CALEDONIAN TRUST

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INTERIM STATEMENT

Half Year to 31 December 2014

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Introduction

The Group made a pre-tax loss of £187,000 in the six months to 31 December 2014 compared with a pre-tax loss of £262,000 for the same period last year. The loss per share was 1.59p and the NAV per share was 145.6p compared with a loss per share of 2.22p and NAV per share of 143.6p last year.

Investment property values were unchanged. Income from rent and service charges was £156,000 compared with £177,000 last year. Administrative expenses were £363,000 compared with £352,000 last year.

Review of Activities

The Group's primary emphasis is now on development, including works to secure existing planning consents, and the provision of infrastructure for development plots and the marketing of house plots and houses.

We have four main development sites in Edinburgh. Brunstane Home Farm lies in the green belt in east Edinburgh but is just off the A1 and lies immediately adjacent to Brunstane railway station with services to Edinburgh (7 minutes) and then north over the Forth Bridge to Fife. The route south is substantially constructed and the Borders Railway to Tweedbank/Galashiels is due to open in September 2015. We have completed the extensive alterations to four listed Georgian stone-built, two-bedroom cottages together with the infrastructure necessary for the next stages of the development. The first of the cottages was sold in November 2013, the second was sold in November 2014 for £225,000. The two remaining cottages are currently being marketed.

The cottages with the stone steading to the east and an amenity plantation to the west form a courtyard. We have recently obtained planning consent for two larger stone –fronted houses over 2,300ft² to the south which will complete an attractive courtyard. We await final tenders for the construction of these houses which we anticipate will commence soon.

Work has started on the next phase of five houses, the Horsemill, which comprises five stone arched cartsheds, a single-storey cottage, the main barn and an hexagon horsemill, a notable feature. Once the stone repairs are complete we anticipate we will commence the next phase of five houses later this year.

We have implemented a consent for eight detached houses at a site in Wallyford, Musselburgh which is within 400m of the east coast mainline station and near the A1/A720 city bypass junction. It is contiguous with a larger, recently-completed development of 250 houses by two national housebuilders and Taylor Wimpey are building over 400 houses nearby but on the other side of the mainline railway which are selling rapidly at prices which have risen quickly to over £200/ft² for large houses and to over £240/ft² for small three- and two-bedroom houses. The market for small houses in the area has improved relative to larger houses and we have obtained consent to replace the two largest detached houses with four semi-detached houses providing ten houses with a larger saleable area of 12,496ft². The environment at Wallyford, formerly a mining village, but well located on the East Lothian coastal strip continues to improve as a result of recent and current developments. We intend to start development shortly.

Our site in Belford Road, Edinburgh, lies in a quiet *cul-de-sac* less than 500m from Charlotte Square and the West End of Princes Street where we have implemented a long-standing office consent for 22,500ft² and fourteen car parking spaces and where we also hold the planning consent for a residential development of twenty flats over 21,000ft² together with indoor parking for twenty cars which we have recently taken up, so securing the development potential. We continue to seek and to promote and improve consents and additional construction and engineering changes further to reduce development costs which will allow the development to start.

At St Margaret's House, our largest Edinburgh development site, our proposals to renew the PPP are well advanced, a lengthy and expensive process. The continuing improvements in the Edinburgh residential market bode well for St Margaret's which has a geared exposure to such rising values. We continue to consider a variety of possible developments.

The Company has three large development sites in the Edinburgh and Glasgow catchment areas. Two are at Cockburnspath on the A1 just east of Dunbar and the East Lothian border where we have implemented the planning consent for 72 detached and four semi-detached family houses.

The third large development site is seven miles from central Glasgow at Gartshore, Kirkintilloch, on the Union Canal and comprises the nucleus of the large estate formerly owned by the Whitelaw family. In order to meet local house building objectives we continue to promote the creation of a new village of a few hundred cottages and houses together with local amenities preserving the existing designed landscape. Such a development would complement our proposals for a high-amenity business park in a rural setting, including an hotel and a destination leisure centre. This is a long-term project for which we are building support in the local community and which meets existing needs and development criteria.

The company owns fourteen separate rural development opportunities, nine in Perthshire, three in Fife and two in Argyll and Bute, all set in areas of high amenity. In Perthshire at Tomperran, a thirty acre smallholding in Comrie on the River Earn, we hold a consent for twelve detached houses over 19,206ft². We have now submitted an application for a revised layout for this site and another planning application for a further thirteen houses on our adjoining two-acre site which until recently was zoned for industrial use. These two applications for twenty-five new houses will occupy over 40,000ft². At Chance Inn, Cleish, by Kinross, we hold a consent for ten houses over 21,836ft² in the farm steading and a consent for two houses on plots adjacent to the former farmhouse. These two house plots will be marketed shortly once the arrangements necessary to meet the strict phosphate reduction programme required for conservation of Loch Leven have been met. Negotiations to meet these criteria for the farm steading conversion should complete shortly.

Nearby at Carnbo, on the A91 Kinross to Stirling road, we recently completed negotiations for the Section 75 Agreement to enable the development of four houses over 7,900ft². It is intended to market these plots in the spring.

