EDISON

# Custodian REIT

Q2 NAV and outlook

## Delivering on income target

Real estate

**Custodian REIT's (CREI's) diversified portfolio of UK commercial real estate delivered a positive total return in H120 despite challenges in the retail sector. Current-year quarterly DPS has increased by 1.5% and CREI targets a fully covered DPS of 6.65p for the year, barring unforeseen circumstances. The company targets further sustainable growth through accretive acquisitions and active management of the existing portfolio.**

| Year end | Net rental income (£m) | EPRA earnings* (£m) | EPRA EPS* (p) | EPRA NAVPS (p) | DPS (p) | P/NAV (x) | Yield (%) |
|---|---|---|---|---|---|---|---|
| 03/18 | 33.2 | 25.2 | 6.94 | 107 | 6.45 | 1.06 | 5.7 |
| 03/19 | 37.6 | 28.5 | 7.26 | 107 | 6.55 | 1.06 | 5.7 |
| 03/20e | 38.1 | 28.5 | 6.98 | 105 | 6.65 | 1.09 | 5.8 |
| 03/21e | 39.4 | 29.7 | 7.20 | 105 | 6.72 | 1.08 | 5.9 |

Note: *EPRA EPS excludes revaluation gains/losses and other exceptional items.

## Diversified income-focused strategy

CREI has a balanced portfolio of regional UK commercial real estate, diversified by sector, location, tenant and lease term. It is focused on institutional quality assets but with lot sizes of less than £10m, where the investment manager believes it has a competitive advantage. Portfolio diversification is an important element of CREI's strategy for growing income and dividends sustainably but, although diversified, the portfolio is actively positioned with a relatively high exposure to industrial, retail warehouse and alternative sectors. Management focus is on maintaining high levels of occupancy and growing income through active asset management and accretive acquisitions. Fully covered dividends paid from the IPO in 2014 to end-FY19 represent more than three-quarters of the NAV total return, a compound 6.8% pa (without assuming dividend re-investment).

## Income growth, but retail weighs on NAV

H120 EPRA earnings increased 1.5% versus H119 to £13.9m and EPRA EPS was 3.4p, fully covering the aggregate quarterly DPS paid of 3.325p (+1.5%), with cover of 105%. Income was supported by a continuing good level of occupancy (95.5% at end-H120 compared with 95.9% at end-FY19) and a slightly larger average asset base. Net loan to value (LTV) was a modest 20.5% but increased to 23.2% with the early October acquisition of an eight-asset portfolio of distribution units, adding c £1.6m in annual passing rent. Reflecting market conditions, weakness in retail property values more than offset continued gains in industrial assets and asset management initiatives; end-H120 NAV per share was 104.3p (end-FY19: 107.1p). NAV total return was a positive 0.5%. We have slightly reduced our FY20e EPRA EPS (c 4%) and EPRA NAV per share (c 3%) but continue to expect full DPS cover with acquisitions leading to FY21e income growth.

## Valuation: Income profile supports P/NAV

CREI shares combine an attractive yield with a fully covered dividend and conservative gearing. Investor demand for the shares, trading at a premium to NAV (unlike peers), provides funding support for accretive acquisitions.

**20 December 2019**

| | |
|---|---|
| **Price** | **114p** |
| **Market cap** | **£470m** |

| | |
|---|---|
| Net debt* (£m) at 30 September 2019<br>*Excludes restricted cash | 112.2 |
| Net LTV at 30 September 2019 | 20.5% |
| Shares in issue | 411.5m |
| Free float | 92% |
| Code | CREI |
| Primary exchange | LSE |
| Secondary exchange | N/A |

### Share price performance


| % | 1m | 3m | 12m |
|---|---|---|---|
| Abs | (1.1) | (3.6) | (2.1) |
| Rel (local) | (4.7) | (7.2) | (13.9) |
| 52-week high/low | | 120.4p | 111.0p |

### Business description

Custodian REIT (CREI) is a London Main Market listed REIT focused on commercial property in the UK outside London. It is income-focused, with a commitment to pay a high but sustainable and covered dividend.

### Next events

| | |
|---|---|
| Q120 DPS declaration | Exp. January 2020 |

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***Custodian REIT is a research client of Edison Investment Research Limited***

# Investment summary

## Company description: Income-focused returns

CREI is strongly focused on sustainable and growing income returns, with the potential for additional capital growth over time. Portfolio diversification, by sector, location, tenant and lease term, is a key element in delivering sustainable income, while the focus on good-quality properties but with smaller lot sizes (less than £10m at the point of investment) not only differentiates the company from a number of peers that also focus on regional commercial, but also enables CREI to benefit from a favourable pricing/yield arbitrage. Smaller lot size properties may appeal to a broader array of occupiers, yet be too small for larger institutional buyers and too large for many private investors. As a result, pricing tends to be less competitive and yields higher, to an extent that is more than sufficient to offset the additional administrative complexity of a broader portfolio. From listing in March 2014 to March 2019 (FY19), CREI generated an EPRA NAV total return of 39.0%, or a compound annual average return of 6.8% pa. Of the total return, the vast majority (77%) has been generated by dividend payments and the balance by growth in EPRA NAV per share.

## Financials: Significant further opportunities

Relatively low gearing, access to debt capital and continuing accretive stock issuance under its block listing facility support selective portfolio growth. The end-H120 portfolio was valued at £547.2m with a net initial yield (NIY) of 6.7%. We estimate a passing rent of £39.0m. The weighted average unexpired lease term (WAULT) was 5.3 years. The October acquisition of a portfolio of distribution units for £24.7m adds c £1.6m to annual passing rent. The acquisition NIY of 6.4% is below the portfolio average, but the 10-year leases on the assets include a 13.1% fixed rental uplift at five years. Targeting a 25% net LTV our forecasts assume a further c £7.0m of acquisitions. We expect acquisitions, continued high occupancy and modest blended rental growth to drive recurring income growth through H220 and FY21, modest (1%) FY21 DPS growth and increasing cover, from 1.04x in FY20 to 1.07x. Our cautious approach to capital value growth limits our forecast NAV growth, but we still look for an average annual NAV total return of 5.2% over the two years FY20–21, more than 100% derived from dividend payments and fully covered by EPRA earnings.

## Valuation: Income profile supports P/NAV

CREI shares combine an attractive yield (FY20e: 5.8%) with a fully covered dividend and a conservative level of gearing. Although the returns implied by our forecasts are lower than the level achieved historically, we believe they represent an attractive, income-based return in the context of a continuing low-return environment (eg 10-year gilt yield 0.7%). A comparison with a group of close peers with a similar income focus and diversified investment strategy (Exhibit 17 on page 14) shows that the shares continue to have an above average yield, supporting the continuing c 7% premium rating to last published NAV per share.

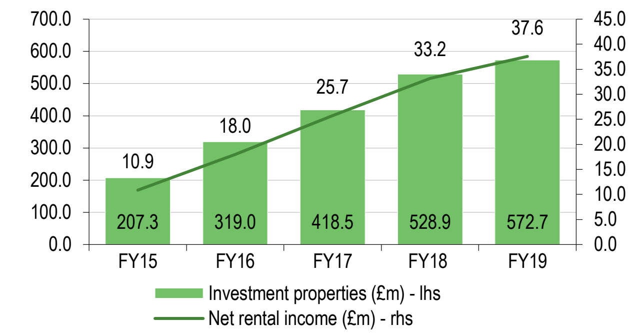
## Sensitivities

We review the main sensitivities on page 14. We consider these to be related mainly to the broader macroeconomic background and the cyclical nature of the commercial property market. Commercial property has historically exhibited substantial swings in valuation through cycles. Income returns are significantly more stable, but still fluctuate according to tenant demand and rent terms. CREI's portfolio diversification, by tenant, property, sector and region has the potential to mitigate the cyclical risks to income.

