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11 July 2016

Drum Income Plus REIT

They say good things come in small packages

DRUM Income Plus REIT (DRIP) is focused on acquiring properties that do not suit the portfolios of the large institutional and overseas buyers, who are targeting larger lot sizes. Its managers say that, by focusing on a less crowded market, DRIP is able to achieve a yield advantage over other property investment companies. DRIP is itself small, but has ambitions to grow and further diversify its shareholder base and portfolio. The managers have identified a pipeline of potential investments and they say that DRIP should be able to expand gradually without cash drag having much impact on returns.

Secondary assets in good regional locations

DRIP invests in a portfolio of regional commercial property assets, principally in the office, retail and industrial sectors, with the aim of providing investors with an attractive level of income whilst also delivering annual capital growth. It is targeting lot sizes between £2m and £15m and looks for second tier property assets in what the managers consider to be good, but not necessarily prime locations. The managers believe that such assets offer marked yield advantages over primary assets in prime locations, but still allow them to make acquisitions with the same level of covenant protection and sufficient liquidity, so that these assets will not be hard to sell. This would appear to be a key differentiator for DRIP versus its peers.

As discussed on page 5, DRIP is also focused on multi-let assets and the managers are seeking properties where they can add value through asset management initiatives. DRIP has a long-term gearing target of 40% of gross assets.

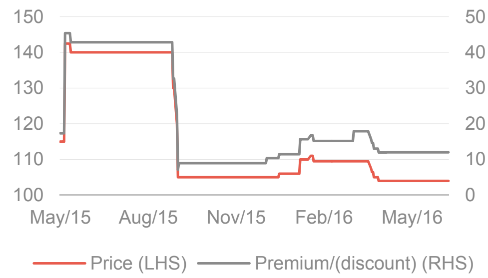
Year ended	Share price total return (%)	NAV total return (%)	FTSE ALL UK Prop. total return (%)	S&P UK REIT Index total return (%)
31/05/16	6.6	(3.9)	5.5	(7.0)

Source: Morningstar, Bloomberg, Marten & Co

Sector	REITs
Ticker	DRIP LN
Base currency	GBP
Price	104.0
NAV	92.9
Premium/(discount)	11.9%
Yield	5.1%

Share price & premium/(disc.)

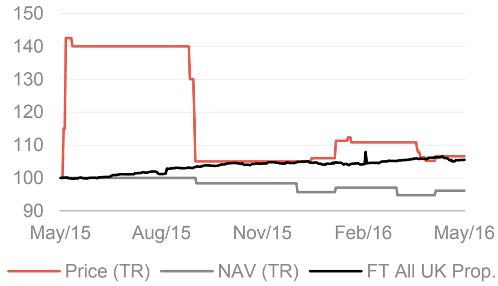
Time period 29/05/15 to 08/07/2016



Source: Morningstar, Marten & Co

Performance since inception

Time period 29/05/15 to 31/05/16



Source: Morningstar, Bloomberg, Marten & Co

Domicile	United Kingdom
Inception date	29 May 2015
Manager	Bryan Sherriff
Market cap (GBP)	36.0m
Shares outstanding	34.635m
Daily vol. (1-yr avg.)	234 shares
Net gearing	34.6%

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Fund profile

Smaller, multi-let assets with the potential for asset management initiatives

You can find out more about the fund at www.dripreit.co.uk

Drum Income Plus REIT (DRIP) is focused on: smaller lot sizes than those that suit the portfolios of institutional and overseas investors; second tier assets in what the managers believe are good locations; and multi-let assets, as these are often overlooked by other property investors and, all things being equal, should provide the company with greater diversification within its rental income stream.

In addition, the managers say that they are looking for properties that offer them the potential to add value by implementing asset management initiatives. Such initiatives come in a variety of forms. For example, when a lease expires, there may be the opportunity to renegotiate better terms, as the market is now tighter than when many leases were originally signed; modest refurbishment of communal areas and amenities can facilitate rental increases and yield improvements; and reconfiguring spaces to increase the rentable area and make them more desirable for current usage can also lead to yield improvements.

It should be noted that, whilst the managers are looking, over time, to construct a portfolio that is diversified by sector, geography and tenant mix, they say that the way in which the portfolio develops will be driven primarily by where they see the strongest opportunities at any given time, as they work to expand the portfolio.

A new REIT

DRIP listed in May 2015, raising £31.9m excluding costs.

DRIP listed on the London Stock Exchange on 29 May 2015. Its initial public offering (IPO) raised £31.9m before issuance costs. The costs associated with listing the company were capped at 2% of the gross issue proceeds with Drum Real Estate Investment Management Limited (DREIM, the manager – see page 6) paying the balance. Other launch expenses reduced the initial NAV to 97.7p. The normal one-off costs associated with the purchase of the portfolio, notably stamp duty, reduced the NAV by a further 6.8p.

DRIP's initial issue proceeds were deployed by February 2016 and a second primary issue was undertaken.

Because DRIP is permitted to borrow and is targeting long-term gearing of 40% of gross assets, its initial fund raise of £31.9m (approximately £31.2m after issuance costs and other initial expenses) gave it the ability to invest in a portfolio with gross assets of approximately £51.9m (ignoring the costs associated with acquiring its property portfolio). With the purchase of DRIP's seventh asset, Arthur House in Manchester, in February 2016, DREIM had effectively invested all of DRIP's initial issue proceeds. Reflecting this, DRIP initiated its next phase of fundraising, which has so far seen DRIP raise gross proceeds of £2.7m.

DRIP's managers believe that the current NAV should be an all-time low.

To undertake the second fundraising, DRIP has incurred the costs of producing the associated prospectus, which has impacted DRIP's NAV. However, the prospectus is valid for 12 months from 25 February 2016 and so DRIP should be able to undertake further fundraisings, during this period, at a low additional cost. Reflecting the balance of all of the costs of bringing DRIP to market, DREIM believes that DRIP's NAV is at an all-time low and should grow steadily from here. Despite all of the above-mentioned costs, a 1.3p per share gain on the valuation of the portfolio meant that the NAV as at 31 March 2016 was 92.9p.

Large, supportive shareholders

DRIP has what the managers describe as two long-term supportive shareholders in the form of TCAM Asset Management (TCAM) and Drum Property Group. Through seven of its funds, TCAM holds over 86% of DRIP, whilst Drum Property Group, the parent company of the investment manager, DREIM, also holds over 6% of the fund.

TCAM Asset Management is a majority shareholder but is keen to see its holding diluted.

TCAM acted as a cornerstone investor to allow DRIP to be established. The managers have advised that TCAM was motivated by the investment opportunity that DRIP seeks to exploit but, having previously held significant property investments in private funds, they also wanted the advantages offered by a listed vehicle. The managers say that, whilst TCAM is happy to maintain and possibly increase its absolute holding in DRIP, it is very keen to see the fund grow so that the size of its relative stake falls. Drum Property Group says that it was keen to align its interests with those of other shareholders.

DRUM Property Group and Drum Real Estate Investment Management are both privately owned by their management teams.

A strong desire to grow

DRIP's board and managers say that they are firmly committed to growing the company, with the aims of improving liquidity, lowering average costs and further diversifying the portfolio and share register.

DRIP's managers say that they did not want to begin the process of expanding the fund until they had invested the initial proceeds. However, they believe that everything is now in place for the company to grow. Their aims in expanding the fund are that it should dilute the holdings of the founder shareholders, improve the liquidity in DRIP's shares, reduce DRIP's average costs (by spreading its fixed costs over a larger asset base) and, by purchasing additional properties, further diversifying DRIP's portfolio and its income stream. They believe that all of these goals should be to the benefit of DRIP's shareholders and that increases in its size and liquidity should make it more attractive to potential investors. The managers have indicated that DRIP's gross assets could be a substantial multiple of its current size without negatively affecting their ability to follow its strategy. As discussed on page 12, the managers believe that they can comfortably deploy £10m of new funding per month (a mix of both debt and equity).

Potential to grow from stock or asset swap

One way by which DRIP could grow is by exchanging shares in DRIP in return for either acquiring a property, or for acquiring shares in a company that owns a property. Whilst by no means exhaustive, Appendix 2 on pages 31 and 32 of this note includes some details that are worthy of consideration in this regard. The managers say that whilst these are potential paths to expansion, any properties would still need to meet their investment criteria and pricing would continue to be key.

The DREIM team

As discussed on page 21, DRIP's Alternative Investment Fund Manager (AIFM) is R&H Fund Services (Jersey) Limited. The AIFM has delegated the day-to-day management of the portfolio to DREIM, which is a subsidiary of Drum Property Group.

More information on Drum Property Group and its key people can be found at www.drumpropertygroup.com

Drum Property Group was established by Graeme Bone in 2004. Its principal activities are property development and investment management, the latter of which is conducted through its subsidiary, DREIM. Bryan Sherriff is the investment director for DREIM. He has over 20 years of experience in commercial property, across all sectors, and has acted for a range of institutional investors. According to DREIM, the majority of its efforts are dedicated to managing DRIP's portfolio. More information on Drum

Property Group's development activities can be found at the company's website. Drum Property Group says that these currently have an end value in excess of £1bn.

