INVESTMENT**COMMENTARY**

CARTLIDGE MORLAND
INDIVIDUAL WEALTH MANAGEMENT

Special Edition **UK COMMERCIAL PROPERTY Update**

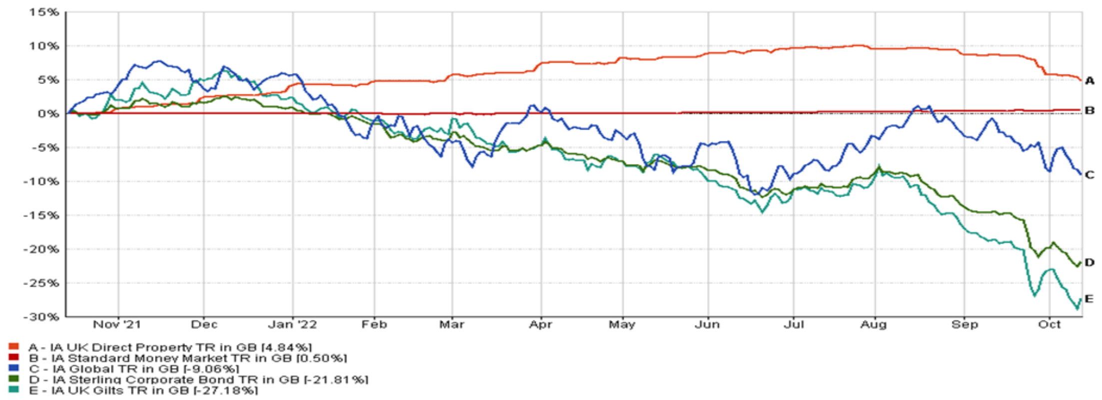
14 OCTOBER 2022

The recent volatility in the gilt markets as a result of the Government's mini-budget and actions by the Bank of England have had significant effects on investment markets. In particular, long dated gilt yields rose (prices fell) and Defined Benefit pension funds were forced to sell assets which support their liability driven investment strategies. Some of the news about redemptions from property funds were centred on these institutional pension funds being forced to liquidate assets.

As the yields from gilts rise, the attractiveness of other riskier assets, including the income arising from property assets, falls. The other factor influencing property demand is the recent strong performance of the commercial property market. Following stresses in the market during the Covid-19 lockdowns in 2020 and the suspension of trading in some property funds, the market recovered strongly and continued to do so despite the growing cost of living crisis and increasing interest rates. The high point for property valuations was June 2022 and now some of these gains are being "given back" in the most recent quarter. This is in part due to debt costs rising quickly and property investors having to review their return requirements. With capital values falling, the cash held in and income generation of funds are key to offsetting the negative capital returns.

Short term predictions are difficult to make in volatile markets against the backdrop of slowing economic growth. We continue to hold UK direct property funds for the income flow they produce and longer term prospects for capital growth. Property is a useful diversifier in investment portfolios as the charts below illustrate comparing the sector returns to those of global equities (IA Global), fixed interest (IA UK Gilts/IA Sterling Corporate Bond) and cash (IA Standard Money Market) over one, five and ten year periods. Over the longer term, property produces a relatively smooth return, outperforming cash and fixed interest.

ONE YEAR RETURNS



13/10/2021 - 13/10/2022 Data from FE fundinfo2022

FIVE YEAR RETURNS

13/10/2017 - 13/10/2022 Data from FE fundinfo2022

TEN YEAR RETURNS

The recent negative sentiment surrounding UK commercial property emanating from stresses in the gilt market and a search for liquidity has impacted on retail property funds. Trading in the CT UK Property fund, which is held in some of our portfolios, has recently been suspended following increased redemptions and a squeeze on its liquidity. The suspension protects the remaining fund holders as the fund managers can carefully manage sales and cash levels in a more controlled way. The property assets in the fund continue to pay income which is accumulated as cash for investors. Other funds that we hold, Legal and General UK Property and M&G Property Portfolio, currently have relatively high levels of liquidity comprising cash and Real Estate Investment Trusts. We hold the funds as longer term investments for their income and diversification benefits. There remains strong demand in the industrial sector, which includes storage and distribution warehouses, and in alternative sectors (hotels, residential, student accommodation, self storage). Demand for office space has ticked up as more people are returning to the office – although on a more flexible basis. Well located, high quality property assets should perform well in the longer term. Weaker sterling also makes commercial property more attractive to foreign investors. The funds in which we invest are well diversified so rental income is derived from numerous sources and sectors. In general, a maximum of around 5% of a balanced portfolio is retained in commercial property funds. Over the past year, they have been some of the only positively performing assets. We could see further suspensions of property funds announced in these volatile investment market conditions, but we will continue to look to the longer term.

If you have any concerns
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