## Income-oriented, targeting quality, smaller lot sizes

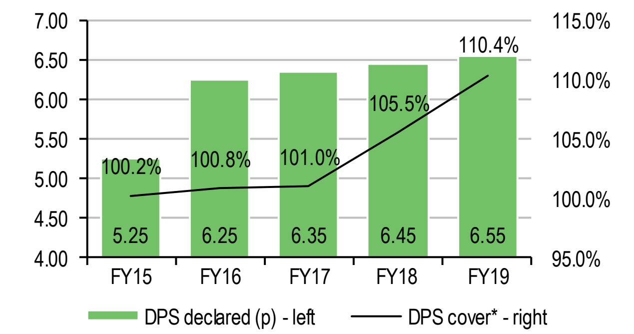
CREI is a UK real estate investment trust (REIT) listed on the Premium Segment of the Main Market of the London Stock Exchange. Its diversified portfolio comprises regional commercial properties, predominantly let to institutional-grade tenants throughout the UK, differentiated by a principal focus on properties with smaller individual values ('lot sizes') of less than £10m at acquisition. Properties of this size may appeal to a broader range of occupiers while attracting less competition from larger institutional investors, resulting in a yield premium. CREI is externally managed by Custodian Capital, a property management and investment business, regulated by the FCA. Custodian Capital is a subsidiary of Mattioli Woods, the specialist wealth management and employee benefits consultants, with £9.4bn of assets under management or advice.

**Exhibit 1: Growth in investment property value and net rental income**




Source: Custodian REIT data

**Exhibit 2: Growth in DPS, fully covered by recurring earnings***




Source: Custodian REIT data. Note: *Earnings excluding gains/ losses on investment properties and one-off costs divided by dividends paid or approved for the year.

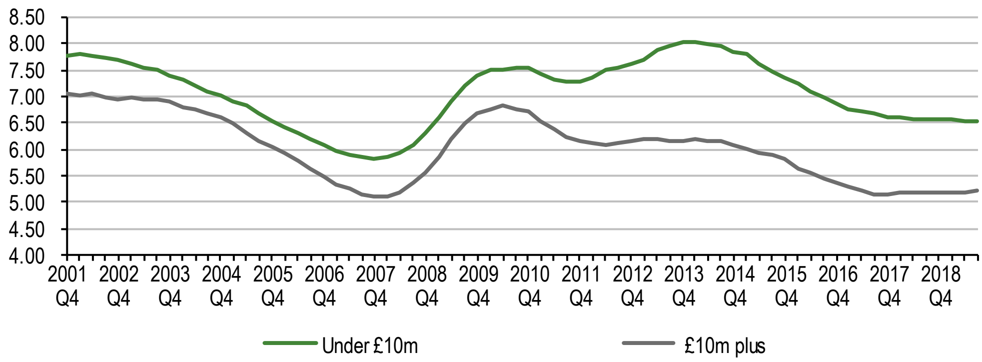
The company seeks to provide investors with an attractive level of income as well as potential for capital growth. It aims to appeal to both retail and institutional investors in the UK REIT sector by providing high and stable dividends from a well-diversified portfolio of UK commercial real estate with conservative levels of gearing. At 30 September 2019, the portfolio was valued at £547.2m, before the addition of a £24.7m portfolio of distribution units in early October 2019. This acquisition took the number of properties to 161, spread across all the main commercial real estate sectors as well as alternatives (including car showrooms, petrol filling stations, children's day nurseries, restaurants, gymnasiums, hotels and health units). The 30 September net LTV was 20.5% and this increased to 23.2% following the portfolio acquisition.

CREI listed in March 2014 with an initial (£95m) portfolio of assets that had previously been held and managed on behalf of clients of Mattioli Woods. At 5 June 2019, including its discretionary management activities on behalf of retail investors, Mattioli Woods controlled c 25.0m CREI shares (6.3% of the total). CREI is externally managed by the experienced property management team of Custodian Capital, a property management and investment business wholly owned by Mattioli Woods and regulated by the FCA.

### Investment objectives target sustainable income

CREI has an income-focused strategy. It targets a diverse portfolio of good-quality, institutional-grade properties but with smaller lot sizes (less than £10m at the point of investment), let to a broad range of tenants to provide income security. The focus on smaller lot sizes differentiates the company from a number of peers that also focus on regional commercial property and is targeted at capturing the pricing arbitrage that exists between smaller and larger assets. Smaller lot size properties may appeal to a broader array of occupiers yet be too small for larger institutional buyers and too large for many private investors. As a result, pricing tends to be less competitive and yields higher, to an extent that is more than sufficient to offset the additional administrative complexity of a broader portfolio. Based on transaction yields, Exhibit 3 indicates that the pricing arbitrage between commercial assets valued at less than £10m and those valued at more than £10m has tended to increase in recent years.

**Exhibit 3: UK two-year rolling average transaction yield**




Source: Custodian REIT FY19 results presentation, Lambert Smith Hampton

Other elements of CREI's strategy for meeting its investment objective include:

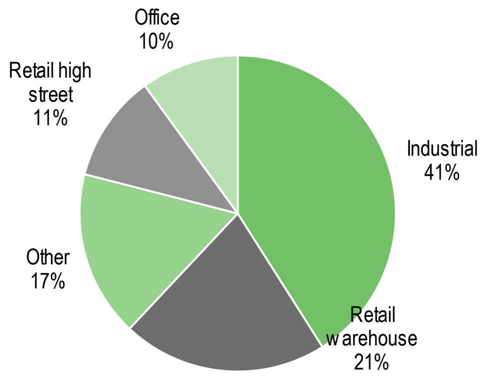
- A preference for single-let properties to high-quality tenants.
- No tenant to represent more than 10% of the rent roll, unless it is a government body.
- A maximum weighting to any one property sector, or any geographic region, of 50%.
- Focus on areas with high residual values, strong local economies and favourable demand–supply characteristics.
- No speculative development, except for refurbishing existing assets or forward funding of pre-let schemes.
- A conservative gearing ratio, limited to a maximum LTV of 35%, with an expected long-term average of 25%.
- A high payout ratio and a fully covered dividend.

The investment manager has a long-term approach to investment, with a focus on properties with low obsolescence and low capital expenditure requirements. It also prefers properties with high residual values, rather than just focusing on the terms of the lease contracts.

## The portfolio is well diversified

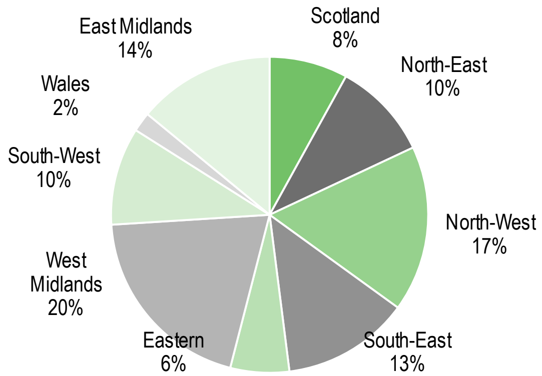
Portfolio diversification, by property, sector, geography and tenant mix, is a key element of managing the cyclicality inherent in the sector, but the investment objectives allow sufficient flexibility for CREI to be contra-cyclical where the investment manager believes this to be appropriate. Exhibits 4 and 5 show the sector and geographic spread of the 161-asset portfolio as at 3 December 2019, which includes the recent acquisition of an eight-asset portfolio of 'last mile' distribution units (see below for details). The portfolio has minimal exposure to London, but exposure to every other region. It is split between the main property sectors, in line with the company's objective of maintaining a suitably balanced portfolio, with relatively low exposure to office and high street retail combined with relatively high exposure to industrial and alternative sectors ('other').

**Exhibit 4: Sector split by income**




Source: Custodian REIT, 3 December 2019

**Exhibit 5: Regional split by income**




Source: Custodian REIT, 3 December 2019

There were c 270 tenancies and, following the distribution unit acquisition, Menzies Distribution, one of the UK's leading print media logistics companies, servicing 1,700 routes per day from over 50 sites across the UK and Ireland, became CREI's largest tenant, although still only representing 3.96% of the rent roll. No single property in the Menzies Distribution portfolio accounts for more than 0.7% of rent roll.