The UK property market

The not-so-squeezed middle

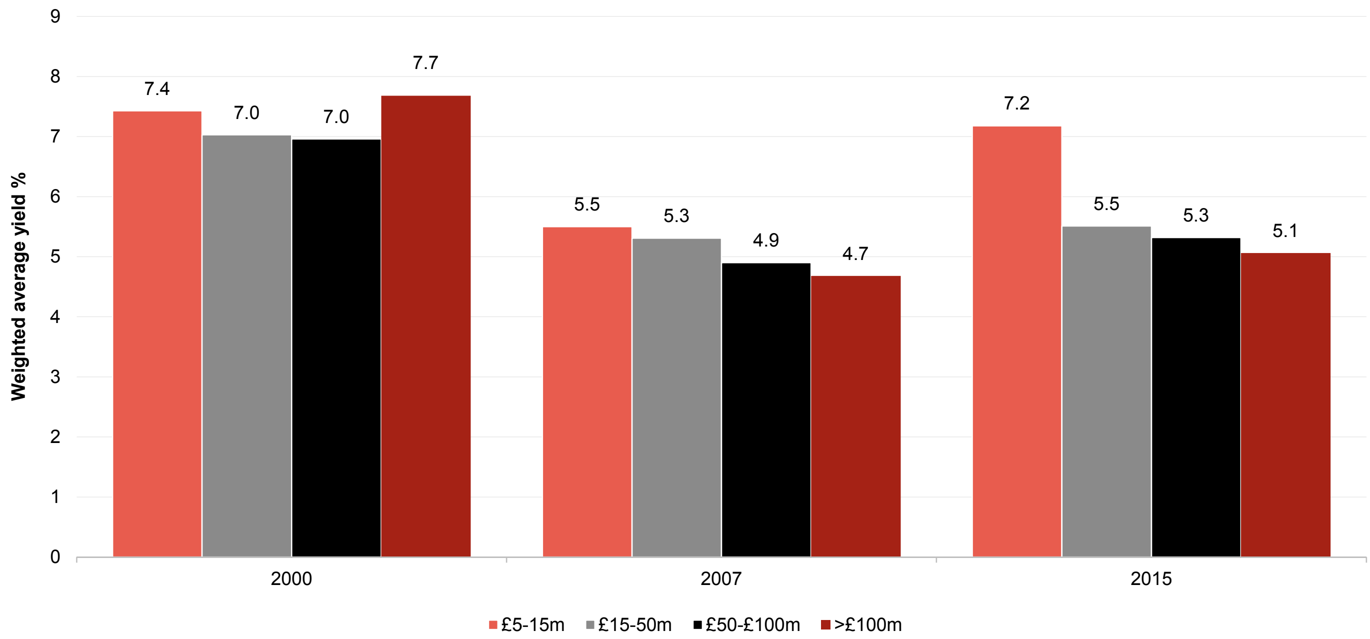
DRIP is focused on properties valued between £2m and £15m. Properties in this bracket tend to fall below the radar of most institutional investors as, for the large property funds, such investments would not be large enough to make a meaningful contribution to the fund's return.

DRIP's managers are focusing on lot sizes in the £2m to £15m segment, where they see a favourable balance between supply and demand for acquirers.

At the other end of the spectrum, DRIP's managers say that individual property investors and developers are struggling to get the levels of borrowing that they were previously able to during the credit bubble. The consequence of this, in DREIM's view, is that it restricts the size of property these smaller investors can target, making the £2m to £15m bracket harder for these smaller investors to participate in. DRIP's managers say that the knock on effect of this is that there is less competition for the types of property assets that DRIP seeks to acquire, which means that, relative to rental income, they can be acquired at lower prices which means higher rental yields and higher returns for investors in DRIP. At the same time, DRIP offers a convenient way for individuals to get access to this part of the property market and, as it expands, also offers diversification benefits for institutions.

Figure 1 shows how average yields have changed for various lot sizes of offices since 2000. The £5m to £15m band of properties offers significantly higher yields than larger lot sizes. Also, in 2015 this yield differential was much more pronounced than it was in earlier years.

Figure 1: Weighted average yield (%) by lot size, for whole of market, over time



Source: Savills

An improving UK macroeconomic environment, coupled with limited new supply, is driving rental growth

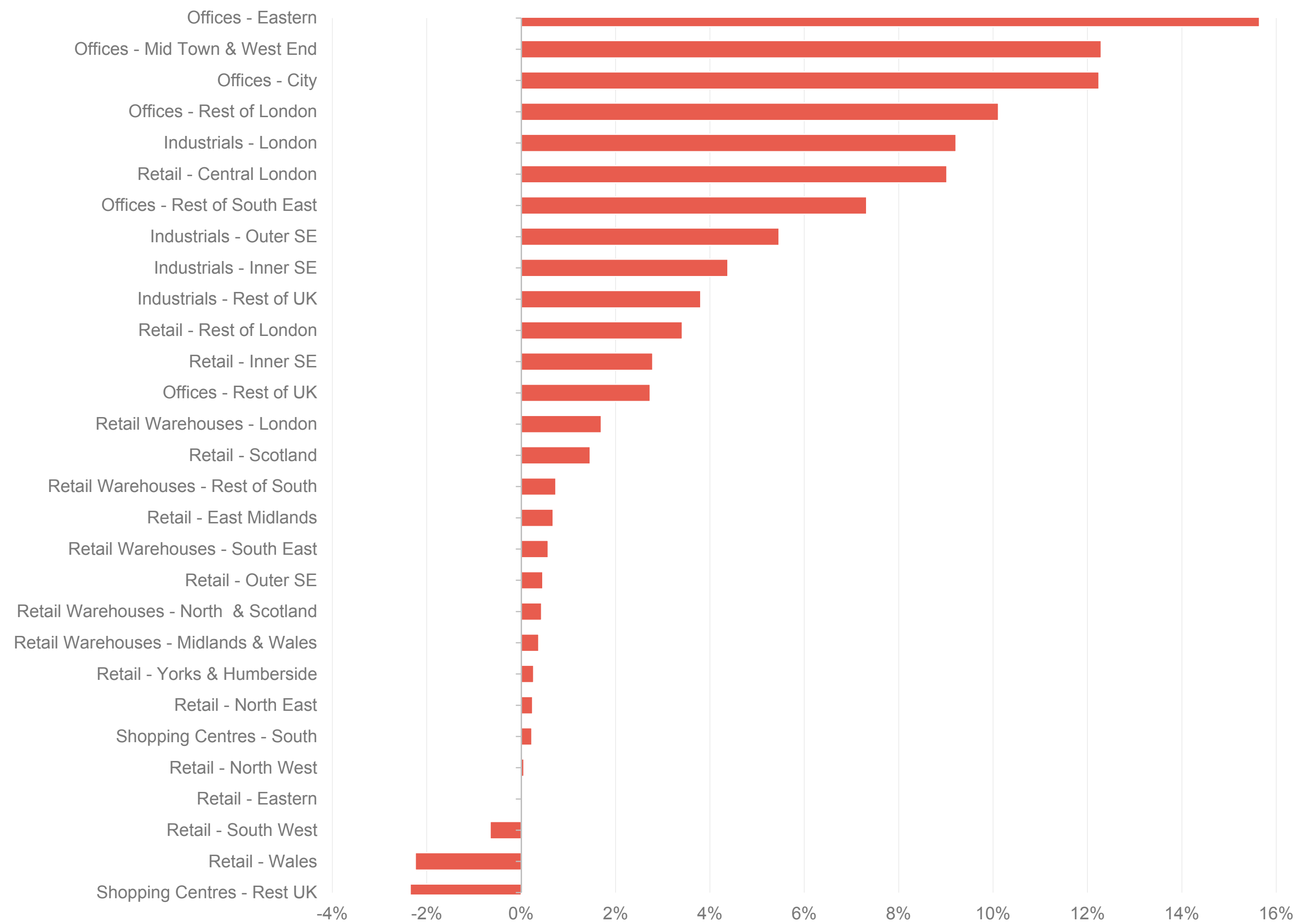
Bryan Sherriff believes that the combination of a lack of new supply of properties in the markets that DRIP targets, persistently low interest rates, relatively low unemployment, low inflation, real wage growth and improving business and consumer confidence are all supportive of positive returns from property of the types and in the locations favoured by DREIM for DRIP's portfolio.

Of all of these influences, Bryan thinks that the lack of new supply (very little commercial property has been built in regional locations since 2008) may be the most significant at the moment. He says that a lack of supply has led to low vacancy rates and, given the lead time in developing new assets and bringing them to market, he believes this provides the prospect of rent increases.

In 2015, rental growth was highest in the office market.

Figure 2 shows how average rents moved over the course of 2015 for various property sectors. Rental growth was fastest in the office market, but industrial property rental growth was also strong, while retail property in most locations lagged the wider property market.

Figure 2: Change in rental values, by property type and geography, over 2015 (%)



Source: Savills

Looking beyond London and the South East

Drum Income Plus REIT's focus away from London and the South East has been benefitting from a broadening of the UK economic recovery. Economic consultancy, Oxford Economics, says that employment growth was recorded across the UK in 2015 (except for Wales) and consumer spending picked up too with the south-western and eastern parts of the UK outstripping Greater London.

Figure 3: Selected UK prime rents and yields at end Q1 2016

Type / location	Q1 rental growth on Q4 2015 (%)	Q1 rents compared to Q1 2015 (%)	Rental growth over 5 years (%)	Actual yield (%)
Shops – South East	0.00	(0.62)	(0.94)	5.66
Shops – Rest of UK*	0.43	1.95	(1.48)	6.31
Shopping centres – London, South East and Eastern	0.57	4.19	2.83	4.39
Shopping centres – Rest of UK*	0.49	1.47	1.11	4.78
Retail warehouses – London, South East and Eastern	1.47	2.39	(0.42)	5.24
Retail warehouses – Rest of UK*	0.00	(0.86)	(0.58)	5.51
Offices – West End	1.16	3.87	6.82	4.18
Offices – City	4.65	10.73	6.40	4.17
Offices – South East	1.11	8.52	3.75	6.39
Offices – Rest of UK*	1.21	2.59	1.38	7.01
Industrial – South East	3.29	8.93	2.96	5.98
Industrial – Rest of UK*	0.22	2.15	1.41	6.67

Source: CBRE *Note: Excluding London, South East and Eastern.

