

# Quarterly Portfolio Update



**Annualised dividend yield of 6.3 per cent, fully covered by income; two capital redemptions undertaken year to date and more expected in the next few quarters**

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 present its performance for the quarter ended 30 September 2023.

## SHARE PRICE / NAV AT 30 SEPTEMBER 2023



## HIGHLIGHTS

- **Further realisation progress** - during the quarter:
  - A total of £74.6 million, 19.6 per cent of the Group’s 30 June 2023 total funded loan portfolio, has been repaid across seven investments
  - This included the full repayment of two loans and five partial repayments
  - Proceeds were used in the quarter to fund the second return of capital to shareholders of £30.0 million and to create a cash reserve for unfunded loan cash commitments which amount to £44.5 million as at 30 September 2023
- **The average remaining loan term of the portfolio is 1.4 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 6.3 per cent on the share price as at 30 September 2023
- **Inflation protection** – 86.6 per cent of the portfolio is contracted at floating interest rates (with floors)
- **Robust portfolio** - the loan book is performing broadly in line with expectations with its defensive qualities reflected in the Group’s continued NAV stability in a challenging macro environment
- **Significant equity cushion** - the weighted average Loan to Value for the portfolio is 58.3 per cent

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

“ Our real estate debt portfolio has continued to deliver results against a difficult market backdrop, providing a regular, consistent and fully covered dividend and substantial inflation protection. Our high quality loan book has performed broadly in line with expectations and there have been no changes to the credit risk levels applied to any of the loan investments during the quarter.

In accordance with the amendments to the Company’s articles of incorporation approved by shareholders at the EGM on 27 January 2023, we are working 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. We have made good progress on this objective so far this year with £40.0 million being returned to shareholders and a cash reserve of £44.5 million being created to fund the committed but currently unfunded loan cash commitments. The average remaining loan term of the portfolio has now reduced to 1.4 years and as such we look forward to updating shareholders on this objective 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 setting out 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.

In August 2023, the Company announced its second capital distribution, returning circa £30.0 million to shareholders through the compulsory redemption of 29,092,218 shares at a price of £1.0312 per share. The first redemption, in June 2023, returned circa £10.0 million to shareholders through the compulsory redemption of 9,652,350 shares at a price of £1.0363 per share.

## DIVIDEND

On 20 October 2023, the Directors declared a dividend, to be paid in November, in respect of the third quarter of 2023 of 1.375 pence per Ordinary Share, equating to an annualised income of 5.5 pence per annum.

## PORTFOLIO UPDATE

The Group continues to closely monitor its loan exposures, underlying collateral performance and repayments. Despite continued heightened risk around high interest rates, economic conditions and lower transaction volumes, the portfolio has continued to perform well.

Significant loan repayments totalling £74.6 million, equivalent to 19.6 per cent of the 30 June 2023 total funded loan balances were received during the quarter to 30 September 2023. This included full repayment of two loan investments; the £49.9 million Hotel & Residential UK loan and the €12.7 million Mixed Use, Dublin loan. These investments were ground up construction projects which had reached substantial construction completion and were successfully refinanced. As a result of this, the Group has no remaining exposure to ground up construction risk and the Group’s exposure to the residential sector has dropped to 1.1 per cent.

The Group’s remaining exposure is spread across 15 investments. Four asset classes represent 84 per cent of the total funded loan portfolio as at 30 September 2023; these are hospitality (38 per cent), office (23 per cent), retail (14 per cent) and light industrial & logistics (9 per cent).

Hospitality exposure is diversified across five loan investments. Two loans (23 per cent of hospitality exposure) benefit from State/Government licences in place at the properties and benefit from significant structural amortisation that continues to decrease these loan exposures. The other trading hotel exposures have either been recently refurbished or are currently under refurbishment. Refurbished assets are expected to be more defensive should consumer spending on leisure decrease in the future. All trading assets currently continue to have strong revenue performance. The weighted average loan to value of the hospitality exposure is 51 per cent.

