VACCINES AND VALUES

Spring/Summer 2021

With the current success of the UK vaccine rollout there is hope that we may now be heading towards some semblance of normality.

Against this background we thought it would be useful to provide an update on how Rougemont's investor portfolio has performed over the past 12 months and to consider how the property market in general may perform over the coming year.

2020 saw an unprecedented expansion in governmental borrowing, combined with a move to negative interest rates in parts of Europe. It also saw the enforced adoption of new working and shopping habits. These lifestyle shifts, some of which had begun pre- pandemic, have accelerated at a pace never envisaged possible and it is debateable as to what extent they will now become a permanent feature of life.

The human impact of the pandemic has been deeply felt. The economic impact, which has been amplified by Brexit, now brings into focus the need to address not only how the fiscal deficit is reduced, but what shape the economic recovery will take and over what length of time.

Over the past 12 months, the performance of most commercial occupational and investment markets have been reminiscent of a recession, where there is a 'bounce back', followed by a period of volatility, followed by a period of stability. Of course, the downturn experienced over the past 12 months has not been caused by a recession, it is more akin to a natural disaster type scenario and we therefore see no reason why the recession type pattern of recovery should not continue but be far quicker.

In comparison to the recovery from the global financial crisis of 2007/2008, the UK Government has provided substantial direct stimulus to both residential and commercial property markets. National housebuilders have benefitted from Stamp Duty holidays, Government 'Bounce Back' loans and furlough schemes. Commercial tenants have been protected from landlords initiating legal action for non-payment of rent and lenders have continued to adopt restraint in dealing with those borrowers who are experiencing a loan covenant default. However, we acknowledge that this stimulus will have to end shortly and, for the residential sector in particular, this is likely to lead to an element of continued price volatility.

During the year a clear divide has emerged between the various commercial sectors. The retail sector, both 'in town' and 'out of town', suffered accelerated decline. In contrast, the warehousing and logistics sector broke all records for new leases and investment activity as investors scrambled to secure exposure to the sector. As for the office sector, many landlords and occupiers remain uncertain as to the future for offices following a long period of enforced 'working from home' – and this is a topic we will touch on in more detail later. The leisure sector was also badly impacted, despite the heavily supported summer of 'Eat Out to Help Out'. This sector seems likely to now see a marked increase in activity over the next few years, it has a long history of being an attractive platform for Private Equity investment, with the consequent introduction of new occupiers vying for the better locations and inflating rental values.

Importantly, unlike the recovery from the global financial crisis, the majority of landlords do not appear to be overly exposed to high levels of expensive debt and the investment markets remain heavily capitalised, with pent up equity seeking a secure return from property. Therefore, whilst opportunities will inevitably present themselves during the recovery, the weight of demand will continue to put pressure on yields in the more attractive sectors. This may lead some investors to be concerned that they are missing out on potential recovery opportunities and to start to consider other less attractive property sectors in the search of higher returns. We would urge caution in this regard.

Rougemont will continue to adopt a positive, but cautious, approach to the secondary markets for both industrial and offices which, in the main, have continued to perform well, despite occupiers becoming increasingly price sensitive. We believe that this strategy, which has benefited investors so well over the past 12 months and which is evidenced by the high percentage of rent collection and uninterrupted quarterly distributions throughout the year, will continue to serve investors well during the next 12 months.
It is anticipated that portfolio valuations in 2021 are likely to either remain static, or show a slight decline, thereby placing greater importance on uninterrupted rental collections in order to deliver income returns. Meanwhile, we will continue with our strategy of improving lease terms to maximise valuations and developing appropriate exit strategies for when greater stability returns.

