impressive, yet the EPRA EPS did not grown from 2016 to 2019. Part of this NAV is to do with growth through pre-funding and redevelopment. In the year to June 2019, rental growth was 24.1%, as a result of major completions. Operational gearing resulted in a 28.6% rise in operating profits. Operating margins rose from 57% to 59% last year. Pre-funding is a successful aspect and typically is delivered ahead of schedule.

We slightly worry that valuers have not got message, with NIY at 4.5%

On 1 May, GCP stated "At 31 March 2020, the valuation of the Company's portfolio was £986.5 million representing a like-for-like decrease over the quarter of 0.9%." We find this an interesting valuation stance. The valuer has – as in most other sectors – tagged GCP as having technically material uncertainty. Asset returns are among the lowest in the REITs covered in this report, at 4.5% NIY. The valuation is, on average, £0.23m per bed. The lack of EPS momentum was set to change to a rise in 2020, but the COVID-19 rent losses have put paid to that. The 1 May announcement is welcomed, putting some clarity and – frankly – quantified reassurance. Like-for-like rental growth was 4.4% in 2019/20, and 3.5% growth was registered in 2018/19.

Summer 2020 less bad than feared

The COVID-19 hit is less bad than we had originally feared, but it still hurts. A lot. "As a result of the flexibility offered to direct let tenants and the wider economic impacts of COVID-19, the Directors anticipate a reduction of c.£9.0m (18%) to all the budgeted 2019/20 academic year income. The Company currently anticipates property operating cost savings of c.£1.0m from lower occupancy reducing the impact on earnings to c.£8.0m." We had feared 70%-90% of tenants would receive a three-month rent rebate.

Autumn could be okay, or could be severe downturn

What of the future? The future is not bleak, but it is insecure. "The Company, in consultation with its Asset and Facilities Managers, has adapted its marketing strategy to reflect current circumstances with a particular focus on digital marketing and existing residents. Bookings for the forthcoming 2020/21 academic year are marginally behind the same time last year." This is good, but time is running short and will the "last rush" that needs to happen take place this year? Actually, it might, as Hardman & Co research indicates that a number of placement years have been cancelled by prospective employers – sadly – and so there may be a "last-minute" flurry of PBSA enquiries, but this is far less than the potential negative of autumn term being online only. Somehow, it is difficult to believe that could happen – but it could. This level of certainty/uncertainty is not what the investment case proposition seeks in this report.

This is a growth stock. Growth through equity issuance brings a year-one cash drag. The past five years' average operating profit stood at £16.4m. An average of £103m p.a. was raised from financing activities (£40.5m, on average, in the past two years). This causes a deployment drag to EPS, creating benefits for the (near) future.

Commentary

Long-term under-supply of competing stock and solid foundation to demand

The risks to the continuation of historical levels of dividend are high. We consider the lack of supply in the locations in which GCP Student operates will serve it well. London is likely to remain a destination that attracts international students, who are crucial to GCP Student's prospects. The current crisis might even exacerbate tight supply. We do, however, consider it likely. Furthermore, there are heightened risks of occasional relatively extreme events, such as a recurrence of international disruption, and the possibility – especially for international students – of a rise in online or hybrid learning, reducing the demand for physical space. Neither of these would make the GCP Student buildings uneconomic, and we do anticipate a good bounce-back in 2021. They are, however, significant risks on multiple levels.

It would be wrong to obsess about a calendar 2020 that could, under some circumstances, register an EPRA (i.e. pre asset revaluation) loss. GCP Student's finances are more than strong enough, and no "rescue" equity financing would be needed. The longer term rests on London's attractions to international students and lack of competing accommodation – or at least a severe under-supply. We see these factors as staying firmly in place.

Non-UK 63% of total

Here too, the multi-month rent cancellation has a major and understandable sentiment impact. Students attend 82 higher education institutions, mostly across London. 69% of rooms are let to non-EU international students, 13% to EU students and 18% to UK students (down from 23%). 66% are undergraduates and 34% are postgraduates (up from 30%). The UK, as a whole, benefits from international students in many ways. Nonetheless, there will be operational problems for summer 2020 occupation. Beyond, we do anticipate that the international student model will survive and thrive. COVID-19 *is* a moment for refection, but London has more higher education establishments in the global top 40 Times Higher Education than any other world city, and costs overall are competitive. As to accommodation, only 30% of international, plus most year-one students, are accommodated by the universities themselves.

Supply is constrained, with the major exposure being London, but also Brighton, Guildford and elsewhere; all share the characteristic of higher rent than the UK average. With 81% of assets in and around London by value, the 2019 London Plan was notable, in that it constrained supply. The cost of land, too, has been a constraint. Any land price falls and switches to PBSA from other commercial land use should probably be limited in number, and COVID-19 probably means less development, anyway.

Couple of years' outperformance until recently. Investment message was being understood. Long term, this is still in place but high turbulence set to stay.

From May 2018, the shares had outperformed the all-property sector each quarter, but not in this quarter. This former performance reflected the perceived resilience of prospects for PBSA versus the broader sector. We fear that this sentiment change – previously, the shares tracked the sector – is under major threat. In this report, major drivers to continuing growth in student numbers are listed. COVID-19 should actually mean that the UK is all the more determined to offer its services to international students. Good things come to those who wait, but we would wait. It is not at all sure that assets will avoid a noticeable downward revaluation.

Strong manager

The manager is Gravis, established in 2008, and focused on infrastructure-style real estate. It manages ca.£3bn assets, including three listed closed-ended trusts.

Impact Healthcare

www.impactreit.com

Ticker: IHR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
96	108	107	6.5	0.90

**Priced as at 18 May 2020*

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Maitland.
- **Next anticipated announcement:** Trading update; prior year 30 July.
- The portfolio comprises care homes, and the landlord works closely with a tight care home operator tenant base – investing to underpin delivery of their expansion plans. It is there for a specific purpose, expanding with the tenants.

Performance

High acquisition yields

Assets are purchased at NIYs of 6.7% to 8.6%, generating good cashflow and a strong base to the dividend capacity.

19-year WAULT, 100% RPI-linked

On top of this, there is contractual certainty. 100% of the estate is rented at RPI-linked, and is capped and collared at 2% to 4%. Like-for-like rent grew 2.3% last year. The WAULT is 19 years.

In the following section – *Commentary* – we set out the drivers and support to this contractual relationship: they are very strong, and represent true partnership. In addition to being tenant-focused, Impact Healthcare has selected medium-sized tenants who wish to expand. It acquires portfolios, and there is therefore also an element of core versus non-core, with some of the assets acquired being subsequently sold.

Despite costs of growth, EPRA EPS covered the dividend: quite an achievement

COVID-19 does at least two things for sector: 1) puts it under pressure to strain every sinew on behalf of nation; 2) highlights need for all stakeholders to invest in long-term care needs.

EPRA EPS was 6.95p in 2019, and adjusted EPRA EPS (stripping out fixed-rent-rise contact accounting) 5.10p. It should be noted that, as a result of two rounds of total £135m share issuance, the rise vs. 2018 was minimal. Deployment is strong and, so, 2020 onwards will see good EPRA EPS advances, we believe. To be able to say this with the COVID-19 tragic issues for care homes is not to minimise the operational difficulties the care providers face. This does not harm the 2021 finances of the providers, and all are strong enough to pay through 2020, which will have raised costs. The WAULTs are long-term, as are the landlord-tenant relationships. See above for 2020 investment to date, with more to come. With the investment having taken place, momentum behind 2020 is stronger. An 18% rise in beds was registered in 2019.

Impact investing, but balance sheet remains among strongest in our universe

Not only is LTV low, at 7%, but the cash position makes this REIT exceptionally strongly financed.

Rent is fully up to date, including the latest quarter. This takes into account that 1.7% due from NHS Cumbria comes a short number of weeks post the normal end-March date. £27m cash was held, and £99m undrawn facilities were highlighted on 6 April, at the time of the company's the COVID-19 update.

Mid-range offering in pricing, but nearly all en-suite, and strong tenant investment in facilities

Impact Healthcare has been very clear on the implications of COVID-19 (see its results announcement of 7 April and the accompanying presentation). As one indication, some local authorities have temporarily increased the fees they pay to cover operators' additional costs. 64% income is from public sources, and 56% is nursing, vs. 44% residential. Impact Healthcare makes sure that the tenants hit stated levels of investment to keep asset re-investment strong – on top of the investment into expansion. It should be stated that 20.5% of assets are CQC "requires improvement", vs. 20.7% national market and 1.2% (one home) "inadequate". Again, Impact Healthcare monitors this closely, and is involved where it can be of assistance. 94% of rooms do have en-suite. The average rent of the core portfolio is £5,927, and the value-add (see above) is £4,340 rent. These are affordable ratios to fees.

Rents vs. fees appear good value

However, fees been rising above RPI in sector

We note a not insubstantial, albeit indirect, caveat. Privately funded care home fees have risen faster than RPI in recent years. In many cases, these fees will be supported by the release of home equity or other savings. Home equity should prove resilient, with mortgage-free assets, but market securities are a different matter. It may be wise to assume moderated rises in privately funded fees – roughly a third of the portfolio. We do not see this as material when assessing the scope for continuing strong covenants, which is, in any case, once removed from the confidence in good dividend per share increases.

Commentary

Appears lower risk, higher return

Impact Healthcare appears to have lower risk and higher income. It states the "aim to grow the target dividend in line with the inflation-linked rental uplifts received in the previous year." We consider this is a realistic and readily achievable goal short and long term.

Looking behind the contract, there are two positives. First, the landlord-tenant relationship is of long-term partnering, matching the long WAULT. Impact Healthcare is there for a purpose. That purpose is to finance growth at the care providers, and, furthermore, growth in specialisms that raise the appeal of the care provider. Second, the strong NIYs mean Impact Healthcare is not tempted to raise returns by high gearing or taking on risks. Impact Healthcare's balance sheet has modest gearing.

Providing growth-finance partner for tightly chosen group of tenants

Impact Healthcare has picked a limited number of care operator tenant partners, and they truly are partners. This represents growth with the tenant partners. 2019 included significant developments at Freeland House, and Diamond House completing during the quarter. In 1Q'20, contracts were exchanged to buy 1,194 beds in 17 homes. "We also committed to forward fund the development of a new 94-bed care home to be operated by Prestige, one of the Group's existing tenants. Taken together, these transactions will increase our contracted rent roll by £5.9m to £29.0m, a 25.5% increase on contracted rent at 31 December 2019." Some non-core assets are purchased within portfolios. 34% are "value-add", where investment can, and will, improve asset quality. 2019 saw seven projects.

Care home assets house the most vulnerable and perform a role without which the UK would not function. There is a migration to the mid-market, in terms of both pricing of fees and in the number of homes per operator, economies of scale being valid only up to a point. The model is to undertake growth funding for the partners, in both extensions – often adding specialist beds and always benefiting from operational gearing at the home – and in acquisitions. There is a steady pipeline of growth opportunities, offering (slightly) premium NIYs, with the lowered risk of this being delivered to shareholders through the route of expansion through existing tenants. The tenants typically have low debt. It is Impact Healthcare's finance that funds the physical expansion, which strengthens the tenants' offering.

Decent rent cover, but 2020 may be difficult for tenants. 2021 should return in robust fashion.

Turning again to COVID-19, occupancy has no immediate effect on rent payment or valuation. Rents have no connection with occupancy unless the care home provider hits financial difficulty. All partners are carefully chosen and financially strong, and all are monitored closely, operationally, on finances and on expenditure back to the homes to optimise their operation and attractiveness. 2021 costs have every reason to return to normal, we believe, and labour pressures may even ease. The group's tenants have a strong level of profit to rent cover, with an average of 1.8 times rent cover across Impact Healthcare's portfolio.

The company's presentation of results is conservative. Adjusted EPS is stated, and it is noted that, in a number of cases, the adjustment is usually higher than statutory EPS. Here, it is the other way around, as the accounting mandated on fixed uplift rents means they are reported in the P&L at levels above the current (cash-paid) level. The adjustment takes care of that.

LXi

www.lxireit.com

Ticker: LXI				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
100	140	125	5.8	0.83

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Maitland.
- **Next anticipated announcement:** AGM due July.
- The remit is long income. LXi invests across a variety of UK asset classes, but the common theme is 20 year-plus leases, with RPI escalators and based on relatively affordable rents. LXi's progressive dividend has been covered by net recurring earnings each year since IPO.

Performance

High share issuance led to some drag, but benefits will increase in 2021

The best assessment is a combination of running yields and the IRR on the disposals that take place from time to time. Not many REITs in this report have recycled capital as sure-footedly as LXi. This is an important driver to returns, and is based on acquiring the long-term stable income flows this report is seeking, and then choosing the right time to sell – at least, to recycle some capital. Annual or half annual EPRA EPS progression is more difficult to assess. This is the result of the significant expansion in recent years. For example, assets at end-September 2019 of £838m compare with £319m at end-September 2018. Investment deployment impacts EPRA EPS. Average shares in issue in 1H'20 (to September 2019) were 228% of the number for 1H'19.

TSR since February 2017's IPO stood at 47% at end-September 2019. Clearly, this is partly share-price driven, and the figure is currently lower, albeit NAV and dividend growth have been consistently strong. LXI's progressive dividend has been fully covered by net recurring earnings each year since IPO.

2019 disposals typical of track record: achieving 23% and 19% annual IRRs. This also "proves up" NAV, which has risen significantly faster since IPO than nearly all in this report.

The NIY on acquisitions averages 5.8%, and the valuation NIY stands at 5.06% at the last results. The recent 18 February disposal was made on a NIY of 4.2%, having been purchased at 5.7%, with an IRR of 36% p.a. being achieved on disposal. 2019 disposals typically generated 23% and 19% annual IRRs. The disposals "prove" the NAV is real.

LXi has low leverage (currently 20% LTV) and long-term debt facilities (averaging 11 years in duration) to Scottish Widows at a low all-in fixed rate of 2.9% p.a.

Current trading and progress on rent receipt

As of 6 April 2020, 67% of the company's rent due in respect of the quarter ending 30 June 2020 had been received, but the company expects to receive the vast majority of the balance following advanced discussions and agreements with tenants regarding payment plans. This includes (as with elsewhere in many of the REITs covered) conversion to monthly payments, to provide short-term assistance in these exceptional times. As of 6 April, LXi states: "where any liability is deferred, it still remains due and the Company expects it to be repaid." LXi undertakes some forward- funding development, but these are pre-let and the risk is solely on timing. Works have recommenced at all of LXI's forward-funding sites, and timing concerns are limited by significantly over-capitalised developer licence fees. The company states that it does not anticipate a financial impact from such potential delays.

