INTUITION
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Schroder European REIT: In pursuit of 'Winning Cities'

Schroders plc is a global investment manager, founded in 1804, with assets under management of c£615 billion. It is also one of Europe's largest real estate managers (£27.3 billion). The Schroder European Real Estate Investment Trust (REIT) plc allows SA investors direct access to a diversified portfolio of commercial real estate across Continental Europe, yielding 6% in Euros. Launched in December 2015 on both the London (Primary) and Johannesburg stock exchanges, the Fund's unique focus on Geo-spatial data science to locate 'Winning Cities' within Western Europe has stood it in good stead to date. However, with the European Central Bank raising interest rates for the first time in years and GDP being revised down across the EU due to rampant inflation from the conflict in Ukraine, the investment landscape across Europe has become extremely volatile. This article will lift the lid on why we believe that over the medium term, the investment story will remain intact, despite the current headwinds.

Nick Rogers

It all begins with GDP growth, not just within a specific high-growth country but more specifically within the fastest-growing cities. Why the focus only on cities one may ask? Firstly, the number of people living in global cities has more than doubled over the last 40 years and is projected to reach five billion by 2050 (UN). This is not an insignificant number. Urbanisation is at its core as people, in search of better opportunities such as jobs, services and education, migrate from rural into urban areas. According to a recent OECD study, 80% of all economic growth is generated by cities. This begs the question, "What makes a 'Winning City'?" According to Schroders, these are the five key ingredients:

SPEED READ

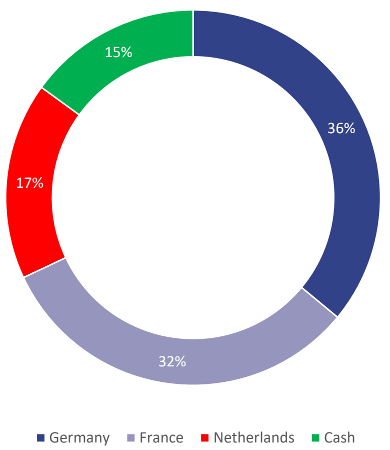
- **The number of people living in cities has more than doubled over the last 40 years and is projected to reach 5 billion by 2050 (UN) – a global megatrend.**
- **80% of all economic growth is generated by cities (OECD).**
- **High levels of education are probably the single biggest indicator of urban success.**
- **Schroders uses Geo-spatial data science to help locate 'Winning Cities' across W. Europe.**
- **The Fund has a diversified property portfolio worth €247.9 million and has delivered growth in NAV of 8.9% p.a over the past 3 years, despite the impact of Covid.**

1. Education is probably the single biggest indicator of urban success. The availability of good schools and universities is crucial to producing a highly skilled workforce.
2. Differentiated economy. A good mix of large multi-national companies and start-ups within different sectors like Financial Services, TMT (technology, media, and telecom) hubs and value-added manufacturing.
3. Employment Growth due to the availability of high-value new jobs which will in turn create a snow-balling wealth effect over time.
4. Good infrastructure including an efficient transport network, high-speed internet (e.g. fibre) and resilient buildings which in turn relies on the quality and vision of the city council's planning for the future.
5. Environment. Is it an attractive place with a mix of new and old buildings and cultural amenities to attract tourism?

Across Europe, tier 1 cities like Berlin, Hamburg, Stuttgart, Paris and Utrecht tick the above boxes and most importantly, are growing faster than their national GDP growth rate as a result. This continued urbanization is a megatrend and still has decades to play out, providing Schroders with a defensive moat during tough economic times.

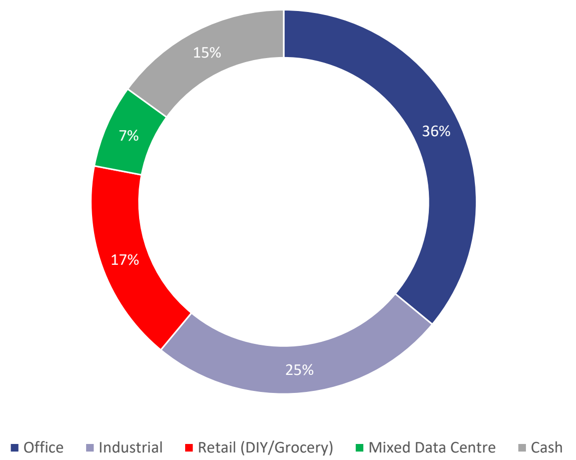
"Location, location, location!" always rings true within the property sector. This can take on many angles. For instance,

PORTFOLIO BY GEOGRAPHY



The portfolio is well diversified across fast-growing Continental European cities

PORTFOLIO BY SEGMENT

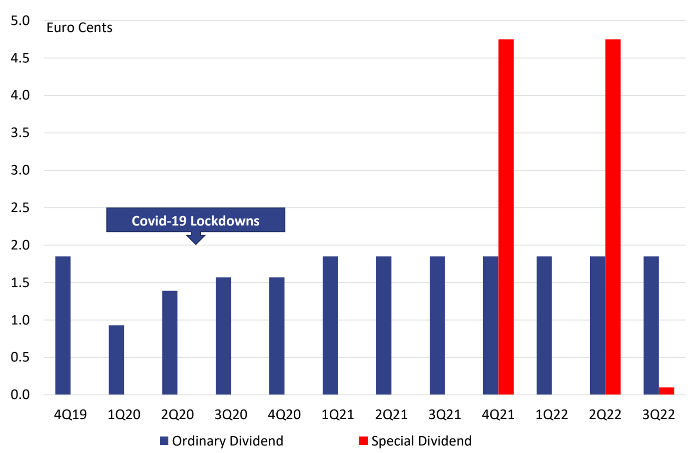


The REIT's assets are spread across a number of different sectors.

