# AEW UK REIT

**25 November 2024**

**Price**
93.8p

**TICKER**
AEWU

**Market Cap**
£148.6m

**NAV per share**
107.9p

**Dividend yield**
8.5%

**Discount to NAV**
13.4%

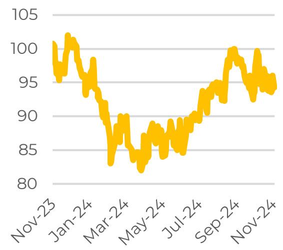
**Loan to GAV ratio**
25.0%

**3mo Av. Daily Volume**
348.9k

**Management group**
AEW UK Investment Management
Laura Elkin, Henry Butt

**AIC sector**
Property – UK Commercial

**Share Price Performance**




*Source: Bloomberg*

**AEWU aims for a combination of income and capital growth potential though investing in smaller commercial properties in the UK. Its value-orientated strategy and focus on asset management have fed into to a superior performance record both in absolute terms and versus peers.**

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Email the Analyst

## Active strategy continues to generate rewards

### Asset management driving NAV growth and a return to full dividend cover

**AEW UK REIT plc (AEWU) is a value-orientated UK real estate investment trust (REIT) with a focus on acquiring mispriced assets and maximising income and capital upside through asset management initiatives. Since our last update, a profitable disposal, new lettings, rental uplifts and lease renegotiations have helped to drive an NAV total return of 10.1% and bring EPRA earnings per share back to fully covering the 2p quarterly dividend, which has been maintained for 36 consecutive quarters since launch in 2015 and represents a dividend yield of 8.5% on the current share price.**

Managers Laura Elkin and Henry Butt, supported by the resources of AEW, invest in smaller properties, almost wholly (95%) outside London, in strong commercial locations but with low capital values versus peers. The result is a higher-than-average income (net initial yield of 8.09%), with capital growth potential through active asset management and the exploration of alternative use values. There are currently 32 properties in the portfolio, let to a total of 131 tenants. In recent months, AEWU has extended its record of successful exits, with the disposal of Oak Park in Droitwich bringing the total properties sold since launch to 19, at an average premium of 36% to their purchase price. The REIT has a five-year annualised property total return of 9.6% as at 30 June 2024. There have been no new purchases in the past six months, but asset management activity has driven new lettings, including a 25-year lease to a bowling alley and entertainment operator in Dewsbury at a c 70% premium to the vacant ERV per square foot. This suggests there is further upside potential to the portfolio's 30 September reversionary yield of 8.64%. AEWU's successful record is reflected in multiple award wins, including being named Citywire's best UK property fund (based on three-year NAV total returns) for five years in a row (2020-24), as well as recognition in similar awards from Investment Week (in both 2023 and 2024), Shares Magazine (2022) and the MSCI UK Property Investment Awards (winning in the listed property funds category for 2023).

AEWU's current c 13% discount to NAV – although narrower than a few months ago – remains substantially wider than its historical average (it began 2024 in the low single digits), suggesting a potentially favourable entry point for long-term investors given its consistent record of superior total returns versus peers.

| Bull points | Bear points |
|---|---|
| • Value-add strategy offers differentiation, with proven record of capital appreciation.<br>• Asset management activity driving earnings and positive NAV performance.<br>• High dividend yield of more than 8% (backed by NIY of 8.1%), moving back to full cover for the first time since the pandemic.<br>• Changes to residential property taxation could drive appetite for REIT investment as an alternative to buy-to-let. | • Shallower than expected path of interest rate cuts could continue to dent demand for commercial property versus other income-producing assets.<br>• Difficult economic backdrop for small businesses could lead to rising risk of tenant defaults.<br>• No guarantee that discount to NAV will swiftly revert to longer-term average. |

| At a Glance (Yr. to 31 March) | Net rental income (£m) | EPRA earnings (£m) | EPRA EPS (p) | NAV*/share (p) | Price/ NAV (x) | Yield (%) |
|---|---|---|---|---|---|---|
| FY24 | 13.03 | 11.55 | 7.29 | 102.73 | 0.84 | 9.32 |
| FY23 | 10.80 | 9.02 | 5.70 | 105.48 | 0.87 | 8.69 |
| FY22 | 10.18 | 10.76 | 6.79 | 120.10 | 1.00 | 6.68 |
| FY21 | 11.96 | 9.82 | 6.20 | 99.11 | 0.84 | 9.64 |