Significant counterparty diversification, all blue-chip

LXi has over 50 tenants across nine property sub-sectors, and therefore benefits from significant counterparty diversification. Travelodge – ultimately owned by a well- capitalised private equity fund – comprises 10% of the rent roll (8% if you strip out the forward-fundings, where income is cash-backed from the developer), and did not pay its rent in full on the March quarter. LXi is not making statements about this position, which is similar to that of Secure Income REIT, which also has Travelodge as a major tenant. Earlier statements – not countermanded – indicate LXi's anticipation of delayed rent being recovered, and we understand that positive discussions with Travelodge are ongoing. Over 50% of Travelodge's customer base is business.

Certain individual tenants may have a difficult 2020, but the problems are not engrained

Being cost-conscious, Travelodge occupancy should remain robust; the situation is similar for Premier Inn, another tenant. LXi rents are not in any way footfall-related, and both these counterparts are highly cash-generative and well-financed. We note that Premier Inn is 6%, Greene King 5% and Jurys Inn 4% of the total roll. We are not concerned about the hotels bar a one-off 2020. Greene King's family pubs, unfortunately, are a little more of a drag, but this is a very substantial entity, with a largely freehold portfolio, and should weather the storm well. Again, no rents are footfall-related.

Looking across the whole portfolio, time will tell if some rent, in the end, has to be written off. It seems to us that the maximum negative impact should be under 1% of NAV for the hotels and possibly similar elsewhere – meaningful but not overly large items in the scheme of things. The fact that over £100m of forward-funded assets (which have averaged an uplift of 12% from purchase price for LXI) were not taken into account in the last published NAV, but will be in the annual results, positively impacts future NAV.

Commentary

96% indexed or fixed uplifts, all on strong covenants

96% of income benefits from indexed or fixed uplifts. All owners of tenants and tenants themselves are well capitalised, with strong historical cash lows.

This is a good manager, with a strong track record. The *modus operandi* is sector-agnostic. It does not trade, but there is an element of asset recycling. Good profits have been taken, illustrating that the revaluations are "real". Underpinning that is the sound long-term income. The portfolio has been invested into a consistent strategy: all investments are into inflation-protected, very long income streams.

All sectors are defensive, but this does include hospitality

Exposure is to defensive sectors, including budget hotels (24%) and discount foodstores (10%), as well as sectors with more favourable market outlooks, such as industrial assets (28%) and healthcare assets (14%). Industrial includes BCA, Bombardier, Johnson Matthey and Brenntag. BUPA is LXi's largest healthcare tenant. Clearly, the budget hotels are not defensive to COVID-19, but may trade well in 2021. The budget hotel problem is constrained – unfortunate but not a long-term issue.

Importantly, rents per sq. ft. are relatively low. The average WAULT is 22 years. More defensive tenants include Aldi and Lidl but, as for tenants in the hospitality, pubs or coffee shop segments, again, the rents are relatively low. For example, the hotels are budget hotels, focused on the domestic customer. Security is provided through the tenants, and the guarantors are the main trading or parent companies within the tenant groups.

The investment policy is to hold assets, rather than trade them, but to take three opportunities to add "alpha". Forward-funding of developments enhances returns. Sector selection attempts to pick winners with lower risks. There is some scope for recycling capital, especially via the capitalisation of inflation-linked rental growth, after assets have been through at least one five-yearly rent review.

Further growth equity issue in 2020

During 1H'20, LXi closed a significantly over-subscribed equity raise. The issue's over-subscription led to the £100m issue size being doubled. As we have pointed out, this does have an EPS impact initially. Management minimised this by deploying the cash into the existing pipeline within a month. After this was achieved, acquisitions continued to bring a certain level of financial gearing.

Primary Health Properties

www.phpgroup.com

Ticker: PHP				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
158	158	133	3.6	1.47

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Buchanan.
- **Next anticipated announcement:** Prior year interims were on 25 July.
- The UK and RoI portfolio is made up exclusively of primary health assets. These assets are local community health hubs. Leases, contractually, are upwards-only, paid by the government, effectively.

Performance

Gilt-edged covenant

90% of rents are government-backed and 100% are upwards-only.

Dividend rises accelerating to over 5%. 23 years out of 23 have seen rise.

The strength of 2019's financial results is summed up by the dividend progression. The 1Q'20 quarterly dividend rise was 5.4%. This followed the 3.7% 2019 full-year dividend rise, which was above the prior year's 2.8%. This was the 23rd consecutive year of rising DPS for PHP. There are a number of drivers, but rents are the most important. Rental growth is accelerating – a marked contrast to the wider real estate rental trends.

Rents growing 1.9%, but accelerating, and will continue to do so…

There were 312 rent reviews in 2019. The uplift was 4.2%, which equates to 1.9% on an annualised basis. This continues the positive trend in rental growth over the last two years, namely the year-ended 31 December 2018 achieved a 1.4% p.a. rise, in comparison with a 1.1% rise in 2017. 69% of rents are reviewed on an open-market basis, but still contractually have to rise at each review. 2019 open-market reviews achieved annualised rises of 1.1%. "Whilst underlying land and construction costs have increased in recent years, the lower number of new schemes approved by the NHS has historically restricted the ability to capture the growth in new rental values. We are seeing signs of more new properties being approved."

… quite a contrast to wider market, so – even in a year when economy was strong – medical assets outperformed

The UK economy grew in 2019, and it could be considered that GDP-exposed real estate would be in a reasonably strong position. Primary medical assets are not exposed to GDP demand-led fluctuations. Yet PHP's total property return was 7.7% in 2019, compared with the MSCI broad property index's return of 2.2%

2019 was a big year – the MedicX merger was just one plank to a very strong year

2019 brought £4.0m p.a. operating synergies from the MedicX merger and a 50 bp reduction in cost of debt, to 3.5%. MedicX had complementary assets and strategy, and the integration was flawless, bringing cost savings immediately and progressively into the future. There is more scope for ongoing reduction. Interest cover is 2.7x, and the average unexpired lease length was 12.8 years at year-end. We estimate a 46.8% end-2020 LTV. At end-2019, this ratio stood at 44.2%. PHP continues to have a strong, active pipeline of potential acquisitions, in both the UK and RoI, totalling ca.£160m, including £44m in legal due diligence. At end-2019, PHP held £357m undrawn facilities, plus cash.

Commentary

There are a wide number of drivers to the earnings and dividend. It is this breadth of drivers, as much as the blue-chip nature of the income streams, that we view favourably.

The MedicX merger, in 1Q'19, brought a complementary portfolio and came with good potential for reducing costs, in both the short term and progressively over the following couple of years. This was acquired through the issue of 341m new shares at 129.2p. In addition to secure rental growth, there are ongoing falling costs of finance. The EPRA cost ratio, at 12.0%, is the lowest in the UK (the ratio stood at 10.5%, excluding the performance fee). Market conditions accelerate PHP's falling cost of debt further for longer. The rental trend is set to continue, with decent rises and all rent pretty much guaranteed to be paid in full on time. The returns available for similar assets in RoI are somewhat higher than in the UK. PHP shortly will have 10% of its assets in RoI. Indeed, it has recently completed two forward-funded assets in that jurisdiction.

4.7% NIY is below the wider market, but perhaps scope for further revaluation. Dividend drivers diverse and clear.

Assets valued at 4.7% NIY are not much below the latest All-Property MSCI, which stands at 5.1%. The risk premium seems low, and particularly so with recent market developments. As to the dividend, the drivers are rent increases, RoI, cost savings and interest cost reductions.

The average lot size is £4.9m and growing. This is slightly larger than Assura. Nonetheless, this is a relatively modest size for a commercial property investment, and is an important and positive aspect for PHP. It takes out some of the largest direct investors into real estate, as accumulation of an appropriately large lot size would be too protracted. This adds to PHP's attractions for those investors who are prepared to invest via a REIT, and it thereby reduces competition in the direct purchase market.

Clear rationale for expansion in highly specialised market

This is a growth sector, and the equity fund raises can be readily – over time – deployed. Larger primary facilities provide a "hub", with co-located pharmacies and dentists, and the ability to undertake testing on a significantly more efficient basis than hospitals. New development is required. These still are small "lot sizes" for investors into commercial assets. Optimised investment needs specialists such as PHP, we believe.

The PRS REIT

www.theprsreit.com

Ticker: PRSR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
70	92	97	5.7	0.72

*Priced as at 18 May 2020
Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** KTZ.
- **Next anticipated announcement:** 4Q update; prior year 4 July.
- The PRS REIT buys open-market housing to rent. Typically, it buys from the developers, providing them with certainty and cashflow early in their project, thereby securing a discount for The PRS REIT. Half of its sites are in the broadly defined Liverpool-Leeds axis. The PRS REIT does not undertake development, but takes letting risk. Its IPO was in May 2017.

Performance

£15.4m run rate on occupied homes

The PRS REIT's average gross yields on delivered assets are 6.2%. Rents are not subsidised, but are affordable ratios to tenant income. It suits the developers to secure certainty of sale, plus early cashflow – so, effectively there is a discount from the developer. The stabilised delivered portfolio should see 22.5% costs, which takes the 6.2% to 4.8%. Of course, 4.8% translates into a much higher figure on the share price valuation. Growth in delivery of homes continues strongly, and the size of the portfolio doubled to 1,947 units in the year to April 2020. This is now securing £17.9m p.a. rental income when fully occupied, with £15.4m annualised rent being paid on 1,675 homes as per the company's latest update.

Growth to £52m rent can be funded from the present capital base

As of 31 March 2020, completed and contracted under construction totalled 4,850 homes, with £46.2m ERV (estimated rental value when rented). So, 5,300 new homes is a firm and deliverable number, from the current base of £500m equity, £400m debt. The ca.£52m ERV from this stock would equate to £40m post non-recoverable property costs.

Income now covers costs

COVID-19 an operational inconvenience but highlights PRS REIT's scope to buy well and solid demand for rental

Interim results, posted on 31 March, showed 444 new rental homes completed, bringing the number to 1,617, up 38% on 2H'19. Despite being early-stage, the rental income covered the cost base – for the first reporting period. Gearing ended 2019 at 21% LTV. As of 31 March, 1,947 homes were completed, with 1,675 of those having been let. Completion was anticipated early in 2022, but COVID-19 may delay this by a few months. Standing stock may be acquired. COVID-19 creates a short gap in income growth from March. Around 600 homes were let or reserved between 1 January and 27 March 2020. The occupation of homes started to return later in April but, clearly, there have been a number of assets empty for a few weeks longer at this seasonally normally busy time.

Developers selling to PRS REIT may "sharpen their pencils"

Rent collection in April totalled 95.5%, vs. 98.6% for January to March 2020, with rental growth on new lettings. From late April, some new tenants have continued to move in, but there has, of course, been a modest hiatus. COVID-19 has led to "inconveniences", but not much more. It also underpins demand for rent, rather than ownership.

Tactical buying opportunities

Again, as of 31 March, "in light of the disruption in the market place, we have taken the strategic decision to defer deployment in order to reassess opportunities, particularly for the acquisition of completed assets." So far, 15% of acquisitions have been of completed sites. This might rise to one third. This would raise speed of delivery of yielding assets, accepting that COVID-19, both physically and through changes in market dynamics, has slowed it. The 5,300 number noted above remains a firm number to be delivered.

Commentary

While net yields are below many REITs in report, "see-through" on share price valuation is that yields are higher – pretty cautious valuation on assets already valued at below vacant possession

Rental yields, which are 4.8% net of costs, will rise through operational gearing and net rent rises. The former requires new equity for expansion, and the latter will be a combination of the already efficient costs improving further, combined with a likely good rental market in "maturing" new developments. These yields are a little below many in this report, but we see good (of course not excessive) rises ahead, maybe from the middle of this decade. The PRS REIT's model is at risk on letting, but demand is strong and strengthening, so this report sees the risk as a positive. The average tenant household income is ca.£37,000, right at the level of the large, mid-market. Build is a fixed-price contract on standard specifications on sites with good links to employment centres, delivered with repeat developer partners. It is worth remembering that the assets are valued at below vacant possession, but disposal is not part of the model.

Model not complex, but route to stage one –target of 5.5p dividend – needs time to analyse

The "stage one" target is based on 5,300 homes, and over 90% of this is completed, in build or contracted. Timing has already been pushed back a number of months, as announced last year, and COVID-19 does the same again. As has been mentioned, the trends from developers and renters are even more supportive of the model than at IPO three years ago. There is clear scope to expand beyond stage one, but this would be with more equity. It is important to note than NAV is set by the valuation as tenanted. This is a ca.13% discount to vacant possession value. This discount is not likely to be unwound, as the homes are not for sale. The discount does not cause an NAV reduction at handover, as the assets are purchased at a discount to open-market values. We have highlighted the benefit to the developers of such an arrangement.

Strong shareholders, including (indirectly) HM Government

The PRS REIT has strong central and local government support, including from Homes England, which is a major founder shareholder.

Strong scalable developer relationships, mutually beneficial

The PRS REIT has a strong developer relationship with Countryside (and others), and is acquiring assets where rents are ca.£760 per month for a family house, which is affordable, taking up 30% of disposable income around the UK national mean income. Optimising gross-to-net rent ratios is crucial. The PRSR REIT, being mostly housing stock, targets 22.5%, which compares with a sector average of 25% and higher for many large investors in the larger market of apartments. It must be stated that costs have been tracking slightly higher than budget recently, with the portfolio in development mode. Indeed, excluding the life cycle maintenance sinking fund (kicking in from year five), the figure is 17%.

New developments through Sigma Capital

Acquisitions are through new build, delivered by housebuilding partners who work closely on a long-term basis with the REIT or its delivery partner Sigma Capital, itself a quoted company. There is close cooperation between Sigma Capital and The PRS REIT, with senior management but, importantly, no board member overlap. The PRS REIT is particularly close to Countryside Properties, the large quoted housebuilder, and the two have worked together for some time. The developer benefits from the cashflow that is directed to the front end of each development. This is of benefit at all times, and especially so at times of market stress.

Existing assets proven the model and operational ratios budgeted

The company's completed properties have continued to perform well, with rental income 2% higher than management's budget across the let properties. The re-letting average, when a vacancy arose, was a little over eight days, which confirms strong underlying demand.

More detail on 5,300 target, which is now almost achieved in terms of securing site-by-site contracts, plus completed stock

5,300 new homes is a firm number to be delivered. The ca.£52m ERV from this stock would equate to ca.£43m post non-recoverable property costs. Post fees and interest, the EPRA EPS would, in due course, rise towards 5.5p per share. Beyond 5,300 units, the REIT and its investment pipeline would expand further, assuming it were to have access to funds beyond the original £900m of equity plus debt. Such incremental growth would be at higher margin than the portfolio to date, as, inevitably, the costs including fees are spread over a wider asset base.

The PRSR REIT is rapidly deploying funds, and has a significant committed pipeline of developments from Countryside and other housing developers, which it has funded. Last year saw slight planning permission-related delays. Nonetheless, growth is high, and the move through development (no risk is taken) through to "on-rent" is highly visible, and was progressing fully to plan prior to the physical stop to construction due to COVID-19.