the focus of local property funds such as Fairvest and Vukile is on rural/township transport nodes and corresponding value-malls across SA. At the core of Schroder's ability to locate the right city and corresponding suburb, building and sector, is data science. Being a large multi-national, all investment teams within the company can leverage off its high-quality Data Insights Unit (DIU). Geospatial data science is a sub-set of this field which combines an understanding of location, distance and geography with traditional analysis skills such as interpreting economic statistics. For instance, by gathering and processing data via satellite imagery and mobile phone GPS signals, analysts can see clearly where most commuters end up travelling to in a particular city, street and even building to enable it to locate potential property opportunities. Datasets also range from points of interest, such as the proximity of airports, hospitals, shops or ATMs, to the demographic characteristics of individual neighbourhoods, to plotting drive times between customers and stores if one were searching for a retail opportunity. This technology gives Schroders a strong competitive advantage coupled with over 100 experienced property specialists on the ground with deep local knowledge.

When analysing financial statements for property companies, we tend to focus on different metrics to the ones used for conventional companies. The weighted average lease expiry (WALE) is a good starting point. If leases expire shortly (0-2 years), cash flow could become a big issue, especially if existing rental levels are above market levels. Schroder's average WALE as of June 2022 is an acceptable 4.5 years yet management is not complacent. It is reacting to the rise in flexible leases post-Covid as a growing trend. With concerns around inflation hitting multi-decade highs, it is comforting that 75% of its leases are index-linked to annual domestic CPI whilst 25% are hurdle-linked. This is a real positive that will manifest in higher income growth, particularly as landlords start to face stronger geopolitical and economic risks over the next 12 months. Another positive is Schroder's focus on value or more affordable leases without sacrificing the quality, allowing tenants more capacity to absorb these increases off low bases. High levels of positive tenant engagement resulted in robust and improved rent collection over the period of 100% (excl. Seville which has been written down to nil as COVID-19 ravaged Spain's retail sector). The team's overall intention is to "sweat the assets, not the balance sheet". This helps to explain why the loan-to-value (LTV - the ratio of net debt to the value of the asset) of 18% sits comfortably below the target of 35%. This is particularly reassuring in a period when interest rates are rising, and debt is becoming more expensive to service.

DIVIDEND PER SHARE



Not many global REITS have managed to collect 100% of rental income and pay special dividends so soon after COVID-19 lockdowns.

The Company has significant cash reserves and potential investable firepower of approximately €50 million. Given current headwinds, many developers face becoming forced sellers so Schroder's cash position will allow management to cherry-pick attractive opportunities at lower prices. The long-term strategy is to further diversify the portfolio by location, sector, size, lease duration and tenant concentration. Two examples are:

- the newly acquired car showroom in Cannes, leased to Fiat and which sits next door to Lamborghini and Ferrari. It was acquired for €8.4 million with a net initial yield of 5.5% and a reversion to 6.4% once the lease is renewed, and
- a freehold industrial warehouse in Venray, the Netherlands, acquired for €1.7 million. This property has a net initial yield of 5.3%, a reversion to 7.6% and a WALE of eight years.
- Despite transactions such as these that highlight the value that active and astute management can bring, the company is trading at a c20% discount to its Net Asset Value (NAV - the Company's total assets less its liabilities) and offers a dividend yield of 6% (excluding the special dividends). One cannot fault how management has managed to navigate a very tricky period.

> "The CEO expects stronger income growth as rentals rise in line with higher inflation."

Lastly, let's examine the risks. About six months ago, the main risks were centred on COVID and ESG regulations. Obviously, those two risks remain, but the most imminent threat is due to the war in Ukraine and consequent concerns around a possible European recession, heightened inflation driven by rampant energy costs, increased construction costs, and a hawkish ECB, looking to raise rates further. The CEO believes that the valuation growth that has been experienced in the past is unlikely to continue for now but that will be replaced by stronger income growth as rentals rise in line with higher inflation.

In conclusion, global cities are powerhouses of the present and of the future and will increasingly shape how people live and work and how businesses grow. Despite the short-term pressure, Schroder's long-term strategy is to continue to implement a research-led approach to determine attractive sectors and locations in which to invest in commercial real estate. This has allowed the REIT to deliver a NAV return of 9.3% over the past 12 months and 8.9% p.a. over the past 3 years (measured in Euros) which includes the COVID-19 lockdowns. Most income and balanced clients have plenty of exposure to property in SA, the UK and Eastern Europe. Schroders European REIT further diversifies both the income stream and geographic risk. We are happy to add on any weakness over the short-term.

Schroders European REIT is invested in Berlin, one of the fastest growing cities in Germany.

Through a variety of news channels and daily commentator, investors are constantly bombarded with advice on where to invest their money. The most vociferous debates often occur between those who argue that everything should be offshore, and those who are the opposite.
Our next seminar will explore the merits of both markets, through the lens of our identified core themes, and explain why we feel it is wise to hedge your bets.

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Topic: **Why still local AND why still global**

Natal Midlands	
Date:	15th September 2022
Venue:	Oasis Conference Centre, 72 Main Road, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg	
Date:	20th September 2022
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

CONTACT DETAILS:

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