

Regional REIT

Q420 dividend as guided

Regional REIT's (RGL's) Q420 DPS, in line with the company's previous guidance, takes the aggregate FY20 DPS to 6.4p, and is supported by continuing strong rent collection. The company has previously indicated that it was targeting dividends to be fully covered by EPRA earnings and we expect this to be confirmed when detailed FY20 results are released on 25 March.

Year end	Net rental income (£m)	Adjusted earnings (£m)	Adjusted EPS* (p)	EPRA NAV*/share (p)	DPS (p)	P/NAV (x)	Yield (%)
12/18	54.4	27.9	7.5	115.5	8.05	0.68	10.3
12/19	55.0	31.0	7.8	112.7	8.25	0.70	10.5
12/20e	53.3	27.9	6.5	100.2	6.40	0.78	8.2
12/21e	53.3	28.8	6.7	100.8	6.50	0.78	8.3

Note: Adjusted earnings exclude revaluation movements, gains/losses on disposal and other non-recurring items, and unlike EPRA earnings also exclude performance fees. *Fully diluted.

Dividends supported by strong rent collection

Rent collection continues to strengthen, with 97.8% of rents due in respect of 2020 received by 19 February 2021, adjusting for monthly rent and agreed collection plans, only slightly behind the 98.6% collected in the equivalent period of 2019. Significant H220 transaction activity (£37.7m of disposals and £42.0m of accretive acquisitions have been disclosed) locked in a significantly positive yield arbitrage, supporting the growth in gross contracted rent roll from £62.9m at H120 to £64.2m at year end. On an EPRA basis, occupancy increased to 89.4% (H120: 89.0%). The portfolio was externally valued at £732.4m (H120: £742.3m), with the reduction primarily the result of a 2.9% like-for-like valuation decline, an encouraging improvement on the -4.3% H120 movement. The end-FY20 net loan to value ratio (LTV) was 40.8%, broadly in line with the medium-term target of c 40%. We will update our forecasts with the detailed FY20 results due on 25 March.

Investment strategy focused on regional offices

Late in 2020, RGL presented on its positive outlook for the regional office market (available on its [website](#)). It believes that the 'death of the office' has been vastly overstated while regional offices are supported by structural demand factors, relatively low rents and limited new supply. As a result, investment will focus solely on offices in the main regional centres outside the M25. The office sector already accounted for 83.5% of the portfolio at end-FY20 and the increased focus will capitalise on the investment manager's strong expertise and operational platform, and will also provide a clear investment proposition to investors. We would expect the portfolio changes to be completed within 12–18 months, with industrial and other assets sold and the proceeds recycled into attractively yielding office assets. Disposals will also provide flexibility in managing LTV around the 40% target and the board also says it will give consideration to a share buyback where it is accretive to do so.

Valuation: Continuing strong yield attraction

Based on the FY20 DPS of 6.4p, the shares continue to yield 8.2% with a discount of more than 20% to FY20e EPRA NAV per share.

NOT INTENDED FOR PERSONS IN THE EEA

Q4 DPS and update

Real estate

2 March 2021

Price 78.5p
Market cap £339m

Net debt (£m) as at 31 Dec 2020* 298.6
*Edison estimate based on disclosed LTV

Net LTV as at 31 Dec 2020 40.8%

Shares in issue 431.5m

Free float 99%

Code RGL

Primary exchange LSE

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (2.9) 2.8 (31.3)

Rel (local) (5.1) (1.3) (32.3)

52-week high/low 116.0p 55.8p

Business description

Regional REIT owns a highly diversified commercial property portfolio of predominantly offices and light industrial units located in the regional centres of the UK. It is actively managed and targets a total shareholder return of at least 10% with a strong focus on income.

Next events

FY20 results 25 March 2021

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Further details

Rent collection continues to strengthen

RGL's continuing strong collection performance reflects a number of factors including the weight of offices in the portfolio (office collections have been above average across the market), the highly diversified income base (by tenant, industry, property and geographic location), the investment manager's integrated multi-office platform that enables it to stay close to tenants and respond to their needs, the quality of the tenants, and the quality and affordability of the assets.

At 19 February 2021, Q420 rent collection had increased to 96.1%, adjusting for monthly rent and agreed collection plans, up from the 88.7% reported as at 22 January 2021. On the same basis, the collection rate for FY20 had reached 97.8%, only slightly behind the 98.6% collected in the equivalent period of 2019. RGL says it remains in supportive and ongoing discussions with occupiers regarding the remainder of the outstanding rent and expects to collect the vast majority in due course. On an annual basis, around 99.7% of rents are typically collected under normal conditions.