Residential Secure Income

www.resi-reit.com

Ticker: RESI				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historic dividend yield (%)	Price to historical EPRA NAV (x)
91	98	97	5.5	0.83

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** FTI.
- **Next anticipated announcement:** Final results; prior year was 20 November.
- The investments are all in UK residential assets, in three asset-class types. Each class has – for its own reasons – high covenants underpinning the rental streams. Lease lengths vary.

Performance

Three asset classes but all in UK residential, mostly in south east and with a simple overarching strategy of high-quality income streams at below-market rent

Interim results were announced on 18 May. All figures were in line with expectations set before COVID-19. This is a resilient model, delivering well. ReSI's rental income is supported primarily by residents' pensions or housing welfare subsidy systems, including leases to local authorities. There is high visibility of income – which is effectively (as in 95%-plus) de-geared from GDP and employment – allied to a combination of blended net rental income yields and particularly strong covenants, which support relatively higher levels of debt. All rent is at below market – details below.

Strong earnings growth; with equity fully deployed by end-2019, 2020 earnings will grow

2019 (full year to September) reported significant growth in operating earnings per share to 2.9p (30 September 2018: 0.9p), reflecting ongoing the ramp-up of rental income during 2018 and 1H'19. 1H'20 has seen small purchases of shared-ownership properties, but COVID-19 has delayed 2H'20 acquisitions. It has not affected rents. 1H'20 saw resilient income from all segments, including retirement. The rate of new tenants contracting to move in has fallen sharply as a direct result of COVID-19. So too has the rate of moving out, typically to care homes. This reduces the transition costs, such as refurbishment between these long tenancies. A couple of half years' continuation of this trend would be unlikely to affect numbers. Regarding shared ownership, the sales prices post COVID-19 have been resilient. Typically, these are first-time buyers seeking their own space – and modern space, well suited to an element home working. Given ReSI's prospects and achievements to date, we believe investors will rightly see through to 2021 when fuller deployment will have been achieved for much of the year.

The two halves of 2019 were flat but deployment boosts 1H'20

ReSI's equity has been fully deployed throughout all of 2019, but it is still expanding through gearing. 1H'19 net, post expenses, rental income was £6.1m, substantially up on 2018. 2H'19 achieved £6.0m. £1.6m operating expenses were incurred 1H'19; 2H'19's figure was £1.5m. 1H'19 EPRA EPS were 1.6p. 2H'19 achieved 1.0p, with higher average debt remaining outstanding in the second half. £83m was invested in 2019, all of which was in 1H'19. Virtually all debt is fixed to 2043.

Commentary

High quality supports slightly more (ultra-long-term) debt than typical REIT in this report

ReSI's investment strategy is to deliver a secure income stream from a residential social housing portfolio of three asset classes with diverse income streams at below-market rents from less economically sensitive tenants; and/or strong counterparty covenants.

This is high-quality/covenant income. Shared ownership owners forfeit equity if rent is not paid. Pensioners in retirement apartments pay well, partly because of cultural reasons, but also because their pension income is steady and stable. The local authority assets are well supported by their covenants. While the historical LTV is 36.3%, the geared assets and the eventual overall target stand at 50% LTV. 90% of ReSI's debt is very long term in nature, with only £14.5m needing to be refinanced before 2043.

Blended NIY of 5.0%; growth now principally shared ownership – yielding somewhat less, but with built-in, above-market rises

Since IPO, ReSI has assembled a portfolio of 2,677 homes comprising: 166 (22.3% by value) shared ownership homes, 289 (10.8% by value) local authority housing units and 2,222 (66.8% by value) retirement rental homes. The blended NIY is 5.0%, with shared ownership homes below the average.

At the moment, independent-living retirement apartments constitute by far the largest asset class. Here, rent comes out of pensions, which are behind the RPI-escalating tenancy contracts. There is a risk (upwards and downwards) at the time of eventual vacancies and re-letting, but the market is under-supplied and rents are not a high ratio of income.

Social value can be quantified

Manager's long-term record

Government agency holds just under 10% of equity

Crucially, there is significant social value added in at least four ways that we list. Housing Associations' delivery targets are enhanced by long-term, third-party partner capital as they are increasingly balance-sheet constrained. ReSI provides investment to move people out of overnight accommodation for the homeless. Retirement housing has virtually no private sector rental to date, but demand has been shown to be strong. ReSI Housing, a for-profit Registered Provider subsidiary of ReSI, is an Investment Partner of Homes England and the GLA, enabling access to government grant funding to deliver additional shared ownership homes. ReSI is managed by ReSI Capital Management Limited, a wholly owned subsidiary of TradeRisks Limited, which has a 19-year track record of executing transactions within the UK social housing sector and, to date, has arranged funding of more than £11bn in the social housing, care and other specialist residential property sectors.

Gresham House

TradeRisks Limited and RESI Capital Management Limited were acquired on 4 March 2020 by Gresham House plc, the specialist alternative asset management business, which is listed on the London Stock Exchange and now has ca.£3bn assets under management. Gresham House plc provides funds, direct investments and tailored investment solutions, including co-investment across a range of highly differentiated alternative investment strategies. The group's expertise includes timber, renewable energy, housing and infrastructure, strategic public and private equity (private assets). It aims to deliver sustainable financial returns and is committed to building long-term partnerships with clients (institutions, family offices, high-net-worth individuals, charities and endowments and private individuals) to help them achieve their financial goals. Shareholder value creation will be driven by long-term growth in earnings as a result of increasing AUM and returns from invested capital.

Expansion with clear operational gearing benefits

The REIT is very much still in acquisition mode, growth being through the shared ownership segment. Average investment assets in the year to September 2019 stood at ca.£270m, with £83m acquired, effectively all in the first half. Rental Income was £19.62m and cost of sales £9.56m. Service charges were 1.6% of investment assets and property operating expenses amounted in 2019 to 16% of gross rents, down from 24% in the previous year, which illustrates the operational gearing.

Retirement rental portfolio leveraged yield of 6.9%

The retirement rental portfolio, with leverage in place, delivers a leveraged yield of 6.9%.

There are both positive and negative financial aspects to COVID-19 in this segment, which should largely balance out. A quarter of the retirement portfolio is used to house the individual managing the retirement home for ReSI and other leaseholders, providing additional rental security. COVID-19 financial effects should largely balance out. For 2020, any increase in lockdown-related voids is expected to be largely offset by a reduction in transaction costs associated with tenant turnover (e.g. letting fees for new tenants, cleaning and repair of flats between tenants). Individual apartments give good scope for minimising the risks to tenants from COVID-19 and deliveries and other servicing assisted by the concentration of a block of dwellings. Gardens allow a degree of flexibility.

Local authority assets: leveraged yield 7.2%

The local authority housing portfolio produces a leveraged yield of 7.2%, unleveraged near 5%. This is a 7.0-year WAULT to Luton BC.

Shared ownership is the growth node

Shared ownership allows owner-occupier rental blending and thus offers occupiers the benefits of ownership with a (subsidised) rent and the ability to buy extra shares over time. Non-payment of rent has serious consequences, affecting the shared ownership tenant's stake in the asset, so non-payment of the rent – which is below market anyway – is extremely unlikely.

Slight delay due to COVID-19, but hardly noticeable

The delivery model is demonstrated by ReSI's wide range of partners, including Metropolitan Thames Valley, Places for People, Crest Nicholson, First Port and Luton Borough Council. In terms of "live" growth points, Clapham Park estate will deliver 2,500 new homes, of which 700 have already been delivered. Partners include Crest Nicholson. COVID-19 is delaying handovers.

Quantifying the social value-added

ReSI's homes deliver a social benefit by providing wellbeing improvements to tenants. It does this by providing the security of a home for life. ReSI also brings fiscal savings; for example, lower costs for housing those at risk of homelessness and savings to the NHS. It also brings wider economic benefits; for example, enabling people to live and find work in otherwise unaffordable parts of the country. The social impact delivered by ReSI is readily quantifiable using methodologies accredited by Social Value UK and Social Value International. ReSI's existing property portfolio on this basis delivers a total social benefit of £731m over 25 years, or £4.27 per share.

Secure Income

www.secureincomereit.com

Ticker: SIR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
250	430	401	6.5	0.58

*Priced as at 18 May 2020
Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** FTI.
- **Next anticipated announcement:** Interim results; prior year: 4 September.
- The REIT invests across a number of asset classes. The strategy is to secure long leases with high-covenant counterparts and escalating on an indexed basis. It so happens that exposure to leisure and hospitality is currently the largest component of several sectors.

Performance

Excellent track record from 2014 IPO to February 2020…

Secure Income REIT has an excellent pedigree and shareholder returns had been impressive. Dividend growth was 17.3% in 2019 and total accounting return has been 19.0% since the 2014 float.

…WAULT 21 years, blue-chip covenants, indexed income, capital recycling 19% compound returns…

That was driven by proactive asset selection and disposals, based on a WAULT of 21 years and blue-chip covenants. LTV is 32%, with £234m uncommitted cash. LTV was 43% end-prior year. Private hospitals were sold in 2019, at 65% book profit.

Not anymore.

An unlucky break in 2020

Travelodge makes up 26% of the contracted rental income. Much of the rest comes from the hospitality sector. All tenants are blue chip and the REIT financing is secure so the REIT, the tenants and the leases will live to fight another day.

It almost seems irrelevant, this year anyway, but the fact remains that the £2.1bn portfolio benefits from contractually fixed uplifts on 49% of passing rents and upwards-only RPI-linked reviews on the remaining 51% of passing rents. This indeed – contractually – is secure income.

Travelodge rents: no agreement yet

On 23 April, the REIT announced the following.

"74% of all rents due for the March quarter have therefore been received. The only rents now outstanding are those due from Travelodge, as noted in our announcement of 20 April 2020, with the overdue rents representing 6.4% of the Company's annual rental income.

Following our announcement of 20 April, the Company finally received a proposal from Travelodge, which was not in keeping with either the nature or the spirit of the proposals made by any of our other tenants who all engaged with us constructively and at an early stage. We have not been able to accept the proposal from Travelodge but have offered support which we believe to be proportionate and consistent with the approach accepted by other tenants in our portfolio.

Until the pandemic struck, Travelodge had substantial earnings and significant operating cash flows, and we consider that this business has considerable equity value as well as long-term viability. It also has very substantial shareholders in Goldman Sachs, Goldentree and Avenue Capital. We will therefore endeavour to work with Travelodge and its owners to find a reasonable solution to ease the current cash flow issues brought about by the lockdown. We are keen to strike a fair and reasonable balance between easing the cash flow burdens on our tenants brought about by the pandemic, and protecting the interests of our own shareholders, lenders and other stakeholders with a constructive and sensible approach to rent deferrals. We are hopeful that such a balance can be struck with Travelodge and their owners too."

Secure Income REIT owns 123 of Travelodge's 586 UK assets.

Commentary

Despite the blue-chip nature of the tenants, we – and no doubt all other entities connected to the proceedings – are dismayed by recent events.

As a technicality, the Secure Income REIT had a three-month cash drag on a 2019 £315m equity placing, which affected the historical EPS and DPS. Historical growth figures are adjusted to exclude this effect.

On 12 March, the REIT stated: "The Group's portfolio comprises key operating assets let to strong businesses in defensive sectors with high barriers to entry."

Not engaging constructively… …but they will resolve this issue

Unfortunately, it is a problem that has to be recognised when a tenant is "not engaging constructively" and constitutes ca.26% of this REIT's income stream. A considerable emphasis is placed on relationships with tenants where long-term security of income is assessed. This report points to how COVID-19 has placed even more emphasis on the stakeholder influences, which are crucial in 2020 (government cash) and for a long time to come: compromises with tenants if those tenants come under pressure. Further, the leisure parks are with a high-quality tenant. However, it is difficult to escape the conclusion the tenant will be under pressure until an effective vaccine is administered to the population and social distancing ends. The leases are contractual and long term, so we do not actually see this as a problem.

Longer-term inescapable problem is that some assets likely to have to be held long term – the model for most REITs in this report, but SIR's policy includes capital recycling

It does perhaps mean this element of the portfolio is unlikely to trade on a low yield (value rise), which would enable Secure Income REIT to continue its past capital recycling success. This may be the main casualty for Secure Income REIT. The capital recycling to date has been excellent – as one might expect from management's excellent track record in this and previous incarnations. From here, the returns may be simply in line with indexed blue-chip uplifts, possibly with a small part of 2020 (only) rent clipped off. This might mean a share price nearer NAV than it has been in the past.

This is a good bread-and-butter REIT. The jam has been – at least temporarily – removed.

Supermarket Income

www.supermarketincomereit.com

Ticker: SUPR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
106	109	102	5.3	1.09

*Priced as at 11 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** Tavistock.
- **Next anticipated announcement:** Final results, prior year: 3 September.
- Investment is into UK supermarkets, principally ones used for internet fulfilment as well as visits to store; i.e. "omnichannel".

Performance

Acquisition-led growth, but underlying is robust long-term RPI-based

1H'20 witnessed strong progress, organically and with the benefit of two acquisitions, to take the total held to nine, with a further one during 1H'20 so far. Operating profit increased 31%, with like-for-like rents growing as a result of the RPI linking. There were modest asset revaluations again as a result of the RPI rent uplifts. EPRA EPS moved sideways at 2.5p, with the increase in shares in issue. EPRA NAV also moved sideways, still slightly below the IPO issue level.

NIY 5.0%: sector was de-rated a few years ago and we strongly expect it to be re-rated at some stage

NIY stands at 5.0%. The initial acquisitions were at the right price, but not an especially cheap one on the face of it, when noting the latest acquisitions have been at 5.2% and 5.5%. This may be overly cautious an assessment. Three stores have benefitted from notable positive revaluations. Below, we assess the possibilities for sector re-valuation. More positively, in terms of "self-help", the sites have low build-cover and there will be possibilities of asset management uplift.

18-year WAULT, all RPI linked

These are attractive leases, which appear entirely sustainable. WAULT is 18 years and all are set at RPI-escalating upwards-only rents. 1H'20 EPRA EPS was flat, with the additional number of shares in issue. A further equity issue recently took place in 2H'20, raising £140m. Already low EPRA cost ratios, historically running at 17.7%, are set to reduce.

Commentary

This REIT has a focused approach., which reduces costs and brings a simple, transparent income stream with long-lease 100% RPI escalating income.

Omnichannel assets – that's important

The large majority of supermarket assets owned by the REIT are omnichannel. This logistics and warehousing element of the supermarkets owned is crucial to the income longevity. It is unwise and impossible, however, to ignore the past years' expansion of the discount supermarkets, taking significant UK market share. Tesco's 2019 results indicate the success of the larger established players' response. The CEO stated: "after four years we have met or are about to meet the majority of our turnaround goals. All formats delivered like for like growth."

Sector leaders have done well

We turn to how the tenants' business models have improved after a nasty wobble. For some years, there has been improvement. In 2019, Tesco's large-store UK sales showed 1.9% positive sales growth, with 2.1% total UK growth. The concern is reducing significantly.

