

# Quarterly Portfolio Update



**Annualised dividend yield of 6.1 per cent, fully covered by income; Portfolio 77 per cent contracted at floating interest rates**

Starwood European Real Estate Finance Limited ("SEREF" or the "Group"), a leading investor managing and realising a diverse portfolio of high quality senior and mezzanine real estate debt in the UK and Europe, is pleased to announce a strong performance for the quarter ended 31 March 2023.

## SHARE PRICE / NAV AT 31 MARCH 2023



## HIGHLIGHTS

- **Positive realisation progress** - during the quarter:
  - A total of £35.9 million, almost 8.5 per cent of the Group's December 2022 total funded loan portfolio, has been repaid across seven investments
  - This included the full repayment of a loan on a hotel in Oxford of £23.0 million, a further small full repayment and five partial repayments
  - Proceeds were used in the quarter to repay the outstanding bank debt as at 31 December 2022 leaving cash balances at £22.6 million as at 31 March 2023 (of which £13.4 million will be used to pay the additional dividend declared in March and the Q1 2023 dividend declared in April)
  - The average remaining loan term of the portfolio is 1.5 years
- **Strong cash generation** - the portfolio continues to support annual dividend payments of 5.5 pence per Ordinary Share, paid quarterly, and generates an annual dividend yield of 6.1 per cent on the share price as at 31 March 2023
- **Regular and Consistent Dividend** - £206 million of dividends paid since inception (not including the dividend of 2p per share declared in March, payable in April and the dividend of 1.375p per share declared in April, payable in May)
- **Inflation protection** - 77 per cent of the portfolio is contracted at floating interest rates (with floors)
- **Robust portfolio** - the loan book is performing in line with expectations with its defensive qualities reflected in the Group's continued NAV stability
- **Significant equity cushion** - the weighted average Loan to Value for the portfolio of 58.3 per cent
- **4.9 per cent** share price total return for the quarter ended 31 March 2023

**John Whittle, Chairman of SEREF, said:**

“ We remain pleased with the continued strong ongoing robust performance of the Group’s portfolio with loans performing robustly leading to an enduringly strong valuation of the underlying collateral and all interest and scheduled amortisations being received as expected. The Group’s overall LTV remains highly comfortable at 58.3 per cent.

As a result of this strong performance over the year ended December 2022, partly as a result of the high floating rate element of the portfolio (currently 77 per cent), the Group was not only able to meet its dividend target of 5.5 pence per share but also declared a special dividend of 2.0 pence per share in March leading to a total dividend distribution of 7.5 pence per share for 2022. In our view, a highly attractive income proposition.

It is also pleasing to report positive realisation progress on the Group’s portfolio with £35.9m repaid during the quarter and used to repay the Group’s outstanding bank debt. We look forward to updating shareholders with further realisation progress and the first anticipated distribution to shareholders in due course.”

## ORDERLY REALISATION AND RETURN OF CAPITAL

On 31 October 2022, the Board announced the Company’s Proposed Orderly Realisation and Return of Capital to Shareholders. A Circular relating the Proposed Orderly Realisation, containing a Notice of Extraordinary General Meeting (EGM) was published on 28 December 2022. The proposals were approved by Shareholders at the EGM in January 2023 and the Company is now seeking to return cash to Shareholders in an orderly manner as soon as reasonably practicable following the repayment of loans, while retaining sufficient working capital for ongoing operations and the funding of committed but currently unfunded loan commitments.

## DIVIDEND

On 21 April 2023, the Directors declared a dividend, to be paid in May, in respect of the first quarter of 2023 of 1.375 pence per Ordinary Share, equating to an annualised income of 5.5 pence per annum. This is in addition to the additional 2022 special dividend declared on 23 March 2023 of 2.0 pence per Ordinary Share, which will be paid in April.