**Exhibit 6: Top 10 tenants (% of rent roll)**

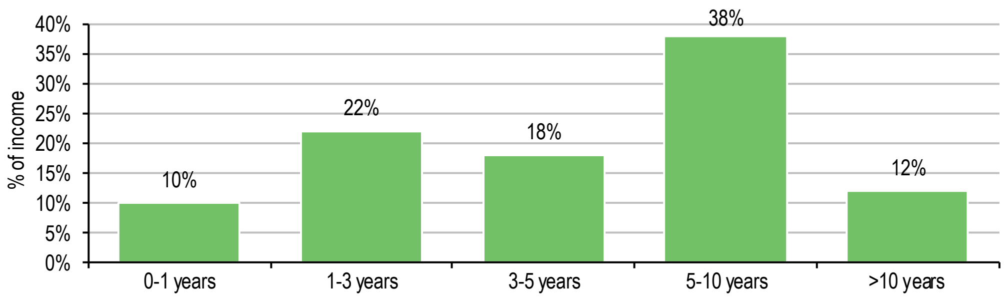
| | | | |
|---|---|---|---|
| Menzies Distribution | 3.96% | Wickes Building Supplies | 1.94% |
| B&Q | 3.35% | Benham (Specialist Cars) | 1.83% |
| B&M Retail | 3.08% | Regus (Maidstone WM) | 1.58% |
| VW Group (UK) | 2.08% | First Title | 1.55% |
| Superdrug Stores | 2.03% | Next plc | 1.38% |
| **Top 10 tenants** | | **22.78%** | |

Source: Custodian REIT, 3 December 2019

The last disclosed portfolio net initial yield, at 30 September 2019, was 6.7%. Based on the portfolio value at that date of £547.2m and allowing for buyers' costs at 6.5%, we estimate a passing rent of £39.0m (to which the October distribution unit portfolio acquisition added c £1.6m). On an EPRA basis, occupancy was 95.5%. The WAULT was 5.3 years.

Data as at the end of FY19 shows a relatively low share of income at risk from near-term lease expiry and only 50% of aggregate income expiring within a five-year period.

**Exhibit 7: Aggregate income expiry**

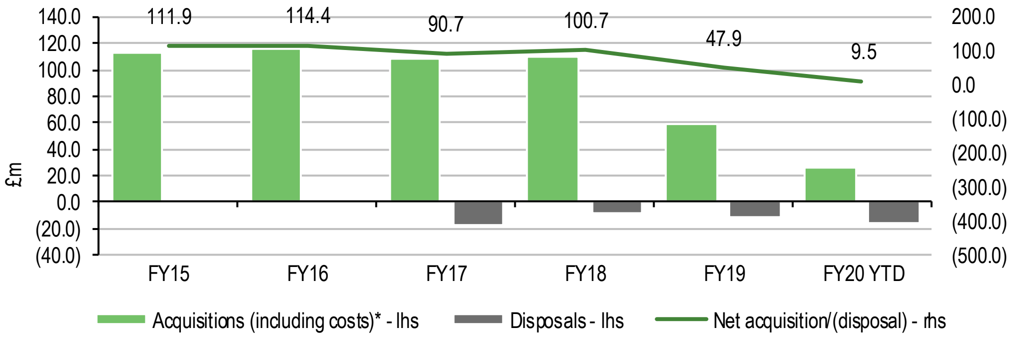



Source: Custodian REIT, 2019 Annual Report

## Recent portfolio activity

CREI's portfolio continues to grow through acquisition but, reflecting market conditions and the difficulty in identifying opportunities that meet the company's investment criteria, there were no additions to the portfolio during late FY19 and H120. Net acquisitions of £47.9m in FY19 as a whole were at roughly half the level of previous years.

**Exhibit 8: Portfolio acquisitions and disposals**




Source: Custodian REIT data, Edison Investment Research. Note: *Includes acquisition costs written off.

However, on 2 October 2019 CREI announced a significant £24.65m (before costs) portfolio acquisition comprising eight 'last mile' distribution units well spread across the UK, with a passing rent of £1.61m pa reflecting a net initial yield of 6.4%. The properties were acquired by the corporate acquisition of the entire issued share capital of property owner, John Menzies Property 4. All eight properties are let to Menzies Distribution (MDL) on new 10-year leases, with only one unit having a second-year break option. The leases provide for a 13.1% fixed rental uplift at year five. The portfolio acquisition is aligned with CREI's investment strategy and the company says that it is complementary to its existing property portfolio, enhancing both the WAULT and regional diversification.

CREI has also been active in recycling capital out of mature assets over the past year and in H120 disposed of two properties for aggregate headline consideration of $15.7m (before the £0.3m cost of rental top-ups and cost guarantees of c £0.3m). In August, it sold an industrial warehouse in Wolverhampton for £6.6m (in line with its most recent, June 2019, valuation). Since acquiring the property in June 2016 as part of a three-property portfolio, CREI had benefited from a 42% rental increase and 47% valuation uplift, and with four years remaining on the lease the fund manager decided that it was the right time to dispose of the asset and deploy the proceeds to fund reinvestment better aligned to its investment strategy. This was followed in September by the sale of an Edinburgh city centre office and retail unit for £9.1m, again in line with the June 2019 valuation. Following the completion of a refurbishment and other asset management initiatives which had increased the WAULT to 8.7 years, and anticipating limited opportunities for future rental growth, the decision was taken to dispose of the property and redeploy the proceeds into opportunities with better income and capital growth prospects.

Looking forward, CREI believes a selective approach to acquisitions can still yield investment opportunities in the current market, additionally spreading fixed costs over a wider income producing asset base and ultimately reducing the scale of asset management charges (on a rise in net assets above £500m). The company is actively considering a pipeline of further acquisition opportunities as well as further asset management initiatives. Relatively low gearing, continuing share issuance under the company's block listing facility at a premium to NAV, and undrawn flexible debt facilities all leave CREI well placed to take advantage of opportunities as they arise.

**Exhibit 9: Recent acquisitions (since September 2018)**

| Period | Location | Tenant | Sector | Price | NIY |
|---|---|---|---|---|---|
| Q219 | Sheffield | UK Government (HSE) | Office | £3.560m | 9.79% |
| Q319 | Stratford | Foxtons Estate Agents, Trustees of the Universal Church of the Kingdom of God | Retail/office | £2.100m | 6.68% |
| Q319 | Evesham | Next, M&S, Boots, Argos, Poundstretcher | Retail park | £14.200m | 6.04% |
| Q319 | Weymouth | B&Q, Halfords, Sports Direct | Retail park | £10.800m | 6.97% |
| Q319 | Loughborough | Lister Group | Other (car dealership) | £2.360m | 6.37% |
| Q320 | Aberdeen | Menzies Distribution | Industrial | £24.650m | 6.40% |
| Q320 | Edinburgh | Menzies Distribution | Industrial | | |
| Q320 | Glasgow | Menzies Distribution | Industrial | | |
| Q320 | Ipswich | Menzies Distribution | Industrial | | |
| Q320 | Norwich | Menzies Distribution | Industrial | | |
| Q320 | Stockton | Menzies Distribution | Industrial | | |
| Q320 | Swansea | Menzies Distribution | Industrial | | |
| Q320 | Weybridge | Menzies Distribution | Industrial | | |

Source: Custodian REIT

## Sector strategy

The fund manager sees industrial property as a particularly good fit with CREI's investment strategy, where it is possible to acquire modern, 'fit for purpose' buildings, where the vacant possession value is closer to the investment value than may be the case in other sectors ('high residual values'), and where there is less risk of obsolescence requiring capital expenditure to maintain vales. For these reasons, CREI's portfolio has always been weighted towards regional industrial and logistics assets (broadly equal parts of CREI's industrial portfolio) and this continues to benefit performance as both subsectors continue to experience a favourable occupier supply-demand balance that is driving rental growth and positive investor sentiment.