Exhibit 1: 2020 rent collection performance at 19 February 2021

	Q120	Q220	Q320	Q420	2020 to date
Rent paid	98.1%	95.1%	96.5%	91.2%	95.2%
Adjusted for monthly rents	0.2%	0.2%	0.2%	2.3%	0.8%
Agreed collection plans	1.0%	2.6%	1.0%	2.6%	1.8%
	99.4%	97.9%	97.8%	96.1%	97.8%

Source: Regional REIT. Note: table may not sum due to rounding

Accretive acquisitions have continued

Since our last [update](#), RGL has disclosed the £16.4m acquisition of Beeston Business Park in Nottingham, continuing to recycle sale proceeds at noticeably higher yields, and in line with the strategic focus on regional offices. The c £1.5m pa rent on the Beeston Business Park acquisition, including undisclosed supplementary rents, reflects a net initial yield of 10.1%, with a weighted average unexpired lease term of 11.1 years to expiry and 7.8 years to the first break. The out-of-town mixed-use site comprises 220k sq ft of internal space, including a c 92k sq ft flagship, multi-let, two-floor office building and three industrial units totalling c 128 sq ft, on a total site of 26.5 acres. The business park benefits from excellent transport links, being adjacent to the Beeston Rail Station, which has direct connectivity to London St Pancras International and is located four miles from Nottingham city centre. Additionally, East Midlands Airport is located only 12 miles to the south-west of the business park. The tenants include Metropolitan Housing Trust, Worldwide Clinical Trials and Heart Internet (trading as GoDaddy).

The single largest sale in H120 was Juniper Business Park in Basildon, an industrial warehouse and office park, for £32.7m, 59.4% above the March 2016 acquisition price adjusted for capex and 3.9% above the June 2020 valuation, which we estimate reflects a 5.7% net initial yield.

Reflecting market-wide valuation trends

Recent market-wide trends in capital values have seen a continuing positive performance in the industrial sector and continued clear weakness in the retail sector, with the office sector continuing to see capital value declines but at a much slower pace than in H120. For Q420, in contrast to performance throughout the year, CBRE data indicates a positive 'all-sector' UK commercial property capital return, driven by gains in the industrial sector. A number of RGL peers reporting on a quarterly basis have similarly reported positive valuation performance for the three months ended

31 December 2020. RGL does not report quarterly (the Q320 valuation shown in Exhibit 2 is based on H120 valuations adjusted for acquisitions, disposals and capex in the period) and its 31 December 2020 valuation captures the whole of the H220 valuation movement. The 2.9% like-for-like decline in capital values across the RGL portfolio in H220 reflects the market trend to a stronger H2 performance. We estimate that adjusted for capex (c £2m) and the H2 acquisitions, the H220 like-for-like reduction in the value of RGL's office assets was c 2.5%. We have attributed the Beeston Business Park acquisition between industrial and office sectors in line with the published floor area split. The RGL office performance appears to be broadly in line with market movements although we had expected a slightly stronger performance, taking into account the strength of rent collection, the resilience of occupancy and the quality of the assets demonstrated in the capital presentation in November 2020.

Exhibit 2: Portfolio analysis

	31-Dec-20	30-Sep-20	30-Jun-20	31-Dec-19
	FY20	Q320	H120	FY19
Share of portfolio value				
Office	83.5%	80.3%	79.9%	79.9%
Industrial	11.1%	13.9%	14.3%	13.7%
Retail	4.1%	4.3%	4.3%	5.0%
Other	1.3%	1.5%	1.5%	1.4%
Total	100.0%	100.0%	100.0%	100.0%
Valuation (£m)				
Office	611.6	594.1	593.1	628.7
Industrial	81.3	102.8	106.1	107.8
Retail	30.0	31.8	31.9	39.3
Other	9.5	11.1	11.1	11.0
Total	732.4	739.9	742.3	786.9

Source: Regional REIT data

Estimates and valuation

We have made no changes to our forecasts and will review these with the detailed FY20 results on 25 March. In line with previous management statements, we expect the FY20 DPS to have been fully covered by EPRA earnings, although our analysis of the H220 valuation performance suggests that FY20 EPRA NAV per share may be 1–2p below our 100.2p forecast. The end-FY20 40.8% net LTV is broadly in line with the company's c 40% medium-term target but slightly above the 39.7% that we previously forecast, primarily resulting from the Beeston Business Park acquisition in December 2020 (not yet reflected in our forecast) but also the revaluation movement.