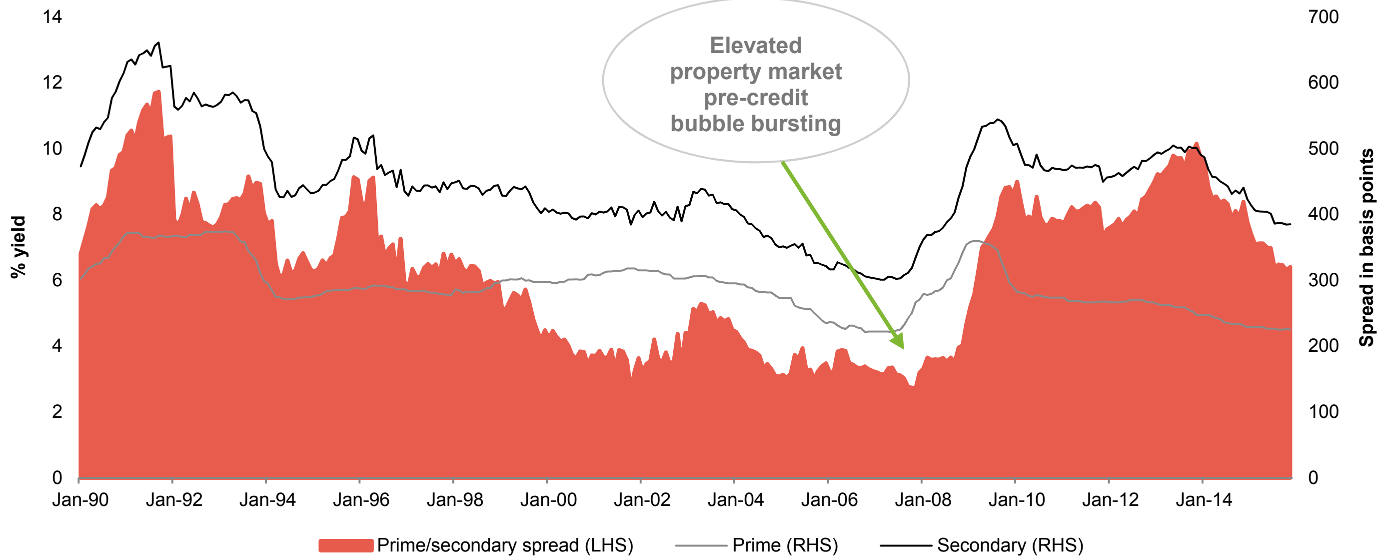
Interest rates, Brexit and yield spreads

The possibility of higher interest rates in the UK was previously a concern for DRIP but, for now, given the weakness in the global economy caused by the slowdown in China, coupled with economic and political difficulties in the wake of the EU referendum, UK rate rises look like a relatively distant prospect. The managers think that, in any case, there is a sufficient yield gap between yields on UK gilts and property yields, especially yields on properties favoured by DRIP, with the result that modest rate rises would not have a significant impact on the valuation of DRIP's portfolio.

At the time of writing, the major concern in property markets is the impact of the UK's vote to leave the EU. It is far too early to tell the wider ramifications but, for now, the UK remains part of the EU and business is continuing as usual although there are reports that some investment decisions are being put on hold. It seems reasonable to us that this could have the greatest impact on the areas of the market that have been most buoyed by overseas buyers – large-ticket, London-centric commercial property and London residential property. A slump in the UK's economic activity has been widely predicted and this could affect the demand for commercial property but this doesn't look to be an immediate concern. However, should there be a noticeable slump, this in itself should reduce any pressure to raise interest rates, provided that inflation remains under control.

Persistent low interest rates and a growing economy have attracted overseas buyers for UK property and have helped increase allocations to the asset class from domestic investors. This in turn put pressure on prime yields to the point where, in many sectors, they were lower than in 2007 (before the financial crisis) prior to the UK's referendum on EU membership. Figure 4 shows prime and secondary yields, as calculated by Savills, from 1990 until November 2015. At the end of April 2016, Savills said that eight of the prime sectors they track had yields at or below their 2007 peak levels.

Figure 4: Prime/secondary yield spread



Source: Savills

The effect of yield compression was most pronounced in London although the managers had observed that the phenomenon was having an impact on some regional markets as UK institutions went in search of higher yields (NB they are still focusing on larger lot sizes). It would therefore seem reasonable that the prospect of capital loss and yield expansion is likely to be less in the regions.

This is illustrated in Figure 4, which shows that secondary yields did not contract to the same extent as prime yields. The shaded area represents the spread between secondary yields and prime yields. At the end of 2015 this was well above peak levels and in line with long-term averages.

At the turn of the year many commentators and investors were saying that they expected the pace of yield compression to ease off or stop altogether, but they thought future returns would be derived from income and the broad trend was one of rental increases. Despite the current economic and political challenges, the managers agree with this assessment and believe high single digit returns can be achieved for DRIP's portfolio over the next 12 months.

DRIP's closed-end structure means that, unlike open-ended property funds, it is not vulnerable to becoming a forced seller of illiquid property to fund redemptions.

The property market does seem to have stalled in 2016, with the blame initially being attributed to the hiatus created by the EU referendum and latterly from the decision for the UK to leave the EU and concerns over what the effects of this decision will be. This in turn has been triggering outflows from open-ended property funds. In response, many managers have suspended redemptions on these funds as their cash reserves (which act as a drag on returns in the good times) dwindle. If this continues, open-ended funds could become forced sellers of property. Fortunately, this is a problem that does not affect closed-ended funds like DRIP.

Importantly for DRIP, the managers believe that its target markets seem to have been much less affected by the flow of money into the sector and so should be less affected if the tide now turns. The general softening of UK property markets might actually be a benefit, though, as DRIP invests the proceeds of new issues of shares. Figure 5 shows money flows into the commercial property sector over the past 15 years.

Figure 5: Money invested in UK property market since 2000

Source: Savills

Investment process

DRIP is targeting lot sizes of £2m to £15m across all sectors of the commercial property market, going where the managers believe that the best opportunities are available. The focus is on acquiring what the managers consider to be well-located property in regional markets where they believe the fundamentals of supply and demand are favourable, for the reasons discussed above. While the managers factor macroeconomic conditions into their assessment of property markets, the investment process is driven by "stock selection". By focusing on good locations, the managers are selecting property which they believe will be in demand throughout the economic cycle and would not be unduly difficult to sell, even in an economic downturn. However, they believe they are avoiding the yield compression that is being seen in primary locations.

In addition to selecting properties that the managers think can benefit from asset management initiatives (see below) the managers may also target properties that they believe are mispriced. This could be attributed to relatively short lease lengths at the time of acquisition or relatively high levels of voids. The managers are also attracted to properties with multiple occupancy. This usually offers greater income security, but can create additional work and this might put off some buyers.

Network-driven origination

The managers' proprietary network and credible reputation for completing transactions supports a strong flow of investment opportunities.

In terms of sourcing opportunities for the portfolio, the managers say that the commercial property market is highly relationship driven and that, with over 20 years of commercial property experience personally, Bryan Sherriff, and the wider DREIM team, are very well networked into the space. They tell us that, crucially, Bryan and the team have relationships with all the major commercial regional estate agents and that they have a credible reputation for completing deals, which gives them a competitive advantage over other potentially less well-known purchasers. They say that estate agents now understand their requirements well (size of deal, location and property type, yield requirements, etc.) and, reflecting the fact that agents can earn in the region of £50k in fees (based on DRIP's average lot size) for a successfully completed transaction, the team continually sees a strong flow of opportunities. Reflecting this, Bryan Sherriff firmly believes that DRIP could comfortably invest £10m in property transactions a month (£6m of equity and £4m of debt using the target long-term debt ratio) equivalent to £120m per year (£72m equity £48m in debt) for good assets that meet their investment criteria. DREIM says that, the strong flow of opportunities allows them to be very selective when choosing assets for DRIP's portfolio.

Due diligence

Having identified a potential asset for DRIP's portfolio, DREIM then conducts detailed due diligence to ensure it meets their investment objectives and requirements. This will include an analysis of such things as the income streams from the individual tenancies, current market rents, the dynamics driving local property demand and supply, current and potential yields, time to expiration or break clauses and individual contract terms. To pass beyond the due diligence phase, properties must meet a number of these quality criteria and, reflecting the emphasis placed on income, they must also meet, or be able to meet, DRIP's yield requirements. The managers will also be looking to ensure that portfolio candidates offer them a range of potential asset management initiatives which will allow them to increase rents.

Based on this analysis, the managers will build an individual business case for each potential asset. This is presented to the board, which challenges it and, based on internal discussions, the case is refined. Assuming that an asset passes this stage, negotiations can begin in earnest, with the usual surveys and searches completed. DREIM says that this process usually takes in the region of six to seven weeks.

Portfolio construction

DREIM's long-term aim is to build a portfolio that is diversified by sector, geography and tenant mix, but evolution is driven by the strength of opportunities.

DREIM's aim is to build a portfolio for DRIP that is diversified by sector, geography and tenant mix over time. However, the managers say that they do not follow this mantra rigidly and will look to add investments to DRIP's portfolio based on where they see the strongest opportunities to earn returns. These opportunities are likely to change as the underlying markets evolve over time and this is likely to be reflected in the way DRIP's own portfolio evolves. For example, as discussed on page 14, DRIP has a large allocation to retail and office properties, but is yet to make an allocation to industrial properties.

Arthur House, Piccadilly, Manchester - a case study in property selection and asset management initiatives

DRIP's most recent acquisition is Arthur House, a multi-let office building, with six lettable floors and undercroft parking, located on Chorlton Street, in Piccadilly, Manchester. The building, which has a city centre location, was designed by the architects Cruickshank and Seward and built around 1963. Pictures of the exterior of Arthur House, as well as pictures of its reception and images of proposed improvements are available in Figures 25 to 32 of the Appendix on pages 28 and 29.

DRIP purchased the 25,500 square foot, freehold property, in February 2016 from Christopher Dee Property Investment for £4.41m (£4.68m including acquisition costs). The property had been marketed as a "refurbishment/repositioning opportunity", with a net contracted rent of £280k per annum after inclusive costs (this being £11 per square foot as an average), a net initial yield of 6% and a low capital value of £173 per square foot. DRIP purchased the property at an acquisition yield of 8.9%

DREIM's analysis suggested a number of attributes that made the property desirable.