*EPRA net tangible assets (EPRA NTA) per share

## Contents

# Capital Access Group's view

**It's not how big it is – it's what you do with it that counts**

AEWU continues to offer a differentiated approach to UK commercial property investing, with an opportunistic, value-orientated approach and a relatively focused selection (32 properties and c 130 tenants) of smaller assets around the UK, chosen for their strong commercial locations, compelling value and opportunities for income and value enhancement through asset management. Rather than glitzy Central London office buildings, the portfolio includes exposure to a wide range of regions and sectors, from car parks to bowling alleys and industrial estates to out-of-town retail, together offering a net initial yield of 8.1% and a reversionary yield of more than 8.5%. The risk of individual tenant defaults is mitigated by the broad and diversified tenant base, rent collection has tended to be close to 100% (even during the pandemic) and the vacancy rate – with some level of voids seen as desirable in terms of achieving rental growth – is consistently less than 10%.

Although a relatively small REIT with total assets of c £215m, AEWU has built an impressive performance record, beating its AIC sector peer average for both NAV and share price total returns over one, three and five years, and convincingly outperforming its property total return benchmark, the MSCI/AREF UK PFI Balanced Funds Quarterly index, over all time periods. This has been achieved through a combination of strong asset and tenant selection, low purchase prices per square foot, and asset management to drive both income growth and profitable exits. A relatively high dividend yield of more than 8% is testament to a solid 8p per share annual dividend – paid quarterly at the same level since launch – rather than reflecting a wide discount to NAV, and recent quarters have shown the dividend moving back to full cover, after dipping between FY21 and FY23.

The REIT sector has had a tough couple of years as higher interest rates increased the attraction of 'risk-free' assets such as cash and bonds, and low transactional volumes limited price discovery, leading to declines in capital values. With the UK base rate once more on a downward trajectory just as higher government borrowing may perhaps limit the long-term appeal of gilts, UK commercial property funds might find favour once more, particularly with changes to residential stamp duty land tax (SDLT) and other taxes making buy-to-let investment less appealing. In such a scenario, we would argue that a differentiated portfolio with a strong performance record and a focus on both achieving and actively creating value could be a good fit for investors seeking exposure to a high-yielding strategy with potential for capital appreciation.

Furthermore, while we have seen interest rates cut twice so far in 2024, AEWU's May 2022 move to a fixed rate debt facility – maturing in 2027 and with an interest rate below 3% – still looks like a smart decision in the current environment with the Bank base rate at 4.75%. The team had acknowledged the macro indicators regarding interest rate exposure and took the decision to refinance some months ahead of the expiry of the previous facility. With a dedicated in-house debt team at AEW UK, AEWU's managers will continue to monitor the financing environment, although they note that as long as they can generate investment returns in excess of the cost of debt, it makes sense to operate with a prudent degree of leverage.

# Profile: Seeking and creating value

AEWU was launched in 2015 with the objective of delivering an attractive total return to shareholders from investing predominantly in a portfolio of smaller commercial properties in the UK. It follows a value investing approach, aiming to find properties that are attractively priced versus local comparators – usually with low capital values and low passing rents per square foot – and seeks to add value through asset management initiatives, boosting both rental income and the eventual sale price.

We consider AEWU's investment **process**, team and board ('**people**'), ESG parameters ('**planet**') and its **policies** on gearing, discount management and fees/charges in detail in our initiation note. In brief, however, the REIT seeks to achieve its investment aims by following a sector-agnostic, opportunistic approach to both purchases and sales, focusing on strong commercial locations with low levels of supply (which supports rents and helps to minimise void periods), and actively undertaking asset management on its portfolio of properties in order to maximise income and unlock capital upside.