The management team is experienced, having instigated £4.5bn transactions in this specific sector. Supermarket REIT is a significant part of the current transactions market, but not an excessive one. We estimate it to have constituted ca.10%, although this may rise slightly in 2020/21.

Luck? No: experienced management has made a vehicle to invest in an undervalued sector

Comparing REITs, Secure Income REIT has been exceptionally unlucky. Supermarket income benefits from the reverse. It has made significant headway and found a strong niche. Investor interest in the supermarket property sector picked up sharply in 2019 with investment volumes increasing ca.70% to £1.8bn (Colliers). We can see why. It is defensive; it is undervalued by historical terms.

There is scope for the sector asset class to be revalued upwards, which is discussed in the segment on supermarket assets later in this report. This sector typically trades off lower NIYs than the market but, recently, this has reversed. It is possible that the reversal took place surrounding the uncertainty subsequent to the entry of well-financed, large, discount supermarkets new to the UK.

Target Healthcare

www.targethealthcarereit.com

Ticker: THRL				
Share price: current (p)*	Share price: end 2019	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
94	117	115	7.1	0.87

**Priced as at 18 May 2020*
Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** FTI.
- **Next anticipated announcement:** Trading update, prior year: 1 August.
- Investment is into UK care homes. Leases are particularly long and are indexed.

Performance

Especially long WAULT and 2.6% rental inflation

Rental income rose 28% in 1H'20 YoY, with a 17% rise in investment properties on the balance sheet at the year-end. Like-for-like rose in line with the inflation-linked leases. WAULT is 29.2 years. The portfolio is widely diversified and its aggregate rent cover on mature homes was 1.6x as at 31 December 2019. As with the other sector REIT, rent payments were fully in line with normal when last reported on 16 and again on 21 April 2020. The latest reported rate of rent rises stood at 2.6%.

Over 6% NIY

Investing 2019 equity raise

The portfolio as most recently reported had an EPRA topped-up NIY of 6.05% based on an annualised contractual rent upon expiry of lease incentives of £38.9m. The EPRA NIY was 5.69% based on passing rent. These are ca.30 bps down on half a year previously. Expansion continues. September 2019's oversubscribed £80m equity raise is being deployed. 1H'20 saw £109m committed (not completed in the period) to 11 acquisitions, including one forward development.

Now a large, efficient REIT

Past growth had left dividends uncovered, which is a bit of a problem.

With a full year of the acquisitions, we anticipate 28% revenue growth and a positive EPS progression of 2%. This should provide a firm base for year to June 2021. A limited number of tenants have discussed stage payments. There are some unknowns over the "tail" effect of COVID-19 and, financially, 2020 is not without risk to some operators. This is all about short-term cost, though, and is strictly limited to the timeframe of the crisis phase. Funding for the operators, it may be anticipated, will be on a slightly better footing, strategically, in the future. Dividend growth in no way relies on better operator funding arrangements.

We expect dividend per share at least maintained, but 2020 might not grow

We note, however, the historical dividend is below 100% cover. Rent deferral, to a limited degree, is expected; however, were, say, 5% of rent to be foregone, 2021 dividend cover could fall to ca.85%, before rising usefully in 2022. This is seen as eminently within the scope of maintained-dividend territory.

We note an important caveat. Private funded care home fees have risen faster than RPI in recent years. In many cases, these fees will be supported by release of home equity or other savings. Home equity should prove resilient, with mortgage-free assets, but market securities is a different matter. It may be wise to assume moderated rises in privately funded fees, roughly a third of the portfolio. This has no direct impact on the REIT. We believe it is one factor that could prompt a maintained uncovered dividend this year. The risk to the dividend, from our estimate, is on the upside.

Commentary

A maintained (only) 2020 dividend per share should not hurt share price

This is long-term, index-linked income, where the tenants are sufficiently resourced to cope well with the short-term cost pressures of COVID-19. If 2020 sees a dividend pause, that is all the more reason to be confident about subsequent rises. Tenants are diverse and, despite sector strains, they are strong. Importantly, there is no exposure to underlying trading of the lessees other than covenant strength. Importantly, the assets are of prime quality in the mid-market. By this, we mean they all have en-suite and are modern. The quality of stock is the strength of the REIT. Many have specialist sections, e.g. dementia. Occupier costs, however, are mid-range with a mix of private and public funding. This market has many operators, seeking this type of high quality, high functionality in their estate. The primary assessment is of the assets. This is a growth sector with many operators. The medium-term outcome of the current crisis will potentially lead to (somewhat) better rather than worse financial dynamics for the operators and hence our confidence in a continued choice of strong operators backing the inflation-linked income stream.

High asset quality

Variety of tenants

There is a diversified income stream, with 27 tenants, and the combination of quality of assets and our expectation that the sector as a whole will see continuing – or even improved – funding ratios is supportive of Target Healthcare REIT. Given the above, we are surprised that the shares are still (slightly) below the levels at which they traded during 2019.

Target Healthcare is one of the longer-established REITs in the universe covered and has become of a size that generates efficiencies of scale. With all the costs of growing from a standing start, the REIT has delivered a total NAV return of 55% since the IPO of March 2013. We see ongoing advances in a sector with a wide range of tenants and assets, while Target Healthcare has demonstrated it has a resilient and diversified range of lessees. Its approach is to have a wider range than the other quoted REIT in this sub-sector. Target fund managers operate exclusively in the care home real estate sector.

Target Healthcare REIT has the longest WAULT in our coverage in this report. The logistics, residential and student REITs' leases are of shorter duration and details are given elsewhere in this report. The table below is to the latest accounting period. Assura has announced lease lengthening since the last half year.

29.2 years is long

Latest WAULT statements

REIT	Years outstanding
Target Healthcare	29.2
Triple Point Social Housing	25.5
Civitas Social Housing	23.8
LXi	22.0
Secure Income	21.0
Impact Healthcare	19.7
Supermarket Income	18.0
Tritax Big Box	14.1
Primary Health Properties	12.8
Assura	11.6

Source: Company accounts

The sector is presented with a significant near-term operational challenge from COVID-19 and also a significant positive case both for investors and for society. In this report, we highlight the importance – permanently increased importance – of owning assets that are essential not only for the operators but also for society as a whole. We have touched on the operators' higher costs for 2020.

COVID-19 may bring more support for this sector

This sector is well placed, weathering a very difficult 2020, but one which is ultimately financially positive on balance: at least for the better-financed operators. Target Healthcare invests in what might be termed the “upper-mid” range of the market. All rooms have fully en-suite wet rooms. It is landlord to 27 care home operators in 73 purpose-built homes (including two pre-let sites). In September 2019, a tenant gave notice and all six homes found a new operator (two operators in total) with minimal financial disruption.

Triple Point Social Housing

www.triplepointreit.com

Ticker: SOHO				
Share price: current (p)*	Share price: end 2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
97	92	94	5.3	0.92

*Priced as at 18 May 2020
Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** n/a.
- **Next anticipated announcement:** Interim results, prior year: 6 September.
- The REIT invests exclusively in supported housing. This constitutes clusters of self-contained flatlets configured for adults with special needs, receiving care. Leases are upwards-only, paid by housing associations which, typically, will have been the former owners of the assets. Income ultimately is derived from government housing benefit.

Performance

COVID-19 not affecting financial profile of rents received…

…or maybe it is?….

…but probably not

This is one of the very few REITs for which the share price post March 2020 exceeded its 2019 high and came within a whisker of its all-time high. 98% of rent due had been received at end-March – a normal state of affairs, with the remainder expected imminently. This applies to Civitas Social Housing too; however, we cannot help but consider there may be some delays in moving-in or some voids or tenant rent defaults in non-supported (i.e. general purpose) social housing, which might affect the lessees. Yet one factor of concern was that the lessees were smaller and were focused on supported housing. The income stream for supported tenants is direct housing grant and is uninterrupted by COVID-19 issues. Late moving-in may well be covered by the developers. We can see why the investors are not very concerned.

Acquired at 5.9%, valued at 5.3%

NIYs of acquisition have been holding steady within only 2 bps over the three year-ends since IPO, currently standing at 5.91%. The period-end valuation yield was 5.27%.

We support the strategy that there is an element of forward-funding of schemes as a means of new-build acquisition. These may be more future-proof and there is a reasonable expectation that assets can be acquired not much below 6.0% NIY. The method of acquisition used to include buying from aggregators who selected good stock. This was good for the creation of a scaled portfolio, but going forward there is some discomfort. New build is the way. As far as possible, developer risk should be avoided and the stock may be more flexible and valuable, at least on the margin.

New build acquired at ca.6.1%

The latest report is that forward-funding NIYs averaged 6.10% with a 5.32% yield on valuation.

There is a specific, identified pipeline of acquisitions comprising assets worth £100m plus. This will take the REIT's EPRA earnings to a level fully covering dividends per share. WAULT is 25.5 years.

The REIT in 2019 acquired 116 assets and at year-end held 388. At year-end, there were 11 forward-funding schemes on the books and, to date, the REIT had completed 11. It is currently engaged physically on seven new-build schemes, all of which developed "in response to direct local authority demand and which all benefit from agreements for lease with registered providers including Inclusion, Chrysalis and Care Housing Association. Currently the cost of completed and audited works on these projects is £13.3m." (Triple Point).

Commentary

Lease model is commercial not residential and source of stock should be new-build commercial, not residential

This REIT acquires standing stock, which has been converted – this is a significant process – for specialist use and it also forward funds new development. We cannot but form the opinion that while NIYs and rents are similar for converted and for purpose-built stock, there is a likelihood of a divergence in ratings in the future: purpose-built should (moderately) outperform.

Politics

The latest results presentation highlighted an update on the Registered Provider (housing association) tenants. "A minority of Registered Providers are having to respond to regulatory notices and continue to address issues raised by the Regulator. The majority of Registered Providers are outperforming well and are taking steps to accommodate increased regulatory scrutiny." It stated that 46 new board members were appointed and the tenants were "recruiting more staff and using better software to improve reporting: focus on consolidation, occupancy, compliance and property management." Further, Triple Point confirms it meets with members of the Regulator at all levels and "seeks guidance as to what changes and improvements to the model the Regulator would like to see made." The Regulator appointed Board members to two Triple Point Social Housing tenants.

Let us not forget that several occasions since 2018 have seen the housing benefit "full pay-out policy" be re-affirmed. It is higher than for mainstream tenants and will remain so.

This is not a residential sector

It so happens that people live in these assets. The sector is and has to progressively evolve into ever tighter focus on the clinical outcome benefits of the care provided and the buildings, in many cases, need to be medical facilities as well as homes. This is not really residential sector and certainly the leases are not constituted that way.

We have commented on the other sub-sector REIT: both have a rigorous focus on this relatively new asset class. For both, the drivers are the long-term, CPI-linked income streams, underpinned by income from the public purse for vulnerable adults. In a highly "political" sector, a difficult 2019 appears to have proven that the ultimate drivers are secure. It has proven to be not without risks. The counterparts are typically small, sometimes under-capitalised and sometimes under resourced housing associations. The Regulator's involvement in 2019 resulted in improvements in the lessees, but it is not outside the range of possible developments in 2020 and beyond that the Regulator might need to get involved again.

Tritax Big Box

www.tritaxbigbox.com

Ticker: BBOX				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
130	148	147	4.8	0.86

* Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- FTSE 250 constituent.
- **IR:** Maitland.
- **Next anticipated announcement:** Prior-year date of interim results was 8 August.
- Tritax Big Box invests in distribution hub depots of the largest size (up to and beyond 500,000 sq. ft.), which are used partly to fulfil e-commerce requirements of tenants. It also – uniquely in this selection of REITs in our report – undertakes development at its own risk as a core albeit smaller portion of capital deployed.

Performance

A strong sector…

The occupational market remained healthy 2019 and into 2020. Tritax Big Box refers to a "large overhang of probable lettings under offer, driven by demand for logistics space over 500,000 sq. ft., initial prospects for 2020 look good." Short and long term, this clearly is a sector where tenants and society as a whole want increasingly more space. The UK is further advanced in internet shopping than other European countries, but so far only accounts for a quarter of the whole. There is more than a decade to go in this trend. At the year-end results, the Board increased its dividend target by 2.2% to 7.0p per share for 2020.

…. but not all plain sailing

This official 7.0p dividend target has now been withdrawn, but we see any likely slippage as small.

Growth

2019 saw physical growth, with 4.7m sq. ft. buildings delivered through developments. Net rental income rose 8.7%, operating profits +7.7% and acquisitions taking the portfolio value up 15.2% including a small revaluation. With share issuance, adjusted EPS fell 3.5%. The EPRA NAV reduced 1.2%, but this equates to a rise of 1.3% excluding transaction costs (including the major corporate acquisition, DB Symmetry).

Growth – minor slippage

The build programme is continuing, albeit more slowly due to COVID-19. 2020 had £9.3m contracted annual revenue assets planned to be delivered and 2021, £4.7m. There is likely to be some shift from 2020 into 2021.

Not a passive model….18% of estate has value-addition prospects

Rental income – contractually and in cash terms – is being affected by the current situation, but, by year-end, we strongly believe all slippage will have been recouped. Tenants are all highly well capitalised and their business model relies heavily on the Tritax Big Box assets. This is a long-term, steady growth business and, in addition, 18% of the total portfolio has scope for value-add. This is through lease re-gears and improvements and also through tenant improvement in well-located assets.

ca.80% rents indexed

The base of the business is an efficient, predicable, long-term income flow within a market that is growing and under supplied. 2019 saw a 2.0% like-for-like rent rise and WAULT is 14.1 years. About 20% of the portfolio is open-market review, the rest is CPI/RPI or fixed. While the EPRA cost ratio rose to 15.1%, up from 13.7%, the rise was the result of acquisition costs. There is a 2.7% capped cost of debt.

Commentary

Our "commentary" section on Tritax Big Box is longer than for others in this report. Its focus is on the major evolution under way, moving from buy and hold into a more development-enriched model, which also indicates a recycling of capital. This is a major change but one, nonetheless, based on a portfolio with most of its leases RPI- or CPI-linked and of long duration with blue-chip, mostly global, tenants.

A major evolution – to development funded in major part by recycling standing assets

Our worries, if anything, have lessened in past year

Writing a year ago in our previous report, we were more concerned than we are now. Equity issuance is diluting shorter-term returns. Development is more risky. However, the shares have fallen significantly and we are not convinced that a share price significantly below NAV is a fair evaluation of the medium term. Returns – from the newer model – are not as secure, but the need is seen for a new model with NIYs having fallen so low. Nevertheless, they have fallen because this is an attractive sector, after all. There are risks. Is it a less attractive sector and model than a year ago? Certainly not. It does need some reflection, though, and more things can go wrong in development.

Existing estate is fine

While COVID-19, on balance, enhances demand and does not increase supply, it highlights that Tritax Big Box has moved to a riskier development model. This does not qualify fully as "development-led". Income from the built portfolio dominates and has lock-in escalators for the long term. But, to achieve equity returns in line with several others in this report, execution of the development programme is required.