Our largest rural development site is at Ardpatrick, a peninsula of great natural beauty on West Loch Tarbert and within two hours' drive of Glasgow and central Scotland. South Lodge, which has commanding views over West Loch Tarbert and which we had fully refurbished, was sold in November 2014. We are marketing several development sites: Bay Cottage, a bothy for conversion with consent for an extension to form a three-bedroom house set in a paddock with views to Achadh-Chaorann Bay; Oak Lodge, a waterfront site with consent for a 1,670ft² house; two plots set in a small field just off the Kilberry Road; and a further three sites on the UC33, a *cul-de-sac*, which leads to the estate.

Economic Prospects

A tale by a 22nd century Grimm:-

> At Eagle Ford, a besieged fort in Texas, Commander PEA K'oil's ghost danced, translucent in the flickering will o'the wisps. Smoke signals, pale blue in the moonlight, betrayed Chief Mon O'Poly's pow-wow with the Algonquinsaids. PEA K'oil's men prayed for General Rig's promised relief; all waited: a bear growled menacingly. A trembling cacophony broke the dawn flaring on the US Cavalry in drill order. Col S O G Frack surveyed the field. Mon O'poly and the Algonquinsaids had fled .... a bear lay, skinned. K'oil's men thanked Mammon, Prophet Technopole and the Animal Spirits, but they feared Mon O'poly's return.

The UK economy, like all the OECD economies, continues to recover from the longest depression in over a hundred years. Stark evidence is provided by the monetary policies of the Bank of England, the Fed, the Bank of Japan and the ECB all of whose base rates continue at record lows and whose use of quantitative easing is widespread. Additionally, particular problems, largely of their own making, attend the Eurozone economies. Into this recovery the US "Cavalry" have ridden providing a boost from significantly lower oil prices – equivalent to a *deus ex machina*. Only a year ago such a price reduction was very widely unforeseen, but has now occurred, as I wrote in my report dated 23 December 2013:-

> "Interestingly, Saudi is reported to have said that it no longer intends to increase its oil capacity beyond its current level [*c* 11,000m bpd] before 2040 because of the growth of supplies elsewhere. The increasing supply from fracking coupled with other higher cost sources such as oil sands and Arctic oil and the increasing competition from gas, where supply is likely to benefit even more from fracking, seem likely to outweigh the continuing but differing supply interruptions as exemplified by the "Arab Spring". Prices will fall from the present $100, but on present technology a limit of $60 to $80 seems likely as that is currently the cost below which most oil from most unconventional sources, including fracking, becomes uneconomic."

Undoubtedly, such a reduction in oil prices, while injurious to oil producers, would further stimulate the economic recovery. More important effects will be geo-political. Low oil prices reinforced by continuing reduction in output, would undermine the economy of an independent Scotland. In the Middle East and Russia, economic and political outcomes are interdependent and oil prices will determine their external relations.

In 2014 UK GDP grew by 2.6%, the fastest growth since before the 2008 recession and the subsequent depression which ended only in late 2013. GDP in Q4 2014 rose 0.5%, lower than the 0.6% widely expected, and well below the 0.7% in the third quarter, but this slight recorded reduction in growth rate should properly be reviewed in the context of "seasonal" adjustment, revisions to the GDP estimate, and the range of significant margin of error which is over 0.2%. The 2014 growth rate is broadly comparable with rates occurring before the recession, and, while a great relief after so long a depression, is hardly a cause for celebration, as rates of growth following a depression are usually above pre-recession levels – a process of "catch up". For instance, following the previous recession in 1990, a recession of only 3.0%, subsequent annual rises in GDP were 3.2%, 4.8% and 2.9% respectively. Forecasts for 2015, while not characterised by such a "bounce", are extremely encouraging and surprisingly consistent. Interestingly, of the 2015 comparisons quoted by the OBR, the highest is the Bank of England 2.9% and the lowest the OBR itself at 2.5%, with the IMF, the OECD, the EC and the NIESR all within this range, as is the HM Treasury March 2015 "comparisons of independent forecasts". A remarkable uniformity! Forecasts for 2016 are similar and almost equally uniform. The Bank of England is again the highest with a repeat forecast of 2.9% and the OBR the lowest, dropping 0.2 percentage points for 2015 to 2.3% and all the other forecasts are either at or between these limits.

Prospective UK growth in 2015 compares favourably with other economies. It is the highest amongst the G7, other than the US, 3.2%, but higher than the Eurozone, 1.2%. A remarkable recovery is expected in Ireland with growth of 3.3% and a severe contraction in Russia of 5.0% – and high growth of 7.0% in China and India. Projected growth rates between the UK regions continue to be marked. London and South East regions which grew 3.0% and 2.9% respectively in 2014, are expected to continue at these levels, while the poorest performing region, Northern Ireland, is expected to fall from 1.8% in 2014 to 1.7% in 2015. The projected rate of output growth in the UK's regions drops steadily from *c*3.0% in London and the South East to 2.4% in East Anglia, Yorkshire and Humberside and the South West to 1.9% in the North East. Scottish growth is expected to fall from 2.7% in 2014 to 2.3% in 2015, a fall reflecting the contraction of the oil sector.

The recovery in the UK economy and its good prospects are rightly a cause for relief. In particular, they provide further proof of the wisdom of those few earlier policy-makers who resisted the shrill voices of those advocating joining the Eurozone, in which some members still flirt with recession, whose growth rate was a meagre 0.8% in 2014 and is expected to be only 1.2% in 2015. The Chancellor, in his Budget speech on 18 March 2015, celebrated the success of his long-term economic plan, the much-vaunted Plan "A" saying: "We set out our plan;"; "A government whose plan is delivering jobs"; and "only if we work through the plan".