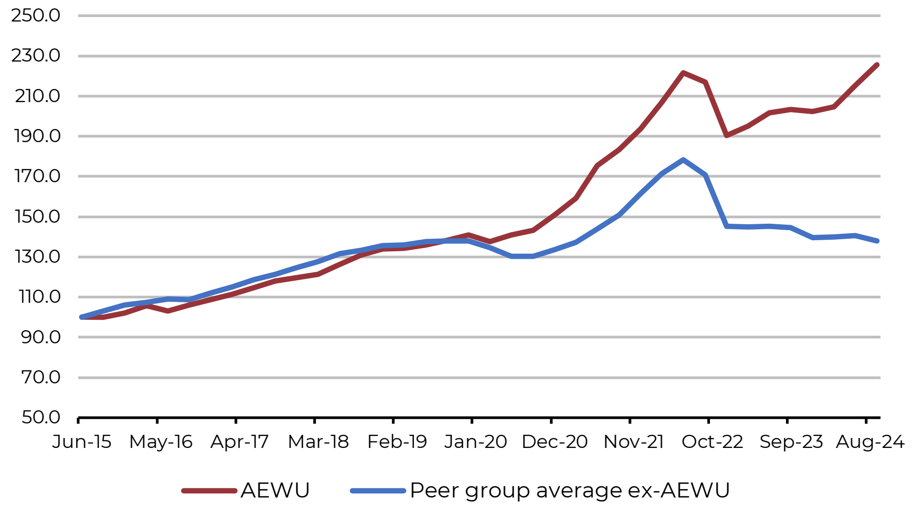
AEWU is externally managed by Laura Elkin and Henry Butt at AEW, one of the world's largest real estate asset managers, with €78.7bn of assets under management as at 30 June 2024. It uses the MSCI/AREF UK PFI Balanced Funds Quarterly index as a benchmark for its property total return performance. Dividends are paid at a rate of 2p per quarter and the current dividend yield (as at 21 November 2024) is 8.5%, the joint third highest in the nine-strong AIC peer group.

Since our initiation note, there has been one change to AEWU's board of directors: as previously announced, Mark Burton, who had been chairman since the REIT's IPO, stepped down at the AGM in September 2024 after nine years of service, and was succeeded on 1 October 2024 by Robin Archibald. With appointments in the previous 12 months having increased the number of directors to five on a temporary basis, we do not anticipate further changes to the now four-strong board in the near future.

# Performance: Proof positive

AEWU's value and income-orientated strategy has continued to drive solid returns, both in absolute terms and relative to peers in the AIC Property – UK Commercial sector and its benchmark, the MSCI/AREF UK PFI Balanced Funds Quarterly index. By avoiding highly valued super-prime locations and focusing on properties with low capital costs, high yields and opportunities to add value, it has produced NAV and share price total returns of c 67% and c 56% respectively over five years to 21 November 2024 (see Figures 2 and 3), and has also comfortably outperformed the AIC sector average over one and three years, in spite of an M&A-driven rerating among some sector peers' share prices in recent months.

**Figure 1: Cumulative NAV performance vs peers to 30 Sept 2024**




*Source: AEWU.*

Figure 1 shows AEWU's NAV total return performance versus its UK Diversified REIT peers (see Peer Group section for an explanation) from inception in 2015 until 30 September 2024 (with the caveat that some of the peers had not yet released 30 September NAVs at the time of writing). A gap initially opened up around five years from launch, as AEWU began to dispose of its first batch of assets and recycle the proceeds into higher-yielding opportunities. The outperformance has accelerated again in recent months, which the team says is testament to the success of its active asset management efforts in driving income growth, meaning the REIT has been able to grow its NAV base in a difficult time for the market.