It is worth noting that while the NIY is 4.4% at valuation, it is 5.5% at cost (excluding Dartford).

On 8 April a statement was made regarding trading and COVID-19. Key facts included: "We expect that 96% of rents will be collected by the end of May 2020 in respect of advanced quarterly rental payments that were due by 1 April 2020. This includes 86% which has been collected to date.....At present, there is continued activity at all our (development) sites, albeit at reduced levels, signifying the importance of these buildings in our customers' supply chains......Immediately available resources under existing, but undrawn, committed borrowings total £500 million. The Group has capital commitments of approximately £130 million in relation to its forward funded pre-let development assets." Regarding the dividend for the year: "The Board therefore considers it prudent to withdraw its dividend guidance for the current financial year." This is due to the "slowdown in the occupational markets and increased likelihood of delays in areas such as planning and construction".

Tritax Big Box owns the largest size distribution depots and over the course of nearly a decade has invested in a portfolio of 58 investment assets with 40 customers. Half of all assets are automated. Half have been built since 2010. The REIT more recently has expanded its model into development and this includes a site to develop the largest asset inside M25.

To fund an acquisition and future growth, including expansion into new developments, a £250m equity placing and open offer was successfully completed in February 2019. 192.3m new shares were issued at 130p. This resulted in some EPS drag in the 2019 reported figures: dividend covered dipped slightly below the historical cover ratio of 100% plus. The historical cover is 96% on EPRA EPS.

Development: only 7% of assets, but rising significantly further

From 2019, development has become a key plank to future shareholder value. Thus,, notably, Tritax Big Box also has a significant development pipeline, which adds value to the asset base and is an integral part of the business model. At end-2019 balance sheet, it owned £3.54bn investment property, up 16.6% in the year. At end-2018, investment property comprised 100% of assets. As at end-2019, the proportion reduced to 92.9%, with £270m in land options, joint venture and other property.

We estimate 23p share uplift

Assessing land for shorter-term development with a £201m book value of land, Hardman & Co estimates a £1.2bn GDV (gross development value). This would lead to an uplift, we estimate, in round figures of £400m, or 23p per share. Tritax Big Box calculates 6% to 8% rental yield returns on developments; typical valuation for standing assets is 4.4%. Average cost price of assets held equates to a 5.5% NIY.

Development to take 2019 passing rent of £153m to an eventual rent roll of £246m

Turning to the sort of size that Tritax Big Box could achieve with the raw materials it currently owns, we estimate there is sufficient to take the end-2019 passing rent of £153m to an eventual rent roll of £246m. This is made up of the current contracted rent of £167m, which includes pre-let and assets under construction under construction. Adding reversions takes the potential rent roll to an annual £180m. Then, as to future development, adding in the Dartford site, land options with consent and with assets with planning submitted brings the total to £246m. This figure excludes any pipeline of future land and some land where planning has not been submitted.

£150m p.a. sales of stock…

How to fund this – post the 2019 equity issue? Tritax Big Box estimates a target of between £125m and £175m annual sales of standing assets. Therefore, it states: "pre-let developments to be financed largely by a combination of both standing sales and ancillary land/ potential consented land sales."

…into a market short of stock

The market is short of stock. One major driver is of course the rise in online shopping. For the UK in 2019, the figure of 19.2% equated to retail online sales (ONS). Some sources estimate 22% currently. This equates to £75bn currently spent on retail online in the UK. Tritax Big Box states every £1bn spent online requires nearly 0.9m sq. ft. logistics space, illustrating this with the past four years' data. Tritax's development pipeline seeks to capture 10%-15% of the rise in market demand.

Supply is relatively high in mid-sized logistics assets, an asset class Tritax Big Box is not exposed to. Sub-100,000 sq. ft., the supply is low, particularly sub-50,000. At 500,000 sq. ft. plus, the focus of Tritax Big Box, speculative supply is 1.0m sq. ft. (ranging between zero and 2m sq. ft. in the past four years). This equates to 1.4 months of speculative supply versus the rate of take-up (source CBRE, Tritax). For assets of the size 250,000 to 500,000 sq. ft., the supply is 8.0 months. For assets of a range 100,000 to 250,000 sq. ft., the supply versus take-up is 10.6 months. Take-up for assets in excess of 500,000 sq. ft. is 50% of the total. As recently as 2016, it was 35%. The market background makes the current portfolio sustainable and adds potentially to end-lease reversionary value. However, it is development that captures the value-add for the next several years.

Development is not without risk, however, and it of course ties up significant capital, which for a while does not yield cash.

Urban Logistics

www.urbanlogisticsreit.com

Ticker: SHED				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
122	145	126	6.3	0.84

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** Montfort.
- **Next anticipated announcement:** Final results, due 29 May.
- Distribution depots and warehouses owned are typically "last mile" and of ca.50,000 to 100,000 sq. ft., located within the urban envelope. Each asset has one tenant.

Performance

Rent collection up with last year's ratio

As of an 8 April announcement, 93% of rents for the quarter to June 2020 had been collected. The rate has risen since and the 8 April figure compares with 91% at the same time last year. This is one of the best performances in the sector and in the 16 REITs covered in this report.

Sector rent growth 3.1% 1H'20, average 3.2% since March 2017

Urban Logistics' like-for-like rent growth stood at 3.1% for 1H'20 (September 2019) and averages 3.2% since the March 2017 year-end.

1H'20, an 8.1% accounting return in just six months

See next page for a longer view. 1H'20's excellent performance is simply in line with experience since IPO. Urban Logistics reported a total accounting return – NAV plus dividend – of 8.1% for 1H'20, putting it, again, in the top 10% of all REITS. Like-for-like capital growth for 1H'20 was 4%, and total property return was 7%. The dividend was raised 25% to 3.75p.

The 25% interim dividend rise for 1H'20 matched EPS, driven by rent reviews, new letting and acquisitions. 1H'20 showed strong total accounting returns (NAV plus dividend) at 16.4% annualised. Asset disposals in the period made total (ungeared) property returns of 50.0%, again all above book. EPRA NAV per share rose 12.4%. WAULT rose to 6.1 years from 5.5.

This is a management-intensive model, yet the Urban Logistics 1H'20 EPRA cost ratio, at 18%, is (slightly) below the UK sector average of 20%. It should be noted that Urban Logistics' 1H'20 £195m portfolio size was well below the mean for the UK sector and is growing rapidly, not least as the recent fund raise is invested. EPRA cost ratio will fall.

Acquisitions: 8 April…

On 8 April, Urban Logistics announced the £56.1m acquisition of nine urban logistics properties and a development site following the successful £136m equity capital raise in March 2020. These properties, apart from an NHS distribution centre in Normanton, formed part of the Advanced Pipeline as outlined in the Circular. The acquisitions were undertaken at an average NIY of 6.3%. It is worth noting that on 27 September 2019, a portfolio of parcel depots was acquired for £9.9m. The acquisition was sourced at a NIY of 7.0%.

…30 April

On 30 April, Urban Logistics announced a seven-site £47.2m portfolio acquisition at NIY of 7.0%. It achieves a passing rent of £4.96 sq. ft. The capital value was £68 sq. ft.

Commentary

4.4-year WAULT: shorter is good in a rising rent environment

Excluding one 20-year lease asset the (end-1H'20), WAULT stood at 4.4 years. In an in-demand market, this is a good thing.

Rents are likely to rise when leases are renewed. We estimate there is a 9% reversionary upside on the current rent of £4.90 sq. ft. as demonstrated by its ability to sell assets at premiums to their current valuations. Assets are modern, typically with low (sub-25%) site cover and tenants are 89% rated low or low-moderate risk by Dun & Bradstreet. Urban Logistics' average tenant has stayed for more than 10 years.

NIY on assets was 7.1% when bought (on assets held) and 6.2% valuation now

Furthermore, the shorter-leased assets tend to be valued lower than the longer leased assets. So, a lengthening of leases as terms are renegotiated should see a valuation uplift as well as a rent uplift. The average NIY on assets was 7.1% when bought (on assets held) and 6.2% valuation now.

Compound returns of 16%

Within this attractive sub-sector, Urban Logistics' management has added considerable value. Since its IPO in 2016, it has generated a 16% p.a. accounting return. The average NIY on its assets was 7.1% when bought (on assets held) and is now 6.2% – a 14% value uplift. The total return includes the dividends paid as well as the NAV uplift.

Urban Logistics total accounting returns

Year-end Mar	Annual return
FY17	19.1%
FY18	10.9%
FY19	17.7%
1H20	16.4%*

** Annualised return*

Source: Urban Logistics accounts

More than 14% of initial portfolio has been sold and capital reinvested

It has not achieved this by standing still. More than 14% of the initial portfolio has been sold and the capital reinvested. There have been seven asset sales, including three in the first half of FY'20. They were all at a significant uplift in value and a 5% premium to most recent book value. The disposals generated a total property return, including income of 58% in a little more than two years, excluding one non-core sale. 1H20: three disposals at, respectively, 23.3%; 73.1% and (a small asset) 126.3% total property returns over their holding period. 1H20 disposals are indicative of market appetite in that they were at 4.7%; 4.7% and 5.3% NIYs. These are interesting yields as they compare with acquisition NIYs of 7.1% across the 45 assets acquired into the portfolio, historically. This is not strictly like-for-like, but we consider it builds the picture of an undervalued asset class. This appears to be a market where value can be added in the buying and then in improving the asset value post acquisition. One way is to lengthen the lease, another to work up the tenant base. Management states 75% value-added derives from asset management initiatives and transaction value-capture, as opposed to simple market moves.

Doing well because…

Since the April 2016 flotation, total (share price plus dividends) returns were +45% for Urban Logistics. This compares with negative 11% for the largest UK real estate sector shares. Year to date, the capital values of the largest real estate sector shares have fallen 30%. Urban Logistics' share price has fallen 16%.

…this is a strong sector and a strong management

Supply is less than even in big-box distribution. Average capital value prices at under £70 sq. ft. are below the build cost and rents at ca.£5.50 sq. ft. are very low compared even with the cost of re-location. Internet fulfilment keeps demand sharp, but the drivers to demand are broadly based.

Warehouse

www.warehousereit.com

Ticker: WHR				
Share price: current (p)*	Share price: end-2019 (p)	Share price: 12 months ago (p)	Historical dividend yield (%)	Price to historical EPRA NAV (x)
103	110	103	5.9	0.97

*Priced as at 18 May 2020

Source: Company, Bloomberg, Hardman & Co calculations

- **IR:** FTI.
- **Next anticipated announcement:** Final results, due 2 June.
- Distribution depots and warehouses owned are typically "last mile" and of ca.50,000 to 100,000 sq. ft., located within the urban envelope. Each asset has multiple tenants.

Performance

Lettings were achieved 8% ahead of ERV

In the latest accounting period, lettings were achieved 8% ahead of ERV (market estimated rental value). The rental values assessed on the portfolio rose 4.1% in the past year. WAULT is 5.1 years, but there are significant opportunities to re-set rents by interaction with the multi-tenant lessee base. LTV stood at 39.9%. This is a strong management in a market that is strong and set to remain so.

April 2019 fund raise fully invested at 7.0% NIY, within six months – a drag on EPS for that period

The April 2019 fund raise was fully invested at 7.0% NIY, within six months. This is a significant achievement on both counts. The equity raise affected EPS calculations. The 1H'20 period (to September 2019) saw EPRA EPS rise to 3.0p, from 1.8p in 1H'19. Nonetheless, the 1.8p was struck after one-off acquisition costs, excluding which the 1H'19 EPRA EPS was 3.1p. The most recent results also saw a reduction in NAV per share, from 109.7p to 105.2p. This was due to the significant £8.6m deployment costs and the ongoing value-add site reconfigurations and asset improvements not being due to complete until the current half year. The REIT management – Tilstone – is deploying capital strongly and investors clearly see the benefits of actions taken in the past half year. Nonetheless, the valuation of both assets – trading at a higher NIY than average UK commercial real estate – and the shares' valuation being at an NAV discount indicate to us the potential for upwards revaluation.

The 17 February 2020 trading update provided a snapshot of the market strength and Warehouse REIT's performance. It completed 28 new lettings and 28 lease renewals across 209,000 sq. ft. of space, achieved at 5.5% ahead of 30 September 2019 ERVs and generating £1.2m p.a. of contracted rent, reflecting the reversionary nature of the portfolio.

The REIT announced that as at 9 April 2020, 74% of contracted rent due for the quarter to 24 June 2020 had been collected. This number increases to 82% where tenants on pay-monthly plans (rather than quarterly) are included. £39m of available facilities plus cash were available: a strong financial position. In any case, the tenant base is strong.

Commentary

Deep value both on rents and capital values

Average rent per sq. ft. is £5.47, which is an NIY of 6.5%. Rent was £4.72 at float and £5.26 end-March 2019. Warehouse REIT states the reversionary yield at 7.3% as market rents are above levels at which the portfolio is currently let. Given the long-term, consistent drivers to demand and the current low valuations, we expect rents to continue to rise on top of the "built-in" increases to catch up with the current market rates.

The REIT has a highly diversified UK portfolio of 95 assets totalling 6.15m sq. ft., with 560 tenants operating across a wide range of sectors, including e-commerce, 3PL, manufacturing and automotive. Over the past 12 months, Amazon, John Lewis and Direct Wines have become tenants.

Strong momentum during COVID-19

As of a 9 April update: "Since 21 January 2020, the Company has completed 24 new lettings and lease renewals across 129,000 sq. ft. of space, achieved at 3.7% ahead of 30 September 2019 ERVs, generating £803,400 per annum of contracted rent." While the market is of course very quiet currently, the portfolio is essential to the functioning of the UK. The market tone – with under-supply and assets trading at below new-build costs – is set to remain firm.

"Since the government-imposed lockdown commenced on 23 March 2020, it has secured new lettings, which are expected to generate a further £183,000 of annual rent. Furthermore, it is currently in active discussions with both existing and potential occupiers for additional space across the current portfolio."

Covenant strength

The top 10 tenants are all rated 5A1 by Dun & Bradstreet, 5A representing the largest net worth businesses (over £35m) and 1 the lowest risk.

Managing multi-let risks well

An example of asset enhancement, both single-let and multi-let

Reflecting management's skill and the strong market, occupancy runs at 96.8% (excluding assets under refurbishment). There are 638 tenants in the portfolio, up from 129 at time of flotation. The portfolio value is driven by the positive market dynamics we have summarised, but there is significant scope by detailed asset management. In a number of cases, value has been created by lengthening leases on assets with strong tenants but disposed of by motivated sellers. One example is the Boots distribution centre two miles from the M3, where a 42% rent uplift to £8.19 sq. ft. was agreed in 2019. Other examples include the reconfiguring and refurbishment of multi-let assets.

