# TIME:Commercial Long Income | Investor Q&A Liquidity Tools and Performance

**Date:** 20 July 2020

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Over the period since the TIME:Commercial Long Income suspended, we have seen a range of questions come up from advisers and investors. This document seeks to answer some of the key questions that are being raised.

## MATERIAL UNCERTAINTY

### What is Material Uncertainty?

The Independent Valuer may declare in the valuation report that because of an event (COVID-19) there is material uncertainty in the market and that the valuer considers that less weight can be attached to transactions occurring in the market to inform opinions of value. For the avoidance of doubt, the inclusion of the 'material valuation uncertainty' declaration does not mean that the valuation cannot be relied upon. It is used in order to be clear and emphasise to all parties who rely on the valuer's report, that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case.

- Current valuation wording: *"The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a "Global Pandemic" on the 11th March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries.*
- *Market activity is being impacted in many sectors. As at the valuation date, the Independent Valuer considers that they can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement."*

Essentially the valuer is saying that there is a lack of transactional activity and concern over the operations of some of the tenants, leading to a lack of clarity over the payment of rent from tenant to landlord.

### How and when will Material Uncertainty be removed from valuations?

Once there is clarity on how the occupying tenants are operating in the new environment, rental payments are being met or renegotiated, and/or there is transactional activity to support the valuations (i.e. properties in that sector being sold in the market), Material Uncertainty Clauses will be removed by the valuers.

For example, standalone food stores have already had Material Uncertainty removed from their valuations. This is because they have remained open, have had no material changes to trading levels (in some cases improved) and are meeting their rental payments. There have been a few transactions that have completed and there is now enough clarity/confidence in the sector to support the numbers and remove the clause.

### How will suspension be lifted?

FCA rules applying to certain funds investing in inherently illiquid assets, such as property, is that these funds should suspend if material valuation uncertainty exists to such an extent across the fund's portfolio that the price for dealing in the shares of the fund cannot be relied on. From September 2020 FCA rules will require these funds to suspend where Material Uncertainty exists in greater than 20% of the fund's net asset value ("NAV"). Currently this is only a guideline, but the FCA has stated it expects managers to apply the guideline.

However, the 20% level is the maximum limit and typically material uncertainty over a lower proportion of the fund's NAV would still be a basis for suspension. An overall level of material uncertainty over less than 5% of the fund's NAV would typically result in the fund lifting its suspension subject to the agreement of the Authorised Corporate Director ("ACD") and depositary, and in consultation with the FCA.

Where overall Material Uncertainty exists between 5% and 20% of the fund's NAV, it will be at the discretion of the manager, with the agreement of the ACD and depositary, to determine whether or not to lift the suspension.

## LIQUIDITY

**What is the current liquidity position?**

As at 20 July 2020, the fund holds cash of around 8% of NAV (£37 million), has exchanged contracts for the sale of an asset for £35 million (to complete in August 2020) and is planning to sell at least another asset. This would create additional liquidity of at least £50 million and enable the fund to increase its exposure to the logistics sector later this year when it completes the acquisition of its logistics contractual commitments later in 2020.

The fund has a £40 million revolving credit facility from RBS, principally for acquisitions and liquidity management purposes. As at 20 July 2020, the facility is undrawn.

**How will you manage liquidity leading up to the lifting of suspension?**

Investor communication is key, and we look to understand our investors' appetite in relation to subscriptions/redemptions, particularly the fund's largest supporters. The fund is not suspended for liquidity nor performance purposes and without the Material Uncertainty opinion from the valuer, the fund would have continued to accept dealing instructions and operated as normal. From speaking to our investors, we are not anticipating a large level of redemptions and have had significant interest in new investment.

**Does the fund have any other liquidity management tools within its Prospectus?**

In the first instance, where a large investor is looking to redeem, we would look to work with them to seek an agreement of a redemption timetable over an agreed period of time. If we cannot agree on this, in order to protect the interests of our existing shareholders, the fund has a number of tools it can apply to (typically large) redemptions.

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| **Dilution Adjustment/Swing price** | When the fund is in net subscriptions and buying property, it is priced on offer i.e. NAV + costs of property acquisitions. Should the fund experience large redemptions requiring it to sell property, it will 'swing' to bid i.e. NAV less the cost of selling property. The total swing from offer to bid is typically c7%-9%. |
| **Large Deal Provision** | Effect instructions (exceeding £50,000) for subscriptions or redemptions of shares on a different pricing basis to the published price. Can also, at the discretion of the ACD, have such large deals refused until such time as there is no prejudicial impact to the best interests of shareholders. The large deal provision looks to reflect the cost of selling a property, which will be typically 7%-9% reflecting the swing from offer to bid. |
| **Redemption charge** | Charge on the redemption of such shares (exceeding £250,000) of up to 5%. |

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| **Market timing charge** | Where a particular shareholder has engaged in short-term trading, effect a charge of up to 3% if a redemption is made within 180 days of the original subscription. |
| **Deferral of redemptions** | Where requested redemptions received across all classes of a fund for a particular dealing day exceed 10% of the NAV, the ACD may defer redemptions to the next dealing day i.e. the next day. |
| **Suspension of Dealing** | Always available. |

It is worth noting that if an investor seeks to redeem an investment that would not be deemed large (i.e. under £50,000) through a platform that is also redeeming other investors at the same time, but together they amount to more than £50,000, the fund will only see one aggregated large redemption and all underlying investors redeeming through the platform that day will be impacted by the large deal provision.