Portfolio rental income has continued to increase as a result of asset management activity in recent quarters, with additional annual income of over £800k secured in the first half of FY25, a similar level to the new income added in the second half of FY24. While the MSCI benchmark saw negative capital performance across all sectors except industrials in the 12 months to 30 September 2024, the only sector to decline in value in AEWU's portfolio was offices (a weighted contribution of -0.5%). However, it is the combination of capital and income returns that has really driven AEWU's property performance versus its benchmark. The focus on attractively valued assets has limited downside in an environment of softer property pricing, while income exceeded the benchmark return in all sectors except offices (where AEWU still outperformed on a total return basis) over 12 months to 30 September. Retail warehouses have been a particularly strong contributor to performance in recent quarters. AEWU's property total return has outperformed the MSCI benchmark by more than 7pp over one year and on a five-year annualised basis, and by more than 6pp annualised over three and seven years.

**Figure 2: Cumulative NAV performance vs AIC sector to 21 Nov**

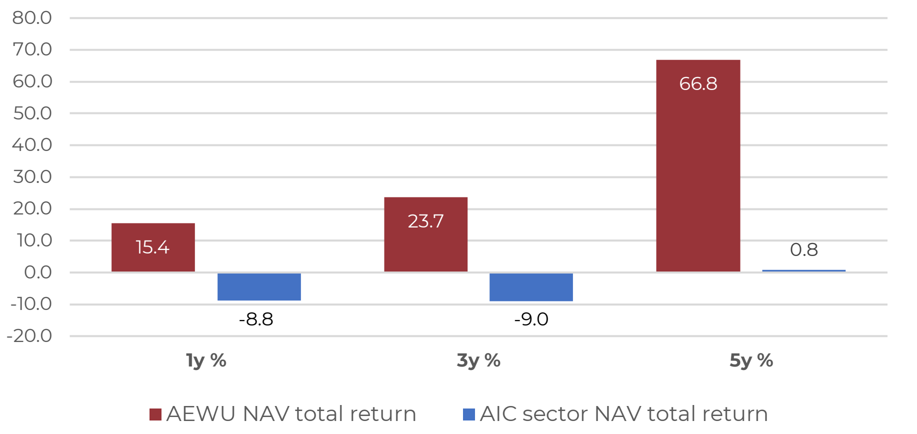
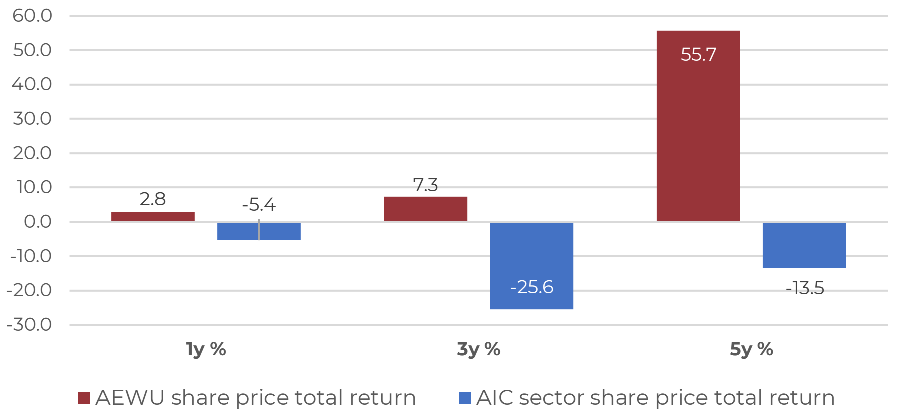