## PORTFOLIO UPDATE

The portfolio continues to perform robustly and in line with expectations. All interest and scheduled amortisation has been paid in line with contractual obligations. Borrowers are also continuing to make progress on underwritten business plans including executing strategic asset sales and paying down the loans. None of the Company’s borrowers had direct exposure to Silicon Valley Bank or Credit Suisse in relation to either bank accounts or counterparty risk (for example interest rate hedging) in relation to any of the cash or assets secured to the Company under the loans. There are existing minimum credit rating requirements for all counterparty banks in the loan agreements and the status of counterparties are monitored to ensure ongoing compliance.

During Q1 2023, a total of £35.9 million, equivalent to almost 8.5 per cent of the December 2022 total closing loan balance outstanding, has been repaid across seven investments. 79 per cent of these repayments (£28.5 million) relate to the full repayment of two loans with the remainder following strategic underlying property sales, regular quarterly loan amortisation or borrowers electing to voluntarily pay down loan balances with surplus cash.

The Group’s exposure to development and heavy refurbishment projects continues to decrease as current developments reach completion. As at 31 March 2023, the portfolio includes only one construction project of a residential plus hotel development, with a loan commitment of £49.9 million or 11 per cent of total loan commitments. Residential units are completing one-by-one over the second quarter of 2023, with the hotel set to be the final completion at the end of the quarter. The majority of the residential for-sale units have been pre-sold and we forecast the loan to be fully repaid during 2023 from the proceeds of these unit completions.

The Group continues to closely monitor its loan exposures. Asset classes representing more than 10 per cent of total investments include Hospitality (35 per cent), Office (21 per cent), Retail (12 per cent) and Residential (11 per cent).

The Hospitality exposure is diversified across six different loan investments. Two benefit from State/Government licences in place at accretive rents with structural amortisation set to reduce these by a minimum of £4 million (8.5 per cent of these two commitments) over the remainder of 2023. The other trading hotel exposures have either been recently refurbished or will be on a rolling basis from mid-2023. All trading assets outperformed the Group’s underwritten ADR (Average Daily Rate) assumptions in 2022, demonstrating ability to push rates despite wider inflationary pressures. This has assisted in mitigating margin erosion from cost inflation.

Office exposure (21 per cent) is spread across seven loan investments. Occupancy across the leased office portfolio has held up well, with the vast majority of the underlying tenants renewing leases and staying in occupation. We also continue to see prospective new tenants being attracted particularly to newly refurbished, high quality buildings such as the Office, London exposure which will reach formal completion in April 2023 and was fully pre-let 11 per cent ahead of the Group’s underwrite.

## KEY PORTFOLIO STATISTICS AT 31 MARCH 2023

Number of investments	<b>18</b>
Percentage of currently invested portfolio in floating rate loans	<b>76.6%</b>
Invested Loan Portfolio unlevered annualised total return <sup>(1)</sup>	<b>7.9%</b>
Portfolio levered annualised total return <sup>(2)</sup>	<b>7.9%</b>
Weighted average portfolio LTV – to Group first £ <sup>(3)</sup>	<b>14.2%</b>
Weighted average portfolio LTV – to Group last £ <sup>(3)</sup>	<b>58.3%</b>
Average loan term (based on current contractual maturity)	<b>5.2 years</b>
Average remaining loan term	<b>1.5 years</b>
Net Asset Value	<b>£410.7m</b>
Amount drawn under Revolving Credit Facilities (including accrued interest)	<b>£0.0m</b>
Loans advanced (including accrued interest)	<b>£395.5m</b>
Cash	<b>£22.6m</b>
Other net liabilities (including hedges and dividend declared in March 2023)	<b>£7.4m</b>

Remaining years to contractual maturity*	Value of loans (£m)	% of invested portfolio
0 to 1 years	<b>£129.3</b>	<b>33.2%</b>
1 to 2 years	<b>£134.6</b>	<b>34.6%</b>
2 to 3 years	<b>£66.0</b>	<b>17.0%</b>
3 to 5 years	<b>£59.2</b>	<b>15.2%</b>

\*excludes any permitted extensions. Note that borrowers may elect to repay loans before contractual maturity.