The portfolio has a relatively low exposure to office property. Although the regional office market continues to see rental growth driven by continuing occupier demand and relatively tight supply, the fund manager regards the cost of ownership (through obsolescence and the requirement for capital expenditure, as well as lease incentives) to be higher than for other sectors.

The investment in alternative sectors provides additional portfolio diversification, in some cases less correlated with economic performance than for the mainstream sectors.

Within the broad retail area, CREI has given greater focus to out-of-town retail warehouses as opposed to traditional high street retail. The latter remains challenged by an oversupply of shops in the face of retailer pressures resulting from the structural shift to online purchasing, as well as more cyclical challenges from constrained consumer demand and rising costs. In contrast, CREI's fund manager sees opportunities for the retail warehouse subsector to benefit from restricted supply, generally free parking, and the convenience that is complementary to increasing online sales for both click-and-collect and customer returns.

## Market backdrop

During the six months ended 30 September 2019, rental value growth across the market remained positive, driven by industrial and – to a lesser extent – offices, while retail and leisure was negative. Capital growth was slightly negative for the market as a whole, again driven by the retail and leisure sector. Industrial and office capital growth was positive, although industrial showed some signs of slowing.

Amid continuing Brexit uncertainty, market investment activity has been lower than in the previous year with overseas investors taking a smaller share. Among domestic institutional investors, most open-ended funds have been net sellers of typically larger lot size assets to meet current redemption calls.

Looking forwards, the most recent quarterly market forecasts by the Investment Property Forum (IPF, canvassing a group of fund managers and surveyors under the IPF Research Programme) were published in September and point to an expectation of positive total returns for the UK commercial property sector in the period up to 2023, driven initially by the industrial and office sectors but broadening out to include strengthening total returns from retail warehouses and standard retail and, to a much lesser extent, shopping centres. The consensus continues to predict negative capital returns from each of the retail subsectors over the forecast period, particularly from shopping centres.

**Exhibit 10: Summary of IPF market consensus**

| | Rental growth value (%) | | | | Capital value growth (%) | | | | Total return (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2019/23 | 2019 | 2020 | 2021 | 2019/23 | 2019 | 2020 | 2021 | 2019/23 |
| Office | 0.8 | 0.6 | 1.3 | 1.3 | (1.1) | (1.1) | 0.5 | 0.2 | 2.9 | 3.1 | 4.9 | 4.6 |
| Industrial | 3.0 | 2.0 | 1.7 | 2.0 | 2.1 | 1.1 | 1.5 | 1.5 | 6.6 | 5.7 | 6.1 | 6.1 |
| Standard retail | (3.1) | (2.1) | (0.9) | (1.2) | (8.1) | (4.4) | (1.4) | (2.7) | (3.9) | 0.1 | 3.3 | 1.9 |
| Shopping centre | (4.7) | (3.3) | (1.8) | (2.3) | (13.8) | (7.2) | (3.7) | (5.7) | (8.8) | (1.5) | 2.3 | 0.0 |
| Retail warehouse | (3.8) | (2.5) | (1.0) | (1.5) | (10.8) | (5.7) | (1.9) | (3.9) | (5.2) | 0.5 | 4.6 | 2.4 |
| **All property** | **(0.2)** | **0.1** | **0.6** | **0.5** | **(3.6)** | **(1.8)** | **(0.2)** | **(0.8)** | **0.9** | **2.9** | **4.7** | **4.0** |

**Change since spring forecast**

| | Rental growth value (%) | | | | Capital value growth (%) | | | | Total return (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2019 | 2020 | 2021 | 2019/23 | 2019 | 2020 | 2021 | 2019/23 | 2019 | 2020 | 2021 | 2019/23 |
| Office | 0.4 | 0.3 | 0.2 | 0.2 | 0.6 | 0.2 | 0.6 | 0.5 | 0.5 | 0.0 | 0.6 | 0.5 |
| Industrial | 0.0 | (0.2) | (0.1) | (0.1) | (0.5) | 0.1 | 1.0 | 0.5 | (0.6) | 0.0 | 0.9 | 0.4 |
| Standard retail | (0.3) | (0.4) | (0.3) | (0.4) | (0.7) | 0.1 | (0.1) | (0.2) | (0.7) | 0.1 | (0.1) | (0.2) |
| Shopping centre | (0.8) | (0.7) | (0.5) | (0.6) | (3.1) | (1.0) | (0.6) | (1.1) | (3.0) | (0.8) | (0.4) | (1.0) |
| Retail warehouse | (0.7) | (0.4) | (0.1) | (0.5) | (1.9) | (0.8) | 0.1 | (0.7) | (2.0) | (0.7) | 0.2 | **(0.6)** |
| **All property** | **0.0** | **0.0** | **0.0** | **(0.1)** | **(0.8)** | **(0.1)** | **0.3** | **0.0** | **(0.9)** | **(0.2)** | **0.3** | **0.0** |

Source: Investment Property Forum (IPF) UK consensus forecasts

We present the market consensus data as a guide to expected overall market direction and returns but would caution against a direct read-across to CREI's, or any other, portfolio. The market consensus is formed of a wide range of differing expectations and at the individual portfolio level much depends on the performance of individual assets as well as the timing and effectiveness of asset management initiatives.

## Management and board

CREI's board of directors has recently increased to five members, all of whom are non-executive, responsible for the overall management of the company's activities. The board has appointed Custodian Capital (www.custodiancapital.com), a wholly owned subsidiary of Mattioli Woods (www.mattioliwoods.com), as investment manager to provide investment and property management, and administrative services to the company. Custodian Capital is authorised and regulated by the Financial Conduct Authority (FCA) and, in addition to acting as fund manager to CREI, provides a structure that enables investors to purchase business premises and/or other commercial property in a tax-efficient and flexible manner.

Four of the board members are independent of the investment manager, including the non-executive chairman, David Hunter, a professional strategic adviser focused principally on UK and international real estate, who sits on the boards of a number of listed and unlisted companies, as well as holding corporate advisory roles. The independent non-executive directors are Matthew Thorne, an experienced former finance director in the UK quoted sector and non-executive director of Bankers Investment Trust for nine years until 2018, Barry Gilbertson, an international consultant with a focus on real estate, strategy and risk, and with more than 40 years' experience advising on property, and Hazel Adam, who joined the board in December 2019 bringing a range of experience including the buy-side and sell-side investment industry, strategies and markets. Ian Mattioli, chief executive officer of Mattioli Woods and a board member of the investment manager, is the fifth CREI non-executive director. Nathan Imlach is company secretary of CREI, and chief financial officer of both Mattioli Woods and the investment manager, Custodian Capital.

Custodian Capital was appointed investment manager at the IPO, with performance reviewed annually. It was reappointed for a further three years from 1 June 2017, terminable by either party giving at least 12 months' notice, with the board noting the investment manager's timely deployment of investment funds, the quality of its asset selection, and its success in generating earnings to fully cover the targeted dividend growth. At renewal, the property management and administrative fees payable to the investment manager were reduced, increasing the potential for continued growth in NAV to support a further reduction in the ongoing charge ratio, and increase dividend-paying capacity. The fee schedule in place since 2017 includes:

- **Property management fees** charged at 0.90% pa on average net assets of up to £200m, 0.75% pa between £200m and £500m, and 0.65% above £500m.
- **Administrative fees** charged at 0.125% pa on average net assets up to £200m, 0.08% on between £200 and £500m, and 0.05% above £500m.

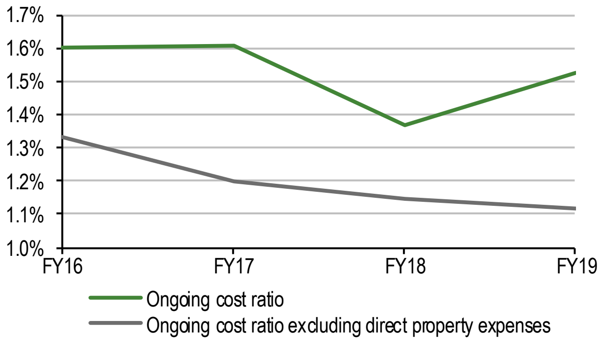
Richard Shepherd-Cross is the managing director of Custodian Capital and the fund manager of CREI. He is a former director of Jones Lang LaSalle in London, where he led the portfolio investment team before joining Mattioli Woods in 2009, with responsibility for its syndicated property initiative, the precursor to Custodian. In total, the Custodian Capital team that is dedicated to the management of CREI's assets consists of 18 members, including eight property professionals, supported by a compliance officer and an investment committee.