Please refer to the fund's Prospectus published on our website for the full detail (specifically sections 21 – 25 covering dealing charges and suspension).

**When can these liquidity tools be used?**

- They may be used at any time where the ACD considers it is in the best interests of the shareholders to do so, in order to protect investors' interests (those coming in and out of the fund as well as those who are remaining invested).
- In simple terms, on redemptions these tools are used when it is believed that there may be a need to sell a property as a result of a single/set of redemptions on a given date or when it is believed there is a pattern of continuing redemptions over a period.
- The focus therefore will be on the effect on the liquidity in the fund (current and future), so that large redeemers bear their proportion of the cost of selling a property.
- The liquidity tools are expected to be used reasonably and be able to be justified.

## PERFORMANCE

**How has the fund performed during the COVID-19 crisis?**

Most recently the fund's property portfolio was valued by the Independent Valuer on 30 June 2020. Taking the current circumstances into account, the valuer reduced the value of the portfolio equivalent to 0.74% of the fund's NAV. This reduction in value has been driven by the fund's exposure to the hotel and leisure sectors held on long leases, which make up c23% of the fund's NAV, and the direct impact COVID-19 is having on their operations. In particular Travelodge (which represents approximately 6.4% of the fund's NAV), who pursued a company voluntary arrangement, which was approved in June 2020. The Independent Valuer has this month reduced valuations on the relevant Travelodge assets by around 6% to reflect this information. This follows previous down valuations that now reflect an average decrease of 17.5% on the fund's four individual Travelodge hotels since 29 February 2020.

The resilience of the fund's overall property portfolio is underpinned by its diversification over a number of sectors, with over 60% (by NAV) of its properties either let to the Government or in the most robust long income sectors during this period, such as supermarkets, logistics and ground rents. The capital loss together with the income earned for the month resulted in the value of the fund's shares decreasing by 0.62% for the month of June 2020.

Although in the period since lockdown the fund has fallen in value by approximately 2.1%, over the last 12 months it has delivered a total return of 0.70%, substantially outperforming its traditional commercial property OEIC peers in those two periods. The main reasons for this outperformance are the specific features of long income (including the high Weighted Average Lease Term (WALT)) combined with tenant quality and also the lack of exposure to high street retail and shopping centre retail.

The property portfolio of the fund is valued at the end of each month and will next be valued by the Independent Valuer at 31 July 2020.

**Do you expect your income distributions to remain at the same level?**

We continue to be in communication with all our tenants and in particular those in the most affected sectors, to better understand the specific issues that they face and the discussions that they have had with other landlords and/or lending banks. We have collected in excess of 80% of the second quarter's rent by the end of the quarter in June 2020. However, some tenants have requested that their rent is deferred and we are in ongoing discussions with those tenants. Any concessions will impact the income received by the fund in the short to medium term, and consequently the future income distributions in August 2020 and beyond, but by supporting tenants through this difficult period, the fund is focused on the value of its property portfolio in the long term.

As we did not collect all of the Q2 rent by the end of June, some has been deferred and should be recovered in the future and the rest is likely to be waived. On current expectations it is reasonable to expect income distributions for August and November to be around 15% to 20% lower than usual but following this we expect distributions to be back at normal (historical) levels.

The fund's income return for the quarter to 31 March 2020 was 0.91% (based on the Class A Gross Accumulation share price) which was paid at the end of May 2020. The fund's income return for the quarter to 30 June 2020 was 0.75% (based on the Class A Gross Accumulation share price) and the distribution will be paid at the end of August 2020.

**How do you expect the fund to perform going forwards?**

Whilst we anticipate further capital value decreases in the long-let hotel and leisure sectors into Q3 2020, the majority of the portfolio remains robust. Our expectations are that by the time the fund reopens, potentially in late Q3 2020 or Q4 2020, dependent on the valuer's timings of removing the Material Uncertainty Clauses, we anticipate a return to positive performance with an annual income return of between 3% and 3.5% and the potential for modest capital growth.

## STRATEGY

**Will the fund's objective change?**

No. Since the fund was launched it has been managed with the focus on lower capital volatility and income security.

**Will the sectors the fund invests in change?**

Sectors have been impacted differently from COVID-19, but the long-term investment drivers behind the sectors the fund is exposed to remain.

That said, additional assessment on certain sectors as to the level of exposure and/or aspects that could be changed on investments (new and existing) in order to reduce risk and the potential impact of a similar event (such as further outbreaks of COVID-19) will be carried out.

The fund will continue to invest in a range of long income sectors to grow a balanced, diversified portfolio.

Logistics continues to be a sector where long-term demand is strong and changes to how businesses operate is increasing the need for a high quality logistics network, and the fund is looking to increase its exposure in this sector as part of a balanced, diversified portfolio. Indeed, the fund is to increase its exposure in the logistics sector later this year when it completes the acquisition of its logistics commitments.

The pressure on the hotel and leisure sectors is expected to remain throughout 2020 and 2021. Consequently, we shall be monitoring the return of this sector closely before making any further investment decisions.

**How can I contact you to find out more about the fund and the suspension?**

For more information as it becomes available, please visit our website or should you require any further assistance please do not hesitate to contact our Client Services Team on 0345 600 1213 or by e-mailing enquiries@time-investments.com.

For all financial advisers, please speak to your Business Development Manager for further information. If you need to remind yourself of the contact details of your local BDM, please check on our website.