Ready to grow

Warehouse REIT has an attractive pipeline of potential asset purchases. Its current portfolio stands at 6.2m sq. ft. This is a niche market compared with the size of some more "mainstream". This is one of the reasons the NIYs are still at a premium to the broader market: 100 bps or more.

Management has a significant equity stake in the REIT.

Investor commentary on each asset sub-sector

Primary medical

Prospects are for secure government-backed rent growth in sector crying out for capital

This sector has been fruitful for investors, outperforming in recent better times as well as the difficult market of 2020. Over the past 12 years, the asset class has returned 8% p.a., with the lowest volatility among all classes; the return is the second highest (*Source: MSCI*). Recently, too, returns have been encouraging in both good and bad times. For example, for PHP, total property return was 7.7% in 2019 (2018: 8.0%), outperforming the MSCI UK Monthly Property Index, which delivered a total return of 2.2% (2018: 7.3%). The assets still bring an income return (before overhead and management costs) of 400 bps over gilts. Leases are long term. The income is government-backed. This UK asset sub-class has outperformed all other MSCI asset classes between the 2007 cycle high and 2019.

Rents had a period of particularly low growth – always upwards-only – but there are signs of modest acceleration

Rents are upwards-only, contractually. Why has the tenant – ultimately the government – chosen to structure the market this way? Delivering community healthcare through the primary estate is better value than through hospitals. Modern buildings cater for the allied trends towards larger clinical groups – including co-located GP partnerships – and the expansion of services undertaken outside hospitals: clinical testing would be a good example. Much primary care is still located in converted houses. For developers to be active, they require the returns and a good way to ensure the right developer returns is through long-term rental growth. The private sector has always had a role in the NHS. 40% of GPs are self-employed, they are part of the private sector. The NHS is a co-operative between the public and private sectors.

Modern primary healthcare assets are long-term hubs in the locality. This is an essential part of them holding their value and warranting rising rents. Leases are long term: often 20 years and often renewed when the remaining term runs down. PHP Properties acquires the larger, modern buildings. GPs own 45% of the total estate by number. 30% of the total estate is unfit for purpose (*NHS Next Steps Five Year Plan 2017*). Although the following details are from the Assura presentation, they are applicable across the board for the larger assets, the type increasingly prevalent in both Assura and PHP's portfolio. It is a central 'hub' serving a wide community: 1,800m^2 to 3,000m^2; up to 50,000 patients; ca.18 consulting rooms and six treatment rooms; a pharmacy; base for community-based healthcare teams; an outpatient services; diagnostics; and mental health teams. Primary care is the growth area of the NHS delivery. Furthermore, a visit to a primary health centre costs £45 on average (*NHS, Assura*) compared with £138 for a visit to A&E. Visits to GPs increased by 3.8% p.a. in the four years to 2014 (*NHS*).

It is useful to the primary medical investing REITs that the lot sizes are relatively modest. Typical lot-size is well under £10m, usually somewhat under £5m. Assura purchases assets of a similar, albeit slightly small size and value. This relatively small size of each "lot" may be a factor encouraging large REITs to aggregate (and pre-fund development of) primary stock, which end-investors are then able to invest in. Financial investors deploy large monetary sums via shares in the two quoted sector equities. Investing direct would be particularly difficult in this sector.

Shortage now beginning to be made good, with step-by-step increases

There has been a dearth of new development, particularly between 2012 and 2016, with incremental steady rises beginning from two or three years ago. There was a reorganisation of the public sector commissioning bodies. Pre 2013, it was local statutory organisations in the English NHS called primary care trusts (PCTs) that were responsible for improving public health. The abolition of PCTs in April 2013, and their replacement by CCGs, resulted in an inevitable period of administrative flux. The underlying funding of the costs of NHS and GP premises were unaffected, but there was a developer gap.

Not just through classic supply/demand, but also for technical factors down to official valuers, commencement of modest development, after a period of undersupply, is supporting rent rises

With rents having risen even in the difficult period of 2008 and subsequent years, the rises in the latter years of past decade were modest. Now, however, in order to stimulate a rising quantum of development and in the face of increasing developer costs (because of materials, specification rises and labour costs), rent increases have recently been ca.2%. We would be surprised if this nascent acceleration were to fade and so this sector's rent progression prospects are in stark contrast to the wider real estate market, where rental growth is hard to find. Whether a UK recession might affect labour costs or not, the essential characteristic is that rents can only rise.

Primary healthcare performs a critical function in the UK, providing a key part of the NHS's Five-Year Forward View (FYFV) and operating as most patients' first point of call when accessing the healthcare system. The primary care estate has faced underinvestment over the past decade, with approximately 50% of the 8,000 GP surgeries in England and Wales now considered by medical professionals to be unfit for purpose. Building on the FYFV, the follow-up *Next Steps on the Five-Year Forward View*, published in March 2017, reiterated that shift, setting out targets for growth.

Supported housing

Robust metrics – good NIYs, long leases – but risk centres around covenant strength and reputational risk

The political backdrop to the sector is important to understand. There are regulatory, local government and central government issues. Funding comes via local providers – housing associations – from central government. It is important that the money is provided centrally and there have been a number of confirmations that the government recognises the importance of continuing to make funds available to the appropriate amount. It also is essential to look at the "detail"; the immediate provider of the rent on the leases REITs have created and invested in. In many cases, the counterpart is a small, specialised housing association. The small size, the specialisation and the relatively young nature of this market has led to problems.

We note Triple Point Social Housing REIT's confirmation that it has inserted a new clause into its leases: a Change in Law Clause. This allows for the review of rental levels were housing benefit policy to change significantly. We believe such a change is unlikely, but are heartened by the appreciation that often the tenants – the housing associations (registered providers) are much smaller organisations than Triple Point and Civitas.

Some problems: positioning to "true" new build and away from aggregators a good strategy

Closely allied, there are issues relating to corporate governance of the housing association tenants. The Regulator has appointed board members to a number of tenants for both the quoted REITs in this sector. The weighting more towards new build and ending purchases from third parties who aggregate small portfolios of homes may prove welcome – indeed, the share prices may be reflecting these two allied trends.

There may have been turbulence, but there is cross-party support for community-based care. Cost savings and improved outcomes are all agreed to be achieved. This leads to excess demand and there is also a demographic driver. Local authorities are the commissioners of new space and this keeps supply and demand controlled. Triple Point data points to demand of 15,600 units in 2015/16; 29,053 2019/20 and 46,771 in 2024/25. This year, a government white paper is anticipated. We have referred to the small nature of the housing associations who are tenants and the novation across a number of leases to new tenants at short-term notice. Both REITs in this sector point to the large proportion of potential acquisitions, which are filtered out through due diligence.

Clinical outcomes and move towards higher-acuity, larger assets

The main driver to value, we think, is the occupants' perceived outcomes and the value proposition. The latter is referenced below. Each patient has his/her own personalised needs, and this is a fairly bespoke product. Selectivity in purchase of assets is important, and the main driver, by far, is ranking how attractive they are to those who ultimately pay the rent of the occupants: the local authority commissioners. The quoted REITs all confirm their selectivity on purchasing assets whose room/flatlet rents are no higher than the local median.

Now, Civitas Social Housing is moving into higher-acuity. larger assets.

There is a significant strategic change coming and Civitas has announced an EGM to amend the policy. It may be best to quote from the 19 March 2020 announcement. A little background is then added to our view that this move away from residential and into "acuity" is a positive and value-adding move. The shares have performed well since the announcement and we believe this to be a rational response.

"The Company has noted previously an ambition to own freehold properties that facilitate not just the delivery of care for long-term conditions such as learning disability, autism and mental health but also in respect of other urgent needs with significant unmet demand including homelessness and step-down accommodation for the NHS.

Whilst discussions can be strategic and therefore take considerable time to result in specific transactions the Company has now engaged with a number of parties and considers that the time is right to seek a widening of the investment counterparties with whom the Company is able to enter into leases and other commitments. This would, in due course, enable Civitas to enter into long-term leases with the NHS which may be structured in the form of specific joint venture arrangements and also with registered charities operating within areas of investment interest to the Company.

Big statement about move to capitalise on delivery of specialist care – higher acuity is direction of travel

The engagement with the NHS and other care providers in particular reflects the Company's focus on properties that facilitate the delivery of mid and higher acuity care and the level of knowledge and operational experience within the Company's Investment Adviser relating to the operation of specialist care businesses.

Increasingly less correct to see this as residential type of asset

Accordingly, it is intended that the Company will in due course seek to convene an EGM with the purpose of seeking shareholder approval to amend the Company's investment policy." As per 11 May update: "The Company's portfolio is specifically focused on properties that are suitable for the delivery of mid-to-higher acuity care and these services remain in high demand as usual."

Sector could become less weighted to residential, more to clinical

For now, attraction is bond-like lease structure – albeit to varied quality covenants

This is a sector that offers ultra-long, upwards-only lease income, provided (not guaranteed) by the government. Leases are reliant ultimately on the willingness of central government to fund CPI-inflating rents for two-decade-long leases. It is likely they will. The total costs by (third parties) delivering care through these assets are significantly below other (more traditional) asset-located alternatives. The vulnerable occupiers remain in these properties for the long term. So, compared with primary health assets, while there are differences, there is a similarity in that regard. Both are replacing assets that are offering poorer outcomes. Note the difference in NIYs on the assets. The supported housing sector is less established. The sector is reliant on rents being seen as good value. This, in turn, is dependent on future housing not being a substantially cheaper – more efficient – source of accommodation.

The National Housing Federation predicts the shortfall in supported housing assets to increase by 86% between 2015 and 2020. Supported housing is compelling, due not only to the quality of life it can afford occupants, but also because of the potential cost savings for local authorities. Research recently commissioned by Mencap (a leading UK charity for people with learning disabilities) showed that demand for new supported housing properties is expected to grow over the next 10 years. The report (referenced by Triple Point) found that it costs, on average, £1,596 per week to house and care for a person with learning disabilities living in supported housing, compared with £1,760 per week for a residential care placement and £3,500 per week for in-patient care.

Note that Residential Secure Income REIT (ReSI) does not invest in this asset class.

Other residential investment

Residential REITs seems obvious market: large assets' market size. However, yields are low, rents variable and costs high. ReSI cuts through these drawbacks.

ReSI REIT invests in i) shared equity housing, ii) age-restricted (sheltered) housing for rent, and iii) local authority housing. We sketch an outline on these categories here. But first, what is ReSI's investment philosophy? The main input to the investment drivers is the high covenant quality of tenants.

It supports government policy and actions support developers for mutual benefit

Four overarching factors underpin and drive ReSI's investment strategy: i) reduced government grant and other financial constraints are causing housing associations to seek third-party equity capital; ii) similarly, government initiatives are encouraging local authorities to bring in third-party capital; iii) UK housebuilders and developers are under pressure to deleverage and reduce their balance sheets; and iv) demographic trends and a historical undersupply are driving growing demand for UK housing. This environment has created a highly scalable, long-term investment opportunity to generate secure, long-term, inflation-linked returns. ReSI was created to meet demands from housing developers (housing associations, local authorities and private developers) for alternative equity-like financing routes to support their development ambitions and investment partners to facilitate their provision of housing.

We turn to the three pillars of ReSI's investment, because it is these three sectors of UK residential property we refer to in this section.

Shared ownership a rapidly growing niche – rents at below-market levels, with ultra-high covenants

Shared equity/shared ownership: As house prices rise, the ability to buy reduces. Add to this a reduction in lenders' willingness to loan 95%-100% of the value of a purchase, and a gap emerged in the market, particularly after 2008. Shared ownership enables a wider range of buyers to afford a home, and is supported by government grant funding from Homes England and the GLA. Occupiers typically purchase 25% equity in the home and the rest is rented from the registered provider. The rent is capped at 2.75% of the value of the unsold share, which is a below-market rent. Purchasers may buy additional shares at market value whenever they can afford to do so; this is known as "staircasing" and enables investors to benefit from bulk discounts and any house price growth.

There are 4m more people in the UK who meet the income requirements for purchasing a £250,000 home through shared ownership than an outright purchase. By making homes accessible to a wider market, shared ownership can increase the absorption rate on a development, making ReSI an attractive partner to housing developers, both private and housing associations.

There is a problem with the market. There are only ca.200,000 shared ownership homes across England, and a total of 11,447 new shared ownership sales were made by registered providers/local authorities in 2018/9 (*Housing Statistical Data Release: October 2019*). Reduced availability of government grants and other financial constraints are causing housing associations to seek third-party equity capital. The housing associations held increasingly more equity in the 75% share of the homes.

However, lenders to housing associations find it difficult to use the shared ownership home as security. This is because the occupiers can increase their share from 25% to a higher number and up to 100% at a time of their choice. The lender's security of course does not disappear, but it changes ownership and is thus not loan security. It makes sense for the housing association to recycle shared ownership equity into other avenues.

It makes sense, therefore, for housing associations to sell their 75% share to a third-party investor: ReSI. For ReSI, it owns an asset-generating rent – admittedly a regulated rent at a relatively modest yield – and one with an excellent covenant. The covenant is strong because if the occupier fails to pay rent, the equity the occupier owns is at risk of forfeit. The yield ReSI generates from its shared ownership investments benefits from its ability to buy assets from developers at a discount to their market value. As shared owners staircase over time, these bulk discounts are released to investors.

Retirement housing – plenty to buy, almost none to rent

ReSI buys, then rents out, on lifetime tenancies, to tenants with very secure income

Private sector retirement housing for rent: This market is as yet of minimal size. Competition is rising – McCarthy and Stone has changed its model and while still concentrating on for-sale, it is partnering to develop assets for rent, albeit targeted at a much higher-value segment of the market than ReSI's properties. Retirees seeing the benefits of retirement apartments may look to rent for numerous reasons, including flexibility, equity release and difficulty in selling their former home or lack of desire to leave loved-ones with the requirement to see the retirement property. Retiree tenants have lifetime security. Tenancies obviously do not vacate after a set amount of years but typically last seven years, we believe. The rent is rebased to local market conditions at that date. There are refurbishment and off-rent costs between tenancies.

Local authority housing: This is provided to a variety of occupiers and has at many times in the past century been the majority home provider. In the context of ReSI, the local authority is providing accommodation to reduce homelessness. ReSI's economic interest is the lease with the borough council – Luton. The covenant is strong and the location is a good one to underpin residual value as well as potential ongoing lease extensions.

This investment is providing capital to address specific social needs. For ReSI, crucially, there is significant social value-added in at least four ways, which we list. Social value-added (which ReSI quantifies) is an increasingly tangible benefit politically – "all in it together". ReSI draws capital into areas of major social need. It is going with the grain on housing associations' delivery targets: they are increasingly balance-sheet constrained. It also is moving people out of overnight accommodation for the homeless. There is an increasing reliance on pay-nightly privately managed accommodation (accounting for 29% of those in temporary accommodation in December 2017, up from 9% in December 2011). It is moving in the direction of travel for retirement housing, which, to date, has virtually no private sector rental but is crying out for it. Private housebuilders benefit greatly – especially in difficult times – from ReSI's shared ownership sector investment capital.