Additionally, in recognition of the marketing services that it provides to CREI, the investment manager receives a fee of 0.25% of the aggregate gross proceeds from any issue of new shares.

In FY19, the investment manager received £3.95m from CREI, comprising investment management fees of £3.49m, administrative fees of £0.43m and marketing fees of £0.03m.

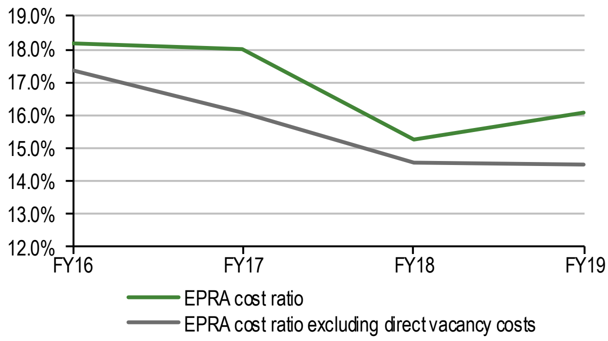
As noted above, the ongoing cost ratio (OCR) has been steadily declining as the company has grown. The EPRA cost ratio also compares well with peers, at 14.5% excluding direct vacancy costs and 16.1% including direct vacancy costs for FY19.

**Exhibit 11: OCR**




Source: Custodian REIT data

**Exhibit 12: EPRA cost ratio**




Source: Custodian REIT data

# Financials

Our last published forecasts were struck following the Q419 NAV update and as a result the audited results that were subsequently published were close to our forecasts and we direct our commentary at the recently released interim results to 30 September 2019. A summary of the recent financial results is shown in Exhibit 13. Supported by a slightly higher average portfolio in the period and with a good level of occupancy maintained, recurring EPRA earnings increased in H120 while EPRA NAV was negatively impacted by revaluation movements in the retail sector. Dividend per share increased at a similar rate to EPRA earnings although, as a result of continued modest equity issuance (at a premium to NAV), EPRA EPS was lower and dividend cover reduced slightly. With supply and demand imbalances continuing to support non-retail sectors of the property market the company believes that it is well placed to meet its target of paying aggregate DPS of 6.65p for the year, fully covered by earnings.

**Exhibit 13: Summary of recent financial results**

| £m unless stated otherwise | H120 | H119 | H120 v H119 | FY19 | FY18 | FY19 v FY18 | FY19e |
|---|---|---|---|---|---|---|---|
| Net rental income | 18.7 | 18.1 | 3.2% | 37.6 | 33.2 | 13.2% | 37.5 |
| Administrative expenses | (2.4) | (2.4) | -0.8% | (4.9) | (4.4) | 12.4% | (4.8) |
| **Operating Profit before revaluations** | **16.4** | **15.8** | **3.9%** | **32.7** | **28.8** | **13.3%** | **32.7** |
| Net interest | (2.4) | (2.0) | 20.1% | (4.4) | (3.7) | 19.5% | (4.3) |
| **EPRA earnings** | **13.9** | **13.7** | **1.5%** | **28.3** | **25.2** | **12.4%** | **28.4** |
| Revaluation of investment properties | (12.9) | 0.2 | | (5.5) | 11.9 | | (5.5) |
| Costs of acquisitions | (0.2) | (1.6) | | (3.4) | (6.2) | | (3.5) |
| Profit on disposal | (0.1) | 4.3 | | 4.3 | 1.6 | | 4.3 |
| **IFRS earnings** | **0.7** | **16.6** | | **23.6** | **32.4** | | **23.7** |
| **EPRA EPS (p)** | **3.4** | **3.5** | **-2.7%** | **7.3** | **6.9** | **4.6%** | **7.3** |
| IFRS EPS (p) | 0.2 | 4.3 | -95.8% | 6.0 | 8.9 | -32.5% | 6.1 |
| **DPS (declared) (p)** | **3.3250** | **3.2750** | **1.5%** | **6.5500** | **6.4500** | **1.6%** | **6.5500** |
| Dividend cover (%) | 105 | 109 | -4.1% | 110 | 106 | 4.6% | 111 |
| Investment portfolio | 547,179 | 546,963 | 0.0% | 572,745 | 528,943 | 8.3% | 572,724 |
| **IFRA & EPRA NAV per share (p)** | **104.3** | **108.6** | **-3.9%** | **107.1** | **107.3** | **-0.2%** | **107.1** |
| NAV total return | 0.5% | 4.2% | | 5.9% | 9.6% | | 7.1% |
| Net LTV | 20.5% | 20.5% | | 24.1% | 21.0% | | 24.1% |

Source: Custodian REIT, Edison Investment Research

Key features of the interim results were:

- Although the property portfolio value was little different at end-H120 to end-H19, allowing for the £15.7m of disposals during the average value was higher. Together with a continued high level of occupancy, asset management initiatives, and rental growth outside of the retail sector this supported a 3.2% increase in net rental income.
- Administrative costs were well contained and operating profit before revaluation movements increased 3.9%.
- The increase in net finance costs was driven by a higher level of gross debt while the average cost of debt was lower as the company made use of its revolving credit facility (RCF).
- Recurring EPRA earnings increased 1.5% to £13.9m although in per share terms it was slightly lower at 3.4p as a result of the continuing share issuance under the company's block listing facility.
- Quarterly dividends paid increased 1.5p to 3.325p, fully covered (1.05x) by earnings.
- Negative unrealised revaluation of £12.9m weighed on NAV, driven by the negative impact of retail properties offsetting positive performance elsewhere in the portfolio. 30 September NAV per share was 104.3p compared with 107.1p at the end of FY19. Including DPS paid H120 NAV total return of 0.5%.

**Exhibit 14: Year to date NAV per share progression**

| Pence per share | Q120 | Q220 | H120 |
|---|---|---|---|
| **Opening NAV** | **107.1** | **106.0** | **107.1** |
| Issue of equity | 0.2 | 0.1 | 0.3 |
| **Movement in property values** | **(1.5)** | **(1.8)** | **(3.3)** |
| o/w profit/(loss) on disposal | 0.2 | 0.0 | 0.2 |
| o/w valuation movements | (1.7) | (1.8) | (3.5) |
| o/w acquisition costs | 0.0 | 0.0 | 0.0 |
| Income in period | 2.7 | 2.4 | 5.1 |
| Expenses in period | (0.9) | (0.7) | (1.6) |
| **Recurring net income** | **1.8** | **1.7** | **3.5** |
| Dividends paid | (1.6) | (1.7) | (3.3) |
| **Closing NAV** | **106.0** | **104.3** | **104.3** |

Source: Custodian REIT

Exhibit 15 shows the year to date valuation movements by sector, clearly highlighting the continuing positive performance of industrial assets, a fairly stable performance from the office assets, but weakness both in high street retail assets and retail warehouses. As noted above, CREI anticipates no early end to the pressure on high street retail assets, but does expect to see a better performance trend emerge for retail warehouse assets.

