PROPERTY UPDATE

Henderson UK Property PAIF and Feeder Fund – suspension update

From noon on 5 July 2016, dealing in the Henderson UK Property PAIF and its associated Feeder Fund was suspended. This was in response to extraordinarily heavy redemptions following the result of the European Union referendum that put exceptional liquidity pressure on the fund. The suspension was taken in the interests of all investors and allows time for the fund managers to conduct an orderly sale of some properties in the portfolio to enable the fund to re-open to daily dealing as soon as practicable.

Suspension remains in place

At the time of the suspension we announced that the situation would be carefully monitored and the suspension would be reviewed at least every 28 days. The Board of Henderson Investment Funds Limited (HIFL), which is the authorised corporate director (ACD) for the fund, has concluded that while good progress is being made in rebuilding liquidity in the fund, the fund is not yet at a stage where it can re-open to daily dealing. **The dealing suspension therefore remains in place and will continue to be reviewed by the ACD with a further update provided within the next 28 days.**

This update details the progress made towards readying the fund for a re-opening, focusing on:

- Liquidity
- Portfolio activity
- Fair Value Adjustment
- Market outlook

Liquidity

The fund over time has typically looked to hold liquid assets broadly in a range of 10% to 20% of the fund's Net Asset Value (NAV), which is used to meet redemptions and to provide working capital. This is primarily made up of cash, although it can also include traded securities such as property equities. The fund managers have always said that during periods of net redemptions the preference is for a cash weighting towards the 15-20% range and possibly above this in periods of heightened uncertainty.

At 31 July 2016, liquid assets made up 11.2% of the NAV, comprising 10.4% in cash and 0.8% held in Real Estate Investment Trusts (REITS). This is not yet sufficient to accommodate intended client redemptions and be comfortable of avoiding a fresh dealing suspension soon after re-opening.

The fund held no REITS immediately ahead of the referendum and therefore avoided the big falls in their share prices but the fund managers believe that the current share prices and dividend yields on REITS allow the fund tactically to extract a more attractive income for investors than is achievable on cash.

Property activity

The fund managers continue to pursue active management of the existing portfolio while making good progress in a programme of property disposals. Since the referendum, the following sales have completed, which has already helped to raise liquidity within the fund:

- The largest sale was the Travelodge Hotel in London which achieved a good price. This was an attractive asset given the long lease length and fixed uplift and the price reflects this.
- A retail store let to Dunelm, the home furnishings group, was sold to the occupier, a reassuring sign that demand is not always from external investors but can come from tenants who are interested in owning their premises.
- An office in Kensington, a retail warehouse in Fareham and two London pubs were also sold.

Marketing activity has been underway on a range of assets for potential disposal, chosen to balance a desire to achieve a strong sale price in the current market while not compromising the diversification and performance potential of the remaining portfolio. A number of these are already under offer to potential purchasers and we are pleased with the sales prices being achieved so far.

Active management of the assets in the portfolio also continues with the following offering a selection of activity in July:

- New lease completed on London West End office building setting new headline rent for the building.
- New letting completed on Manchester office building with existing tenant (expanding within the building).
- Agreement for Lease completed at retail park in Crayford with new operator on the park.

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Fair Value Adjustment

The Fair Value Adjustment (FVA) to the physical property portfolio of the fund is now -3.5%, down from -5% previously.

The FVA (an adjustment to the valuations of properties in the portfolio) was applied the day that the result of the EU referendum was announced. This was because the Board of HIFL were not confident that valuations post the Brexit result were accurately reflecting the value of properties in the market given the lack of transactional evidence. The move to weekly independent valuations and greater transactional evidence should see the fair value adjustment (FVA) removed over time although with markets in flux the FVA could move up or down in the short term.

Market outlook

In recent weeks there has been a reappraisal of risk and a flight to quality. The challenge is determining whether this is part of a late-cycle adjustment or purely down to the Brexit vote. There are some downgrades to occupier assumptions in terms of take-up and rent expectations but these are offset to some extent by lower bond yields and a likely lower interest rate environment, which continues to make the yield on property attractive.

Core assets with longer unexpired leases and those with fixed/RPI* rental uplifts should be the most robust. Core assets have a depth of market at the occupational level given the interest from a quality tenant base. There is also greater overseas interest at the investment level, particularly as the fall in sterling gives overseas investors a window to buy UK assets at attractive prices. Larger lot sizes and secondary properties in the regions outside the South East, and those with short lease lengths and no rental uplifts, are the most untested part of the market as yet.

Around two thirds of the portfolio comprises properties in London and the South East of England and even adjusting for sales (assuming all marketed properties under offer proceed to a sale) this regional allocation will be broadly unaltered. Fixed rental/RPI uplifts exist on around one third of the tenant income in the portfolio.

At 31 July 2016, the estimated historical yield on the PAIF was 3.2% net (4.0% gross) and the estimated historical yield on the Feeder was 3.2%. These yields relate to I and A share classes. Yields may vary and are not guaranteed.

*RPI= Retail Prices Index, a measure of inflation.

Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise and investors may not get back the amount originally invested.

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