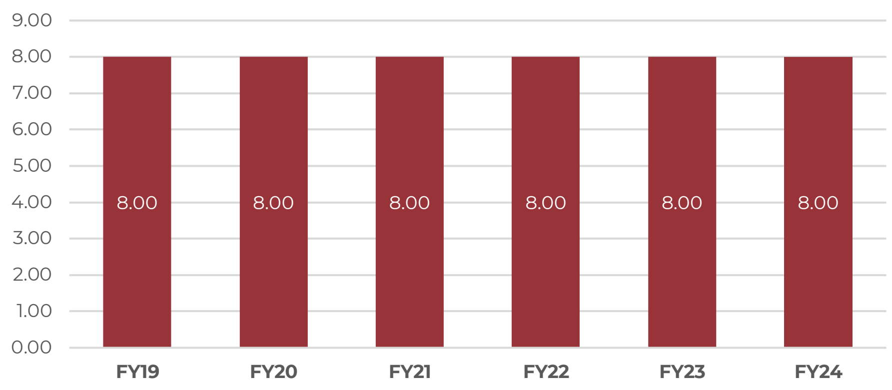

**Figure 3: Cumulative price performance vs AIC sector to 21 Nov**




*Source: AIC/Morningstar, CAG Research.*

**Dividends** are paid quarterly, in February, May/June, August and November/December, and have been maintained at a level of 2p per quarter (8p a year) since June 2016 – a record that now stretches for 36 consecutive quarters.

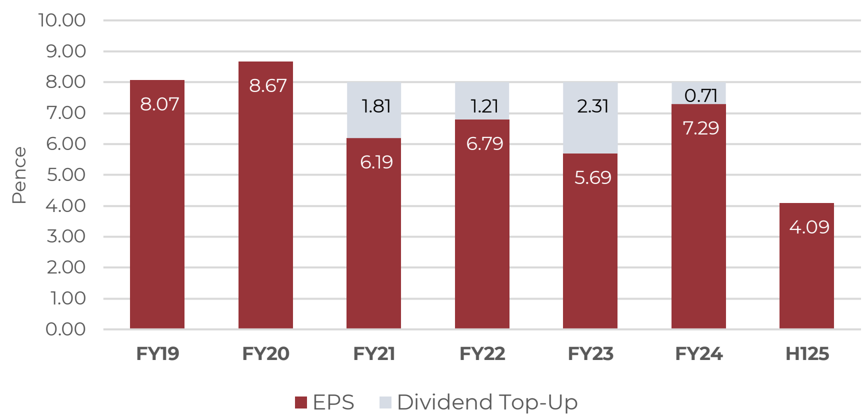
Figure 4: Dividends since FY19 (p): 5y CAGR 0.0% to end-FY24




*Source: AEWU, CAG Research.*

While many peers cut their dividend payouts during the Covid years, AEWU's total return approach worked to its advantage in this period, allowing the board to make small top-ups out of crystallised profits to keep the payout consistent (see Figure 5). Dividends have been somewhat uncovered by income in recent years (with the 8p annual dividend 68.4% covered by EPRA EPS in FY23, 75.1% in FY22 and 90.1% in FY21). However, the improving trend seen in FY24 (91.1% cover) has been carried into the first half of FY25: with underlying EPRA EPS of 4.09p (4.94p including the recognition of indemnity income), AEWU is on track for a fully covered dividend in the current financial year. There is a large distributable reserve that can be used to support the quarterly income payments if necessary. Based on the 8p annual dividend and the 21 November closing share price of 93.8p, AEWU has a forward and historic dividend yield of 8.5%.

Figure 5: EPS and dividend top-ups since FY19 (p)

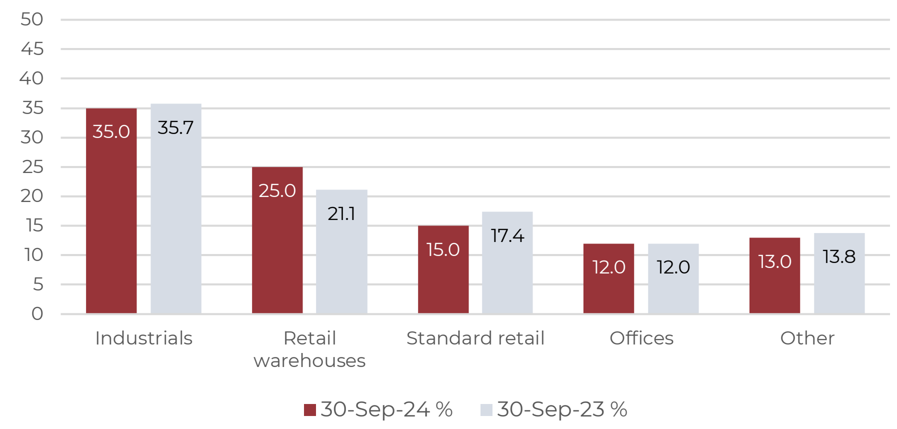



*Source: AEWU, CAG Research.*

## Portfolio: Asset management is king

At 30 September 2024, there were 32 properties in AEWU's portfolio, let to 131 tenants with a weighted average unexpired lease term (WAULT) of 4.5 years to break and 5.9 years to expiry. The vacancy rate is c 6.8% and across the portfolio the net initial yield is 8.09%, with a reversionary yield of 8.64%.