The Retail exposure (12 per cent) has continued to perform in line with expectations; occupancy continues to remain robust and footfall continues its post pandemic recovery. Our retail loan borrowers continue their active asset management and are signing new leases where tenants wish to expand and renew existing leases.

Residential exposure (11 per cent) is predominantly related to the successfully pre-sold residential for sale development project that is due to complete by the end of the second quarter of 2023, with the loan projected to be fully repaid this year. In general market outlook for residential product remains high as rents have trended upwards with inflation over the prior year and many markets remain supply challenged.

Across all loans we continue to benefit from material headroom in underlying collateral value against the loan basis, with a current weighted average LTV of 58.3 per cent across the portfolio. These metrics are based on independent third party appraisals which are typically updated annually for income producing assets and following completion on newly constructed or refurbished assets. The weighted average age of valuations is 1.2 years for income producing assets and seven of these will be updated in the next quarter. The only other valuations over a year old either relate to assets that are undergoing refurbishment or loans which we are forecasting to be repaid in the next six months. While we recognise that interest rate increases within the last year are expected to place downward pressure on valuation inputs, we are confident in the very significant buffer to absorb any negative valuation impact of the current market.

## PARTIAL REPAYMENTS

During the quarter, despite lower transaction volumes across the markets because of the cautionary approach being adopted by investors, borrowers repaid the following loan obligations:

- £5.5 million, Office and Industrial Portfolio, UK (repayment of loan in full)
- £23.0 million, Hotel, Oxford (repayment of loan in full)
- €5.5 million, Hotel, Dublin (partial repayment of loan)
- €1.5 million, Mixed Portfolio, Europe (partial repayment of loan)
- £1.0 million, Hotel and Office, Northern Ireland (partial repayment of loan)
- €0.4 million, Three Shopping Centres, Spain (scheduled amortisation)
- €0.04 million, Mixed Use, Dublin (partial repayment of loan)

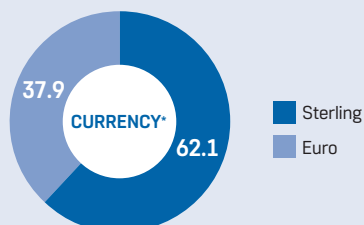
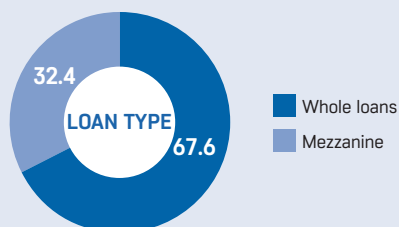
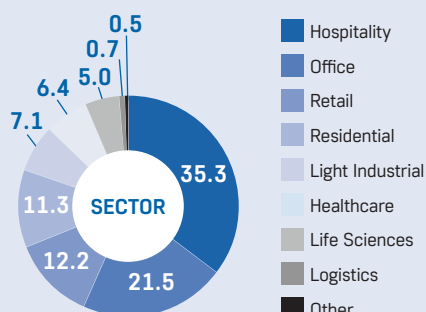
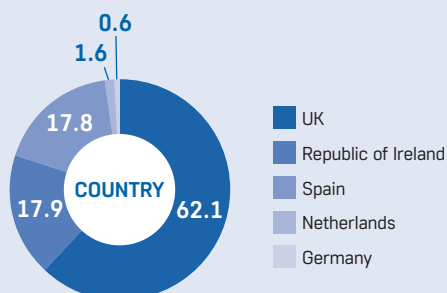
These repayments were used in the quarter to repay the bank debt outstanding as at 31 December 2022. Cash balances were £22.6 million as at 31 March 2023 (of which £13.4 million will be used to pay the additional dividend declared in March and the Q1 2023 dividend declared in April).

