

Legal & General UK Property / Legal & General UK Property Feeder*

31 December 2020

Opinion

- This Recommended fund benefits from the fund managers' market insights and the level of their research into both the market and individual properties.
- We believe they are adept at combining a long-term, strategic focus on income quality with the flexibility to add value through property-specific initiatives and selective new development activity.
- The fund benefits from their interaction with other investment teams within Legal & General.

Characteristics and Utility

- Underpinned by rental income, commercial property can play a complementary role in investors' portfolios. We view this fund as a relatively mainstream exposure to the asset class, underpinned by the managers' cautious mentality and desire to offer characteristics in keeping with the broader market.
- As with similar funds, however, there is an inherent mismatch between the time taken to buy (or sell) commercial buildings and the fund's daily dealing profile. This leads the manager to hold a structural allocation to cash and liquid assets to help meet any surge in redemptions.
- Cash exerts a drag on performance during positive markets, as can the considerable costs of property transactions. The fund will, therefore, often underperform in sharply rising markets.
- Moreover, investor flows are often pro-cyclical and can therefore exacerbate this drag, while outflows during negative periods may reduce the level of cash that would otherwise provide a degree of resilience.
- The asset class is subject to cyclical swings in supply and demand, which will lead to periods of markedly negative performance.

Risk Commentary

Direct property funds do not have a KIID Synthetic Risk and Reward Indicator (SRRI). However, we are mindful that the liquidity mismatch between the asset class and the fund's daily dealing profile potentially creates risks to investors during times of outflow, especially if forced selling is required to meet redemptions. The fund currently has a fixed dual pricing structure with all buyers receiving the offer price and all sellers the bid price. The treatment of large outflows can vary between property funds according to each manager's pricing policy. Where property funds have a single swing price, large flows can lead to meaningful swings in a fund's price to ensure the seller and buyer bears the cost of transaction. In addition, the manager's REIT positions expose the portfolio to equity risk and can increase its volatility.

Key Fund Facts

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| Inception Date: | 27 May 2014* |
| Manager(s) Since: | Michael Barrie (Feb 06)*, Matt Jarvis (Jan 10)* |
| Fund Size: | £2,281m at 31 Dec 20 |
| Fund Domicile: | United Kingdom |
| Fund Benchmark: | IA UK Direct Property |
| IA Sector: | UK Direct Property |
| Share Class Type(s): | Acc and Inc |
| Ongoing Charge Figure: | 0.75% at 30 Nov 20 |
| Charges Levied Against: | Income |
| Yield: | 2.70% (historic) at 30 Nov 20 |
| Dividend Distribution: | 28 Jan, 28 Apr, 28 Jul and 28 Oct |

Dividend Distribution Date(s)/Charges Levied Against/Yield relate to "Clean" Income Shares.

*The Legal & General UK Property Trust was launched in 2006 and it converted to a PAIF in May 2014.

Formal documentation, including the fund prospectus and the KIID, should be sought directly from the asset manager. A link to the asset manager's website can be found on the relevant fund page at theadvisercentre.co.uk. An asset manager adviser factsheet is also provided there.

Fund Snapshot

A UK commercial property fund that can also invest in derivatives and equities. The approach seeks to combine a conservative focus on income stability with added value through active management initiatives. Within its sector, the fund features in our 'Commercial Property, Diversified' category.

Investment Team

Michael Barrie has managed the fund since launch, with Matt Jarvis added as co-manager at the start of 2010. The fund managers on the team are all chartered surveyors and the well-resourced team also incorporates expertise at project management and property management.

Investment Philosophy

The fund managers believe that their fund can be an attractive long-term, strategic property holding by dint of their conservative mentality. They have a focus on high-quality, stable properties with secure, often inflation-linked income and low vacancy rates.

Investment Process

The managers expect around one-third of the fund's relative performance to come from top-down sector strategies, with the rest from property selection and added value initiatives. Top-down market analysis also drives derivative strategies on direct property indices. The sector preferences are created through proprietary research into the supply, demand and risk factors influencing different segments of the market.

Each property that is considered for the portfolio is subject to an asset analysis process. Rather than a broad definition of quality through categories such as "prime" and "secondary", the managers consider the nature of each opportunity through its potential return stream, namely, income, growth potential or another factor. In the bottom-up assessment, the team researches the characteristics of the property, including lease terms, tenant quality, location and building specification, to forecast the return potential from the property. This often includes the potential for active management, including re-negotiating leases, changing tenant mixes and refurbishments, and the managers seek to add at least 1% per annum through such activity.

Portfolio Construction and Risk Controls

In line with their focus on income delivery, the managers use a Quarterly Income Report to help assess the risk inherent in the fund's income characteristics relative to the benchmark. This includes the lease expiry profile and the exposure by tenant and sector. The portfolio includes a permanent allocation to more liquid assets, notably cash, real estate investment trusts and derivatives related to the IPD UK All Property index, in part to help meet potential redemptions. They typically aim to hold at least 10% in liquid instruments.

*Note: The Legal & General Property Trust was converted into a property authorised investment fund (PAIF) in May 2014. Investors who are unable to participate in the PAIF can consider the Legal & General UK Property Feeder fund. Please refer to Legal & General for further information. The funds are exposed to the same underlying portfolio, but are subjected to different tax treatments.

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