- Location – in DREIM's view, Arthur House has a desirable city centre location, in the Portland Street Corridor, which should support demand for its space. The office building is close to the city's professional business and financial hub, which is home to many insurance, banking, legal, financial, media and government organisations. It is also well serviced by transport links, being in close proximity to the train station, Manchester Piccadilly, and the bus and Metrolink stations. The building is also located close to the centre's shopping district, with access to a range of other amenities.
- Mispricing – DREIM felt that a number of factors were weighing heavily on the building's valuation. At the time of acquisition, the building was in need of refurbishment, which coupled with vacancies, the complications of its heavily multi-let status (23 professional services firms spread across six floors), a low weighted average unexpired lease term (WAULT) and the fact that the building has operated in a cash-constrained environment for a number of years, had served to depress its value so that, in DREIM's view, the asking price suggested a yield that did not reflect the income that could be achieved from the property. However, the managers believe that, with an improving economic backdrop, its locale will be less cash constrained going forward and other initiatives can be used to improve the building's desirability with potential tenants.
- Attractive features - in addition to lettable car park spaces located in the city centre, Arthur House has a range of features that would make it desirable to potential tenants in DREIM's view. For example, lifts to all floors, suspended ceilings (incorporating LG7 lighting) and Disability & Discrimination Act (DDA) compliance. The property also benefitted from moderate tenant retention.
- Asset management opportunities – the managers saw a number of potential opportunities to improve net rental income from the property. Specifically these include:
  - Conducting essential repair works to common parts to reduce ongoing landlord irrecoverable costs
  - Carrying out refurbishment of common parts to create what the managers describe as a "sense of arrival" (see Figures 28, 30 and 32 on pages 28 and 29).
  - Carrying out refurbishment works to the building to create a modern feel
  - Reducing the circulation areas within the building, by converting these to lettable areas. For example, by reducing the number of tenants within the building (an average of 3.8 tenants per floor) and letting out a smaller number of larger areas, the size of communal areas on each floor, which do not earn rental income, can be reduced thereby increasing the property's yield
  - Changing lease terms from IRI (internal repairing and insuring) to FRI (full repairing and insuring). Under FRI leases, the landlord has no repairing or

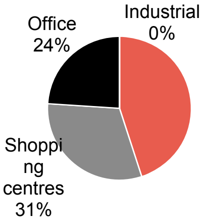
insuring liability and so this should increase the burden of cost on the building's tenants.

  – Reconfigure current all-inclusive rental packages. The managers say that tenants currently pay an all-inclusive package of rent, rates, service charge and insurance fixed costs that is low compared to the local market and that there is good scope to reconfigure these packages and increase net rental income.

- A strong upcoming pipeline of lease events (breaks and expirations) reflected in the building's WAULT of 1.3 years at the time of acquisition. The managers say that this should allow them to quickly increase rents to reflect the improvements in the building.

Asset allocation

Figure 6: Portfolio allocation by property type



Source: Drum Income Plus REIT

DRIP owns seven properties spread across the UK with a bias away from London and the South East. According to DREIM, the properties were acquired on yields between 7.3% and 9.3%. Each of the property values falls within DRIP's target £2m to £15m range. As at 31 March 2016, the portfolio had 76 tenants (an average of 10.9 per asset), a WAULT of 5.92 years, 96% occupancy and an acquisition yield of 7.9%. It has a loan-to-value ratio of 27.3%, which is below its 40% target level, but the managers say that they have an attractive pipeline of opportunities, which will lead to the company being fully invested in due course. As illustrated in Figure 6, which shows the portfolio split according to property type, DRIP has a 45% allocation to retail properties, 31% allocation to shopping centres, 24% allocation to office properties and a zero allocation to industrial properties. However, within this allocation, DRIP has 76 tenants across its seven properties, which the manager say provides DRIP with considerable diversification within its tenant base.

Figure 7: Portfolio, values as at 31 March 2016

	Location	Type	Actual rent £'000	Estimated rent £'000	Acquisition yield %	Market value £m
Gosforth Shopping Centre	Newcastle	Shopping centre	949	1,004	7.3	12.6
Monteith House	Glasgow	Offices	465	461	7.6	5.9
Lakeside 5500	Manchester	Offices	453	453	7.8	5.3
Eastern Avenue	Gloucester	Retail	472	389	8.4	5.3
Duloch Park	Dunfermline	Retail	357	363	7.4	4.5
Arthur House	Manchester	Offices	417	461	8.9	4.4
Mayflower House	Gateshead	Offices	257	259	9.3	2.6

Source: Drum Income Plus REIT

As DRIP grows, the concentration in its rent roll should reduce. Further details on all portfolio properties, including some commentary of the rationale behind their purchases is included in Appendix 1 on pages 23 to 30.

As illustrated in Figure 7, which shows the 10 largest tenants in terms of annual contracted rent, there is a degree of concentration, with the top four tenants accounting for 36.7% of the current rent roll. The top 10 tenants account for 57.8% of the current rent roll, with the remaining 66 tenants accounting for the balance of 42.2%. However, if it is assumed that DRIP continues on its path of expansion, as it intends, whilst continuing to target smaller lot sizes in the same range, all things being equal, the concentration in DRIP's rent roll should reduce. Within the current list of major tenants are many well-known companies (Sainsbury's, Staples, Worldpay, Maplin Electronics and WHSmith) and two government agencies – the Scottish Network 1 & Tourist Board (Visit Scotland) and The Skills Development Scotland Company (Skills Development Scotland). Further details on each of the properties in Figure 7 can be found in Appendix

1 on pages 23 to 30. DRIP's portfolio is valued by an independent third party on a quarterly basis.

Figure 8: Top 10 tenants as at 31 March 2016

Tenant	Property	Contracted gross annual rent £'000	% of portfolio contracted gross annual rent	Next lease break/ expiry
Sainsbury's	Gosforth SC	386	11.5	10/04/32
Staples UK	Eastern Avenue	315	9.3	24/03/24
Agilent Technologies LDA UK	Lakeside 5500	299	8.9	24/03/22
Scottish Network & Tourist Board	Monteith House	235	7.0	26/01/21
Worldpay	Mayflower House	158	4.7	11/03/20
Micron Europe	Lakeside 5500	153	4.6	24/03/17
The Skills Development Scotland Co	Monteith House	126	3.8	23/07/18
LS Buchanan	Monteith House	104	3.1	19/01/17
Maplin Electronics	Eastern Avenue	87	2.6	27/03/21
WHSmith	Gosforth SC	79	2.3	28/01/16
Total		**1,942**	**57.8**	

Source: Drum Income Plus REIT

Following the letting of three units at Gosforth Shopping Centre, DREIM says that DRIP's portfolio has 96% occupancy.

In terms of portfolio development the managers say that, geographically, they believe the portfolio would benefit from the addition of an asset in the Midlands and they are investigating a number of potential candidates. In terms of property type, the portfolio is yet to purchase an industrial property. The managers say that they intend to diversify the property mix and are keen to add some industrial properties in due course. However, the managers say that the industrial underweight may persist in the near term, as this is not where they are currently seeing the strongest opportunities, and they prefer to take a more entrepreneurial view and invest where they see the most attractive valuations.

Performance

DRIP has been listed on the main market of the LSE for just over a year but, in terms of analysing its performance, it is still very early days for the company. There are reasons why DRIP's first year of listing may not be representative of the sort of NAV development that it should experience in the future. As discussed on page 5, the initial costs of bringing DRIP to market saw it open with an NAV of 97.7p (a 2.3% reduction over its issue price). Furthermore, the issue proceeds took time to invest. DRIP announced its first purchases in October 2015 and then, following further purchases, announced that it had effectively reached full investment in January 2016. During this period, DRIP earned interest on its uninvested cash, but this is lower than the returns it would expect to earn on its property investments (an average yield of 7.5% on the current portfolio before expenses and the potential benefits of asset management initiatives). Reflecting this, it has only recently started to pay its quarterly dividends, which inevitably weighs against its total return performance when compared against the broader market (see Figure 9 below for illustration). There are also the one-off transactional costs associated with purchasing the portfolio of properties (mostly stamp duty), which cost 6.8p per share (6.8% of the issue price) and, whilst this is likely to remain a feature, as DRIP grows in size, it will not apply over the entire portfolio as it has done it this first year and so its impact should be less marked.

Figure 9: Cumulative total return performance to 31 May 2016

Heading	1 month (%)	3 months (%)	6 months (%)	1 year (%)
DRIP NAV	1.4	(1.0)	(2.3)	(3.9)
DRIP share price	1.3	(3.8)	1.5	6.6
FTSE All UK Property	(0.6)	1.2	1.0	5.5
S&P UK REIT	1.7	9.1	(6.5)	(7.0)

Source: Morningstar, Bloomberg, Marten & Co

Dividend

Dividend policy

DRIP pays quarterly dividends in equal instalments.

DRIP's dividend policy is to pay quarterly dividends, in equal instalments, in February, May, August and November of each year. All of these are paid as interim dividends. As discussed below, to meet the obligations required to maintain its REIT status, DRIP is required to pay out at least 90% of its tax-exempt profit, from property rental, to shareholders each year.

Revenue generation

Now that it is fully invested, DRIP's managers expect that the overwhelming majority of DRIP's income will be derived from property rentals. Reflecting its strong focus on generating income, DREIM says that DRIP's property development activities are expected to be relatively limited (DREIM points out that vacant properties that are under development do not generate income and instead incur void costs – for example rates and insurance, etc.). With the exception of Arthur House, DRIP's leases are fully insured and repairing. This should reduce the scope for voids due to significant damage and the requirement for significant capital expenditure to maintain the capital value of existing assets.

Of DRIP's leases, 11% are indexed against RPI, which, voids aside, should help to preserve their real value and all of the leases have upward only rent reviews. In the case of Arthur House, the managers intend to move the leases to an FRI basis (see pages 13 and 14).

Expense allocation

In terms of expense allocation, the primary cost DRIP incurs in relation to its property portfolio is the asset management fee, which is charged wholly to its revenue account. Other expenses (director's fees, fees in relation to the administration and secretarial agreement, legal fees, marketing costs, annual listing costs, brokerage costs, audit fees, registrar fees) are also charged to the revenue account. The analysis below assumes that these fixed expenses are in the region of £380k per annum on an ongoing basis.

Income sensitivity analysis

As at 31 March 2016 DRIP has a total passing rent of £3.37m per annum (after rent guarantees) and, going forward, it is assumed that annual fixed costs are in the region of £380k. Based on gross assets as at 31 March 2016 of £44.0m (i.e. based on DRIP's current portfolio of assets) and assuming DRIP is operating at its target gearing level of 40% of net assets, this suggests target net assets of £26.4m with DRIP incurring an estimated annual management fee of £370k (1.15% of net assets up to £150m). However, DREIM has committed to reduce its management fees to the extent necessary to keep DRIP's fixed costs to less than 2% of its net assets.