(1) The unlevered annualised total return is calculated on amounts outstanding at the reporting date, excluding undrawn commitments, and assuming all drawn loans are outstanding for the full contractual term. 15 of the loans are floating rate (partially or in whole and all with floors) and returns are based on an assumed profile for future interbank rates, but the actual rate received may be higher or lower. Calculated only on amounts funded at the reporting date and excluding committed amounts (but including commitment fees) and excluding cash uninvested. The calculation also excludes the origination fee payable to the Investment Manager.

(2) The levered annualised total return is calculated as per the unlevered return but takes into account the amount of net leverage in the Group and the cost of that leverage at current SONIA/Euribor.

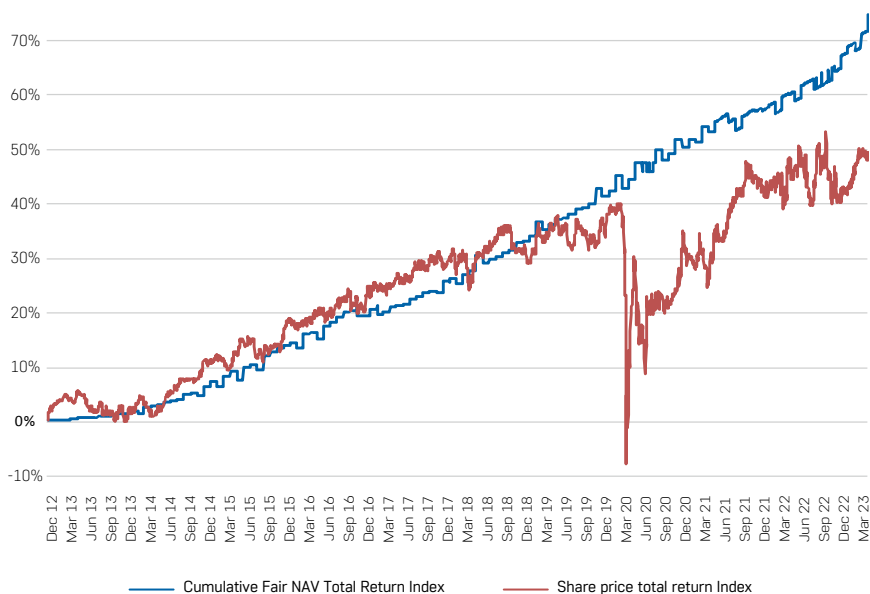
(3) LTV to Group last £ means the percentage which the total loan drawn less any deductible lender controlled cash reserves and less any amortisation received to date (when aggregated with any other indebtedness ranking alongside and/or senior to it) bears to the market value determined by the last formal lender valuation received by the reporting date. LTV to first Group £ means the starting point of the loan to value range of the loans drawn (when aggregated with any other indebtedness ranking senior to it). For development projects the calculation includes the total facility available and is calculated against the assumed market value on completion of the relevant project.

% of invested assets

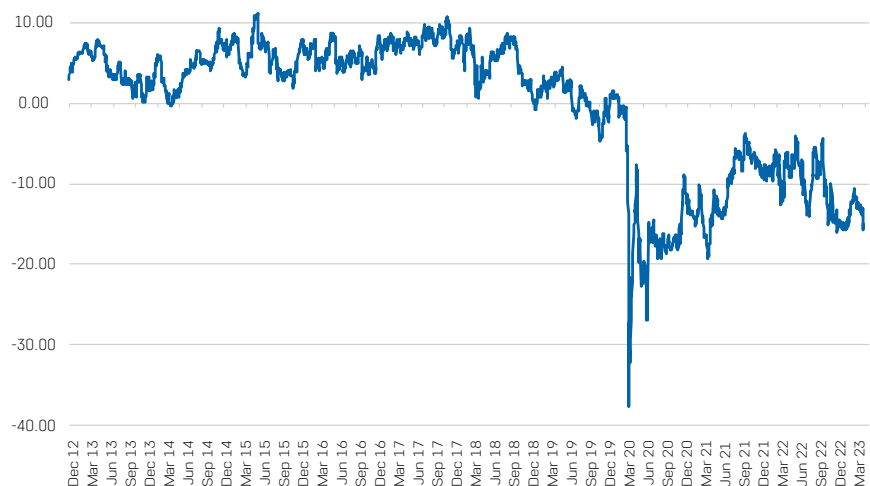


\*the currency split refers to the underlying loan currency, however the capital on all non-sterling exposure is hedged back to sterling.