Consistency, purposefulness and long-term planning, provided there are palpable results, makes good theatre and even better politics, especially when an election looms. In reality Mr Osborne has exhibited the even greater political attributes of review, adaptation and expediency and his success derives from the targets he has abandoned, so avoiding the worst effect of these policies rather than those to which he has adhered. A key element in Plan A was to eliminate, or nearly so, the structural deficit -8.7% of GDP in 2010 – largely by austerity. This year the deficit is likely to be about 4.5%, or £50bn more than first planned. Reacting to weak economic growth, caused in part by the Eurozone's poor economic performance, the Chancellor rightly delayed planned austerity, pushing it back to the next Parliament. The resulting deficit spending increased economic growth, probably avoiding another recession: Plan B by the back door. Plan A endorsed the previous Labour government's policy to cut capital budgets, and in the first two years under Plan A public investment fell by 35%. Happily this policy was reversed in practice, although not renounced, in 2011 as this closet Keynesian policy was implemented – better late than never. The third reversal of policy took place in another policy area, but it bears heavily on the economic recovery. Coalition immigration policy pledged to reduce annual net migration to "tens of thousands", but now, four years later, the latest count is 298,000 and rising! Immigrants are predominantly young, healthy and hardworking and, accordingly, have boosted UK GDP. Since the Coalition was formed GDP has risen 7.8%, but GDP per person has only risen 4.2% in spite of the disproportionately high contribution by the immigrants who so greatly assisted the proclaimed success of "long-term plans" which plans specifically excluded them. Good political tactics beat, or at least rebalance, poor policy.

Plan A, or Plan A modified, has coincided with the recovery. Whether the recovery is because of, or in spite of it, or even independent of it, is not determinable from the coincidence of the events. A point that is indisputable is the weakness of the recovery compared with those since 1955, an analysis most clearly made in GDP *per capita* which has risen by only about 1.0% pa since its trough in mid-2009, or roughly 5.6% by end 2014. In the five previous recessions, the earliest one in the mid-1950s, *per capita* GDP had risen by 15% or more over the same period. Thus the longest recession is being followed by the slowest recovery and therefore it is hardly surprising that the loosest monetary policy ever continues, but what is surprising is that this policy has had so little apparent effect on output or inflation.

Low interest rates are pervasive, affecting not just short-term rates but long-term gilts and Treasuries at 2.5%, Japanese bonds at 1.5% and 30 year German *Bunds* at 0.7% and index-linked gilts at minus 0.7%. QE understandably influenced long-term yields, lowering them by up to one percentage point but they have remained low since QE ceased and were low in Germany even before QE was contemplated.

Unusual phenomena usually have unusual causes, an egregious one posited by Martin Wolf, writing in the Financial Times. Rates are low because the market rates are low and the Central Banks are reacting to market forces: the supply of credit only balances the demand for credit at low interest levels because investment opportunities have risky or small returns, a product of risk aversion and low demand: a phenomenon labelled "Secular Stagnation" by Lawrence Summers as Central Banks ultimately respond to global economic contraction. Previously these "excess" world savings were repackaged by the banks into consumer credit, creating or at least, reinforcing the pre-recession boom. Amazingly the boom, the bust and the boring recovery share a common ancestor, excess savings.

An oil price fall transfers resources from the oil producers to the oil consumers, a group with a much higher propensity to spend. The UK, a net importer of oil and gas, is benefitting from this increase in demand. The Bank considers that each 10% fall in oil prices increases UK GDP by 0.12% or a 50% fall, by 0.6%, but if the underlying increase in GDP is 2.25% then GDP is increased by 27%. The OBR review several empirical studies on the effects of oil price changes. For long-term changes, say three years or more, the NIESR consider that a drop from $100 to $80 would lead to an increase in UK GDP of 0.5%, a much larger response than the Bank's estimate. While it follows that a drop to $50 would have a larger, but not necessarily a proportionate, effect, the boost to GDP would probably be at least 1.0%. The effect on inflation is also very significant, but quite separate, and is about 0.75 percentage points, again very significant as the inflation rate in the UK is already very low. The marginal effect on inflation is at its greatest after one year, and as inflation effects are computed compared with previous periods, the effects virtually drop out of the figures in two years.

The UK remains a significant but rapidly declining oil producer. The OBR assumes that oil prices recover quickly to over $60 and remain in the $60 - $80 range until at least 2020. (Crude Oil Brent Futures are currently January 2016, 60.99; December 2020 $75.85.) Given this assumption, they estimate that under the pre-2015 Budget fiscal regime, the oil price fall would have reduced UK North Sea oil output by 30%. However, the ameliorating effects of the tax reductions announced in the 2015 Budget would reduce this 30% fall to 15%, a fall in output reducing the UK GDP by, say, 0.1%. Thus, for the UK as a whole, the OBR estimates that the likely continuing low oil price will increase GDP by, say, a net 0.4%. Patently, the increase implied by the NIESR's estimate would be greater. In addition, the OBR estimates that productivity growth will increase by 0.25 percentage points as a result of lower oil prices, a large improvement on the current 0.9% rate of productivity growth currently estimated by the Bank.