The office exposure (23 per cent) is spread across six loan investments. This exposure is expected to further reduce during the fourth quarter as the office London loan (29 per cent of office exposure) is under contract to sell. Occupancy across the leased office portfolio has held up well, with the vast majority of the underlying tenants renewing leases and staying in occupation. The Group’s office exposure is predominantly weighted towards substantially Grade A product (52 per cent of office exposure) and well-located city centre Grade B product (34 per cent). Only 13 per cent of office exposure or 3 per cent of the total invested portfolio is Grade B located in city periphery sub-markets. The weighted average loan to value of loans with office exposure is 60 per cent. The average age of

## KEY PORTFOLIO STATISTICS AT 30 SEPTEMBER 2023

Number of investments	<b>15</b>
Percentage of currently invested portfolio in floating rate loans	<b>86.6%</b>
Invested Loan Portfolio unlevered annualised total return <sup>(1)</sup>	<b>8.1%</b>
Weighted average portfolio LTV – to Group first £ <sup>(2)</sup>	<b>11.9%</b>
Weighted average portfolio LTV – to Group last £ <sup>(2)</sup>	<b>58.3%</b>
Average remaining loan term	<b>1.4 years</b>
Net Asset Value	<b>£372.8</b>
Amount drawn under Revolving Credit Facilities (including accrued interest)	<b>£0.0m</b>
Loans advanced (including accrued interest and net of impairment)	<b>£311.2m</b>
Cash	<b>£60.7m</b>
Other net assets (including hedges)	<b>£0.9m</b>

Remaining years to contractual maturity*	Value of loans (£m)	% of invested portfolio
0 to 1 years	<b>£123.2</b>	<b>40.1%</b>
1 to 2 years	<b>£102.1</b>	<b>33.3%</b>
2 to 3 years	<b>£48.4</b>	<b>15.8%</b>
3 to 5 years	<b>£33.2</b>	<b>10.8%</b>

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

these independently instructed valuation reports is less than one year and hence there continues to be significant headroom to the Group's loan basis on these loans.

The retail exposure (14 per cent) is spread over three investments and has continued to perform strongly from an operational perspective, with occupancies across the shopping centre exposures fully recovered to pre-pandemic levels and in the high eighties or nineties per cent. The sponsor of the shopping centre loans has granted exclusivity to a credible potential purchaser who is currently conducting due diligence. The sponsor is targeting a sale by year end. The weighted average Loan to Value of the Retail exposure is 76 per cent.

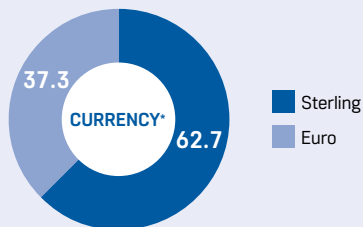
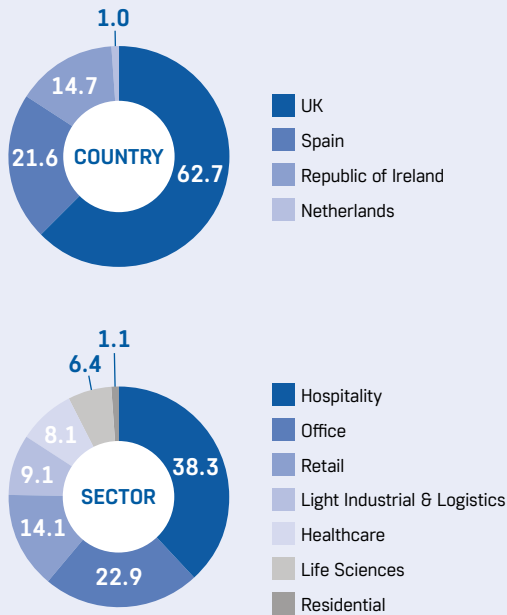
Light industrial & logistics exposure comprises 9 per cent of the total funded portfolio (in two investments) and provides good diversification into an asset class that continues to have very strong occupational and investor demand. Weighted average loan to value of this asset class is 65 per cent.

On a portfolio level we continue to benefit from material headroom in underlying collateral value against the loan basis, with a current weighted average loan to value of 58 per cent. These metrics are based on independent third party appraisals (with the exception of two loans that have been marked against a sale process bid level). These appraisals are typically updated annually for income producing assets. The weighted average age of valuations is just under ten months.

