

UK PROPERTY TRUST.

MATT JARVIS

Webcast Summary, 26 July 2011

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Webcast highlights

- Active management of properties aids returns. The UK Property Trust is actively purchasing, with several deals in the pipeline.
- The UK commercial property market is slow but there's growing optimism and stronger signs of a recovery, expected in 2012/2013.
- The outlook for offices remains strong and the sub-sector is expected to fare better than retail.

Acquisitions and active property management are key themes in the £565 million Legal & General UK Property Trust helping it to outperform the average fund within its bricks and mortar peer group over one, three and five years to 30 June 2011*.

*Source: Lipper and Investment Property Databank (IPD).

Matt Jarvis, co-manager of the fund, said its cash weighting remains high and he is looking to deploy it when he can. The market has been flat and trendless so far this year, making it difficult to find opportunities. That said, he does have a number of deals in the pipeline and expects to complete at least half a dozen before the year is out.

So far this year, capital growth in the direct UK commercial property market has been marginal, typically just 0.1% month-on-month. Rental growth has also been stagnant, leaving property gains to be derived from existing income streams. Matt commented that while that doesn't paint the rosiest of pictures, it does indicate greater stability with no strong signals on the market in either direction.

Matt said: "At the beginning of 2011 people were expecting it to be a year with negative capital growth. That sentiment seems to have reversed. We've seen in the Investment Property Databank (IPD) how capital growth has remained stubbornly positive and that appears to be a pattern which is likely to continue for the rest of the year."

Rent from existing tenants is providing a consistent income stream for property portfolios. According to the IPD, the initial yield on the direct property within the Legal & General UK Property Trust is currently 6.6%. This is exclusive of fees, cash, real estate investment trusts (REITs) and derivatives.

Matt attributed some of the growing optimism in the market to the inaction of banks. Fears have centred on if and when banks would release their property stock, potentially flooding the market and lowering values. However, banks have found other ways to reduce their property exposures, selling on the loans themselves rather than the physical holdings. As a result, the exposure banks have to direct property is falling as a proportion of their loan books. Consequently, this has reduced fears of a flood of assets entering the market, Matt added. However, while that large risk may have subsided slightly, other issues such as Basel III, a new global regulatory standard on bank capital adequacy and liquidity, means new availability of finance will still remain challenging.

Within commercial property, Matt is most positive on the office sub-sector and has concerns over retail, which looks weaker. With the consumer struggling, there have been a number of retail casualties affecting supply and limiting performance. Industrial units are seeing vacancy rates come down but questions remain as to the sustainability of that trend, he noted.

One key investment idea within the fund at the moment is a heightened exposure to long duration, RPI-linked leases due to their ability to off-set risks. The growing scarcity of such leases also makes this an attractive area. Matt said:

"The traditional thought that inflation can be hedged very well with property will start to break down because lease lengths in general are shrinking. As such you are likely to encounter more voids and void costs. With that you may not necessarily be able to peg against real-price growth as easily as you could with a long let, RPI-linked lease."

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Emphasis on the active management of the properties themselves has and continues to be at the core of the UK Property Trust, with the managers working hard to create more returns from existing holdings. Actions such as conversions, refits and general lease and asset management have also aided the portfolio in keeping its void rate low. The fund currently has a vacancy rate of just 2.4% compared to the IPD index average rate of 9.7%.

While Matt sees the low void rate in the portfolio as a significant positive, he noted it had risen slightly in recent months. This has mostly been the result of normal leases expiring and the fund losing a tenant for two properties when Focus DIY went into administration earlier this year. While such actions have the potential to hurt the portfolio, strong asset management can help mitigate the effects and potentially generate even greater returns.

On a number of other occasions, the Legal & General Property team have renegotiated longer leases, restructured tenants or have undertaken refurbishment to improve overall capital values.

Matt also commented that sustainability is a growing area for the team: “We believe making improvements, like increasing the energy efficiency of properties, not only helps raise the income profile of properties but can add capital value. It can also cut running costs, reduce depreciation and in the long term that should mean higher rents.”

The yield aspect and low volatility of property funds make them attractive choices for investors right now. Although 12-month performance has favoured equity-based property funds, he noted the Legal & General UK Property Trust has the ability to invest some of its cash weightings into REITs, which it did at the start of the year. This has boosted performance in the fund over the past year. Over three and five years to 30 June 2011 the fund has also fared well, beating the IPD Monthly benchmark over both time frames.

In terms of regions, Matt favours London but doesn't focus on just one area, believing the entire UK commercial property offers opportunities if examined carefully:

“London is the powerhouse that will drive recovery but we feel commercial property investing is more than just investing in a region. One of the strengths of the Legal & General UK Property Trust is that we do not write off parts of the country just because they appear to be lagging. We try to understand the micro markets and if things are priced correctly, we'll be interested.”

Going forwards, Matt believes the fund is well placed to reap the rewards of a strengthening market and to leverage from the expertise of Legal & General's Property team. As a result he expects to complete further acquisitions in order to bring down the fund's cash position.

To hear a recording of the Legal & General UK Property Trust webcast on 26 July 2011, [click here](#), or visit www.landginvestments.com/events

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