**Exhibit 15: Valuation movement by sector**

| | Valuation (£m) | | | Valuation movement (£m) | | | | Valuation movement (%) | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 30-Sep-19 | 30-Jun-19 | 31-Mar-19 | 30-Sep-19 | 30-Jun-19 | Half-yearly | Annual | 30-Sep-19 | 30-Jun-19 | Half-yearly | Annual |
| | **Q220** | **Q120** | **Q419** | **Q220** | **Q120** | **H120** | **FY19** | **Q220** | **Q120** | **H120** | **FY19** |
| Industrial | 226.6 | 227.4 | 224.3 | 4.7 | 2.0 | 6.7 | 11.5 | 2.1% | 0.9% | 3.0% | 5.5% |
| Retail warehouse | 117.2 | 122.4 | 123.4 | (5.3) | (2.4) | (7.7) | (7.8) | -4.3% | -1.9% | -6.2% | -7.3% |
| Other* | 92.5 | 94.0 | 95.7 | (1.5) | (1.1) | (2.6) | (1.2) | -1.6% | -1.1% | -2.7% | -1.5% |
| High street retail | 58.3 | 64.1 | 68.6 | (4.9) | (4.0) | (8.9) | (7.9) | -7.6% | -5.8% | -13.0% | -10.5% |
| Office | 52.6 | 60.1 | 60.7 | 0.0 | (0.5) | (0.5) | (0.0) | 0.0% | -0.8% | -0.8% | 0.0% |
| **Total portfolio** | **547.2** | **568.0** | **572.7** | **(7.0)** | **(6.0)** | **(13.0*)** | **(5.4)** | **-1.2%** | **-1.0%** | **-2.3%** | **-1.0%** |

Source: Custodian REIT data, Edison Investment Research. Note *Slight difference to £12.9m reported due to quarterly rounding

## Forecast update

For the full year FY20, we expect flat EPRA earnings with the income benefits of net acquisitions offset by slightly lower average occupancy (affecting both income and direct property costs), and increased funding costs (higher average debt). We still expect the increased dividend (the company is targeting aggregate DPS for the year of 6.65p, barring unforeseen circumstances, a 1.5% increase on FY19) to be fully covered (104%). For FY21, we forecast increased EPRA earnings, modest (1%) DPS growth, and increased dividend cover (106%).

A summary of our estimates is shown in Exhibit 16.

**Exhibit 16: Forecast revisions**

| | Net rental income (£m) | | | EPRA EPS (p) | | | DPS (p) | | | EPRA NAV/share (p) | | | Net LTV | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Old | New | Change (%) | Old | New | Change (%) | Old | New | Change (%) | Old | New | Change (%) | Old | New | Change (pp) |
| 03/20e | 38.8 | 38.1 | -1.9 | 7.3 | 6.98 | -4.1 | 6.65 | 6.65 | 0.0 | 108 | 105 | -3.3 | 24.3% | 25.0% | 3.1 |
| 03/21e | N/A | 39.4 | N/A | N/A | 7.20 | N/A | N/A | 6.72 | N/A | N/A | 105 | N/A | N/A | 25.0% | N/A |

Source: Edison Investment Research

Our key forecasting assumptions are:

- We have included the acquisition of the 'Menzies portfolio' of eight last-mile distribution units announced on 2 October 2019 and we have assumed further acquisitions amounting to £7.0m, sufficient to take our forecast net LTV to 25%, in line with the company target. We assume the £7.0m of acquisitions are made at end-FY20 at a net initial yield of 6.7% (the current portfolio level) and contribute fully to FY21 income. Equity issued at the date of this report is included but we assume no additional equity issuance.

- We assume no change in occupancy from the end-Q220 position (95.5% on an EPRA basis), and for rental growth to add 0.2% pa to passing rent in H220 and 0.4% pa in FY21. The changes to passing rent assume 2.0% annualised growth in industrial rents in H220 (and 2.0% in FY21), 1.0% in offices (1.0%), no change in other (no change), a 1.5% decline in retail warehouse (1.0% decline), and a 2.5% decline in high street retail (2.0% decline) weighted by Q220 income share.
- Based on the disclosed net initial yield of 6.7% and the portfolio value of £547.2m, and assuming buyers' costs of 6.5%, we estimate an end-Q220 passing rent of £39.0m. Including the Menzies acquisition we forecast an end-FY20 passing rent of £40.7m, increasing with rent growth to £40.9m at end-FY21.
- We have assumed non-recoverable property costs at 4.7% of gross rental income and in line with H120 (H219: 4.1%; FY19: 3.9%). Including investment management fees (71% of the total administrative in FY19) that are based on average net asset value as per the agreed fee scale we expect a similar ongoing cost ratio (OCR) in FY20 as in FY19 (1.12%).
- Our forecast increase in net interest cost in FY20 and to a much lesser extent in FY21 reflects our assumed debt drawing (see below).
- We assume a small positive gross revaluation movement equivalent to 0.3% pa of the opening portfolio value, following the assumed rental changes weighted by valuation. This assumes increases in industrial and office valuations substantially offset by declines in high street retail and retail warehouse valuations. In H220, this is partly offset by our estimate of the costs (c £0.5m or c 2% of the consideration) on the corporate acquisition of the Menzies portfolio. On this basis, portfolio net initial yield falls slightly to 6.6% at end-FY21 compared with 6.7% at end-Q220, driven by the slight shift in sector mix implied by the differing sector rental growth rates. We estimate that a 0.25% increase/decrease in the net initial yield would reduce/increase FY20 EPRA NAV per share by 5.4p/5.6p or c 5%.

## Funding

At 30 September 2019 (end-Q219), CREI had drawn borrowings of £152.5m and, allowing for £40.3m of cash net of tenant rental deposits and retentions, net debt was c £112.2m. The net LTV was 20.5%. The cash balance included £23.6m held in solicitors' hands relating to the acquisition of the Menzies portfolio. Allowing for completion of the Menzies portfolio the net LTV increased to 23.2%.

The current debt facilities amount to £165m and comprise three fixed-rate term loan facilities (in aggregate £115m) plus a £50m revolving credit facility (RCF) that provides more flexible access to debt over the shorter term, facilitating growth and minimising cash drag. The RCF was increased from £35m in September with an extended term of three years to 17 September 2022 with an option to extend by a further two years, subject to the bank's agreement. The cost of the new facility is also lower (with an interest margin of between 1.5% and 1.8% depending on LTV compared with 2.45% on the earlier facility) and it also benefits from an accordion option with the facility limit initially set at £46m, which can be increased to £50m with the bank's agreement.

Including the new RCF facility, at end-H120 the weighted average cost of the debt facilities was 3.0% and weighted average maturity was eight years. In total, 70% of the facilities were at a fixed interest rate.

In addition to the RCF, the bank facilities include:

- A £20m term loan with Scottish Widows at a fixed rate of 3.9335%, repayable in August 2023.
- A £45m term loan with Scottish Widows at a fixed rate of 2.987%, repayable in June 2028.
- A £50m term loan with Aviva Investors Real Estate Financing comprising:
  - A £35m tranche at a fixed rate of 3.02%, repayable in April 2032; and

– A £15m tranche at a fixed rate of 3.26%, repayable in November 2032.

Using a Libor rate of 0.8%, we estimate an average cost of the facilities of 3.2%.

With continuing good demand for CREI shares, reflected in a continuing share price premium to NAV, the company has continued to issue shares under its block listing facility. The ability to do so, on terms that are accretive to earnings and NAV, is particularly beneficial when making acquisitions, providing an offset to acquisition costs that otherwise act as a drag on NAV. During FY19, CREI issued 11.35m new shares under the facility at an average 11% premium to dividend-adjusted NAV per share and raising £13.2m net of costs. This added 0.4p to NAV per share, and fully covered the cost of raising and deploying the proceeds. In H120, 12.5m new shares were issued at an average 11.4% premium to dividend-adjusted NAV, raising £14.7m of gross proceeds (£14.5m net) and enhancing NAV per share by c 0.3p. Issuance on similar terms has continued in H220.

## Valuation

As an income-oriented REIT, CREI's focus is on generating a secure and growing income stream that can support its progressive and sustainable dividend objectives, while delivering capital value growth over the long term. As a result, the shares combine an attractive dividend yield, with a fully covered dividend, and conservative gearing.

From listing in March 2014 to March 2019 (FY19), CREI generated an EPRA NAV total return of 39.0%, or a compound annual average return of 6.8% pa. Of the total return, the vast majority (77%) has been generated by dividend payments and the balance by growth in EPRA NAV per share.