## SHARE PRICE AND CUM-FAIR NAV TOTAL RETURN



## PREMIUM / DISCOUNT CUM-FAIR



## **INVESTMENT RESTRICTIONS AND GUIDELINES (UNDER WHICH THE PORTFOLIO WAS ORIGINATED PRIOR TO THE CHANGE IN INVESTMENT OBJECTIVE TO THE ORDERLY REALISATION OF THE ASSETS OF THE COMPANY)**

### **LOCATION**

UK & wider European Union's internal market. No more than 50 per cent in any country except the UK where it is unlimited (subject to sector limits below).

### **LOAN TERM**

Between 3 and 7 years but discretion retained. At least 75 per cent of loans 7 years or less.

### **LOAN TYPE**

Senior, subordinated and mezzanine loans, bridge loans, selected loan on loan financing and other debt instruments.

### **LTV**

Absolute maximum of 85 per cent with a blended portfolio LTV of no more than 75 per cent.

### **REAL ESTATE SECTOR & PROPERTY TYPE**

Commercial real estate. No more than 30 per cent of NAV in residential for sale. No more than 50 per cent of NAV in any single sector in the UK except office which is limited to 75 per cent.

### **COUNTERPARTY & PROPERTY DIVERSIFICATION**

No more than 20 per cent of NAV exposed to one borrower legal entity and no single investment exceeding 20 per cent of NAV at time of investment.

## **MARKET COMMENTARY AND OUTLOOK**

Energy costs spiked in February 2022 when Russia invaded Ukraine. Now that we have passed the anniversary of the beginning of the war, we can see inflation from energy is beginning to subside. Headline annual inflation within the Eurozone has fallen to its lowest level in over a year, having dropped to 6.9 per cent in March, down from 8.5 per cent the previous month. This was a bigger than expected drop driven by a 0.9 per cent decline in energy in March compared with an increase of 13.7 per cent in the previous month. A decline in core inflation which excludes energy and food costs will lag overall inflation as the impact of higher input prices may take some time to filter through. Core CPI hit a new Eurozone high of 5.7 per cent in March, up from 5.6 per cent in the previous month. We have seen the same pattern in the data from the US with annual CPI reaching its lowest level since May 2021 and having fallen to 5 per cent in March from 6 per cent in the previous month. US core CPI is now higher than headline CPI at 5.6 per cent.

There has been some moderation in interest rate expectations driven by the knock-on effects from the recent bank market issues around Silicon Valley Bank, Credit Suisse and others which has led to expectations of lower loan availability at higher pricing and so a less expansionary environment. In the second week of March the expectations for the end of year rates for US SOFR declined by a remarkable 1.1 per cent in the week from 5.3 per cent to 4.2 per cent. However, we continue to expect central banks to be hawkish around concerns around the persistence of inflation.

The recent events in the bank market provide a keen reminder of the importance of confidence for banks. Generally the banking system is in a robust position with equity ratios having been significantly bolstered over recent years. The issues with Silicon Valley Bank were somewhat idiosyncratic and in retrospect could also have been avoided in a number of ways. The bank had a unique business profile given the nature of its client base and accordingly had an unusually large number of uninsured deposits. The beginning of the unwind came as these deposits were gradually withdrawn to meet clients' needs, but the bank's strategy of having tied those deposits up in longer term fixed rate assets led to the realisation of a mark to market issue when those investments were realised to meet declining deposits. This could have been avoided by the bank holding shorter dated assets or by interest rate hedging of these longer dated fixed rate assets which would have mitigated the loss realised. Subsequently the effort to raise capital to bolster the equity ratio could also have been handled better. Once it failed the consequence was the uninsured depositors created the fastest withdrawal of deposits of all time as technology allowed them to move cash out faster than in any previous bank run.