Imposing this cap suggests that DRIP incurs an actual management fee in the region of £263k (the effect of the cap being a reduction in management in the region of £107k) and that DRIP's rental income, less its fixed costs and management fee is £2.73m. Using the current three-month Libor rate (0.71788%) and assuming that DRIP borrowings levels are at its long-term target of 40% (it is worth noting that DRIP's gearing is currently below this long-term target – see page 21) DRIP's annual interest cost is estimated to be £320k, leaving DRIP with net distributable property income of £2.41m (6.95p per share or a minimum of 6.25p assuming a minimum 90% distribution). Based on the current share price of 104.0p per share, this is equivalent to a yield of 6.7%.

Taking the above base case scenario, an analysis of the sensitivity of DRIP's distributable property income to changes in rental income, fixed costs, Libor rate and size of gross assets (through equity and debt issuance) has been conducted. The results are presented in Figures 10, 11 and 12. An illustration of the sensitivity of DRIP's distributable property income to changes in fixed costs has not been included. This is because the cap on management fees (to keep costs to less than 2% of NAV – see page 21) implies that, at the company's current size, increases/decreases in fixed costs are matched one for one with decreases/increases in the management fee with no overall impact on distributable income. However, this analysis suggests that the portfolio would have to grow by approximately 70%, assuming it maintains its target gearing level of 40%, for DREIM to receive the management fee in full without it being capped.

Looking at Figure 10, it can be seen that, on the basis of this analysis, DRIP's portfolio would appear to be well-positioned to meet its current dividend obligations once it has reached a steady state and that its targets for the year ended 30 September 2016, 2017 and 2018 would seem to be readily achievable (please see below for details of DRIP's dividend targets). This analysis also suggests that if DRIP is able to achieve modest increases in passing rent from the portfolio, there could be scope for dividend payments beyond those it is targeting. In terms of threats to DRIP's dividend, rental voids are an obvious risk. Voids are problematic as not only is rental income not received, the owner is still required to pay the ongoing costs such as business rates, insurance, etc. However, this analysis suggests that DRIP could suffer a fall of some 8% in passing rent (inclusive of void costs) and still meet its 2016 target, whilst retaining a maximum 10% of rental income.

Figure 10: Sensitivity of revenue per share estimates and minimum dividend per share to changes in passing rent

Passing rent (change)	-10%	-5%	-3%	-1%	0%	+1%	+3%	+5%	+10%
Passing rent (£m)	3.03	3.20	3.27	3.34	3.37	3.40	3.47	3.54	3.71
Fixed costs (£m)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)
Management fee (£m)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)
Interest expense (£m)	(0.32)	(0.32)	(0.32)	(0.32)	(0.32)	(0.32)	(0.32)	(0.32)	(0.32)
Distributable prop. inc.	2.07	2.24	2.31	2.37	2.41	2.44	2.51	2.58	2.74
Revenue per share	5.98	6.46	6.66	6.85	6.95	7.05	7.24	7.43	7.92
Min. dividend per share	5.38	5.82	5.99	6.17	6.25	6.34	6.52	6.69	7.13

Source: Drum Income Plus REIT, Marten & Co.

Figure 11 suggests that DRIP's profitability is sensitive to the Libor rate. However, based on the assumptions discussed above, the analysis suggests that modest increases in the Libor rate should not prevent DRIP from achieving its stated targets.

Figure 11: Sensitivity of revenue per share estimates and minimum dividend per share to changes in Libor rate

Libor rate changes (percent point change)	-0.5%	-0.25%	0%	+0.25%	+0.5%	+1.0%	+2.0%	+3.0%	+4.5%
Passing rent (£m)	3.37	3.37	3.37	3.37	3.37	3.37	3.37	3.37	3.37
Fixed costs (£m)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)
Management fee (£m)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)	(0.26)
Interest expense (£m)	(0.23)	(0.28)	(0.32)	(0.36)	(0.41)	(0.50)	(0.67)	(0.85)	(1.11)
Distributable prop. inc.	2.49	2.45	2.41	2.36	2.32	2.23	2.05	1.88	1.61
Revenue per share	7.20	7.08	6.95	6.82	6.69	6.44	5.93	5.42	4.66
Min. dividend per share	6.48	6.37	6.25	6.14	6.02	5.80	5.34	4.88	4.19

Source: Drum Income Plus REIT, Marten & Co.

Figure 12 provides an illustration of the impact of portfolio growth (on revenue and minimum dividend per share assuming that 1) DRIP is financed at its long-term target rate of 60% equity and 40% debt, 2) DRIP is able to make further investments which earn an average yield equal to that of its existing portfolio (7.5%), 3) fixed costs are in the region of £380k per annum and 4) interest is charged at the current three-month Libor rate of 0.71788%. It should be noted however that, in reality, should DRIP's gross assets grow as intended, it will take time to deploy the funds and so DRIP will likely operate above and below its borrowing target, which will inevitably cause its returns to differ from these estimates, amongst other estimation errors. However, the analysis suggests that growth in gross assets is accretive to all shareholders' revenue income. This analysis also suggests that DRIP could suffer a contraction in gross asset of 10% and still meet its dividend targets (this assumes that DRIP reduces both debt and equity and maintains its target ratio).

Figure 12: Sensitivity of revenue per share estimates and minimum dividend per share to changes in gross assets

Passing rent (change)	-10%	-5%	0%	+5%	+10%	+50%	+100%	+250%	+500%
Gross assets (£m)	39.6	41.8	44.0	46.2	48.4	66.0	88.0	154	264
Passing rent (£m)	2.97	3.14	3.30	3.47	3.63	4.95	6.60	11.55	19.8
Fixed costs (£m)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)	(0.38)
Management fee (£m)	(0.09)	(0.12)	(0.15)	(0.17)	(0.20)	(0.41)	(0.61)	(1.06)	(1.81)
Interest expense (£m)	(0.29)	(0.30)	(0.32)	(0.34)	(0.35)	(0.48)	(0.64)	(1.12)	(1.92)
Distributable prop. inc.	2.21	2.33	2.45	2.57	2.70	3.68	4.97	8.58	14.71
Revenue per share	6.90	6.99	7.08	7.16	7.24	7.69	8.03	8.53	8.83
Min. dividend per share	6.21	6.29	6.37	6.44	6.51	6.92	7.23	7.68	7.95

Source: Drum Income Plus REIT, Marten & Co.

Dividend history and dividend targets

At its launch, the board's expectation was that, once fully invested, DRIP would pay an annualised dividend of 5p per ordinary share but, in reality, the company has been performing ahead of this initial target. The company paid its first quarterly dividend in February 2016 of 1.3125p per share, which was followed in May with a second dividend of equal size. The company says that, in the absence of unforeseen circumstances, it intends to pay third and fourth quarterly dividends at the same level, which gives an annualised dividend for the year ending 30 September 2016 of 5.25p per share.

Furthermore, DRIP's board says that it is targeting fully covered aggregate quarterly dividends of at least 5.5 pence per share in respect of the year ending 30 September 2017 and at least 6.0 pence per share in respect of the year ending 30 September 2018.

DRIP's REIT status means that its income and capital gains are both exempt from UK taxation at the REIT level. At least 90% of tax-exempt property rental income must be distributed to shareholders each year.

Tax considerations for REIT dividends

The following summary is only intended to provide an overview of tax considerations in relation to REIT distributions. It should not be considered as comprehensive, adequate for making decisions or as a substitution for professional tax advice.

As a UK-domiciled real estate investment trust (REIT) DRIP's income and capital gains are both exempt from UK taxation at the company level, provided that it continues to meet the criteria to qualify as a UK REIT (which DRIP's board says it has every intention of continuing to do so). The REIT rules affect the distributions a REIT can make to shareholders. Specifically, UK REITS are required to distribute at least 90% of their tax-exempt property rental income to shareholders each year. This is referred to as a property income distribution (PID). A UK REIT is also permitted to distribute taxed income from other activities. This is commonly referred to as a non-property income distribution (non-PID). Distributions can be any combination of PID or non-PID and the tax treatment of the two differs.

When distributed to tax-paying shareholders, PIDs are treated as property letting income and, whilst they are treated separately from any other property letting income, they may be fully taxable. Such PIDs are normally paid net of a 20% withholding tax (UK income tax basic rate) although these are some exceptions to this – for example charities, local authorities, managers of some savings schemes (e.g. PEPs, ISAs and Child Trust Funds), UK companies and UK pension schemes may be able to claim an exemption and receive gross PID dividends.

Non-PID dividends are treated in the same way as dividends received from other non-REIT UK companies.

Premium/discount

As illustrated in Figure 13, DRIP has consistently traded at a premium since its launch in May 2015. DRIP's premium rating may, in part, reflects the fact that it has a number of features that might make it attractive to investors seeking income, particularly in the current low interest-rate environment. Most notably DRIP offers a high yield, with smooth regular payments, which is backed by assets that should offer a strong degree of inflation protection as well as a smooth and predictable underlying income stream.

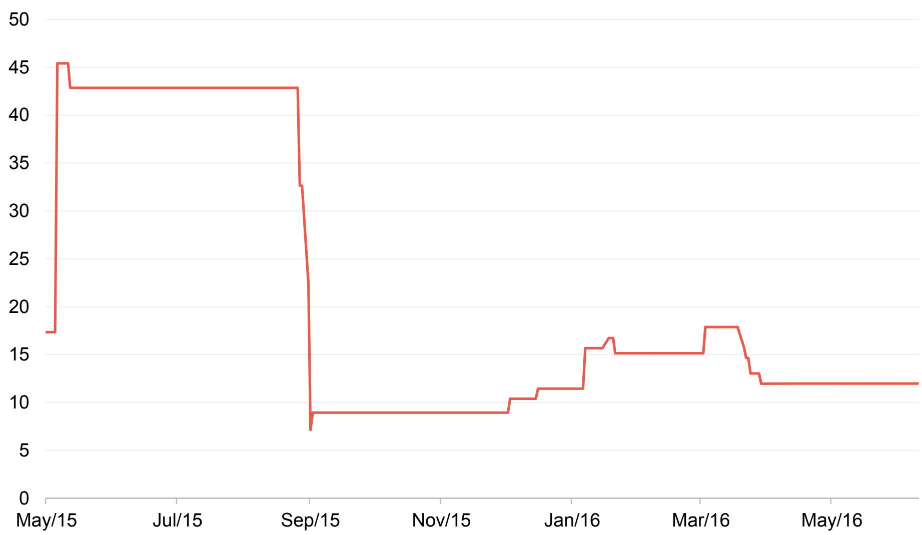
However, as also illustrated in Figure 13, DRIP's premium has been subject to sharp movements, which may reflects the current limited liquidity in its ordinary shares. As discussed on page 6, this is a challenge that the board and managers are firmly committed to overcoming by growing the company. Assuming that they are successful in this regard, this should provide a number of benefits to shareholders and make it more attractive to investors. As such, whilst this is likely to stimulate further demand for DRIP's shares, the increased size might actually make it easier for the company to issue further stock to satisfy increasing demand and help the company to moderate the premium.