ROUGEMONT INVESTOR PORTFOLIO KEY FACTS:

25

25 properties nationwide

£120m

£120m of property under management

99%

99% of all rents collected and distributed 25th March 2020 to 25th March 2021

0.5%

0.5% of the property portfolio is vacant and available to let

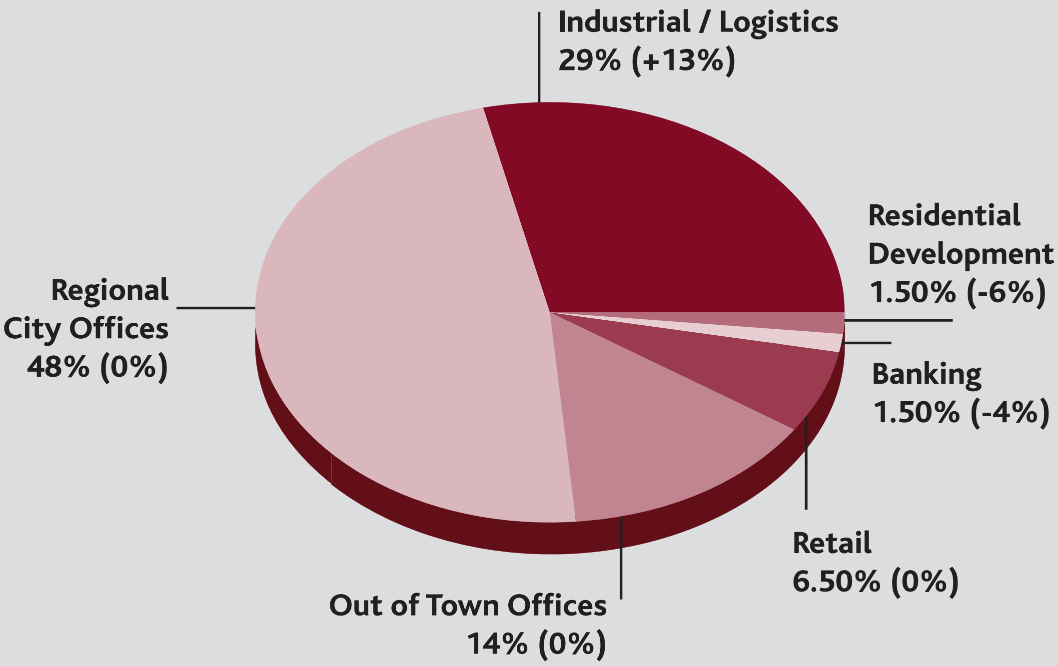
2.5%

2.5% of the portfolio is debt funded (one asset) with a LTV ratio of 50%

7.75%

Average annual distributed return 7.75%, paid quarterly in advance

SECTOR ANALYSIS



ROUGEMONT PORTFOLIO ACTIVITY REVIEW MARCH 2020 – MARCH 2021:

The HBOS Sheffield Syndicate

The Syndicate purchased the property for £2,075,000 in July 2012. The tenant, HBOS Bank, vacated in August 2017 but remained legally responsible for the rent until their lease expiry in July 2025.

A comprehensive search for an alternative tenant was undertaken and Mitchells & Butlers plc was identified as a potential occupier/owner.

A price of £2,880,000 was subsequently agreed, subject to obtaining a surrender premium from HBOS bank and obtaining planning permission for conversion of the Property to a restaurant.

Contracts were exchanged in March 2020 and the sale was completed in September 2020.

Annual Income Return	7.00%
Net Capital Growth over 7 year ownership	27.00%
Annual Return on Investment over 7 year ownership	11.00%

The Royal Mail Thirsk Syndicate

The Syndicate purchased the property in September 2016 for £800,000 benefitting from a lease to Royal Mail with an unexpired lease term of 4 years and a rent of £5.50 per sq ft.

The strategy from the outset was to improve the existing lease terms and to benefit from the impending increase in industrial rents.

Lease renewal negotiations were concluded in September 2020, resulting in a new 10 year full repairing and insuring lease, with no break options, at a rent of £6.00 per sq ft.

Following completion of the new lease, Knight Frank valued the property at in excess of £1,000,000 representing a 25% increase in value since 2016. The rental uplift has also increased the annual income return from 6.60% to 7.00%.

Annual Income Return	7.00%
Net Capital Growth over 4 year ownership	20.00%
Annual Return on Investment over 4 year ownership	12.00%

The Dalton 49, Dalton Industrial Estate, Thirsk, A1(M) (J49) North Yorkshire

In April 2020, Dalton (Thirsk) Limited, a joint venture company between the directors of Rougemont and Opus North, agreed to purchase 43.5 acres of industrial distribution land on the established Dalton Industrial Estate.