The beneficial effect of lower oil prices for the UK masks the net detrimental effect on the oil-producing locations. The UK oil sector employs about 375,000, of whom about 160,000 are in Aberdeen. In December 2014 the Government estimated that up to 35,000 of these jobs would be lost if oil prices did not recover, although the Scottish Secretary estimates the recent fiscal relaxation announced by the Chancellor in the 2015 Budget will save "tens of thousands" of these jobs. Currently there are almost daily reports of job losses, anecdotal accounts of oil agency workers not obtaining work and of offshore jobs now having 50% longer onshore leave. The fall in employment will not be a one off disaster as was the closure of the Ravenscraig steel works, but gradual, more like the coal industry. The production cycle of large capital off-shore projects is very long with marginal costs well below average costs, leading to the retention of facilities operating below "costs". However, new facilities to replace depleted ones will not be established. Some estimates of long-term job losses seem conservative. The trade organisation, Oil and Gas UK, estimated that, while even 5% of North Sea fields operate at a loss in the "good times", with prices at $50 almost one third of the fields are unprofitable.

Industry sources recall previous price collapses to $10 in 1986 and to $12 in 1998 and comment: "The black stuff always bounced back in the end". However, this time is different, as both the economics of the North Sea and the long-term pricing power of OPEC, and therefore its strategy, have changed. North Sea oil and gas production peaked in 1999, fell slowly until 2010 and then declined rapidly. Operating costs have more than doubled in the last five years and the North Sea is now the most expensive offshore basin in the world, and even the shallower North Sea fields cost more to work than the deep waters in the Gulf of Mexico!

These low prices will inevitably reduce the development of new fields or the extension of existing fields (only eight wells were drilled in 2014 compared with twelve in 2014 and 28 in 2009) which in turn will reduce the use of shared facilities, such as pipelines. The progressive reduction in the use of shared facilities makes such facilities uneconomic even for existing fields and leads to closure. One or two cards can bring down the whole edifice.

Field closure reduces the market for specialist services supporting the oil industry and makes relocation to areas nearer expanding markets more attractive. Thus what is at risk is not just the production economy but also the service economy. Scotland has had leading positions in other industries with supporting services such as the steel, ship-building and mining and engineering industries, but the absence now of the previously large supporting industries is, unfortunately, notable. There is no guarantee it will not become so with the oil-supporting services.

The potential damage to the Scottish economy of a prolonged period of low oil prices is serious, and is wisely being mitigated by fiscal and other measures by the UK Government. However, the damage to the Nationalists' case, as predicated on the economic benefit of North Sea oil is incapable of such mitigation. The SNP's preferred forecast assumed an independent Scotland would receive £20.2bn of revenue between 2016-17 and 2018-19 based on $113 per barrel. At the present *c* $50 per barrel the Scottish revenue allocation from these three years would be a paltry £1.0bn *per annum*. The early Scottish Nationalists may rightly have campaigned: "It's Scotland's oil", but its value has virtually vanished due to depletion, increased cost and a more competitive market.

The price collapse has several disparate causes. Recently most commodity prices have declined as shown by lead indicators such as the Copper price and the Baltic Dry Shipping Index, which has almost halved in a year, illustrating a reduction in demand, or at least its growth but oil supply has increased in spite of recurring interruption in the Middle East and Africa, primarily because of the growth of US supplies from fracking. Small changes in supply cause a disproportionate change in price because the demand for oil is relatively inelastic – an airline will keep to its schedule independent of its fuel prices, at least in the short term, so must keep buying. The OBR estimate that oil supply is about 94.25mb/d while usage is 93.25 mb/d, or a surplus of about 1mbd. The Bank say: "Oil supply news is likely to have been the biggest driver of [the] drop in oil prices, although a weakening outlook for demand is also likely to have played a material role". Given the inelasticity of demand, small differences in supply at the "tipping point", where supply and demand balance, clearly effect large price changes.

The oil production and distribution industry has large economies of scale, particularly in operations outside the consuming country, and requires vast capital investment to "enter". It has long been dominated by a few large companies, notably the "Seven Sisters" forming the cartel, "Conservatism in Iran" from WWII until the 1970s. These "girls" – Anglo-Persian Oil; Gulf; Texaco; Shell and Standard Oils of New York, of New Jersey and of California controlled 85% of the world's petroleum reserves, and effectively the international oil market. Another cartel, OPEC, was formed in 1960 "to secure the best price available from the major oil companies" for the OPEC countries which controlled about 40% of world production. OPEC objectives have been well served by the political maelstrom that has prevailed in the Middle East since just over a decade after their foundation. Their members instigated the Arab Oil Embargo in 1973-74, the time of the Yom Kippur war, which quadrupled prices and the members subsequently benefited from the supply interruptions caused by the Iranian revolution and the Iran-Iraq war in the late 1970s and early 1980s. Prices rose (in 2010 US dollars) from *c* $15 to *c* $40 because of the embargo, and to $80 in the early 1980s at the time of the Iran-Iraq war.