Purpose-built student accommodation

Part 1

Importance of resolution to poor visibility on timing of opening of campuses cannot be overstated

The importance of visibility on the timing of opening of campuses cannot be overstated. If they open in January 2021, this would be a devastating blow to university finances and to landlords for first-year and post-graduate students.

Surprisingly hard-hit sector

In summary, typically 15%-20% of the contracted rent for the 2019/20 academic year is lost with no recourse to recoup part. As to 2020/21, many PBSA providers would only be ca.50% booked by March of any year. The scope for shortfall in 2020/21 is clear. The voids will rise – perhaps not much – and there is still the problem of possible empty rooms contractually let, just like in 2019/20.

COVID-19 has hit 2019/20 quite hard, but the extent of the hit is broadly known, with announcements from the quoted players. What about 2020/21? In the absence of any clarity, many students will defer courses a year. This will be a major strain on universities' depleted finances (depleted in part by the decision to forego three months' rents). It will also lead to gaps in demand for year-one and post-graduate accommodation, with all the operational gearing (and marginal pricing) issues that brings for the likes of Empiric, GCP Student, Unite and the others.

Short leases and extreme effective-demand turbulence for next two years

The problem is not that leases are short. Many REITs in this report that have leases of a few years benefit from that, because of reversionary uplift in these in-demand sectors. Here, leases are 52 weeks or even in many cases 40 weeks. That is not at all the problem. There is plenty of fundamental demand but, in 2020, it may not be "effective" demand. That knocks on for two to three years. 2020/21 forward rental demand may be enhanced by "placement year" offers to undergraduates being summarily withdrawn and students scrapping the mid-course year in employment off-campus. However, the bigger pressure is the other way. The longer there is uncertainty about campuses opening in September/October, the more there will be attrition to 2020/21 student numbers.

Could have been worse: typical 2019/20 academic year rent shortfall ca.20%, or less. Possible likely 2020/21 shortfall.

2019/20 could have been worse. As GCP Student stated on 1 May: "As a result of the flexibility offered to direct let tenants and the wider economic impacts of COVID-19, the Directors anticipate a reduction of c.£9.0m (18%) to all the budgeted 2019/20 academic year income." We had originally been more pessimistic. The uncertainties for 2020/21 might be overstated here, though. The danger is the operational gearing and the relatively short visibility on profits. PBSA has booked the majority (just about) of its rooms by any given March, but the April to August bookings generate the profits.

PBSA is intimately involved with the universities themselves. These may nominate tenants directly or not, but all are drivers to the decision of developers and investors in PBSA. Often it is university land being used or at least securing third-party sites adjacent to university and with some type of understanding regarding competing new developments.

Many/most universities that still hold large amounts of PBSA themselves have decided to offer three- or four-month rent rebates to undergraduate tenants. We wonder if there is a broader attention being paid by the universities to their reputation and how that reputation drives fee income. COVID-19 is proving a shock to the university sector in numerous ways. Overseas income is important to universities. "Gig-economy" and hospitality job income is important to the tenants. In this context, the three-month rebate on tenancies, which are contractually fixed, may be more understandable.

In power of quoted REITs to weather the storm

While the rent rebate is painful, it is in the power of the quoted REITs to weather the storm. The problem is that pricing power has been called into question: they are takers, not setters of the agenda. Furthermore, the same may be said – we hope temporarily – of the higher education sector. Expansion has been strong for 30 years but was given an extra fillip by "deregulation" of growth quotas five years ago. Through loss of income on rents between April and August and loss of income from conferences and other income, allied to risks (and potential upside) from overseas student exposure, the finances of the sector are unclear. It seeks £2bn in government aid. This is a sector that is crucial to the UK's economy and its export earnings.

On the numbers, the share prices seem to have over-reacted. But investors need much more insight as to whether the major rent rebates by Unite, Empiric, GCP Student and the like are reputation-enhancing, or altruistic, or evidence of weakness. The sector NIY has now reduced to a 4.8%-5.7% range for the quoted stocks. Maybe this still stands up. In an uncertain sector, the risk is on the downside, at least for valuations if not rents. The number of student purpose-built new beds delivered in the year rose to 31,248 in 2018: a record. There is still a shortage of accommodation and still a growth in student numbers, to date.

Plenty to go for; could work out

The UK has 10% of the global international student market. This is second only to the US, where degree costs are significantly higher, and above Australia's 6% share, where costs are higher too. The March 2019 Department for Education and International Trade plan to increase international student numbers to more than 30% was encouraging in that there is a real focus here. Their income contribution to the UK is ca.£20bn a year. One risk from Brexit is not only fewer European students (who comprise 7% of the total UK and somewhat more of PBSA), but also fewer non-EU students who seek a UK visa as a hassle-free door to some years' visiting Continental Europe. Published in May 2019, the Augar report suggested a reduction of fees to £7,500 and some maintenance grants. We shall see. The market has pluses and minuses.

Part 2

The aim of this segment is to hypothesise some "what ifs" based on trends in recent years and possible problems for the imminent future.

Some pause for thought on rent

In 2018, *Which?*, Unipol and NUS published the *Accommodation Costs Survey*. Between 2012 and 2018, costs rose by more than 30%, nearly 5% p.a. The average student rental bill was £6,366 and some of this was not even for a full 52 weeks. PBSA often quotes 42- to 45-week occupancy as a cheaper cost for the student. However, students may wish to remain in the city/town of their choice to earn money (not in 2020). The average bill equated to 58% of the maximum student loan in 2011 and 73% in 2018. London students paid £8,875. The UK average excluding London was £5,928. The ratio is 67%.

In the survey, *Which?* suggested that private halls relative to university-controlled halls can be pricey. HomeLet Rental states (March 2020) UK average rents excluding London at £793. South East England is £1,025, Greater London £1,673. The non-London England vs. London ratio here is 47% – not comparable with the 67% by which student costs are higher. Utilities, maintenance and other costs are higher. However, if this element is maybe 15% of UK non-London accommodation costs and this fixed amount is deducted from London and from non-London, then the student non-London vs. London ratio is still 63%. If the private non-student ratio (47%) is right, non-London student rents should fall, in theory, by maybe 25%. That is on top of the rise we noted in the ratio of accommodation costs to maximum student loan having risen. We see 15% as a real possibility.

None of this is evidence of anything but it illustrates a concern that accommodation – particularly in the provinces, especially outside south eastern England – is too expensive. This is before looking at the effects of COVID-19. Or, perhaps it is an indication of how far down one might look if COVID-19 forced one to re-think. This is entirely a "what if", with little scientific basis. It hits Empiric more than Unite (not in this report) and more than GCP Student as the latter is much more London-centric. The converse is that COVID-19 might hit overseas students and that would affect GCP Student more. Or the affordability problem could be absolute not relative. Maybe London is simply too expensive. Maybe London might be more under pressure to shift to two-year as opposed to three-year courses. Given under-supply in London, two-year courses would not lead to surplus accommodation. It would lead to some difficult marketing, though.

Care homes

How fortunate the nation is to have a well-run, dedicated sector caring for those in chronic need of assistance

All are concerned and saddened by statistics confirming that which was already understood. ONS has published that age-adjusted COVID-19 deaths are 23.4 per 100,000 for male social care workers vs. the already high 10.2 in health care. For female workers, the figures are, respectively, 9.6 and 4.8 per 100,000.

All real estate relates directly to human needs, but care homes possess a particularly high profile. We believe the morally right thing will be for more government funding. We believe the morally right path will coincide with the economic outcome. As to their economic drivers, it is important to distinguish between the operators' cashflow and the characteristics of the tenancies.

The sector is progressively moving into stronger operators' hands. Looking first at the "raw material" for lease income, the smallest and the largest operators are losing market share. Small operators struggle to invest. Large operators find that, beyond a certain level, there can be dis-economies of scale. Professionalisation drives a slightly growing number of rooms per home, incremental investment into targeted care for dementia and a balancing of private income occupiers and publicly funded beds. This is, therefore, a tenant market where the landlord needs to understand the occupier requirements intimately. Care home NIYs trade on a particularly wide range, based on the quality and positioning of the homes.

Politics – sector long in need of attention and now has this attention; we consider this a significant silver lining

On 18 March 2020, Target Healthcare REIT wrote of the market opportunity. "The Government's newly introduced points-based immigration programme seems likely to further challenge the sector's ability to attract appropriate numbers of care staff, particularly into the poorer quality working environments offered by the prevailing older real estate. Social care's drop down the list of national government priorities is evidenced through the long-awaited policy paper being delayed until at least the end of 2020. We remain cognisant of the critical need for investment in this sector and are proud to be driving up the standards of care environments through our careful investment in modern, purpose-built care home real estate at sustainable rental levels."

Some political will required

Anticipate upside, rather than downside, for better-quality operators

We are strongly of the view that the political environment has changed permanently, just as it did – in perhaps a smaller way – as a result of the Grenfell Tower disaster. That – with a year's delay – has led to significant changes in fire-safety across a very wide range of housing sectors. Currently, some operators are labouring under cashflow issues as well as the operational strains of COVID-19. We are strongly of the view that operators that provide modern facilities and are well run will secure robust ongoing funding from the public sector as well as private paying occupiers. COVID-19 will be far more wide-ranging and there will be significant and positive changes to the care sector. The political will is certainly in place to ensure that quality operators thrive. There will also be an accelerated differentiation of the quality operators vs. the less purpose-built, modern accommodation. COVID-19 has been difficult on many levels, but it is likely that there will be further consideration of the benefits of purpose-built assets or ones with en-suite and ability to accommodate wider, separated categories of people at home. Target Healthcare and Impact Healthcare tenants have done well in the difficult environment already.

Migration to higher-quality operators

One metric, which gives a good insight into the sustainability of a tenant, is the combination of good cash-backed profitability allied to strong cash-backed maintenance capital expenditure into its estate. Operators and landlords need to be sure of their business models. Impact Healthcare stipulates ratios both for maintenance capex and profitability. It is important to remember that the accommodation element of costs to the end-user is only ca.10% of the total.

Supply will continue to be constrained as operators exit the market

As smaller operators and non-purpose-built homes exit the market, the overall size of the UK market supply has hardly grown and has not kept pace with demographics.

Private-pay fees have risen at around twice RPI for some years, but public funding pressure has constrained this element, which remains over half the market. Time will tell – it will be difficult for public funding to be so constrained as to limit the ability of the sector to take patients from hospitals and other referrals within the publicly funded elements of the market.

Cost drivers are predominantly wages, yet salaries in the sector are not high. Avoiding London and much of the Home Counties, IHR's assets are staffed to the extent of over 90% UK residents. In the short term at least, supply of workers from the hospitality industry takes some of the supply-side pressure off.

Open-market family rental houses

Demand growth obvious; challenge is to achieve scale while minimising risk

Currently, the private rental market is typically privately managed and fragmented, with the market for new family houses (rather than flats) under-served, and with the "traditional" buy-to-let market now declining in size. In 2003, 600,000 UK families were private-sector tenants. Now, the figure is over 1.8m (*Source: Ministry of Housing, Communities and Local Government*). In 2006, 13% of UK households rented privately. Now, the figure is 20%. Over the same period, social-sector renting moved from 18% to 17% and buying with a mortgage fell from 37% to 28%. Privately rented was 20% previously in 1971, a figure down from 55% in 1945 and over 70% pre-World War One.

Only 0.5% of total UK real estate comprises privately rented property held by non-buy-to-let investors – the institutions. This market is served, currently, almost entirely by PRSR. PRSR purchases stock from developers who seek pre-sales on larger sites, thereby securing early cashflow. Market demand will almost certainly increase as a result of the uncertainties related to COVID-19. 120,000 mortgage redemptions have taken place in the buy-to-let sector in the past three years (*Savills, Sigma Capital*). 150,000 new tenants entered the rental sector in 2018/19 (*English Housing Survey*), the majority of renters now are with family. Annual renewal rates are 88%: these are families where more than half have children at local schools. The more difficult the market for developers, the more useful is PRSR's early-stage investment.

This market is totally distinct from the small but rapidly growing build-to-rent market in urban apartments. The apartment market is focused on London and the Home Counties and to a very minor extent, regional cities. This is a highly specialist market.

Supermarkets

Real sector uncertainty some four to six years ago, but appears to have been circumvented. Asset values have taken hit, though.

There is scope for the sector asset-class to be re-valued upwards. There are two positives to bear in mind for a potential upward asset price move. First, the asset class is defensive. In 2008, supermarket NIYs rose to ca.6.0%, from 4.5% two years before. But the broader sector figures are 7.0% and 4.5%, respectively. Secondly, all-property yields between 2009 and 2013 stood 100 bps above supermarket NIYs. Recently, the NIYs stand ca.60 bps higher for supermarket REITs versus the all-property level. Most recently, the valuation uncertainty for supermarkets is distinctly less than for the broader market. We think there is a good possibility the yield gap may reverse.

Tesco's UK large-store sales showed 1.9% positive sales growth, with 2.1% total UK growth. Like-for-like UK growth registered 1.9%. So, we are definitely "out of the woods." With Supermarket REIT's exposure to omnichannel stores, the market share issues become much less relevant and the long-term requirement for the large-store format is not under question as it might have been six or so years ago. Back in pre-history of 2016, the large supermarkets were struggling with changes in shopping habits. New budget-price entrants were – and still are – taking market share and the public's move towards more frequent convenience-related shops was in full swing. Neither of these competition issues has changed. Nonetheless, the large supermarket chains have adapted. Most have their own convenience chains (although experiments in new chains have generally failed) and Sainsbury's 2016 merger with Argos has proven to be an inspired move. This is a dynamic sector: a positive attribute.

"Last-mile" logistics hubs

Surprising concurrence of good investment characteristics here

This sector is driven by several distinct factors. It thrives on urbanisation. This drives demand for the products travelling through these assets and also competing for land use, thus restricting supply of assets. A second, distinct driver is internet shopping fulfilment. But it is essential to appreciate that this is only one of the drivers to demand. It is important, but data suggest it provides 30% to 40% of the expansion in demand.