**Exhibit 17: EPRA NAV total return**

| Year ending 31 March | 2015 | 2016 | 2017 | 2018 | 2019 | 2015–19 cumulative |
|---|---|---|---|---|---|---|
| Opening EPRA NAV per share (p) | 98.2 | 101.3 | 101.5 | 103.8 | 107.3 | 98.2 |
| Closing EPRA NAV per share (p) | 101.3 | 101.5 | 103.8 | 107.3 | 107.1 | 107.1 |
| Dividends paid per share (p) | 3.750 | 6.350 | 6.350 | 6.425 | 6.525 | 29.4 |
| EPRA NAV total return | 7.0% | 6.4% | 8.5% | 9.6% | 5.9% | 39.0% |
| Compound annual total return | | | | | | 6.8% |

Source: Custodian REIT, Edison Investment Research

Our forecasts for FY20–21 imply an average annual NAV total return over the period of 5.3%, more than 100% derived from dividend payments and fully covered by EPRA earnings. With economic indicators pointing to a sustained period of low interest rates these prospective income returns continue to appear attractive in our view.

Exhibit 18 shows a valuation and share price performance comparison of CREI with a group of close peers with a similar income focus and diversified investment strategy. CREI's yield continues to be above the average, as does its P/NAV.

**Exhibit 18: Peer comparison table**

| | Price (p) | Market cap (£m) | P/NAV* (x) | Yield** (%) | Share price performance | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | 1 month | 3 months | 12 months | From 12M high |
| Ediston Property | 90 | 190 | 0.83 | 6.4 | 3% | 1% | -9% | -18% |
| BMO Real Estate Investments | 85 | 204 | 0.82 | 5.9 | -1% | 1% | -1% | -15% |
| BMO Commercial Property Trust | 120 | 958 | 0.90 | 5.0 | 2% | 4% | -6% | -11% |
| Picton | 95 | 520 | 1.01 | 3.7 | 3% | 9% | 17% | -5% |
| Regional REIT | 109 | 471 | 0.96 | 7.5 | 0% | 7% | 16% | -3% |
| Schroder REIT | 58 | 301 | 0.85 | 4.5 | 4% | 5% | 4% | -2% |
| Standard Life Investment Property | 91 | 369 | 1.00 | 5.2 | 2% | 6% | 8% | -6% |
| UK Commercial Property Trust | 90 | 1175 | 1.00 | 4.1 | 4% | 9% | 9% | -3% |
| **Average** | | | **0.91** | **5.5** | **2%** | **5%** | **5%** | **-8%** |
| **Custodian** | **114** | **471** | **1.10** | **5.8** | **-1%** | **-1%** | **-1%** | **-5%** |
| UK property index | 1,927 | | | 3.5 | 5% | 15% | 20% | -1% |
| FTSE All-Share Index | 4,161 | | | 4.6 | 3% | 3% | 11% | -1% |

Source: Company data. Note: Prices at 16 December 2019. *Last reported EPRA NAV per share. **Trailing 12-month DPS declared.

# Sensitivities

The commercial property market is cyclical, historically exhibiting substantial swings in valuation through cycles. Income returns are significantly more stable, but still fluctuate according to tenant demand and rent terms. From a sector viewpoint, we also highlight the increased risks and uncertainties that attach to development activity, including planning consents, timing, construction risks and the long lead times to completion and eventual occupation, although with its income focus, CREI is not a developer and avoids such risks. It does actively invest in improvements to existing assets with the aim of enhancing long-term income growth and returns, and has demonstrated a willingness to fund pre-let development on a modest scale. We consider that the main sensitivities include:

- **Sector risk**: some of the inherent cyclical risk to vacancy in commercial property can be mitigated by portfolio diversification. As noted above, CREI invests across the main UK commercial property sectors, with a portfolio that is well diversified by property and by individual occupiers. As noted above, the largest tenant accounts for less than 4% of the total portfolio income. CREI has a strong record of occupancy and on an EPRA basis this was 95.9% at 30 September 2019.
- **Macro risk:**
  - The UK economy has lost momentum in recent months, in line with the global trend. GDP growth of 1.4% in 2018 was the slowest annual growth since 2012 and in March 2019 the Office of Budget Responsibility revised down its 2019 GDP forecast to 1.2% from 1.6%, in part reflecting heightened Brexit uncertainty. GDP growth of 0.3% in Q319 (July to September) brought relief that the economy would avoid slipping into technical recession following a 0.2% decline in Q219 (April to June); however, the trend remains weak, with growth flat in the rolling three-month period to end-October. The labour market has remained resilient, with the Office for National Statistics (ONS) estimating a 3.8% unemployment rate in the three months from July to September while the rate of pay growth has trended upwards since March to May 2017, to be close to 4%, which is the highest nominal pay growth rate since 2008. In real terms, annual pay growth has been positive since December 2017 to February 2018 and is now 1.8% for total pay and 1.7% for regular pay.
  - The ONS estimated October consumer price inflation at 1.5%, down 0.2% from September and down from 2.0% in July. With the Bank of England targeting 2%, there appears no near-term pressure for the Bank of England to increase the official interest rate from 0.75% where it has been held since August 2018; indeed there appears room for a reduction should the Bank of England wish to support growth. On a longer-term basis real interest

rates are low and seem likely to increase. Other than its flexible RCF, CREI's debt is long-term, fixed-rate borrowing, significantly mitigating future interest rate risk. The floating rate RCF represents £50m out of total debt facilities of £165m. An increase in longer-term rates is likely to have a knock-on effect on NAV, through increased property yields.

- **Management risk**: as CREI is externally managed, any management risk is indirect. The management agreement with Custodian Capital was renewed on 1 June 2017 and runs for three years. Custodian Capital operates with a relatively small team, and if a senior member of that team were to leave, they would need to be replaced.
- **Stock issuance**: the ability to regularly issue new equity on attractive terms has enabled CREI to grow its portfolio, minimising cash drag and mitigating the negative impact of property acquisition costs on NAV, while maintaining a conservative level of gearing. The sustained P/NAV premium is evidence that issuance is in response to investor demand rather than representing a share overhang and is driven by the availability of attractive investment opportunities, mitigating cash drag.