The American saying: "The cure for high prices is high prices" is proving accurate. In the US, price rises encouraged political changes which eliminated price controls, reduced taxes and otherwise encouraged production. High prices enabled the development of many higher cost resources: for example in the North Sea, in Russia, which in 1980 became the world's largest producer, and in the USA where the high-cost Alaska field alone supplied 2m bpd of oil, almost 3% of the world's supply. Simultaneously, oil consumption in the USA, Europe and Japan declined by 13% over a short period and the oil price, which peaked in early 1981, started to decline. To maintain prices OPEC cut production in 1980, the principal cuts being made to Saudi Arabia where production fell from 10m bpd in 1981 to 3.5m bpd in 1985, but the price continued to fall reaching $27 in 1985. The planned OPEC cuts were not met by most other

OPEC members who inflated their reserves to achieve higher quotas, cheated, or just refused to honour their undertakings. Saudi Arabia, selling less at lower prices, abandoned their role as "swing" producer and produced at full capacity, resulting in a large surplus, which for a brief two months in mid-1986, drove prices below $10 before recovering again, but to less than $20 for the next few years.

The years following the Arab Embargo in 1973 had made OPEC seem impregnable, but the same forces had exposed a growing weakness as the market responded to the cartel's high prices. In the 1970s OPEC's share of world production was about 50% but by the 1980s it had contracted to less than a third. The unsettled political situation which had contributed so greatly to the price rises from which the OPEC members had so greatly benefited militated against them as the antagonisms inherent between them prevented the co-operation and discipline so necessary to operate an effective cartel.

Paradoxically, the political acrimony, so damaging to the purposes of the OPEC cartel, was again instrumental in achieving OPEC's purpose. Iraq invaded Kuwait in 1990, alleging, *inter alia,* Kuwait's transgression of the OPEC rules and its theft of Iraq's oil by pumping it underground across the border into Kuwait from Iraq's Romaila field. The war caused a temporary spike to $30, but prices then eased back in the range $15-20 before rising above $20 in 1996/97. Consumption rose only 14.5% between 1986 and 1996, but output rose in the Middle East by 53%, more than compensating for a 44% fall in the Soviet Union, an empire then in disarray. Increasing supplies from many sources, including renewed Iraqi exports, entered a market reduced by the Asian economic crises and by a mild winter in the Northern hemisphere and resulted in a surplus of about 1.5m bpd. (The current surplus is estimated at 1.0 m bpd – see above). The *coup de grâce* was OPEC's suicidal decision in November 1997 to raise its quotas. Unsurprisingly, the price dropped rapidly in 1998 falling briefly below $10, similar to the low point in the 1986 crisis.

OPEC, an organisation of unbridled power in 1975, lost market control in the 1980s, a control only re-enacted after the powerful and expensive demonstration by Saudi Arabia of the effects of ill-discipline, sought outside support in order to limit production and restore prices. In 1995 an accord was reached between Saudi Arabia and Venezuela and Mexico whereby Saudi Arabia matched their combined output cut of 300,000 bpd, an accord which formed the basis of further cuts within OPEC and in certain non-OPEC producers. With outside help the cartel managed to re-establish higher prices.

For the next decade political and economic events secured both higher volumes and higher prices for OPEC producers as the events of 11 September 2001 precipitated political upheaval in the Middle East and the long economic boom before the crash of 2007/08 boosted demand and prices, while production and production capacity lagged so reducing "spare output capacity" over that period. Supply was effectively limited by economic considerations and not by OPEC and prices rose very rapidly peaking at over $145.85 in 2008. The onset of the 2008/09 recession, exacerbated by the ill-judged decision not to rescue Lehman Brothers, caused a collapse in all asset values and oil fell very briefly to $32 in December 2008, before recovering during 2009 to $80.

The enduring high oil prices, abundant credit and the "animal spirit" of the pre-recession boom years fostered an array of oil production schemes, some requiring break-even oil prices of about $100 – heady days! Principal amongst these schemes was "fracking", a technique very successfully adapted to the US shale oil industry which has boomed in recent years, whose high production costs, some over $80, have now been significantly reduced, occasionally to $40 and further productivity increases are expected. For example, this year BHP report that in Eagle Ford, Texas drilling costs have declined 17% in six months. From 2008 the US shale oil output has risen from virtually nil to over 4.0b bpd, a third of total US output, making the total US production almost equal to the largest producers, Russia and Saudi Arabia and in 2014 world supply increased 2.5%.

Fracking is a classic "swing" supplier. If prices rise above the breakeven additional production is available within a year, and, inversely, if prices fall, no new production is undertaken and the existing wells deplete so rapidly that total production quickly declines. Fracked wells are almost like short-term agricultural commodities – a rise in wheat prices soon stimulates extra production and *vice versa* and in classical Ricardian economics brings marginal land into production. Deep North Sea production could not be more different; highly capital intensive, large "ticket" investment, five - ten year start-up times and 20-40 year production cycles.

In 2013, as quoted above, Saudi Arabia announced that it intended to maintain its market share and specifically not restrict output in order to increase oil prices. On close analysis this decision, although largely unexpected, has a rational interpretation which has unfortunate implications for the UK traditional oil industry.

A key conclusion is the OPEC cartel today is different from the OPEC cartel of 1973. Then its members were cohesive, now they cheat, pursuing short-term individual gain; then they controlled about 50% of the market, now they control only 30% making increased output restriction necessary to move the market; then they controlled virtually all the easily accessible oil situated in distant continents which required huge capital infrastructure to extract and transport it, now a drilling rig and $1m or so produces oil in the world's principal consumers' backyard, a material change that has undermined OPEC.