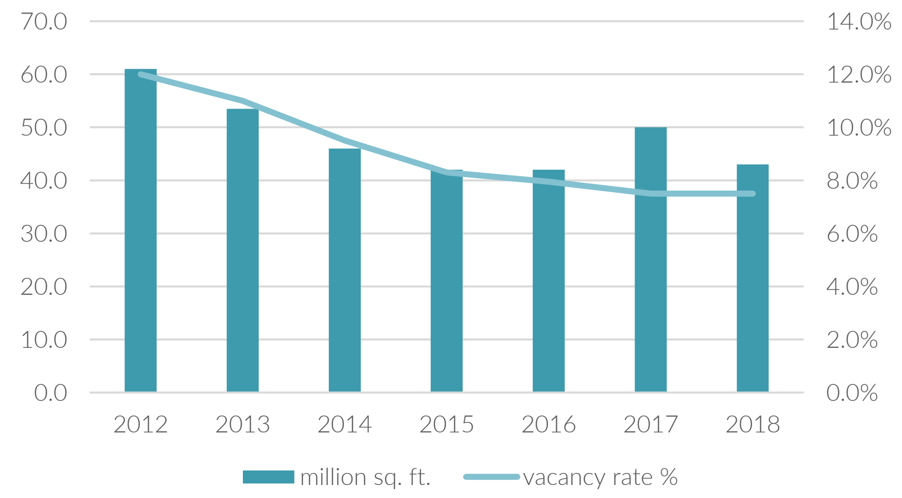
NIYs strong, rents modest and new supply minimal

Despite this expansion in demand and constraint of supply, rents are almost exclusively under £5 per sq. ft. and typically valued on NIYs of ca.6% towards 7%, well above yields on All-Property. The MSCI average stood at 5.1% at end-2019. Urban Logistics REIT's assets average 6.2% NIY at valuation, Warehouse REIT similar. Together, this means the large majority of assets in this class are valued at below the build cost (excluding land costs), which typically would be £90-100 sq. ft. A cheap valuation, but a sector attracting significant occupier interest. UK take-up (*Savills*) reached 34.1m sq. ft. in 2018, a 32% increase on 2017. This compares with a long-term average of ca.20m sq. ft. institutional interest. Institutional investment interest is also strong.

Supply in the 20,000 sq. ft. to 200,000 sq. ft. logistics asset class has reduced by 30% since 2012. Supply-demand balance is attractive for this asset class. The supply is falling because of competing land uses in the urban locations this sub-200,000 sq. ft. asset class typically occupies. The cheapness of the assets in itself restricts their supply. See, however, comments from Tritax Big Box, quoted below, suggesting take-up for the sub-200,000 sq. ft. market has reduced in the past four years.

30% reduction in market supply

Supply (sq. ft., m) and vacancy rate (%)



Data for logistics assets sub-200,000 sq. ft.
Source: Savills, Hardman & Co Research

Tight supply in sub-100,000 sq. ft. segment; much more balanced supply/demand in mid-sizes

We consider it very important to differentiate the markets for logistics assets in three different size categories. The "last mile" almost invariably consists of assets between 20,000 and 100,000 sq. ft. We consider the prospects here to generally be better supported by tight supply/demand compared with the 100,000-250,000 sq. ft. size range.

There are many sources of tenant demand – many being nothing to do with the internet. 3PL is as large a component as online retail. 28% of 2018 take-up was from online retail (*Savills*) while 25% of 3Q19 take-up was from online retail (*CBRE*).

In March 2020, Tritax Big Box stated: "In 2019, the speculative supply of buildings in the 100,000-250,000 sq. ft. size range represented 10.6 months of take-up compared to the over 500,000 sq. ft. category where there was a 50% reduction in speculative supply to just over 1m sq. ft., which is the equivalent to just 1.4 months of 2019 take-up."

In 3Q19, Blackstone launched a £7bn pan-European last-mile logistics fund, owning and operating over 1,000 assets already owned by Blackstone in the UK, Germany, France, Netherlands, Spain and the Nordics. It will use this vehicle to expand exposure.

This structural change, allied to the fact that much stock trades at below replacement (with land) cost, is a compelling factor on which to focus attention. We list below some market-dynamic headlines. Another compelling factor is that the NIY on both SHED and WHR (Urban Logistics and Warehouse REIT, respectively) is 6% or more. This is also quite an active investor market, with a workable lot size. It offers the scope to take value gains on a granular basis. Both the above REITs have done this. Value can be locked in by using expertise to secure under-rented or void assets and then optimising income.

"Big box" logistics

Internet not only driver here, so story compelling

The NIY on large, modern logistics hubs is some way below that of the "last mile" urban logistics (small-medium assets). An important contrast between Tritax Big Box (BBOX) and SHED and WHR is the length of the average lease, at over 14 years for BBOX, almost three times the length of WHR and SHED leases. While the positives of long leases with strong covenants are clear, the sector bellwether, Segro, is aiming its incremental capital deployment more to the shorter lease "last mile" logistics.

Problem predominantly ability to add new space and NIYs, which have been competed down

Good momentum remains. IPF states the consensus rental growth YoY for industrial and logistics is 2.7% for the current year, after 3.0% estimated last year. This compares with 0.2% for All-Property for 2019.

However, market momentum is not actually that strong, as an operator such as Tritax Big Box is correct at its 2019 results announcement to state: "We are well placed to benefit, but also take comfort that 53% of our income is subject to fixed or minimum level increases." Rents are rising but not as fast as 2018 and, in any case, 2018 was buoyed by urban logistics assets. Boyed by demand for urban buildings (see previous segment), 2018 witnessed regional average rental growth of 5.6% p.a. for logistics buildings units over 100,000 sq. ft. This reduced in 2019 to 1.2%.

Tritax Big Box stated in March 2020, "In 2018, logistics property take-up for buildings over 100,000 sq. ft. was the highest on record at 31.5m sq. ft. Despite Brexit and the UK general election, the equivalent figure in 2019 was 25.4m sq. ft., remaining above the 10-year average of 22.6m sq. ft. Importantly, the level of market demand can be represented by combining "take-up" and "under offer" statistics; for 500,000+ sq. ft. buildings (as a percentage of total market activity), this has increased in each of the last four years, whereas the equivalent figure for smaller-scale logistics buildings has reduced over the same period."

Cushman Wakefield stated in its Autumn 2019 report that, across the UK, availability rose by 6% YoY to reach 64.2m sq. ft. at the end of 3Q19, equating to two years of supply. This is not a deterioration in supply/demand, which should prove of concern, especially given the ongoing growth from e-fulfilment. Nonetheless, given the NIYs, which are not at a premium to all-property, this is a sound long-term asset class rather than one with a particularly strong value/growth profile.

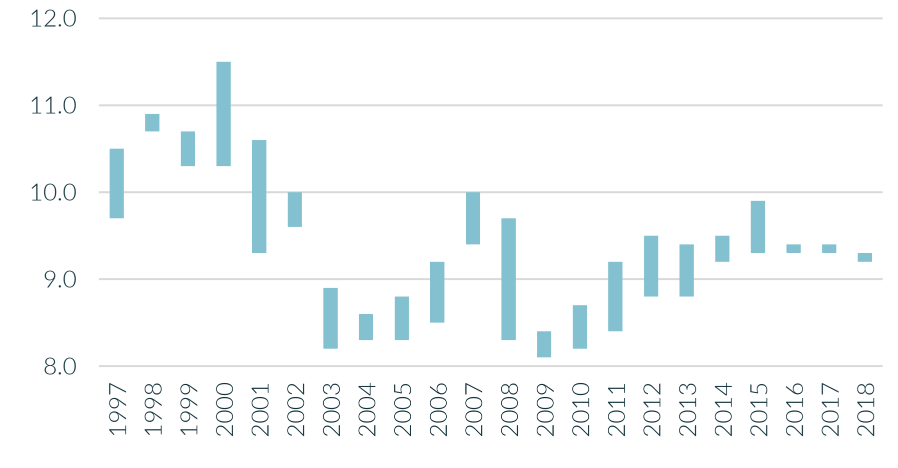
Interest rate weakness

The attractions of secure income will only rise further

UK business investment has been consistently, significantly weak for 20 years, and the recovery that seemed to be in place post the financial crisis in 2008 failed to follow through. While there are a whole host of factors driving global interest rates, we point to the fundamentally anaemic commitment of cash towards business investment. Long-term interest rate trends are crucial determinants of investor positioning.

Lack of business investment, even pre-2020, which negates rises in demand for, or cost of, money

Real UK business investment as % of GDP



Source: EY ITEM Club, Oxford Econometrics, OBR

- Returns from risk-free assets show that they are still in a phase of decline; i.e. long US treasury bonds and UK gilts.
- The chart above illustrates just one driver to lower rates.
- While the recent explosive growth globally in government indebtedness has of course increased the demands put on investors' cash, high government borrowing does not inevitably lead to high cost of money. The Bank of England was founded to fund large war expenditure through debt and thereby reduced cost of money. The post WW2 environment was one of constrained cost of money for a decade.
- This is not to say that the private sector is advised to take on high gearing. Yet this has not been a feature of the quoted REITs ever since the reaction to the 2008 financial crash.

The counter-argument

Financial repression – stagflation

- There is an argument that, with so much government debt, there will in due course be a temptation towards "financial repression" – that is to say, negative real interest rates driven by an encouragement of a modest rise in price inflation.
- Or, rises could get out of hand and rates would rise. If this were to happen very soon, PHP and Assura would be exposed in five years or so unless they de-geared within that period of time.

Risks

- Real estate, by its nature, has risks of ownership, but a crucial series of risks comes from the liabilities side of the balance sheet.
- Refinance risk (when lines of credit mature) is minimised if the borrower has a wide range of possible sources of finance. Accounts state all finance break/termination dates. By their nature, assets with long-term, relatively secure (high-covenant) income streams will be preferred by lenders.
- Fixing interest costs may prove onerous if the rate struck proves to be above future market rates. However, this does not affect the cashflow beyond what was budgeted when the debt was taken on. We consider this risk scenario as unlikely.
- If RPI is low (say, well below 2%), some REITs with CPI- and RPI-linked leases would be solid but unexciting if they did not develop other strategies; quite the reverse, however: we expect increasingly heightened investor interest in RPI-linked assets. This will likely be reflected in asset prices well ahead of the potential future acceleration in RPI.
- Sustained long-term house price weakness would have an impact on PRS REIT and ReSI, but less than the "headline" indices would show. The drivers are strong rental covenants, amply illustrated by reported rent collection, and value for money.
- The younger REITs are still in the investment phase. Many (the 2017 IPO cohort) have invested all equity, and are now investing debt finance. This steadily reduces "cash drag." However, with £2.2bn extra having been raised since May 2018, many REITs are experiencing "cash drag." Much investment is via forward-funding of new assets or by acquisition in company structures. Where this is not the case, purchase costs can reach 7%.
- REITs listed here undertake no (or very limited) development risk. Some (e.g. BBOX) are now enhancing their NIYs through undertaking their own development. This has some risk, but it does not rely on selling the asset created to a third party.
- We are supportive of Civitas Social Housing REIT's move to widen from supported housing as the only string to its bow. The change does bring transition risks, but we understand strong partners are being used.
- Naturally, all the REITs rely on their tenants paying rent. Nonetheless, in terms of accounting *transparency*, this is all very clear. Either they pay or (in a *de minimis* number of cases) they do not. Yet, this simple state of affairs is becoming slightly muddied, with bespoke deals struck with tenants to defer or forgive. Sometimes, this is under pressure from third parties such as – indirectly – the government.
- Not all REITs here are COVID-19 immune.
- Some REITs, we estimate, will not be financially affected by COVID-19, but they would be if government funding were not advanced to operator tenants. This is the case, for example, in the care home REITs.
- There are no pension fund liabilities, and management contracts are clear and simple (including contingent termination costs).

- "De-urbanisation" may be a big, slow-burn theme of the decade. We do not consider this to negatively affect REITs here, but some of the consequences could take time to emerge.

- If there is a rapid and sustained recovery in the UK economy, thereby raising prospects and rents across GDP-related sectors, some REITs with a wider investment style may outperform.

- Rather than concern about the outlook being more bullish than anticipated, we fear a return to a deeper "risk-off" scenario, maybe if extended lockdowns have to return. We believe the sector would generally do well under such a scenario, but some investors may look at wider asset allocation and see the Yen or Dollar as a strategic safe haven. In this case, it is worth noting we specifically are choosing Sterling income plays. It should be kept in mind that other, large, quoted real estate REITs have significant exposure to asset classes, such as London city offices and retail, which appear even more under pressure post COVID-19.

Conclusion

We see little justification of dividend yields of the REITs covered in this report to be twice the level achieved by the top 100 in 2020. In 2021, they will also pay significantly more.

The investment strategy – aiming for security – pre-dated 2020

Universe was in right space when economy was growing in 2019, when it shrank (if that is the word) in 1H'20 and will be too in 2H'20 and 2021 onwards

2020 has begun in the same manner as 2019 played out – only more so. Many of the large-cap stocks in the UK real estate sector faced dividend uncertainties in 2019, and not just those that were unhappily over-exposed to retail malls. Few of the REITs covered in this report faced such concerns. For 2020, several, including British Land, have cut or suspended dividends. Some of the REITs in this report have, but few in all. They comprise the PBSA stocks and also a passing of a quarter by PRS REIT, a cut by Secure Income REIT and a modest reduction at Tritax Big Box. The PBSA REITs probably should not be seen in the same light as "secure income" or safe-harbour-type asset classes. But the other REITs should bounce back.

So, it was and is still a strategy of seeking security. It outperformed in 2019 when the economy was growing, it has outperformed significantly in 2020 and we are confident it will outperform in 2021, whether the economy bounces back well or anaemically.

Dividend progression remains by far the most reliable factor

With most REITs offering dividend yields of more than 5% (and the lower-yielding Assura and PHP looking well positioned, too, on a risk-reward basis), dividend yields here currently are higher than the top 100 UK companies offered on their historical dividends. The bad news is that these top 100 seem likely to cut 2020 payouts by 50%. Some REITs, not current dividends, yield well over 6%, which appears attractive.

Median change for REITs covered here is a rise in dividend per share

This is all the more so as we consider the likely extent of dividend cuts to be 10% (weighted) and that the REITs where dividend cuts are not projected have very solid bases for continuing progressive payouts.

Dividend yields of 5.0% (weighted) historical and 4.5% prospective

Dividend yields of REITs covered in this report will be twice level achieved by top 100

- The majority of REITs here will grow their dividends.
- Those set to cut are clearly identified.
- Total dividend reduction set to be 10% – an outcome we consider robust.
- Share prices have outperformed.
- Yet dividend yields in REITs covered are well above the broader market.

Backing winners

Share prices YoY: weighted down only 1.8%; unweighted down 8.5%

The selected REITs have outperformed the sector and the market in the past year, but share prices have still fallen. Unweighted, the share price fall in the past year has been 8.5% and weighted, 1.8%. Clearly, the weighted figure has an element of "winner bias"; nonetheless, we consider it a noteworthy outcome. We consider the modest average decline in share prices is encouraging, rather than an indication of over-valuation. The historical dividend yield of 4.99% (weighted) and 5.64% (unweighted) is attractive, we consider.

Overall, the 14.9% (unweighted) 2020 share price falls reflect – we consider – market sentiment, as opposed to a dispassionate look at i) the absolute fundamentals of the REITs or ii) the heightened need to find secure, sustainable dividend streams on offer at levels above yields available in the broader market.

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(Disclaimer Version 8 – Effective from August 2018)

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The full detail is on page 26 of the full directive, which can be accessed here: http://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-regulation-2016-2031.pdf

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