**Figure 6: Sector breakdown (% of portfolio at 31 September 2024)**




*Source: AEWU, CAG Research.*

While the strategy is sector-agnostic, the differing dynamics at play across the property market can mean that, for a value-conscious investor, better opportunities may arise in certain sectors at certain times. An example of this is the changing weightings of industrial and retail warehouse assets in the AEWU portfolio over the medium term. At the end of H121 (30 September), over half the portfolio by value (55.5%) was in industrial properties, with just over 7% in retail warehouses. However, as rising capital values (both at a market level and as a result of asset management initiatives) combined to make the yield on industrial properties less compelling, a series of profitable exits enabled a rotation into higher-yielding retail warehouse assets, where ongoing asset management and new lettings – such as at Central Six Retail Park in Coventry – have considerably boosted annual rental income. This has seen the proportion of the portfolio in retail warehouses rise to 25%, while industrial properties now stand at 35%. Looking ahead, the team continues to view potential holdings opportunistically, although assistant portfolio manager Henry Butt says that given an attractive combination of rental growth and the potential for capital appreciation as interest rates fall, there is scope for the industrial weighting to increase again if the right property with asset management potential comes along.

**Figure 7: Top 10 holdings (% of portfolio)**

| Name | Sector | Region | End-Sept 2024 | End-Sept 2023 |
|---|---|---|---|---|
| Central Six Retail Park, Coventry | Retail warehouses | West Midlands | 12.1 | 9.8 |
| Gresford Industrial Estate, Wrexham | Industrial (single let) | Wales | 6.1 | 5.4 |
| Northgate House, Bath | Mixed use (retail and offices) | South West | 5.9 | 5.9 |
| Cambridge House, Bath | Mixed use (offices and retail) | South West | 5.1 | 5.2 |
| London East Leisure Park, Dagenham | Other (leisure) | Rest of London | 5.1 | 4.6 |
| 40 Queens Square, Bristol | Offices | South West | 4.9 | 5.2 |

| Figure 7: Top 10 holdings (% of portfolio) | | | | |
|---|---|---|---|---|
| **Name** | **Sector** | **Region** | **End-Sept 2024** | **End-Sept 2023** |
| Tanner Row, York | Other (multi-storey car park) | Yorkshire & Humberside | 4.6 | 4.6 |
| Arrow Point Retail Park, Shrewsbury | Retail warehouses | West Midlands | 3.8 | 3.9 |
| Apollo Business Park, Basildon | Industrial (multi-let) | Eastern | 3.3 | 3.3 |
| Barnstaple Retail Park, Barnstaple | Retail warehouses | South West | 3.2 | N/A |
| **Top 10 (% of portfolio)** | | | **54.1** | **51.2** |

*Source: AEWU, CAG Research. Note: N/A where not in portfolio at end-September 2023.*

The largest asset in the portfolio is Central Six Retail Park, which we covered in detail in our initiation note. A series of new lettings to strong tenants earlier in the year has added markedly to annual rental income as well as bolstering capital values across the park, and as of Q2 2024, the site is now fully let, having been c 24% unoccupied at purchase in late 2021. The remainder of the top 10 properties are a diverse mix of office, industrial, retail and leisure assets, mirroring the sector diversification of the portfolio as a whole (see Figure 7).