(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. 13 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.

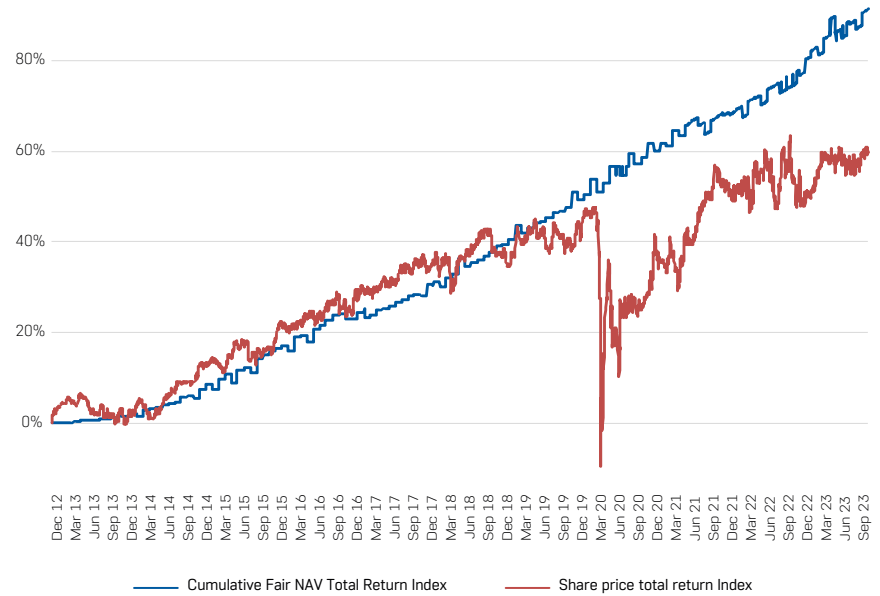
(2) LTV to Group last £ means the percentage which the total loan drawn less any deductible lender controlled cash reserves and less any amortisation received to date (when aggregated with any other indebtedness ranking alongside and/or senior to it) bears to the market value determined by the last formal 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**

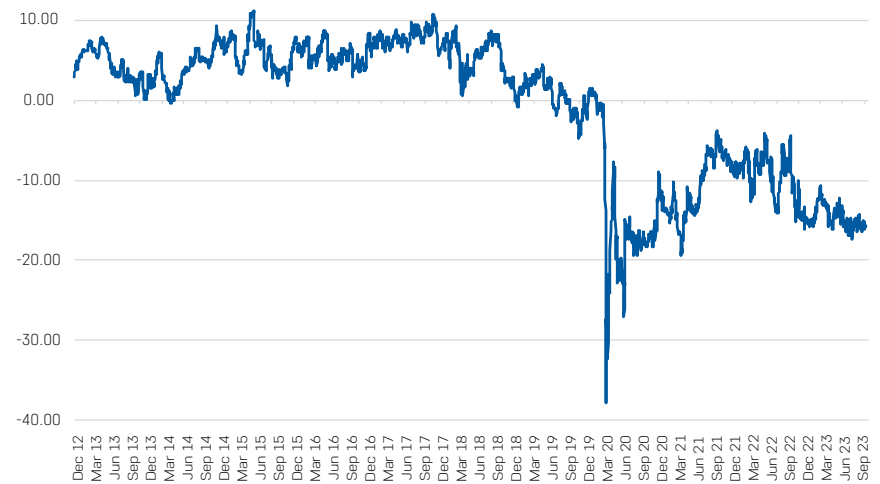


\*The currency split refers to the underlying loan currency, however the capital on all non-sterling exposure is hedged back to sterling.

**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.

## **CREDIT RISK ANALYSIS**

All loans within the portfolio are classified and measured at amortised cost less impairment.

During the quarter there have been no changes to the existing credit risk levels for any of the loans in the portfolio.