After the Silicon Valley Bank failure, the market tested other potentially weak players and in Europe it was Credit Suisse that failed the test as it also quickly lost deposits. Credit Suisse on the face of it was well capitalised but had suffered a series of recent issues that meant it was already suffering from low client and market confidence. The way the deal with UBS was structured further spooked markets due to the treatment of conditional convertible bonds. While this was allowed for in the documentation, the failure to fully respect the priority between the equity and the conditional convertibles was not what markets expected. Bank regulators in Europe distanced themselves from this approach which provided some reassurance to conditional convertible investors. The long term implications are that investors may demand higher returns for these bonds making banks' cost of capital higher.



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The fallout from the bank market turbulence is yet to be fully realised but what we can see already is the move from bank deposits, particularly from smaller American banks to both larger banks and money market funds. This will reduce the ability of these banks, who have provided a substantial proportion of historical real estate lending, to continue to make new loans. We are also seeing some market commentators calling for yet higher capital requirements and further increased regulation for banks. These factors are all likely to contribute to an increasing portion of real estate lending from non-bank lenders.

In the real estate markets we have seen decreased investment volumes. Overall Europe saw an 18 per cent reduction in investment volumes in 2022 versus 2021 with the fourth quarter down 58 per cent versus the previous year. However, there is significant differentiation between markets. For example German multifamily residential transactions declined by 73 per cent in 2022 versus 2021 but German industrial volumes were up by 5 per cent in the same period and UK multifamily was up by 14 per cent. These statistics are driven by investor sentiment toward which asset classes and markets are benefiting from the best ability to drive rental growth. Industrial, residential in growth markets and operationally geared assets such as student accommodation and hospitality continue to be particularly in favour and are attracting the highest level of both investor and lending interest.

On the office side we are seeing a high level of differentiation between markets due to a number of key drivers. For example, US office workers have been much stickier in continuing to work from home than in Europe and Asia. Work from home combined with reductions in headcount in the technology sector has led to some markets experiencing big increases in vacancy and a cautious approach by lenders to new lending for office in the US will lead to issues for some investments.

In Europe office vacancy rates have tended to be lower generally and return to work has been stronger. We are however continuing to see the bifurcation between the best assets with high ESG ratings where there is good tenant demand, which are commanding good rents, and lower quality legacy stock where tenant interest is lagging. A recent example of this is Great Portland Estates leasing for the year ending March 2023. Great Portland signed £55.5 million of new leases in the period, which was a 44 per cent increase on the previous period and notably average rents were 3.3 per cent higher than the estimated rental value at the beginning of the period reflecting the high level of demand for high quality office in prime locations.

There will be continued focus in inflation and interest rate moves and expectations which have been a key driver for real estate markets over the past several quarters. Until the outlook settles further market volumes are likely to remain lower and we anticipate conditions will be favourable for investing in real estate credit.

## NO CREDIT LOSSES RECOGNISED

All loans within the portfolio are classified and measured at amortised cost less impairment. The Group closely monitors all the loans in the portfolio for any deterioration in credit risk. There are some loans for which credit risk has increased since initial recognition. However, we have considered a number of scenarios for these cases and do not currently expect to realise a loss in the event of a default. Therefore no expected credit losses have been recognised.

This assessment has been made based on information in our possession at the date of reporting, our assessment of the risks of each loan and certain estimates and judgements around future performance of the assets.