In terms of downside risks, an event that had a significant negative impact on DRIP's ability to meet its dividend expectations, such as a significant void in its portfolio, could potentially undermine confidence and reduce its attractiveness. However, as discussed on page 14, DRIP has a highly diversified tenant base, which all things being equal, should help to mitigate this risk.

It would also seem reasonable that moves towards interest rate normalisation could see a reduction in demand for DRIP shares (rising interest rates traditionally being negative for equities as fixed income becomes more attractive). However, the manager believes a significant interest rate rise is unlikely in the near term, especially while the UK economy remains subdued. Were that situation to change, while DRIP's leases have upward only rental reviews (with an increasing proportion being indexed against RPI) the manager thinks improving economic activity would likely bode well for both rising capital values in its portfolio as well as improved prospects to increase rents at the margin.

A further consideration is DRIP's 96% occupancy level. All things being equal, an increase in occupancy should increase DRIP's income, making it more attractive to investors and stimulate demand for DRIP's shares. NAV would be relatively insensitive to such changes and so the discount would likely narrow or a premium could increase. On the downside, the reverse also applies and so a deterioration in occupancy could lead to a discount widening or a premium reduction.

Figure 13: Premium/(discount) since launch (%)



Source: Morningstar, Marten & Co

Fees and costs

Management arrangements

Although DRIP's management arrangements might first appear to be a little complex, they are actually quite straightforward and now commonplace for UK investment companies. DRIP is required to appoint an Alternative Investment Fund Manager (AIFM) and, under the terms of an AIFM agreement between DRIP and R&H Fund Services (Jersey) Limited, the latter has been appointed as DRIP's AIFM. Under this agreement, R&H Fund Services (Jersey) Limited is responsible for overall portfolio management and ensuring compliance with the company's investment policy. However, under the terms of an asset management agreement between R&H Fund Services (Jersey) Limited and DREIM, the latter is responsible for the management of DRIP's portfolio. Specifically, it advises on the acquisition, management and disposal of DRIP's real estate assets. These management arrangements are terminable on 12 months' notice by either side.

AIFM and asset management fees

Under the terms of these agreements, DRIP pays its AIFM a fixed fee of £15k per annum plus an annual portfolio management fee of 1.15% of its net assets up to £150m, falling to 1% of its net assets thereafter. The AIFM then pays an annual portfolio management fee to the asset manager (1.15% of its net assets up to £150m, falling to 1% of its net assets thereafter, so that the AIFM effectively receives £15k net). DRIP's management arrangements do not include a performance fee element. Furthermore, the asset manager has agreed to reduce its portfolio management fee to the extent required to ensure that the annual expenses of the company do not exceed 2.0% of its net assets.

Administration and company secretarial fees

Administration and secretarial services are provided to the company by R&H Fund Services for a fixed fee of £75k per annum plus 0.05% of the company's total asset in excess of £100m. The variable element of the fee is capped at £90k per annum, so that the total fee is capped at £160k. The administration and secretarial agreement can be terminated at six months' notice by either side.

Capping management fees

As discussed above and on page 17, the asset manager has agreed to reduce its fees to the extent necessary so that the company's costs do not exceed 2% of net assets. The analysis discussed on page 18, and illustrated in Figure 12, suggests that DRIP needs to grow to its gross assets by approximately 70%, assuming it maintains its target gearing level of 40%, for the asset manager to receive its management fee in full, uncapped. By way of an example, DRIP currently had gross assets of £44.0m and net asset of £32.2m as at 31 March 2016. DRIP's management fee is 1.15% of net assets up to £150m which suggests an annual fee, prior to capping, of £370k. The analysis assumes that DRIP's fixed annual expenses are in the region of £380k, which suggests a combined cost for management and fixed expenses of £750k. However, the terms of the cap (2% of net assets) implies a maximum of £640k for DRIP's fixed annual expenses and management fee combined with DRIP's management fee being reduced by £107k to £263k (this being equivalent to 0.82% of net assets or 0.6% of gross assets).

Capital structure and life

DRIP has one class of ordinary share in issue. These have a premium main market listing on the London Stock Exchange.

DRIP has a simple capital structure with one class of ordinary share in issue. Its shares have a premium main market listing on the London Stock Exchange. DRIP is also permitted to borrow and has a £20m 18-month revolving credit facility, with the Royal Bank of Scotland, for this purpose. DRIP's articles of association limit its borrowings to 50% of gross assets at the time of investment. However, DRIP is targeting a long-term gearing level of 40% of gross assets. As at 31 March 2016, DRIP had cash balances of £3.3m and borrowings of £11.1m. This equates to a loan-to-value ratio of 27.3% or net gearing of 34.6%. DRIP's year end is 30 September and its first full set of accounts will be made up to 30 September 2016.

Life

DRIP's indefinite life reflects the longer-term nature of its underlying investments.

Arguably reflecting the longer-term nature of its underlying investments, DRIP has been established with an indefinite life and there is no specific mechanism, such as a regular continuation vote, to wind up the company.

Board

The board comprises three non-executive directors, all of whom were appointed on the company's incorporation in March 2015. The company's articles of association require that all directors automatically stand for election at the first AGM following their appointment. Thereafter, all directors are required to stand for re-election at three-yearly intervals, unless they have served for nine or more years, after which it is board policy that they stand for re-election annually.

DRIP's directors have at least 2.1 years of their fees invested in the company.

As illustrated in Figure 14 below, all directors have made, what the managers describe as, significant personal investments in DRIP's ordinary shares (between them the directors a minimum of 2.1 years of fees, and an average of 2.7 years of fees invested in the company). This is generally considered to be favourable as it should help to align the board's interests with those of the ordinary shareholders.

Figure 14: Board member - length of service and shareholdings

Director	Position	Appointed	Length of service (years)	Annual director's fee (GBP)	Share-holding*	Years of fee invested*
John Evans	Chairman	26 March 2015	1.2	30,000	100,000	3.5
Hugh Little	Chairman of the Audit Committee	26 March 2015	1.2	25,000	50,000	2.1
Alan Robertson	Director	26 March 2015	1.2	20,000	50,000	2.6

Source: Drum Income Plus REIT, Bloomberg, Marten & Co. *Note: shareholdings as per most recent company announcements as at 8 July 2016. Years of fee invested based on DRIP ordinary share price of 104.0p as at 8 July 2016.

Further details regarding the board are available in the company's prospectuses, published in April 2015 and February 2016, as well as at the company's website: www.dripreit.co.uk. However, in summary, John Evans (chairman) has over 30 years of experience in the investment management industry. He was a founding partner of Aberforth Partners in 1990 and retired from the firm in 2011. He is also a director of Investor Capital Trust. Hugh Little, chairman of the Audit Committee, qualified as a chartered accountant in 1982. Between 1990 and 2006 he oversaw the growth of Aberdeen Asset Management's private equity business before moving to the corporate team as Head of Acquisitions. Alan Robertson is a Fellow of the Royal Institution of Chartered Surveyors and has over 30 years' experience of working in the commercial real estate sector. He has previously held posts as managing director of Jones Lang LaSalle (JLL) in both Scotland and Turkey and is currently JLL's CEO for the Middle East and North Africa region.

Appendix 1 – DRIP portfolio assets

Gosforth Shopping Centre, High Street, Newcastle upon Tyne

Gosforth Shopping Centre is DRIP's largest asset. It was purchased in October 2015 at a cost of £12.25m (a net initial yield of 7.3%) and, as at 31 March 2016, was valued in the portfolio at £12.6m. It is anchored by Sainsbury's, which occupies 33,000 of the shopping centre's 73,000 square foot of rentable space and provides around 40% of DRIP's income from the centre. Other significant tenants include Boots, Lloyds Bank and WHSmith. Sainsbury's lease expires in 2032, has no break clauses and has a guaranteed rental uplift of 2% per annum compound. There are currently 17 tenants in total and three vacant units, which occupy 4,800 square foot. The WAULT for the property is 5.8 years. The next 12 months see 8,900 square feet of lettings reach expiration.

Figure 15: Gosforth Shopping Centre - exterior

Source: Drum Income Plus REIT

Figure 16: Gosforth Shopping Centre - interior

Source: Drum Income Plus REIT

At the time of acquisition, both Boots and WHSmith had lease expirations approaching. A new 10-year lease has since been put in place with Boots and negotiations have commenced with WHSmith. There were also three vacant units but off these have been re-let and the centre has 100% occupancy. Two of the units have been let to Naked Deli and the third has been let to Card Factory. Both contracts have been signed and the tenants are now trading.

Looking forward, DREIM says that it is focused on increasing 'dwell time' in the centre (initiatives could include wi-fi and Amazon lockers), and developing a tenant and shopper engagement strategy.