The Group follows a three-stage model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified as Stage 1 and has its credit risk continuously monitored by the Group. The expected credit loss ("ECL") is measured over a 12-month period of time.
- If a significant increase in credit risk since initial recognition is identified, the financial instrument is moved to Stage 2 but is not yet deemed to be credit-impaired. The ECL is measured on a lifetime basis.
- If the financial instrument is credit-impaired it is then moved to Stage 3. The ECL is measured on a lifetime basis.

The Group closely monitors all loans in the portfolio for any deterioration in credit risk. As at the date of this factsheet, no additional downgrades or impairments have been recognised since the prior quarter end. As at 30 September 2023, assigned classifications are:

- Stage 1 loans – nine loan investments equivalent to 63% of the funded portfolio are classified in the lowest risk profile, Stage 1.
- Stage 2 loans – five loan investments equivalent to 33% of the funded portfolio have remained in Stage 2. The average loan to value of these exposures is 68 per cent. The average age of valuation report dates used in the loan to value calculation is eight months old. While these loans are considered to be higher risk than at initial recognition, no loss has been recognised on a 12-month and lifetime expected credit losses basis. Therefore, no impairment in the value of these loans has been recognised. The drivers for classifying these deals as Stage 2 are typically either one or a combination of the below factors:
  - lower underlying property values following receipt of updated formal appraisals by independent valuers or agreed and in exclusivity sale values;
  - sponsor business plans progressing more slowly than originally underwritten meaning that trading performance has lagged expectation and operating financial covenants under the facility agreements have breached; and
  - additional equity support is required to cover interest or operating shortfalls as a result of slower lease up or operations taking longer to ramp up.

The Stage 2 loans continue to benefit from headroom to the Group's investment basis. The Group has a strategy for each of these deals which targets full loan repayment over a defined period of time. Timing of repayment will vary depending on the level of equity support from sponsors. Typically, where sponsors are willing to inject additional equity to partially pay down the loans and support their business plan execution, then the Group will grant some temporary financial covenant headroom. Otherwise, sponsors are running sale processes to sell assets and repay their loans.

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- Stage 3 loan – one loan equivalent to 4 per cent of the funded portfolio is classified as Stage 3. This investment has a loan to value of 92 per cent. This value is based on the projected net proceeds which are expected to be available for loan repayment upon sale of the underlying loan collateral. The sponsor has run a comprehensive competitive sale process through a global advisory firm with oversight by the lenders and the bidder has a proven execution track record in the same asset class and deal size and intends to close with all equity with no reliance on debt. Given continued capital markets volatility, materially lower transaction volumes and uncertainty regarding interest rates, the Group has approved the sale and the buyer is in exclusivity while undertaking standard purchaser due diligence.

While the current projected net sale proceeds on the stage 3 loan would fully pay down the Group's loan balance, the Group has applied sensitivities to the expected net proceeds and, on that basis, has accounted for a credit impairment of £1.7 million / circa 0.5 per cent of total funded loan portfolio as at 30 September 2023. We note that despite the impairment, this loan investment is projected to achieve local currency returns of over 1.4 times the Group's capital invested.

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.

## **REPAYMENTS**

During the quarter borrowers repaid the following loan obligations:

- £49.9 million, Hotel & Residential, UK (repayment of loan in full)
- €12.7 million, Mixed Use, Dublin (repayment of loan in full)
- €10.0 million, Hotel, Dublin (partial repayment of loan)
- €3.0 million, Mixed Portfolio, Europe (partial repayment of loan)
- £1.2 million, Hotel and Office, Northern Ireland (partial repayment of loan)
- €0.8 million, Shopping Centre, Spain (partial repayment of loan)
- €0.3 million, Three Shopping Centres, Spain (scheduled amortisation)

These repayments were used in the quarter to fund the creation of a cash reserve to cover the unfunded cash loan commitments (which were £44.5 million at the end of September 2023) and the second return of capital to Shareholders (which amounted to circa £30.0 million).

## **MARKET COMMENTARY AND OUTLOOK**

The US Federal Reserve has been consistently messaging that it will do whatever it takes to bring inflation under control. Now it seems that the Fed has succeeded in convincing the market that rates will remain "higher for longer" with this phrase being one of the most commonly used in the media and in discussions in the markets over the past few weeks. "Higher for longer" has impacted longer dated debt pricing. UK bond yields have hit a 30-year high and US Treasury yields a 16-year high.