**Exhibit 19: Financial summary**

| Year end 31 March | £'000s | 2015 | 2016 | 2017 | 2018 | 2019 | 2020e | 2021e |
|---|---|---|---|---|---|---|---|---|
| | | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS | IFRS |
| **PROFIT & LOSS** | | | | | | | | |
| Gross rental income | | 11,228 | 18,561 | 26,980 | 34,055 | 39,108 | 39,995 | 41,279 |
| Re-charge income | | 342 | 451 | 630 | 758 | 866 | 918 | 1,020 |
| Total revenue | | 11,570 | 19,012 | 27,610 | 34,813 | 39,974 | 40,913 | 42,299 |
| Gross property expenses | | (715) | (1,023) | (1,869) | (1,610) | (2,396) | (2,802) | (2,939) |
| Net rental income | | 10,855 | 17,989 | 25,741 | 33,203 | 37,578 | 38,111 | 39,360 |
| Administrative expenses | | (2,327) | (2,828) | (3,643) | (4,377) | (4,919) | (4,763) | (4,810) |
| Operating Profit before revaluations | | 8,528 | 15,161 | 22,098 | 28,826 | 32,659 | 33,348 | 34,550 |
| Revaluation of investment properties | | 6,083 | 3,031 | 9,016 | 11,859 | (-5,499) | (11,977) | 1,691 |
| Costs of acquisitions | | (5,844) | (5,768) | (6,103) | (6,212) | (3,391) | (1,204) | 0 |
| Profit on disposal | | 269 | 56 | 1,599 | 1,606 | 4,250 | (79) | 0 |
| Operating Profit | | 9,036 | 12,480 | 26,610 | 36,079 | 28,019 | 20,088 | 36,241 |
| Net Interest | | (289) | (1,273) | (2,405) | (3,659) | (4,373) | (4,838) | (4,880) |
| Profit Before Tax | | 8,747 | 11,207 | 24,205 | 32,420 | 23,646 | 15,251 | 31,362 |
| Taxation | | (2) | 0 | 0 | 0 | 0 | 0 | 0 |
| Profit After Tax | | 8,745 | 11,207 | 24,205 | 32,420 | 23,646 | 15,251 | 31,362 |
| Net revaluation of investment property/costs of acquisition | | (239) | 2,737 | (2,913) | (5,647) | 8,890 | 13,181 | (1,691) |
| Gains/(losses) on disposal | | (269) | (56) | (1,599) | (1,606) | (4,250) | 79 | 0 |
| EPRA earnings | | 8,237 | 13,888 | 19,693 | 25,167 | 28,456 | 28,511 | 29,671 |
| Average Number of Shares Outstanding (m) | | 146.1 | 204.2 | 298.7 | 362.4 | 391.9 | 408.4 | 412.1 |
| IFRS EPS (p) | | 5.99 | 5.49 | 8.10 | 8.95 | 6.03 | 3.73 | 7.61 |
| EPRA EPS (p) | | 5.64 | 6.80 | 6.59 | 6.94 | 7.26 | 6.98 | 7.20 |
| Dividend per share (p) | | 5.25 | 6.25 | 6.35 | 6.45 | 6.55 | 6.65 | 6.72 |
| Dividend cover (x)* | | 1.00 | 1.01 | 1.01 | 1.06 | 1.10 | 1.04 | 1.07 |
| Ongoing charges ratio (excluding property expenses) | | 1.41% | 1.33% | 1.20% | 1.15% | 1.12% | 1.11% | 1.11% |
| **BALANCE SHEET** | | | | | | | | |
| Fixed Assets | | 207,287 | 318,966 | 418,548 | 528,943 | 572,745 | 581,644 | 587,081 |
| Investment properties | | 207,287 | 318,966 | 418,548 | 528,943 | 572,745 | 581,644 | 587,081 |
| Other non-current assets | | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Current Assets | | 1,921 | 9,973 | 10,260 | 12,942 | 6,146 | 13,789 | 12,504 |
| Debtors | | 1,072 | 4,518 | 4,453 | 7,883 | 3,674 | 6,127 | 6,225 |
| Cash | | 849 | 5,455 | 5,807 | 5,059 | 2,472 | 7,662 | 6,279 |
| Current Liabilities | | (5,411) | (8,165) | (12,572) | (12,755) | (14,160) | (13,113) | (13,211) |
| Creditors/Deferred income | | (5,411) | (8,165) | (12,572) | (12,755) | (14,160) | (13,113) | (13,211) |
| Short term borrowings | | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Long Term Liabilities | | (23,811) | (65,714) | (64,359) | (113,928) | (138,108) | (151,422) | (151,722) |
| Long term borrowings | | (23,811) | (65,143) | (63,788) | (113,357) | (137,532) | (150,846) | (151,146) |
| Other long-term liabilities | | 0 | (571) | (571) | (571) | (576) | (576) | (576) |
| Net Assets | | 179,986 | 255,060 | 351,877 | 415,202 | 426,623 | 430,898 | 434,652 |
| NAV/share (p) | | 101 | 102 | 104 | 107 | 107 | 105 | 105 |
| EPRA NAV/share (p) | | 101 | 102 | 104 | 107 | 107 | 105 | 105 |
| **CASH FLOW** | | | | | | | | |
| Operating Cash Flow | | 12,780 | 13,945 | 23,066 | 28,388 | 36,035 | 28,726 | 33,804 |
| Net Interest | | (204) | (1,285) | (2,200) | (3,521) | (4,198) | (4,540) | (4,580) |
| Tax | | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net additions to investment property | | (129,788) | (113,621) | (92,126) | (105,884) | (46,199) | (20,904) | (3,000) |
| Ordinary dividends paid | | (5,546) | (12,220) | (18,493) | (23,007) | (25,484) | (26,977) | (27,607) |
| Debt drawn/(repaid) | | 23,811 | 41,700 | (1,000) | 49,364 | 24,000 | 13,500 | 0 |
| Proceeds from shares issued (net of costs) | | 99,796 | 76,087 | 91,105 | 53,912 | 13,259 | 16,001 | 0 |
| Other cash flow from financing activities | | | 0 | 0 | 0 | 0 | 0 | 0 |
| Net Cash Flow | | 849 | 4,606 | 352 | (748) | (2,587) | 5,807 | (1,382) |
| Opening cash | | 0 | 849 | 5,455 | 5,807 | 5,059 | 2,472 | 8,279 |
| Closing cash | | 849 | 5,455 | 5,807 | 5,059 | 2,472 | 8,279 | 6,896 |
| Debt as per balance sheet | | (23,811) | (65,143) | (63,788) | (113,357) | (137,532) | (150,846) | (151,146) |
| Unamortised loan arrangement fees | | (489) | (857) | (1,212) | (1,643) | (1,468) | (1,654) | (1,354) |
| Total debt | | (24,300) | (66,000) | (65,000) | (115,000) | (139,000) | (152,500) | (152,500) |
| Restricted cash | | (230) | (490) | (1,307) | (1,341) | (1,369) | (1,328) | (1,328) |
| Closing net debt | | (23,681) | (61,035) | (60,500) | (111,282) | (137,897) | (145,549) | (146,932) |
| Net LTV | | 11.4% | 19.1% | 14.4% | 21.0% | 24.1% | 25.0% | 25.0% |

Source: Custodian REIT, Edison Investment Research forecasts

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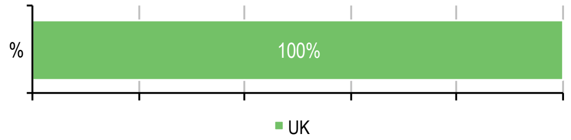
**Revenue by geography**




**Management team**

**Chairman of Custodian REIT: David Hunter**

David Hunter is an international property consultant, specialising in supporting the creation, operation and liquidation of property funds and companies. He is chairman of a UK-based real estate debt fund manager and has corporate advisory roles in the UK and France. He was managing director of Aberdeen Asset Management's £6.5bn UK and international property fund business from 2001–04. He was president of the British Property Federation in 2004

**Managing director of Custodian Capital: Richard Shepherd-Cross**

Richard Shepherd-Cross is the managing director of Custodian Capital and the fund manager of Custodian REIT. He is a chartered surveyor and a former director of Jones Lang LaSalle in London, where he led the portfolio investment team before joining Mattioli Woods in 2009, where he was responsible for the syndicated property initiative, which was the precursor to CREI. He was instrumental in establishing CREI and raising £55m at IPO.

**Non-executive director: Ian Mattioli**

Ian Mattioli is the founder director of Custodian REIT and, together with Bob Woods, founded Mattioli Woods, the AIM-listed wealth management and employee benefits business, which is the parent company of Custodian Capital, external fund manager of Custodian REIT. He has more than 30 years' experience in the financial services industry. Ian is responsible for the vision and operational management of Mattioli Woods and instigated the development of its investment proposition. This included the syndicated property initiative that developed into the seed portfolio for the launch of Custodian REIT.

**Company secretary: Nathan Imlach**

Nathan Imlach qualified as a chartered accountant with Ernst & Young, specialising in providing mergers and acquisitions advice to a broad range of quoted and unquoted clients in the UK and abroad. He is a fellow of the Chartered Institute for Securities & Investment and a member of the Institute of Chartered Accountants in Scotland.

| Principal owners, incorporating control of voting rights through acting as discretionary investment manager | (%) |
|---|---|
| Mattioli Woods | 6.3 |
| BlackRock | 3.5 |

**Companies named in this report**

Ediston Property (EPIC), BMO Real Estate Investments (BREI), BMO Commercial Property Trust (BCPT), Picton Property Income (PCTN), Regional REIT (RGL), Schroder REIT (SREI), Standard Life Investment property (SLI), UK Commercial Property Trust (UKCM)

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