| Figure 8: Regional breakdown of portfolio | | | | |
|---|---|---|---|---|
| **Region** | **End-Sept 2024** | **Change (pp)** | **Region** | **End-Sept 2023** |
| South West | 27.0 | +1.0 | South West | 26.0 |
| West Midlands | 20.0 | 0.0 | West Midlands | 20.0 |
| Yorkshire & Humberside | 16.0 | +1.0 | Yorkshire & Humberside | 15.0 |
| Eastern | 10.0 | 0.0 | Eastern | 10.0 |
| North West | 8.0 | -2.0 | North West | 10.0 |
| Wales | 7.0 | 0.0 | Wales | 7.0 |
| Rest of London | 5.0 | +1.0 | Rest of London | 4.0 |
| South East | 4.0 | -1.0 | South East | 5.0 |
| East Midlands | 2.0 | 0.0 | East Midlands | 2.0 |
| Scotland | 1.0 | 0.0 | Scotland | 1.0 |
| **Total** | **100** | | | **100** |

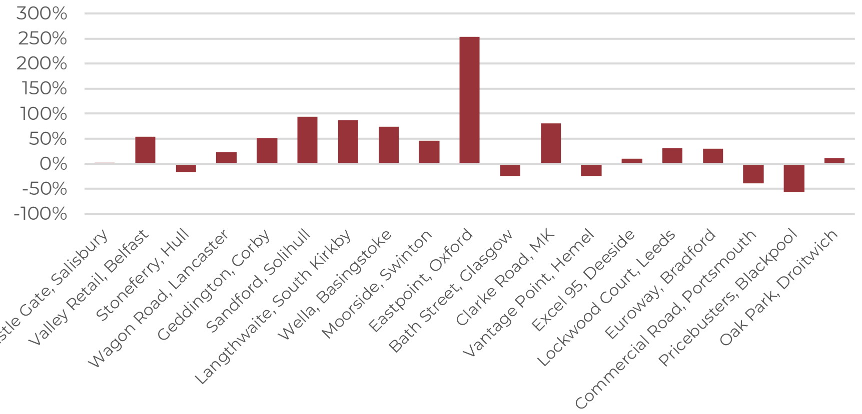
*Source: AEWU, CAG Research.*

As shown in Figure 8, the South West continues to be the top geographical location, boosted by the acquisition in recent years of well located city centre office and mixed-use assets in Bristol and Bath. The portfolio remains broadly diversified by geography, although in line with the managers' value-orientated approach, there is no exposure to central London, where capital values tend to be highest.

New purchase activity has been quiet in the past six months, with the AEWU team focusing on asset management at recently acquired assets, such as the refurbishment of offices in Bath and Bristol, as well as lease renegotiations, renewals and re-lettings at a number of properties. Major new lettings have included a bowling alley at a site previously used as a bingo venue, and a frozen food and grocery supermarket at a former Sports Direct store. In

Dewsbury, the ex-Mecca Bingo site is being redeveloped into a bowling and entertainment venue by leading operator Tenpin. The 25-year lease (with a tenant break option after 17.5 years) was completed in September at £13.59 per square foot, a significant uplift on the vacant ERV of £8, which Butt advances as proof that there is more potential uplift in the rental value of the portfolio than the 8.64% reversionary yield suggests. The letting will add annual income of over £375,000 (with five-yearly CPI-linked reviews), and, while AEWU has made a sizeable capital contribution of c £1.5m, Butt points out that the rent is towards the higher end for a leisure asset, and Tenpin is also investing a significant sum of its own money in developing the site for the long term. The former Sports Direct at Barnstaple Retail Park in Devon has been let to Farmfoods for 15 years at £13 per square foot (an ERV of £125,000 a year), with no tenant incentives other than a refurbishment of the exterior, the cost of which AEWU expects to recoup through dilapidations due from the former tenant.

**Figure 9: Average sale to purchase price premium of 36%**




*Source: AEWU*

One sale has been completed so far in FY25, with the disposal of the Oak Park multi-let industrial site in Droitwich. The asset was purchased for £30 per square foot and sold for £33 per square foot, a 33% premium to the March 2024 valuation. Having completed three new lettings, the property was fully let and, with further refurbishment work likely to be needed in the next two to three years, the AEWU team took the view that it was better to take the opportunity to sell out at a premium to the acquisition value and use the proceeds to fund further improvements elsewhere in the portfolio. Since launch, AEWU has now sold 19 properties at an average premium of 36% compared with their purchase price.