Confirmed by the Q420 DPS declaration, RGL continues to trade at a significant yield premium to the group average with a very similar P/NAV. With a strong focus on dividends, supported by very strong rent collection, the yield continues to stand out as attractive in a low-rate environment. Despite some recent increase in market interest rates, the UK 10-year gilt yield remains well below 1%.

Exhibit 3: Peer performance and valuation comparison.

	Price (p)	Market cap (£m)	P/NAV* (x)	Yield** (%)	Annualised yield*** (%)	Share price performance			
						One month	Three months	12 months	From 12M high
Circle Property	177	50	0.62	2.5	N/A	1%	-6%	-17%	-19%
Custodian	93	389	0.96	5.3	5.4	2%	5%	-14%	-18%
Picton	88	479	0.92	3.1	3.6	4%	16%	-10%	-14%
Real Estate Investors	34	62	0.52	7.5	6.0	-3%	-6%	-34%	-37%
Schroder REIT	41	214	0.70	3.8	6.1	3%	11%	-17%	-20%
Palace Capital	205	94	0.59	3.7	4.9	5%	-8%	-32%	-34%
UK Commercial Property REIT	69	897	0.82	2.7	2.7	5%	-5%	-15%	-19%
BMO Commercial Property Trust	71	570	0.61	2.5	5.9	-7%	-6%	-26%	-29%
BMO Real Estate Investments	75	180	0.76	5.3	4.5	8%	15%	-2%	-8%
Average			0.74	4.2	4.9	2%	3%	-19%	-22%
Regional REIT	79	339	0.77	8.2	7.6	-2%	4%	-31%	-33%
UK property sector index	1,626					3%	3%	-6%	-10%
UK equity market index	3,761					1%	3%	1%	-3%

Source: Refinitiv, company data. Prices as at 1 March 2021, Note: *Based on last reported EPRA NAV per share. **Based on trailing 12-month DPS declared. ***Based on last quarterly/monthly DPS declared.