There is another important underlying strategic consideration but one not immediately obvious. In 1978, five years after the Oil Embargo, world oil reserves were estimated to be less than thirty times the then production. In 1996, after thirty-eight years of production, world oil reserves were estimated to be over forty times that much higher output. Now BP estimate that world reserves at December 2013 were 53.3 times the 86.8m bpd production in 2013. The largest producer, Saudi, has a Reserve/Production ratio of 63.2 years! The Red Queen might observe the more you produce, the more you will have ....

There will be many elegant calculations to be made to determine the return from delaying present production and possibly getting higher prices and the present value of these future supplies. Amongst the complicating assumptions are the effects of current higher oil prices on supply: for instance, past high prices have allowed the development of high cost sources, promoted fuel switches, alternative energy and energy saving, and what value does it have if it is not realised? Additionally, it seems likely the reserves will be extended as these reserves do not include the potential of the huge shale oil deposits distributed across the world, largely outwith OPEC territories.

A small cloud obscures all these calculations as it hangs over all fossil fuel producers: obsolescence. Perceptively, even at the time when OPEC was most powerful in 1973, it was the Saudi Oil Minister Sheik Yamani who said: "The paleolithic age did not end because we ran out of stones." The possibility of low-priced alternative energy creeps higher year by year, much encouraged by the recent high price of fossil fuels. In particular there is an aesthetic elegance in utilising sunlight directly rather than have it routed via plants, and possibly plankton in the case of oil, with a delay of many millions of years.

For years shale was discussed as unworkable, then it was minimised as unsustainable and now it is hailed as an economic and geopolitical game changer. Solar power is presently subject to the same strictures, but those treating it as a mirage may discover it also as a reality. Certainly it has many times been declared a winner, only to founder, but all technological advance is erratic, entering many *cul-de-sacs* and progressing as if through a fog. Solar power accounts for 1% of the global energy supply and has expanded 50% for six years! In California 40% of solar installations operate without state subsidies. There are continuing revolutions in the production of solar panels. Industrialisation, especially in China, has given mass production, economies of scale, improved production processes and lowered profit margins. Technological advance has reduced the price of the raw material, polysylicone, by 90% and solar panel costs have fallen 80% since 2005. Prices fell by 5% – 12% in the first half of 2014. Emulation of the electronics industry would yield considerable further economies. The third factor is technological innovation. Solar panels currently convert 20% of the incident energy into electricity – two watts for every ten falling. New materials are expected to improve this conversion where a one percentage point increase in efficiency gives a 5% reduction in the whole system cost.

Historically, the OPEC cartel may have increased their current income, and possibly rightly so, but they have contributed to the development of other oil extraction methods and higher cost oil supplies and the extensive development of other energy supplies, all contributing to the undermining of their once dominant position.

Saudi Arabia appears likely to continue to defend its market share and a robust attempt to corner the oil market seems unlikely and, if made, likely to fail, barring any major interruption of normal supplies occasioned by, say, a major geopolitical event. In these circumstances oil prices will be controlled by the fracking swing producers, at, say, \$60-\$80 as posited above. For Scotland, for the UK, the North Sea oil bonanza is over – perhaps this conventional oil was harvested at the optimal time. However, shale oil offers a major opportunity for the UK where the distribution is relatively uniform.

For the whole of the UK economic conditions are more favourable than they have been since 2007, but Scotland faces the consequences of a more rapid contraction of the oil industry than previously seemed likely.

Property Prospects

The IPD Index commercial property returns were 17.8% in 2014, 10.7% in 2013, 2.7% in 2012, 8.1% in 2011, 14.5% in 2010, 2.1% in 2009 and – 22.5% in the disaster year of 2008. The 2014 return comprised 5.2% "Income" return and 12.0% "Capital" return. Equities returned 0.5%, Property Equities 24.3% and Gilts 11.8%. Over ten years, Property has returned 6.2%, Equities 6.8%, Property Equities 2.4% and Bonds 6.3% while inflation has been 3.1%. The CBRE All Property Yield in December 2014 was 5.6%, a 0.4 percentage points decrease in the year. The 10 Year Gilt Yield fell 0.9 percentage points in the year to December 2014 to 1.8%, 3.8 percentage points lower than the All Property Yield. At the market peak in May 2007 the All Property Yield was 4.8% compared with the current 5.6%, or equivalent to a fall in property values of 14.3%, assuming unchanged rents. The All Property Rent Index was 188 in May 2007 compared with 180 in December 2014 which, with the yield change, is equivalent to a fall of 17.9% in investment value since the peak.

Over the year the yields fell for all sectors in all geographical areas, the largest sectoral fall was 0.63 percentage points in the "All Retail Warehouses", and the largest geographical fall was 0.8 percentage points in the North West and in Scotland, both for Industrials. Present yields are very approximately the same as they were at the end of 2007, having started to rise quite sharply prior to the 2008 recession, but Gilt yields were then over 2.5 percentage points higher than the present extremely low 1.8%.

