Standard Life Commercial Ground Rent Pension Fund

Rationale for investing

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Introduction

The Standard Life Commercial Ground Rent Pension Fund (the fund) was set up in 2012 in response to investor demand for an inflation-linked secure real estate investment proposition providing longer term income streams and greater underlying asset-backed security than the Standard Life Long Lease Property Fund.

Ground rents are regarded as the most secure investment sector within the real estate investment universe. The combination of long lease length, inflation-linked income streams and underlying vacant possession asset values provide an attractive long-term investment opportunity. Generally, ground rents are less susceptible to market pricing movements, typically moving in smaller increments than the wider Real Estate market.

This reduced risk profile comes at a cost, with yields on ground rents typically ranging from 2.5%-4.5% (Sept 2023). This has increased by about 50 - 100 basis points in the past 12 months in response to increases in the risk-free rate.

Why ground rents?

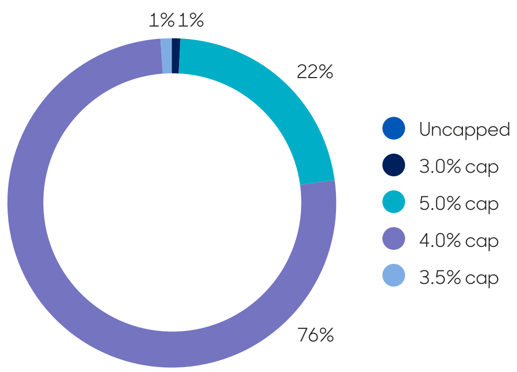
Long Term Solution

- Lease lengths usually exceed 100 years and underpin highly reliable income streams. The current unexpired lease term for the fund is 167 years.

Inflation Linked Income Stream

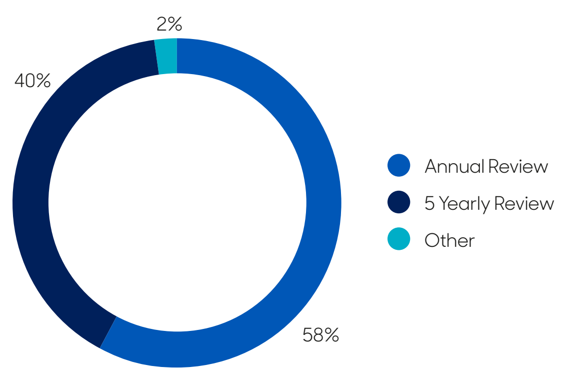
- The fund has 98% of rents linked to RPI (Retail Price Index), with a minimum cap of 3% per year. This is in stark contrast to the cyclical nature of conventional real estate income, which is subject to changes in market rent in response to wider property and economic market cycles. The charts below summarise the frequency of our rent reviews as well as a breakdown of the uplift caps.

RPI cap breakdown (out of 100%)



Source - abrdn as at June 2023.

Rent review structure



Source - abrdn as at June 2023.

Income Distribution

The fund offers an income distribution facility which started in Q3 2022, generating an annualised income return of 3.20% p.a. (Q2 2023).

Underlying Asset Backed Security and Negligible Tenant Default Risk

Due to the highly collateralised nature of the ground rent income stream, there is limited risk of default. In the event of non-payment of rent, the freeholder (the fund) can forfeit the lease and inherit the value of the land and the buildings on the site. In most cases, our tenants have bank debt secured against the leasehold asset. The bank would usually step in to pay the rent in the event of a tenant failure.

It is also worth remembering that ground leases are usually put in place over operational assets generating high levels of turnover, such as hotels, holiday parks and crematoria, where the real estate is critical to the functioning of the business. Without the underlying asset the business does not exist. This ensures our tenants are motivated to pay their rents.

At fund level, we regularly monitor the vacant possession (VP) value of each asset with the aim of an overall coverage level where the VP value is at a minimum of twice that of the value of the ground rent investments.

ESG

We recently began gathering tenant data to enable us to subscribe to the GRESB (Global Real Estate Sustainability Benchmark) rating system, collecting 85% of data (by floor area) - an excellent starting position. As part of this exercise, we have been able to gauge our tenants' progress in terms of environmental, social and governance (ESG) activities. Many have already installed electric car charge points and solar photovoltaic systems. A number of tenants are also working on making a positive social impact. We expect this trend to continue, as ESG starts to become more important in consumer decision-making. At a fund level, we are working with our tenants to encourage them to consider ESG measures when redeveloping properties. For example, the tenant of one Edinburgh Hotel was able to boost the property's EPC (Energy Performance Certificate) rating from a G to B.

In the longer term, the fund will be able to become a carbon-neutral vehicle, likely via the offsetting of any residual carbon by means of a natural capital solution.

Why now for Ground Rents?

- Opportune time to invest in the Ground Rent Fund to capture market recovery.
- Units may be available in secondary market, providing an immediate performance gain.

Fund Performance

The fund has proved very resilient in terms of performance since it was established, generating a net total return since inception of 6.25% per annum. The fund has a portfolio of high-quality assets. Two examples are shown in the images below.

Holiday Inn Express, Leigh.

New Porsche Dealership, Poole.

Summary

The fund aims to provide a stable, long-dated inflation-linked income stream opportunity for investors, underwritten by a diverse high-quality portfolio of prime assets across the UK. It also offers the long-term prospect of capital growth as an attractive alternative asset class to bonds.

The fund is run by a dedicated Secure Income team with the longest track record in the sector. We see an opportunity to grow the fund by widening the client base to new types of investors. We believe we can offer a lower risk, liability-matching income stream with a longer duration and higher percentage of inflation linkage compared with the Long Lease Property Fund.

Important information

For professional investors only – not for use by retail investors.

Investment involves risk. The value of investments, and the income from them, can go down as well as up and an investor may get back less than the amount invested. Past performance does not predict future returns.

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Subscriptions will only be received and shares issued on the basis of the current Prospectus, relevant Key Investor Information Document (KIID) and Supplementary Information Document (SID) for the fund. These can be obtained free of charge from abrdn Fund Managers Limited, PO Box 9029, Chelmsford, CM99 2WJ or available on www.abrdn.com.

The risk descriptions below correspond to the main risk factors applicable to the Fund. The Fund could potentially be affected by risks beyond those described here and these risk descriptions themselves are not intended to be exhaustive.

- Commercial property is less liquid than other asset classes such as bonds or equities. Selling property can be a lengthy process so investors in the fund should be aware that they may not be able to sell their investment when they want to.
- Commercial property transaction charges are higher than those which apply in other asset classes. Investors should be aware that a high volume of transactions would have a material impact on fund returns.
- Property valuation is a matter of judgement by an independent valuer and is therefore a matter of the valuer's opinion rather than fact.

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