# The Charities Property Fund
## Annual Meeting Summary 2009

The meeting was held in three parts;

**View of Andrew Allen, Fund Director and Head of Research and Strategy at Cordea Savills**

- The UK economy, highlighting that whilst economic growth was weakening further and was likely to reduce occupier demand, inflation was also dropping fast and UK interest rates have fallen from 5½% to 1%. The markets are anticipating that the Bank of England will reduce rates further; these historically low interest rates being likely to stimulate economic growth in due course.

- The long term case for UK property remains. The UK is fortunate to have one of the most transparent property markets, a favourable lease structure, and continues to offer the security of long lease lengths and a strict planning regime which compares extremely favourably to its European counterparts.

- Foreign investors were 'massing on the UK's borders' as they sought to take advantage of the fall in property values which had been significantly enhanced by sterling's weakness. In capital terms the market is c.60% cheaper for foreign investors than 18 months ago.

- Although markets were expecting further falls (consensus is 10% to 15%) this was likely to happen within the first half of 2009. Against this pricing for available transactions seems to have stabilised.

- Bank lending to commercial property remains a concern, particularly where the value had fallen below the value of the loan. So long as the rental income is able to cover the interest payments, banks would be reluctant to foreclose thereby crystallising a loss. However, this was likely to remain a drag on the market as banks continued to deleverage their balance sheets.

- Tenant default remains a risk. The abolition of exemption for empty business rates has increased the risk to those property funds that use borrowing.

- The economic slowdown has had a significant impact on the retail market particularly the high street. High Street retailers remain under pressure from supermarkets selling non food goods, over supply through the construction of new shopping centres and the internet.

- Relative value can be found in parts of the industrial and the provincial office markets.

- Andy concluded that as a result of the recent property price falls the UK property market is now showing the greatest historic yield gap over government gilts of over 3%, (IPD is standing at 7% versus gross redemption yields on 10 year bonds of 3.7%, cash on deposit of c.1% and the FTSE All Share of 4.5%). In the past this has given a strong buying signal for UK property. Investors should be attracted by the sheer level of income deliverable and for properties where the income is secured by tenants with strong balance sheets. Income has historically provided the majority of returns to investors and rewarding levels are now attainable in the UK property market.

**View of Harry de Ferry Foster, Portfolio Manager at Cordea Savills**

- A review of the Fund's portfolio, highlighting the diversity of the 37 properties and 131 tenancies and the broad geographical spread. The portfolio remains financially secure having an unexpired lease term to its tenants of nearly 9 years which is similar to the market. However, the Fund on average exhibits a much lower covenant risk than the average as measured by IPD. Additionally, the portfolio has a very low void rate at 2.4%, compared to the UK average of 10.4%. This is particularly important with the removal of the exemptions on the payment of empty rates.

- Highlights of management successes: 17 tenants agreed rent reviews in the year increasing their rents by 7.2% on average, 11 new lettings increased income by over £650,000; of 7 potential tenant breaks in the year just 2 left their properties, representing only £38,000 of income. As a result this increased the income distribution to unitholders by 3.8% in 2008 from 7.48p per unit to 7.77p per unit.

- Summaries of some initiatives taken on specific properties: Highlighting, the receipt of planning permission for housing and the associated sale of vacant land adjacent to one of the industrial estates, an example of a tenant making a significant capital payment to surrender lease obligations (after securing an alternative occupier) and two examples of tenants taking up the offer to extend their existing leases, each example providing evidence of the pro-active stance on the portfolio to secure and enhance value.

- Details of the 8 property sales in 2008. These properties had all been earmarked for sale in 2007 in the annual review. They were in general small lots with shorter than average leases, where future opportunities to add value were limited. These properties achieved a combined sale price of some £30 million and in total were sold at -2.8% below the December 2007 valuations (compared to the market which was down -25.0% in 2008) and ensured that all December 2007 redemptions could be met without having a detrimental impact upon the long term investors in the Fund.

Harry concluded by showing that there are significant opportunities to acquire good quality properties from distressed sellers at yields approaching 10%. At these levels, the target return of the Fund of 8% pa can be exceeded through income alone. For example recent opportunities have included an office building in Bristol let to Orange which could be purchased for 9.5%, an industrial estate in Sevenoaks which could be acquired for 10%+ and an office building in Solihull let to National Grid for 8 years which could be purchased for 9.75%. These illustrated that high and secure income properties are available in the UK and would not wish to miss out on properties of this quality for investors in the Fund.

**View of Charles Mesquita, Charity Specialist at Rensburg Sheppards Investment Managers**

- Fund overview: highlighting the bias to income (currently yielding around 8%), the diversified nature of the portfolio and the lower risk characteristics with above average tenant quality. The Fund remains precluded from speculative development and the use of borrowing (gearing).

- The Fund's strong income qualities. The distribution yield was 7.9% as at December 2008, significantly ahead of the average balanced property funds (5.5%) and far ahead of cash and government bonds (gilts). The income distribution from the Fund had risen by 3.0% per annum since the Fund's launch in 2000 and paid an enhanced distribution payment in February (2009) of 2.3p per unit. This additional income payment being due to Harry's success in negotiating a payment of around £1 million from our tenant in Redditch seeking to vacate the premises; income quality being maintained as a new tenant has been secured at a similar rent.

- Erring on the side of caution, the prediction was to maintain the 2009 distribution at the same rate as 2008 (7.77p per unit).

- The Fund's outperformance against the property market (IPD) by some 0.9% per annum since launch on a total return basis. The Fund recorded a total return of -17% in 2008 which compared to the Average Balanced Fund as measured by the IPD pooled property funds indices of -23.9%. This placed the Fund 4th out of 27 Funds over the year and 5th over the last 3 years and it remains one of the highest yielding funds in the Index.

- A comparative table of returns from UK property funds; this strongly illustrates that those funds that had used borrowing (gearing) had underperformed the average (some by significant margins) in 2008. As economic weakness prevailed such geared funds left their investors exposed to higher risk than they may have been aware . For example if tenants default then the loss of income would be exaggerated for such funds and could cause breaches of banking agreements.

The position regarding redemptions. All redemptions from December 2007 have been cleared and the Fund has around £3½ million outstanding from 2008. These residual redemptions being approximately covered by the Fund's cash balance; albeit Charles explained that the Fund also has a requirement to retain some working capital. During 2008 the Fund had received a modest net inflow of investor monies which was considered a positive for the Fund. The Board was keen to resume normal dealing but continued to have concerns regarding the significant number of other open ended property funds that are still closed; to protect investors from the Fund potentially being 'cannibalised', the board is likely to retain the delay on redemptions. The Board would continue to monitor the situation carefully.

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