Rental growth took place last year in all sectors, averaging 3.8%, except Retail Warehouses where rental values declined 1.2%. Shop rentals rose overall but they continued to decline outside London and, surprisingly, Scotland. Offices improved by 8.2% overall, largely due to 10% or higher rises in Central London. The recovery in the commercial market, which began in 2013, has accelerated in 2014 and returns in 2015 are expected to be very good but below 2014's exceptional 17.8% return. The IPF forecast "Total returns" of 12.4% in 2015, significantly above their forecast of 9.2% given last year for 2015. Rental growth of 6.6% is forecast for Offices and 3.0% for Industrials, but lower rates for all retail categories, and capital growth, including some further reductions in yield, results in forecast returns of 14.6% for offices, 13.9% for Industrials and just over 11.0% for all retail categories. IPF are forecasting rental growth continuing in 2016 at 3.0%, 0.3 percentage points lower than in 2015, but capital value growth will fall to 3.1% because yields are expected to improve only marginally, resulting in total returns of 8.2%. The five year return to the end of 2019 is forecast at 7.2%. Surveyors' reports are even more optimistic. Cluttons report that in 2014 43% of investment purchases were made by overseas buyers, rising to 60% in London, as investors are attracted by prospective rental growth and the yield difference of about four percentage points over bonds. Colliers report that investment sales in 2015 are 20% higher than in 2014 and declining stocks and better yields are attracting investors to the better regional areas. In general yields are expected to decline, especially outside London, with returns for Offices and Industrials expected to be over 20%.

The commercial property market has recovered from a very significant fall. Some investment property values, notably in London and the South East, will probably exceed 2007 peak levels, but many are unlikely to regain such levels. In particular, the continuing revolution in retailing is having widespread significant effects. I repeat my previous assessment that segments of the investment market will continue to suffer a secular erosion caused by technical obsolescence, loss of locational primacy and competition from new formats.

In 2014 the residential market continued the improvement in 2013 that followed three years of little change. In Scotland, the LSL house prices index rose 4.2% compared with 3.1% in 2013 and in England and Wales the price index rose by 9.6% but, excluding London and the South East, by 5.7% compared with 3.4% in 2013. A remarkable feature of 2014 was the annual rise in house prices in Greater London of 20.4% in the year to June. The Halifax and the Nationwide report lower rises of *c*8.0% for UK houses for 2014, but their sample is based on their mortgages and exclude the approximately 35% of cash buyers. If cash buyers are more frequent in the higher-priced properties that have been rising more quickly in London and the South East then the mortgage-based indices will show lower average price increases. Additionally, both these mortgage providers give national figures, including Scotland where growth rates have been lower, so compounding that bias.

In 2014 in England and Wales the largest price rise in the LSL index occurred in Greater London, 18.1%, with the neighbouring area, the South East, rising 10.8%. East Anglia, the South West and South East Midlands rose about 7.0% and the other regions about 5% excepting the North at 3.5%. Throughout England and Wales price rises were greater for the most expensive properties and least for the cheapest: the most expensive quartile rose 10.7% and the cheapest quartile rose 2.9%.

In Scotland there has been no overall house price boom as Registers of Scotland report prices increased only by 3.4%, only marginally above the 3.1% in 2013. In contrast to England and Wales where the highest increases were in Central London, Scotland's most outlying district recorded the largest rise: in Shetland the average price rose by 17.6% and by 26.2% in the last quarter alone! Absent an "oil rush", surely a statistical anomaly!!

In Scotland, in the major conurbations, price changes were more varied among geographical areas than among price quartiles. In Aberdeen prices rose by 5.4%, the highest of any Local Authority, but in Glasgow by only 0.3%. The category of housing having the greatest price rise varied among the cities. In Edinburgh, detached houses, the most expensive category, averaging £395,000, rose by 13.1%. In Glasgow, semi-detached houses averaging £156,000, rose by 13.0%. Lastly in Aberdeen, the cheapest houses, flats, rose by 7.8%. Encouragingly, LSL Property Services report that in January 2015, Scottish prices, having risen by 1.0%, achieved a record average high of £166,771, in national terms £1,238 more than at the peak of the housing boom in May 2008. Tellingly, perhaps, given the developing oil crisis, prices in the city of Aberdeen fell 2.0%.

Independent forecasts for UK house prices are published by HMT. In February 2014 the forecast growth for 2015 was 7.3% with a range from 16.0% to 3.2%. This year the median forecast growth is 5.0% with a range from 7.4% to 2.0% and for 2016 the forecast is 3.7%

growth with a range from 9.9% to 2.0%. The OBR are forecasting growth rates of 4.5% in 2015 and of between 4.3% and 7.0% until 2020.

Savills dintinguish between "Mainstream" and "Prime" housing markets. UK Mainstream prices, including London, are expected to rise by 2.0%, 5.0%, 5.0%, 3.0% and 3.0% from 2015 onwards, rising 19.3% over five years. In Scotland, Savills expect Mainstream prices to rise by 3.5% in 2015 and then by 4.0%, 4.0%, 2.5% and 2.5% or by 17.6% over five years. These projections are slightly lower than those made last year, and, possibly unusually for surveyors, lower than many other forecasters. Savills consider that the stricter mortgage availability testing introduced by the Bank effectively caps individual borrowing, reducing demand. This Bank test has caused the average loan-to-income multiple to decline from a peak reached in June 2014. The Prime housing market is being affected by the more progressive (and higher) stamp duties now in force together with the threat of the introduction of a "mansion" tax. Prime house prices are not expected to change appreciably in 2015 and are expected to be stable or fall in London and Scotland. The five year Prime forecast is for a 20 – 25% gain in Central London and for over 20 – 25% in England, but in Scotland the forecast rise is restricted to 17.5%.