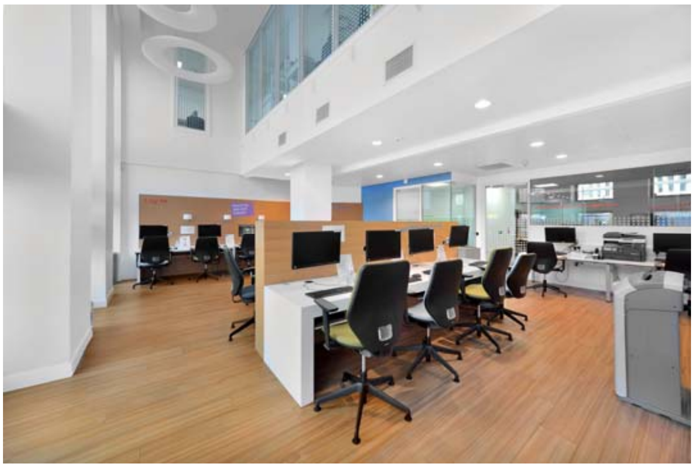
Montieth House, 11 George Square, Glasgow

Montieth House is the second largest asset, by market value, in DRIP's portfolio. It was purchased in November 2015 at a cost of £5.75m (a net initial yield of 7.6%) and, as at 31 March 2016, was valued at £5.9m. The building is located in Glasgow's main civic square and has seven floors (including a ground floor) as well as a basement storage area, with a combined net internal area of 27,000 square feet. From the outside, it appears to be a traditional mid-terraced building but it was redeveloped in 1996, behind its Grade B listed façade, and offers recently refurbished open-plan office accommodation with secure parking (seven spaces). The building was marketed as a high-quality multi-let office development with a passing rent of £465k per annum and a WAULT of five years to expiry (4.1 years to breaks). It has three tenants: The Skills Development Scotland Company Limited (Skills Development Scotland), Scottish Network 1 Tourist Board (Visit Scotland) and LS Buchanan Limited. Skills Development Scotland and Visit Scotland have leases that run through to January 2021 (Skills Development Scotland has break options on two of the floors it occupies in July 2018) whilst LS Buchanan's leases (fifth and sixth floors) expire in January 2018 and have a break option in January 2017. The managers say that they liked the building's location where they see strong occupational demand generally (84% of local employment is in services). This is coupled with what they also believed to be low rental values, at the time of purchase, which provided for opportunities to increase income through lease renegotiations and rent reviews (the property was marketed suggesting that a possible asset management initiative as the re-letting of the fifth and sixth floors after LS Buchanan had vacated). The managers also believe that the building's city centre location and good transport links should support tenant demand and that, having already been refurbished to a high standard, they saw limited need for further investment in the near term.

Figure 17: Montieth House - exterior

Source: Drum Income Plus REIT

Figure 18: Montieth House - ground floor



Source: Drum Income Plus REIT

Montieth House was purchased in an institutional sale from Alliance Trust and followed Alliance Trust's announcement in October 2015 that it would be focusing on its global listed equities portfolio and disposing of non-core assets. Montieth House had been a long-time holding of Alliance Trust's and was its sole remaining direct property investment. Edinburgh based Graham & Sibbald, which organised the sale, say that the purchase was completed at 14% above the asking price whilst Alliance Trust say it was completed at 15.6% above its holding value. However, Alliance Trust had previously been generally writing the property's value down in its accounts. Between

31 December 2010 and 31 December 2014 (the final year end before its sale) the value that Alliance Trust held Montieth House at fell from £6.1m to £4.8m.

Lakeside 5500, Cheadle Royal Business Park, Manchester

Lakeside 5500 was acquired, fully let, from Quorum Properties in December 2015 for £5.475m (a net initial yield of 7.82%). As at 31 March 2016 it was valued at £5.3m. The building, which is a three-storey modern office building located on the Cheadle Royal Business Park in Manchester, provides 26,000 square feet of modern office accommodation and is fully let to two tenants - Agilent Technologies (UK) Ltd and Micron Europe Ltd who occupy 17,100 square feet and 8,800 square feet respectively. At the time of purchase, the property had a WAULT of 4.78 years.

The building was constructed as part of the first phase of development of the Royal Cheadle Park. It is configured in an 'L-shape' with two wings positioned around a central core. Being of modern construction, the space is of a very flexible design with raised floors and suspended ceilings. It also has air conditioning, gas-fired central heating, male and female toilet provision for each floor and 139 car parking spaces. The managers liked the building's location and say that the Royal Cheadle is seen as one of, if not the, premier out-of-town business parks in Manchester and the North West. It is very well connected to the motorway and road network and is located seven miles from Manchester's city centre with all the amenities this offers (Manchester has the second-largest urban population and second-largest centre outside of London). The park also has substantial on-site amenities that could make it attractive to potential tenants.

Figure 19: Lakeside 5500 - exterior

Source: Drum Income Plus REIT

Figure 20: Lakeside 5500 - exterior aerial

Source: Drum Income Plus REIT

The building has benefitted from strong tenant retention and the managers believed that demand for space in the park has seen rentals rising and that the property has inherent rental growth potential with short term upside from a rent review arising in 2017. The property was marketed saying that existing tenants are paying rents in the region of £17.50 per square foot per annum, that an open market rent review is due in March 2017 and that current open market rents for comparable accommodation in South Manchester are in the region of £18 to £19.50 per square foot. However, market intelligence by Edwards & Co suggested that prime locations in South Manchester were attracting rents in the region of £21.50 per share and that there were other occupiers seeking space in the market, which was felt likely to put further upward pressures on rents.

108 Eastern Avenue Retail Park, Gloucester

108 Eastern Avenue Retail Park, Gloucester (Eastern Avenue) was purchased from CBRE Investors, in an institutional sale, in February 2016 for £5.3m, which reflected a net initial yield of 8.4%. The property, which is a three unit scheme of 32,000 square feet with a wide bulky goods consent, was acquired fully let to Staples, Maplin Electronic and Farmfoods. The sale of the freehold followed a new letting of a previously vacant 7,000 square foot unit to Farmfoods. At the time of purchase, the property had what the managers considered to be a strong WAULT (8.9 years to expiry or 8.4 years to breaks). As at 31 March 2016, the property was valued at £5.3m.

Figure 21: 108 Eastern Avenue Retail Park - exterior

Source: Drum Income Plus REIT

Figure 22: 108 Eastern Avenue Retail Park - exterior

Source: Drum Income Plus REIT

The managers were attracted by what they saw as a strong tenant line up and an attractive yield for the location. Eastern Avenue is anchored by a number of strong tenants including Curry's, Carpetright, Lidl, Harvey's, Homebase, Halfords, Magnet, PC World, KFC and Pizza Hut, which the managers expect to underpin ongoing demand for retail space in the park. They also comment that, in their view, Gloucester Council is keen for the site to remain an attractive retail destination and have proven helpful, in terms of planning applications, to allow this to be achieved. Constructed in 1998, the building is of a flexible design which lends itself to reconfiguring into different size units to suit demand (when originally constructed the building comprised two units and was later reconfigured to three). However, the configuration remains appropriate and the site attractive and so they see limited need for investment in the near term.

Duloch Park, Turnstone Road, Dunfermline

Duloch Park was one of the first three properties DRIP acquired following its IPO (along with Gosforth Shopping Centre and Mayflower House). The multi-let retail property was purchased in October 2015 for £4.5m, which reflected a net initial yield of 7.4%. Constructed in 2008, the 17,000 square foot property comprises 11 units with 58 car parking spaces with a mixture of one and two storey units. One of the units, Unit 5, is currently subdivided into two sub-units and so there are 12 tenants in total. The units are let to Barrhead Travel, Tote Bookmakers (trading as Betfred), Greggs, Innovate Hair, Children's Hospice Association Scotland, Indigo Sun Retail, Lloyds Pharmacy, Johnson Cleaners, British Red Cross, Marini's Café, Subway and Pizza Hut. The park is fully let and nine of the 12 tenants are national operators. The site benefits from being immediately adjacent to an Aldi food store (16,500 square feet), a Tesco superstore

(70,000 square feet) and a Tesco petrol station as well as from its close proximity to a primary school, leisure centre and library. DRIP's property effectively serves as a gateway to the overall site. As at 31 March 2016, the property was valued at £4.5m.

The managers were attracted by the Park's location and specifically its proximity to other local amenities, which should support footfall and underpin demand from retail tenants. Furthermore, they say that Dunfermline is the principal town in Fife, its population continues to grow and with the property located in Dunfermline's eastern expansion area, they expect to see continued demand for retail space in the Park (the managers say that further residential development is resulting in an increasingly affluent catchment for the Park). Furthermore, a new bridge over the Firth of the Forth (The Queensferry Crossing) is expected to open this year with improved connectivity and reduced travel times between Edinburgh and Fife. The managers say that Dunfermline is expected to be a major beneficiary. The combination of these factors leaves the managers to believe that there is inherent rental growth opportunity over the medium term. The managers were also attracted by the yield, WAULT (5.73 years to break and 9.15 years to expiry at acquisition) and varied tenant mix. They also saw a number of near term opportunities, from lease events, to increase the yield from the site. For example, a rent review for Lloyds Pharmacy, backdated to 2013, saw an increase in passing rent of approximately 15%.

A further consideration is that the building is of modern construction (barrel style roofs, timber cladding and substantial glazing) and the managers see limited need for investment to maintain the site's desirability in the medium term.

Figure 23: Duloch Park, Dunfermline - exterior

Source: Drum Income Plus REIT

Figure 24: Duloch Park, Dunfermline - exterior

Source: Drum Income Plus REIT

Anecdotally, Duloch Park was purchased from Schroders Property in an institutional sale. The park had originally been purchased by Schroder Emerging Retail Property Unit Trust (SERPUT) in June 2010 but this vehicle was subsequently acquired by the Schroder Exempt Property Unit Trust in 2011. Various assets, including Duloch Park, have subsequently been disposed of. It appears that the smaller lot size and more remote location did not fit well with the seller's portfolio, despite its attractive yield.

Arthur House, Chorlton Street, Piccadilly, Manchester

Details of Arthur House and the managers' rationale underlying its purchase are included on pages 13 and 14 of this note. Pictures of the building and as well as some potential options for improvement are provided here. As at 31 March 2016, the property was valued at £4.4m.