An outline planning application for c.700,000 sq ft of industrial warehousing is due to be determined during June 2021.

A Rougemont syndicate has been formed to assist with the purchase of the site upon determination of the planning application.

The site will have the potential capacity to accommodate a single c.700,000 sq ft warehouse.

The New Look Jersey Syndicate

The Syndicate purchased the property in March 2015 with a strategy of seeking to take back possession of the unused upper floor accommodation for conversion to 36 residential units. Attempts to negotiate possession failed until March 2020, when New Look stopped rental payments due to the global pandemic and New Look entered into a second CVA.

Whilst New Look remained in arrears for most of 2020 the unique Jersey legal system enabled the Syndicate to legally enforce the payment of all arrears in exchange for a 12 month rent reduction and the ability for the Syndicate to take back possession of the upper floors, subject to obtaining planning permission for 36 apartments.

The New Look lease variation was agreed and completed in April 2021, at which time 100% of all rent arrears were collected. The Syndicate will be submitting a planning application for the upper floors during the summer of 2021.

The Ruskin Sheffield Syndicate

The Syndicate purchased the property in December 2019 for £2,375,000, reflecting a return of 8.60% per annum. The property is let to Hays Recruitment and HLM Architects, who occupy the two upper floors, with the ground floor being occupied by The Crucible Corner (a subsidiary of the Sheffield Theatre Trust) for use as a pre theatre bar and restaurant.

Whilst the Crucible Corner was forced to temporarily close during the pandemic, Hays decided to renew their lease in January 2021 leading to the negotiation of a new 5 year lease at an increased rent of £70,000 per annum. This reflected a 12% increase on the previous passing rent and increased the annual income return from 8.50% to 8.90%.

Canons Garth LLP, Helmsley

In August 2015, the Canons Garth LLP lending syndicate provided a loan to assist with the construction of 17 houses and 4 affordable apartments behind the Black Swan Hotel in Helmsley.

By December 2016, 12 houses were complete and were sold to 'second home' purchasers. In April 2017, the Government introduced an additional stamp duty tax upon 'second home' purchases as a result, no further house sales were achieved for 18 months. A decision was therefore taken to rent the remaining houses to tenants until market conditions improved and the issue of Brexit had been resolved.

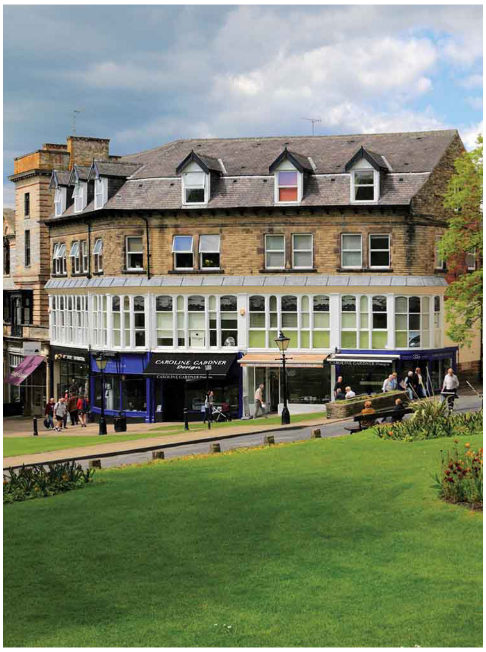
In April 2020 the UK government provided an economic stimulus package, which included a reduction in stamp duty on 'second home' purchases. All the houses have now been sold to 'second home' purchasers thereby delivering an exit strategy for the project, albeit considerably later than expected.

The Barnsley Logistics Syndicate

The Syndicate acquired a grade B logistics warehouse in March 2021 for £2,860,000. The annual income return is c.9.10%, per annum.

The property was selected due to its comparatively low rental tone within the growing logistics sector and due to its established industrial location, which is positioned to benefit from the proposed Barnsley West Masterplan.