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**INVESTMENT PORTFOLIO AT 31 MARCH 2023**

As at 31 March 2023, the Group had 18 investments and commitments of £437.6 million as follows:

	<b>Sterling equivalent balance <sup>(1)</sup></b>	<b>Sterling equivalent unfunded commitment <sup>(1)</sup></b>	<b>Sterling Total (Drawn and Unfunded)</b>
Hospitals, UK	£25.0 m		£25.0 m
Hotel & Residential, UK	£49.9 m		£49.9 m
Office, London	£19.5 m	£1.1 m	£20.6 m
Hotel, Scotland	£42.6 m		£42.6 m
Hotel, North Berwick	£15.0 m		£15.0 m
Life Science, UK	£19.5 m	£7.1 m	£26.6 m
Hotel and Office, Northern Ireland	£10.5 m		£10.5 m
Hotels, United Kingdom	£32.0 m	£18.6 m	£50.6 m
Industrial Estate, UK	£27.2 m	£19.0 m	£46.2 m
<b>Total Sterling Loans</b>	<b>£241.2 m</b>	<b>£45.8 m</b>	<b>£287.0 m</b>
Three Shopping Centres, Spain	£29.7 m		£29.7 m
Shopping Centre, Spain	£14.9 m		£14.9 m
Hotel, Dublin	£36.8 m		£36.8 m
Office, Madrid, Spain	£16.3 m	£0.9 m	£17.2 m
Mixed Portfolio, Europe	£6.4 m		£6.4 m
Mixed Use, Dublin	£11.2 m	£1.7 m	£12.9 m
Office Portfolio, Spain	£8.4 m	£0.1 m	£8.5 m
Office Portfolio, Ireland	£21.5 m		£21.5 m
Logistics Portfolio, Germany	£2.7 m		£2.7 m
<b>Total Euro Loans</b>	<b>£147.9 m</b>	<b>£2.7 m</b>	<b>£150.6 m</b>
<b>Total Portfolio</b>	<b>£389.1 m</b>	<b>£48.5 m</b>	<b>£437.6 m</b>

<sup>(1)</sup> Euro balances translated to sterling at period end exchange rate.

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## LOAN TO VALUE

All assets securing the loans undergo third party valuations before each investment closes and periodically thereafter at a time considered appropriate by the lenders. The current weighted average age of the dates of these third party valuations for the whole portfolio is just 1.7 years while the current weighted average age of the valuations for the income producing portfolio (i.e. excluding loans for development or heavy refurbishment) is 1.2 years.

On the basis of the methodology and valuation processes previously disclosed (see 30 June 2020 factsheet) at 31 March 2023 the Group has an average last £ LTV of 58.3 per cent (31 December 2022: 58.6 per cent).

The table below shows the sensitivity of the loan to value calculation for movements in the underlying property valuation and demonstrates that the Group has considerable headroom within the currently reported last LTVs.

Change in Valuation	Hospitality	Retail	Residential	Other	Total
-15%	65.4%	80.9%	66.7%	68.2%	68.6%
-10%	61.8%	76.4%	63.0%	64.4%	64.8%
-5%	58.5%	72.4%	59.7%	61.1%	61.4%
0%	55.6%	68.8%	56.7%	58.0%	58.3%
5%	52.9%	65.5%	54.0%	55.2%	55.5%
10%	50.5%	62.5%	51.5%	52.7%	53.0%
15%	48.3%	59.8%	49.3%	50.4%	50.7%

## SHARE PRICE PERFORMANCE

The Company's shares closed on 31 March 2023 at 89.9 pence, resulting in a share price total return since for the first quarter of 2023 of 4.9 per cent. As at 31 March 2023, the discount to NAV stood at 13.4 per cent, with an average discount to NAV of 13.2 per cent over the quarter.

Note: the 31 March 2023 discount to NAV is based off the current 31 March 2023 NAV as reported in this factsheet. All average discounts to NAV are calculated as the latest cum-dividend NAV available in the market on a given day, adjusted for any dividend payments from the ex-dividend date onwards.



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