Figure 25: Arthur House - exterior

Source: Drum Income Plus REIT

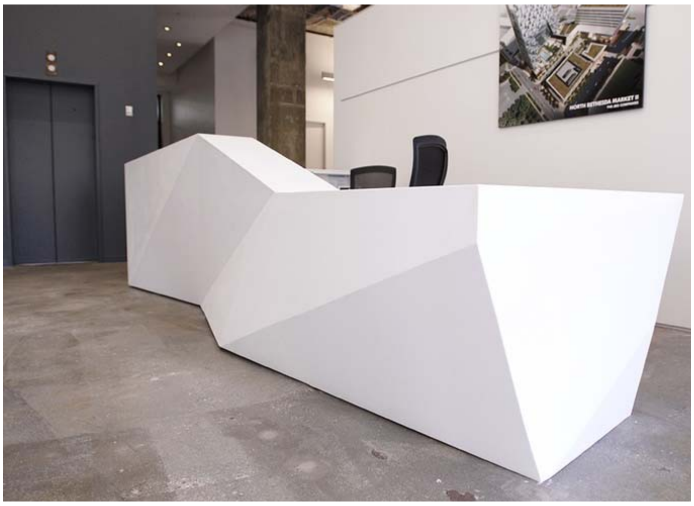
Figure 26: Arthur House - exterior

Source: Drum Income Plus REIT

Figure 27: Arthur House - current reception

Source: Drum Income Plus REIT

Figure 28: Arthur House - proposed reception

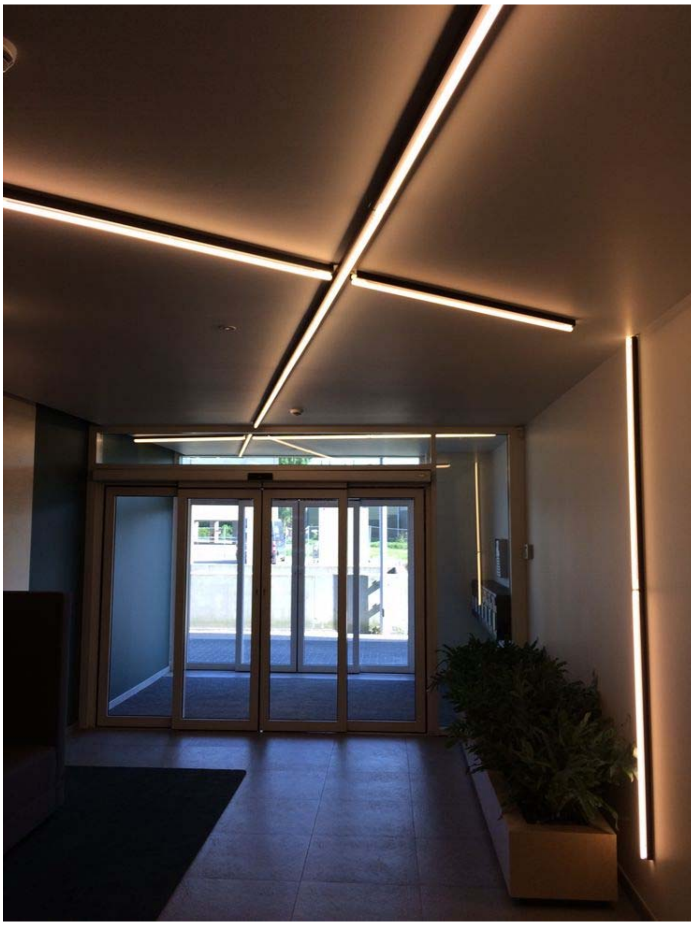


Source: Drum Income Plus REIT

Figure 29: Arthur House - current reception entrance

Source: Drum Income Plus REIT

Figure 30: Arthur House - proposed reception entrance



Source: Drum Income Plus REIT

Figure 31: Arthur House - current reception/lifts

Source: Drum Income Plus REIT

Figure 32: Arthur House - proposed reception/lifts

Source: Drum Income Plus REIT

Mayflower House, Fifth Avenue Business Park, Gateshead

As noted above, Mayflower House was one of the first three properties that DRIP acquired for its portfolio. The multi-let office property was purchased in October 2015 for £2.67m, which reflected a net initial yield of 9.25%. The building is a two-storey, steel-framed construction with brick curtain walling and a pitched tiled roof. It was constructed in the 1990s and comprises four suites covering 28,000 square feet (one of the suites is split into two sub-suites). The property was acquired fully let. The largest tenant is Worldpay, which occupies 17,800 square feet, followed by Datawright Computer Services (6,900 square feet) and Addison Motors (trading as Benfield Group and acquired by Lookers in September 2015 – 3,500 square feet). As at 31 March 2016, the property was valued at £2.6m.

The building, which is located on the Team Valley Trading Estate and part of the Fifth Avenue Business Park, underwent a refurbishment programme prior to purchase, which saw the entrance completely remodelled, the staircase and landings refurbished and three of the suites fitted with new carpets, suspended ceilings and LG7 lighting. The property also has a car park to the front with 112 spaces. Internally, it has one eight-person lift located in the building's central core. There are also male, female and disabled toilet facilities on each floor.

The managers were attracted by the property's attractive yield, low rents, strong WAULT (4.7 years to break and 9.4 years to expiry) and low capital per square foot (£94). The managers say that all of the leases benefit from strong covenants. They also considered the property's location to be favourable, being situated in a large mixed use commercial location and with a prominent position at the front one of the estate's principal roads. They believed the property's facilities would make it attractive to potential tenants and that, following the refurbishment, there would be limited capital required in the near term to keep it up to current market specifications.

Figure 33: Mayflower House - exterior

Source: Drum Income Plus REIT

Figure 34: Mayflower House - exterior

Source: Drum Income Plus REIT

Appendix 2 – Asset and stock swap tax considerations

The following summary is only intended to provide an overview of some of the considerations for REIT and REIT investors in relation to:

- The issues surrounding the acquisition of property by a REIT in exchange for shares in a REIT
- The issues surrounding the acquisition of property by a REIT by way of the acquisition of shares in a Property Company (rather than the direct acquisition of a property asset).

This summary should not be considered as comprehensive, adequate for making decisions or as a substitution for professional tax advice.

Acquisition of property by a REIT in exchange for shares in a REIT

Under this scenario, The REIT will issue ordinary shares to the value of the property assets rather than receive cash and the acquisition would be subject to stamp duty land tax (SDLT) or land and buildings transaction tax (LBTT) in the normal way. However, the issue of shares should not ordinarily result in a stamp duty charge.

The REIT needs to ensure that the resulting share ownership does not breach any of the REIT conditions (e.g. in particular the 10% corporate shareholder rule or the close company/diverse ownership condition). It should also be noted that the principal company of a REIT can only issue one class of ordinary shares, it cannot have classes with varying rights. Furthermore, if the REIT is issuing shares to a specific seller (individual or company), the REIT should confirm whether any non-tax restrictions apply as the REIT is a listed company (e.g. regulatory or legal issues).

Under this scenario, the seller will receive ordinary shares in the REIT (rather than cash) in return for the value of the assets being sold and the seller will be treated as disposing of the asset for tax purposes. As such, the seller will realise a capital gain/loss on disposal (or a trading profit/loss if the property is held on trading account). However, if the seller is an individual, it may be possible to 'rollover' the gain into the base cost of the new shares being issued (i.e. defer the crystallisation of the gain until such time as the REIT shares are sold). This is very dependent on the facts and circumstances and tax advice should be sought by the seller to confirm tax treatment and, if relevant, obtain clearance from HMRC.

Acquisition of property by a REIT by way of the acquisition of shares in a property company

Under this scenario, the REIT should only be liable for stamp duty at 0.5% although the REIT will have increased risk and the Company being acquired will require due diligence (rather than just that for the Property Assets). Given the purchaser is a REIT, any capital gain in the Company relating to assets of the property rental business should be extinguished on entry into the REIT group. However, de grouping charges may apply to seller (see note below). Furthermore, due diligence should be undertaken to confirm the REIT rebasing is available for the target company's assets, as well as to identify other inherent tax risks (e.g. SDLT, LBTT, VAT).

It should also be noted that the REIT purchaser will (indirectly) suffer any SDLT group relief clawback on assets transferred to the target company within the 3 years prior to the date of purchase (i.e. any SDLT group relief claimed by the target company for any intragroup transfers within the last 3 years will be clawed back in full and is a liability of the target company). Therefore, the REIT will need to adjust for any such charges in the pricing mechanism. If the REIT is issuing shares to a specific seller (individual or company), it would be worth confirming whether any non-tax restrictions apply as the REIT is a listed company (e.g. regulatory or legal issues).

For the seller, the sale of shares will trigger a capital gain/loss. However, it may be possible to ‘roll over’ the gain on the sale of shares by the seller into the base cost of the new REIT shares, i.e. defer the crystallisation of the gain until such time as the REIT shares are sold (therefore avoiding a ‘dry’ tax charge). The treatment requires that the transaction is carried out for bona fide commercial reasons, and not with a tax avoidance motive. It is possible to seek clearance from HMRC on this point (known as a ‘Section 138 clearance’ – referring to the clearance provisions in the legislation, s.138 Taxation of Chargeable Gains Act 1992).

For corporate sales, it is also important to consider whether any additional anti-avoidance provisions apply, e.g. degrouping charges or SDLT/LBTT group relief clawbacks.

Degrouping charges

Because of degrouping charges, the seller needs to carefully review 6-year transaction history of any property assets in the Company being sold. Potential degrouping charges can arise if properties were transferred between companies within a Group, and subsequently the company which received the property left a Group within 6 years. The gain that would have arisen on the transfer of the property between the group companies becomes chargeable. That gain is transposed to the share disposal that Company to leave the group (and therefore should be a liability of the seller). Furthermore, any stamp duty group relief that was claimed on any transfers between Group Companies within the last 3 years is also clawed back in full and SDLT/LBTT on the intra-group transfer also becomes payable by the company that acquired the asset, and claimed the relief, i.e. the target company (noted above as an issue for the REIT purchaser).

The seller should seek their own tax advice as the overall tax outcome and structuring options depend heavily on the specific facts and circumstances of each transaction.

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123a Kings Road, London SW3 4PL
0203 691 9430

www.quoteddata.com

Registered in England & Wales number 07981621,
135a Munster Road, London SW6 6DD

Edward Marten
(em@martenandco.com)

James Carthew
(jc@martenandco.com)

Matthew Read
(mr@martenandco.com)

IMPORTANT INFORMATION