A strategy to improve and modernise the estate through asset management initiatives has been identified which will support rental growth in the short-medium term. The property also lends itself well to a full redevelopment or refurbishment, to mirror the developments that have taken place in the local vicinity to address the demand for modern industrial units. A redevelopment or refurbishment is expected to secure both rental and capital growth in the medium to long term.



The Montpellier Harrogate Syndicate

The Syndicate acquired the property in December 2019 for £1,795,000, reflecting an income return of 6.50% per annum. The property comprises four small retail/kiosk units on the ground floor, with office accommodation above. Just before the March 2020 lockdown, one of the tenants gave notice of their intention to vacate at their lease expiry in June 2020. A new tenant was immediately identified and by July a new lease had been agreed, at the same passing rent and with a stronger tenant covenant.

The difficult trading conditions caused by the pandemic led to a number of requests for rental holidays by retailers. Where rental concessions were agreed, the tenants have, in exchange, agreed to extend their lease terms to offset the financial implications of the rental concessions provided. The principle being that neither the landlord nor tenant has suffered as a result of not being able to trade during the pandemic.

RETURNING TO THE OFFICE?

Throughout the pandemic a lot has been written about the longer-term impact of working from home. In some quarters many crystal ball gazers have the opinion that a return to work in a traditional office environment will be unlikely and this in turn will lead to swathes of empty office accommodation.

Whilst there is little doubt that working from home has been a positive experience for many people and will inevitably form part of the new working landscape, we feel that the impending death of office working has been greatly exaggerated.

Central London offices are likely to be impacted more than anywhere else in the country. Some companies may review whether they need to have an office presence in London at all. The net effect of this being the potential for a material reduction in central London commercial rental rates. Conversely, we believe that regional cities will be far better placed due largely to the restricted development supply over the past decade following the global financial crisis.

Savills UK provided the following useful research in April 2021:

"The regional office vacancy rate has increased very slightly due to the Covid-19 pandemic, moving from 10% in 2019 to 11% as of April 2021, however, it remains extremely low in a historic context as there is an undersupply of office space within the UK's regional markets. Regional office supply still currently remains 35% down on 2009 levels.

During the global financial crash, the situation in the regions was very different as there was an office oversupply, with the regional vacancy rate moving from 14% to 18% between 2007 and 2009.

The regional markets are therefore now significantly less at risk of downward rental pressure than they were during 2009, evidenced by the fact that virtually all regional markets experienced prime rental growth during 2020."

So, whilst greater thought will have to be given to how we return to office work safely, in reality the camaraderie, culture and co-operation of physically working in close proximity to colleagues is fundamental to the success of many businesses. Once the glorious spring of 2020 subsided, many became frustrated with the 'work from home' experience. The lack of training, mentoring, direction and support provided by the social interaction within an office can not replicated via a Zoom or Teams call.

The office therefore seems here to stay, but there is no doubt that many larger companies are already rationalising their accommodation requirements and a blended mix of office and home working has already been adopted for the long term.

The focus is now very much on what the new office working environment will look like to safeguard staff. Adequate social distancing measures will have to be accommodated when setting out workstations and greater emphasis will be put on agile working with more space allocation to break out areas and meeting rooms.

Equally, the same considerations will be given to staff welfare facilities, kitchens, bathrooms and water points. For larger office occupiers looking to rationalise their space requirements and their working patterns, this is likely to result in them reducing their national office exposure. But for many smaller businesses, which account for most office occupiers, there is likely to be minimal change in accommodation requirements, just a greater concentration on the facilities provided for staff.

As a consequence, we see little change in the small regional office sector, which is what the majority of the Rougemont's portfolio office holding is exposed to. It has been encouraging to see that five office lease renewals within our portfolio undertaken during the past 12 months have resulted in rental growth and improved lease terms. Rougemont will still be targeting cost effective small offices in locations where there has been limited development and where appropriate supply demand underpins future growth prospects.

NEW TEAM MEMBER

It is with great pleasure we announce the arrival of Jayne Golightly who joins the Rougemont team to assist with all investor relations and administration. Jayne joins with a wealth of experience in running residential development projects, dealing with day-to-day property administration and has also worked with our Chairman Jan Fletcher OBE as Executive Assistant for a number of years.

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