U.S. CPI had dropped as low as 3 per cent in June but both July and August data showed rises with higher petrol and residential occupancy costs largely responsible for the increase back to 3.7 per cent. Oil prices had risen sharply following Russia's invasion of Ukraine in 2022 and subsequently fell back between mid 2022 and mid 2023 from a peak of over 120 dollars a barrel to as low as 64 dollars. Since that trough, prices have since risen as high as 95 dollars a barrel with lower supply from Saudi Arabia and Russia helping push prices higher. Tension and conflict are likely to further exacerbate oil price volatility.



**FOR FURTHER INFORMATION,  
PLEASE CONTACT:**

**Apex Fund and Corporate Services  
(Guernsey) Limited as Company Secretary**

Duke Le Prevost  
T: +44 203 530 3630

**Starwood Capital**

Duncan MacPherson  
T: +44 207 016 3655

**Jefferies International Limited**

Gaudi Le Roux  
Harry Randall  
Ollie Nott  
T: +44 207 029 8000

<b>Buchanan</b>	+44 207 466 5000
Helen Tarbet	+44 778 852 8143
Henry Wilson	

**Notes:**

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Despite the slight uptick in inflation, the resolute Fed position of doing whatever it takes and after 5.25 per cent of increases in the preceding eleven meetings, the September Federal Open Market Committee meeting was the first since early 2022 where the Fed did not raise rates. Similarly, the Bank of England also held rates in September. The Bank of England only raised rates once by 25 basis points in the third quarter versus two increases for a total of 75 basis points in the second quarter. The ECB, which started raising rates later than the Bank of England and the Fed, hiked rates for the tenth consecutive time in September; however, it also signalled that policy tightening is likely finished as inflation has started to moderate.

Transaction volumes in commercial real estate remain low and the summer was perceived to be a particularly quiet one. Despite that perception there are a number of notable recent headlines particularly in favoured asset classes. In prime London offices we saw Great Portland Estates report new rentals signed at 13 percent higher than March rental values and reporting that it had committed to a 66,600 square foot, office-led redevelopment at Jermyn Street in London's West End. Land Securities presented similar themes at its capital markets day with new leases 3 per cent ahead of estimated rental values and strong and increased occupancy.

Land Securities also signalled a show of confidence in London's office market committing to delivering their latest net zero development, Timber Square, a 380,000 square foot project in Southwark. Their announcement was a showcase of all the key themes that occupiers, investors and lenders are looking for in best in class office space. Sustainability, net zero, top certifications, occupier well-being, amenities, integration of the public realm and a vibrant mix of retail, leisure and food and beverage all feature. Location remains a top priority for occupiers with the announcement highlighting the proximity to three of London's key transport hubs of Waterloo, London Bridge and Blackfriars.

An asset class area we have highlighted as being in favour is "beds" where there are strong occupational dynamics in many markets. Despite the slower summer period and the fact that real estate financing is typically private and opaque, a number of recent headlines show the popularity of the sector with public announcements on over £2 billion of new financings that closed in this sector over the summer. The lending has been from a mixture of banks and alternative lenders and covers both development and investment loans across all of residential, student and hotels.

With a limited number of acquisitions, we are seeing healthy levels of competition for new acquisition financing. Leverage levels are lower than in recent years due to constraints on interest coverage caused by higher base rates. Development financing also remains healthy for well capitalised borrowers with the right projects. A key benefit of prime developments is that they deliver buildings that are completely up to date with sought after ESG credentials and certifications. With lower transaction volumes providing less market evidence, refinancings are less in favour. Lenders tend to prefer the benefit of the validation on valuation that the new equity in an acquisition brings.

The European banks remain well capitalised and commercial real estate loan to values are much more conservative than during the GFC. However, there are some stresses coming through for European banks that had invested in the more difficult US office markets; on older, browner buildings and in some over-levered pockets of the German development market. Despite cracks in these areas, banks as a whole are still well positioned to continue to play a meaningful part in the market but will not be the right lender for all types of loans. We have seen and expect to continue to see the share of alternative lenders growing and often with banks and alternative lenders working together creating solutions for commercial real estate financing requirements.