# Peer group: A solid showing

**Figure 10: AIC Property – UK Commercial peer group**

| Name | Total assets (£m) | Price TR 1y | Price TR 3y | Price TR 5y | Price TR 10y | Discount | Gearing | Dividend yield | 5y div growth (% pa) |
|---|---|---|---|---|---|---|---|---|---|
| **AEW UK REIT** | **231.1** | **2.8** | **7.3** | **55.7** | **N/A** | **-13.4** | **125** | **8.5** | **0.0** |
| abrdn Property Income Trust | 381.3 | 37.6 | -1.3 | -4.8 | 42.6 | -6.2 | 151 | 6.6 | -3.4 |
| *Alternative Income REIT* | *105.4* | *13.1* | *19.2* | *37.8* | *N/A* | *-14.1* | *157* | *8.5* | *1.4* |
| Custodian Property Income REIT | 608.2 | -4.3 | 0.4 | -7.9 | 32.5 | -18.8 | 138 | 7.7 | -3.4 |
| *Life Science REIT* | *375.5* | *-38.7* | *-56.7* | *N/A* | *N/A* | *-49.8* | *137* | *5.2* | *N/A* |
| Regional REIT | 777.2 | -53.2 | -80.3 | -80.6 | N/A | -49.2 | 191 | 47.0 | -8.2 |
| Schroder Real Estate | 471.8 | 26.4 | 22.8 | 23.9 | 44.5 | -20.2 | 144 | 6.4 | 5.6 |
| *Supermarket Income REIT* | *1,702.9* | *-8.9* | *-29.3* | *-12.3* | *N/A* | *-23.2* | *139* | *8.9* | *1.5* |
| *Value & Indexed Property Income* | *144.1* | *11.2* | *-7.1* | *-3.0* | *17.9* | *-13.2* | *155* | *6.9* | *2.3* |
| **Sector average*** | **533.1** | **-5.4** | **-25.6** | **-13.5** | **37.0** | **-23.1** | **151** | **11.2** | **-1.1** |
| **AEWU rank in sector** | **7** | **5** | **3** | **1** | **N/A** | **3** | **9** | **3=** | **5** |

*Source: AIC/Morningstar, at 21 November 2024. All % unless stated. *Size-weighted averages.*

AEWU is a member of the Association of Investment Companies' Property – UK Commercial sector, a peer group of funds that invest in UK commercial property but do not specialise in the three subsectors of the market – logistics, healthcare and residential – that have their own AIC peer groups. This leads to a grouping where some funds are generalists but some are specialists in other areas. In Figure 10 above we have included all the members of the AIC peer group (excluding Channel Islands Property Fund, for which very limited data is available). However, it is worth noting that AEWU uses a reduced group of 'UK Diversified REITs' for its own comparison purposes; this list excludes the four italicised funds in the above table, all of which have some kind of specialism, such as concentrating on a particular sector, or having a focus on inflation linkage.

While it ranks comfortably first in the peer group for NAV total returns over one, three and five years to 30 September 2024, a high level of M&A activity in the REIT sector and a partial rerating for some peers that had been trading on wider discounts have dented AEWU's share price total return in relative terms over the past 12 months, pushing it into fifth place. (The top-ranked REIT as at 21 November, Aberdeen Property Income Trust, is the subject of a cash bid at a substantial premium to its pre-bid share price, while Balanced Commercial Property Trust, which previously ranked first, was delisted from the London Stock Exchange on 18 November on the completion of a similarly premium-priced takeover.) However, it ranks third and first respectively over three and five years, reflecting its superior NAV performance and narrower discount to NAV. While the current discount is wider than its long-term average, it is still towards the narrower end of the peer group. Gearing (based on loan to gross asset value) is the lowest in the sector. Meanwhile, the dividend yield remains one of the highest in the group, with the 2p quarterly dividend moving back to full cover in recent quarters.

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