Exhibit 3: Financial summary

Year end 31 December	£m	2016	2017	2018	2019	2020e	2021e
INCOME STATEMENT							
Rental & other income		43.0	52.3	62.1	64.4	63.4	62.9
Non-recoverable property costs		0.0	(6.5)	(7.7)	(9.4)	(10.2)	(9.6)
Net rental & related income		43.0	45.8	54.4	55.0	53.3	53.3
Administrative expenses (excluding performance fees)		(8.0)	(7.8)	(10.5)	(10.9)	(11.5)	(11.0)
Performance fees		(0.2)	(1.6)	(7.0)	0.0	0.0	0.0
EBITDA		34.8	36.4	36.8	44.1	41.8	42.4
EPRA cost ratio		n.a	0.3	0.4	0.3	0.3	0.3
EPRA cost ratio excluding performance fee		n.a	0.3	0.3	0.3	0.3	0.3
Gain on disposal of investment properties		0.5	1.2	23.1	1.7	(1.1)	0.0
Change in fair value of investment properties		(6.8)	5.9	23.9	(3.5)	(48.1)	0.0
Change in fair value of right to use asset					(0.2)	(0.1)	0.0
Operating Profit (before amort. and except.)		28.5	43.5	83.8	42.0	(7.5)	42.4
Net finance expense		(8.6)	(14.5)	(15.7)	(13.7)	(13.8)	(13.5)
Net movement in the fair value of derivative financial investments and impairment of goodwill		(1.7)	(0.3)	(0.1)	(2.0)	(3.1)	0.0
Profit Before Tax (norm)		18.3	28.7	67.9	26.3	(24.4)	28.8
Tax		0.0	(1.6)	(0.6)	0.3	0.1	0.0
Profit After Tax (FRS 3)		18.3	27.1	67.4	26.5	(24.3)	28.8
Adjusted for the following:							
Net gain/(loss) on revaluation/disposal of investment properties		6.2	(7.1)	(47.0)	1.9	49.2	0.0
Net movement in the fair value of derivative financial investments		0.9	(0.4)	(0.5)	1.5	2.6	0.0
Other EPRA adjustments including deferred tax adjustment		(4.3)	4.5	1.0	1.1	0.5	0.0
EPRA earnings		21.1	24.0	20.9	31.0	27.9	28.8
Performance fees		0.2	1.6	7.0	0.0	0.0	0.0
Adjusted earnings		21.3	25.6	27.9	31.0	27.9	28.8
Period end number of shares (m)		274.2	372.8	372.8	431.5	431.5	431.5
Fully diluted average number of shares outstanding (m)		274.3	297.7	372.8	398.9	431.5	431.5
IFRS EPS - fully diluted (p)		4.9	9.1	18.1	6.6	(5.6)	6.7
EPS - normalised (p)		7.8	8.6	7.5	7.8	6.5	6.7
EPRA EPS, fully diluted (p)		7.7	8.1	5.6	7.8	6.5	6.7
Dividend per share (p)		7.65	7.85	8.05	8.25	6.40	6.50
Dividend cover		101.6%	109.7%	93.1%	94.2%	101.0%	102.8%
BALANCE SHEET							
Non-current assets		506.4	740.9	720.9	806.0	739.7	745.5
Investment properties		502.4	737.3	718.4	787.9	722.4	728.4
Other non-current assets		4.0	3.6	2.5	18.1	17.3	17.1
Current Assets		27.6	66.6	127.0	69.4	109.1	101.8
Other current assets		11.4	21.9	22.2	32.2	32.9	27.1
Cash and equivalents		16.2	44.6	104.8	37.2	76.1	74.8
Current Liabilities		(23.3)	(42.6)	(83.7)	(36.2)	(44.3)	(40.1)
Borrowings		0.0	(0.4)	(0.4)	0.0	0.0	0.0
Other current liabilities		(23.3)	(42.2)	(83.3)	(36.2)	(44.3)	(40.1)
Non-current liabilities		(219.0)	(372.0)	(334.7)	(355.5)	(377.2)	(377.3)
Borrowings		(217.4)	(371.2)	(285.2)	(287.9)	(306.9)	(306.9)
Other non-current liabilities		(1.5)	(0.8)	(49.5)	(67.6)	(70.3)	(70.4)
Net Assets		291.7	392.9	429.5	483.7	427.2	429.9
Derivative interest rate swaps & deferred tax liability		1.5	2.8	1.0	2.6	5.2	5.2
EPRA net assets		293.2	395.7	430.5	486.3	432.4	435.1
IFRS NAV per share (p)		106.4	105.4	115.2	112.1	99.0	99.6
Fully diluted EPRA NAV per share (p)		106.9	105.9	115.5	112.7	100.2	100.8
CASH FLOW							
Cash (used in)/generated from operations		31.4	40.3	38.8	26.0	41.6	44.2
Net finance expense		(6.6)	(9.2)	(11.9)	(12.7)	(12.9)	(12.6)
Tax paid		(1.7)	(0.2)	(1.5)	(0.8)	0.0	0.0
Net cash flow from operations		23.1	30.8	25.4	12.4	28.7	31.6
Net investment in investment properties		(99.3)	(8.3)	100.6	(25.6)	16.3	(6.0)
Acquisition of subsidiaries, net of cash acquired		(5.6)	(51.9)	(32.6)	(43.9)	0.0	0.0
Other investing activity		0.1	0.0	0.2	0.2	0.1	0.0
Net cash flow from investing activities		(104.8)	(60.1)	68.2	(69.4)	16.4	(6.0)
Equity dividends paid		(15.7)	(23.3)	(29.4)	(32.5)	(24.5)	(26.1)
Debt drawn/(repaid) - inc bonds and ZDP		91.4	13.9	(50.5)	3.5	18.7	0.0
Net equity issuance		0.0	71.3	(1.2)	60.5	0.0	0.0
Other financing activity		(1.7)	(4.2)	47.7	(42.1)	(0.5)	(0.8)
Net cash flow from financing activity		74.0	57.7	(33.4)	(10.6)	(6.3)	(27.0)
Net Cash Flow		(7.8)	28.4	60.2	(67.6)	38.9	(1.4)
Opening cash		24.0	16.2	44.6	104.8	37.2	76.1
Closing cash		16.2	44.6	104.8	37.2	76.1	74.8
Balance sheet debt		(217.4)	(371.6)	(374.6)	(337.1)	(356.4)	(356.5)
Unamortised debt costs		(2.6)	(4.8)	(5.8)	(6.9)	(6.4)	(6.2)
Closing net debt		(203.9)	(331.8)	(275.5)	(306.8)	(286.6)	(288.0)
LTV		40.6%	45.0%	38.3%	38.9%	39.7%	39.5%

Source: Regional REIT historical data, Edison Investment Research forecasts

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