**FOR FURTHER INFORMATION,  
PLEASE CONTACT:**

**Apex Fund and Corporate Services  
(Guernsey) Limited as Company Secretary**

Duke Le Prevost  
T: +44 203 530 3630

**Starwood Capital**

Duncan MacPherson  
T: +44 207 016 3655

**Jefferies International Limited**

Gaudi Le Roux  
Harry Randall  
Ollie Nott  
T: +44 207 029 8000

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**INVESTMENT PORTFOLIO AT 30 SEPTEMBER 2023**

As at 30 September 2023, the Group had 15 investments and commitments of £351.4 million as follows:

	<b>Sterling equivalent balance</b> <small>(1), (2)</small>	<b>Sterling equivalent unfunded commitment</b> <small>(1), (3)</small>	<b>Sterling Total (Drawn and Unfunded)</b>
Hospitals, UK	£25.0 m		£25.0 m
Office, London	£20.5 m		£20.5 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	£9.3 m		£9.3 m
Hotels, United Kingdom	£33.2 m	£17.4 m	£50.6 m
Industrial Estate, UK	£27.2 m	£19.0 m	£46.2 m
<b>Total Sterling Loans</b>	<b>£192.3 m</b>	<b>£43.5 m</b>	<b>£235.8 m</b>
Three Shopping Centres, Spain	£28.7 m		£28.7 m
Shopping Centre, Spain <sup>(2)</sup>	£14.1 m		£14.1 m
Hotel, Dublin	£23.8 m		£23.8 m
Office, Madrid, Spain	£16.0 m	£0.9 m	£16.9 m
Mixed Portfolio, Europe	£3.2 m		£3.2 m
Office Portfolio, Spain	£7.6 m	£0.1 m	£7.7 m
Office Portfolio, Ireland	£21.2 m		£21.2 m
<b>Total Euro Loans</b>	<b>£114.6 m</b>	<b>£1.0 m</b>	<b>£115.6 m</b>
<b>Total Portfolio</b>	<b>£306.9 m</b>	<b>£44.5 m</b>	<b>£351.4 m</b>

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

<sup>(2)</sup> Balances shown are funded balances before any impairments.

<sup>(3)</sup> These amounts exclude interest which may be capitalised.



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PLEASE CONTACT:**

**Apex Fund and Corporate Services  
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Duke Le Prevost  
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Duncan MacPherson  
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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 LTVs shown below are based on independent third party appraisals with the exception of two loans that have been marked against a sale process bid level. The current weighted average age of the dates of these valuations for the whole portfolio is just under ten months.

On the basis of the methodology and valuation processes previously disclosed (see 30 September 2020 factsheet with the exceptions as noted above) at 30 September 2023 the Group has an average last £ LTV of 58.3 per cent (30 June 2023: 56.0 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	Office	Retail	Light Industrial & Logistics	Other	Total
-15%	59.8%	70.8%	89.2%	76.5%	63.6%	68.6%
-10%	56.5%	66.9%	84.2%	72.3%	60.1%	64.8%
-5%	53.5%	63.4%	79.8%	68.5%	56.9%	61.4%
0%	50.9%	60.2%	75.8%	65.0%	54.1%	58.3%
5%	48.4%	57.3%	72.2%	61.9%	51.5%	55.5%
10%	46.2%	54.7%	68.9%	59.1%	49.1%	53.0%
15%	44.2%	52.4%	65.9%	56.6%	47.0%	50.7%

**SHARE PRICE PERFORMANCE**

The Company's shares closed on 30 September 2023 at 87.8 pence, resulting in a share price total return for the third quarter of 2023 of 0.7 per cent. As at 30 September 2023, the discount to NAV stood at 15.9 per cent, with an average discount to NAV of 16.5 per cent over the quarter.

Note: the 30 September 2023 discount to NAV is based off the current 30 September 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.

## **DISCLAIMER**

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