The continuing rapid growth in the UK economy together with the increased availability of credit, at least within the limits of the Bank's criteria, and crucially for first-time buyers, the Government Help to Buy schemes, will increase demand substantially. The available short-term supply, principally an overhang of sellers previously unable to get their sale prices, has substantially cleared. Longer-term supply becomes available only after a long production cycle, including particularly planning, and continues to be restricted by the elimination of many small house builders and by the lack of finance. I foresee that, given political stability, prices will continue to increase, especially for family homes for which the supply seems most constrained and for which the potential demand seems greatest.

Conclusion

The UK has at last emerged from the longest depression in recorded history. Economic prospects for the UK are at present very favourable, and only slightly less so for Scotland, given their political uncertainty and economic adjustment due to lower oil prices. The UK housing market is expected to continue to improve significantly subject to specific local constraints.

We continue to promote our strategic land sites, some of which are nearly ready for development, provided market conditions continue to improve. In our existing portfolio most development properties are valued at cost, usually based on existing use, and, when these sites obtain consent and are then developed or sold, the considerable upside value will be realised.

I D Lowe
Chairman 31 March 2015

Consolidated statement of comprehensive income for the six months ended 31 December 2014

	Note	6 months ended 31 Dec 2014 £000	6 months ended 31 Dec 2013 £000	Year ended 30 June 2014 £000
Revenue from properties		**156**	177	344
Property charges		**(112)**	(116)	(181)
Sale of trading properties		**440**	513	513
Cost of sale of trading properties		**(273)**	(480)	(480)
Net rental and related property income		**211**	94	196
Other income		**27**	47	53
Other expenses		**(4)**	-	-
Net other income		**23**	47	53
Administrative expenses		**(363)**	(352)	(761)
Operating loss before investment property disposals and valuation movements		**(129)**	(211)	**(512)**
Valuation gains on investment properties		**-**	**-**	975
Valuation losses on investment properties		**-**	**-**	(195)
Operating (loss)/profit before net financing costs		**(125)**	(211)	268
Finance income		**-**	-	1
Finance expenses		**(58)**	(51)	(105)
(Loss)/profit before taxation		**(187)**	(262)	164
Income tax expense	5	**-**	-	-
(Loss)/profit for the financial period attributable to equity holders of the company		**(187)**	(262)	164
(Loss)/profit per share				
Basic (loss)/profit per share (pence)	4	**(1.59p)**	(2.22p)	1.39p
Diluted (loss)/profit per share (pence)	4	**(1.59p)**	(2.22p)	1.39p

Consolidated statement of changes in equity for the six months ended 31 December 2014

	Share capital £000	Other reserves £000	Retained earnings £000	Total £000
At 1 July 2014	2,357	2,920	12,068	17,345
Loss for the period	-	-	(187)	(187)
At 31 December 2014	**2,357**	**2,920**	**11,881**	**17,158**
At 1 July 2013	2,357	2,920	11,904	17,181
Loss for the period	-	-	(262)	(262)
Share buyback	-	-	-	-
At 31 December 2013	2,357	2,920	11,642	16,919
At 1 July 2013	2,357	2,920	11,904	17,181
Profit for the period	-	-	164	164
Share buyback	-	-	-	-
At 30 June 2014	2,357	2,920	12,068	17,345

Other reserves consist of the share premium account £2,745,000 and the capital redemption reserve of £175,000

Consolidated balance sheet as at 31 December 2014

	Note	31 Dec 2014 £000	31 Dec 2013 £000	30 June 2014 £000
Non current assets				
Investment properties		**9,415**	8,635	9,415
Plant and equipment		**38**	24	35
Investments		**1**	-	1
Total non-current assets		**9,454**	8,659	9,451
Current assets				
Trading properties		**11,308**	11,317	11,498
Trade and other receivables		**99**	170	67
Cash and cash equivalents		**285**	376	34
Total current assets		**11,692**	11,863	11,599
Total assets		**21,146**	20,522	21,050
Current liabilities				
Trade and other payables		**(658)**	(503)	(525)
Interest bearing loans and borrowings		**(3,330)**	(3,100)	(3,180)
Total liabilities		**(3,988)**	(3,603)	(3,705)
Net assets		**17,158**	16,919	17,345
Equity				
Issued share capital	6	**2,357**	2,357	2,357
Other reserves		**2,920**	2,920	2,920
Retained earnings		**11,881**	11,642	12,068
Total equity attributable to equity holders of the parent company		**17,158**	16,919	17,345
Net asset value per share		**145.6p**	143.6p	147.2p

Consolidated cash flow statement for the six months ended 31 December 2014

	6 months ended 31 Dec 2014 £000	6 months ended 31 Dec 2013 £000	Year ended 30 June 2014 £000
(Loss)/profit for the period	**(187)**	(262)	164
Adjustments			
Investment property valuation movements	**-**	-	(780)
Depreciation	**-**	-	13
Net finance expense	**58**	51	104
Operating cash flows before movements in working capital	**(129)**	(211)	(499)
Decrease in trading properties	**190**	455	273
(Increase)/decrease in trade and other receivables	**(32)**	6	108
Increase/(decrease) in trade and other payables	**75**	21	(10)
Cash inflows/(outflows) from operating activities	**104**	271	(128)
Interest paid	**-**	-	-
Interest received	**-**	-	1
Cash inflows/(outflows) from operating activities	**104**	271	(127)
Investing activities			
Purchase of listed investments	**-**	(1)	(1)
Purchases of property, plant and equipment	**(3)**	-	(24)
Cash (outflows) from investing activities	**(3)**	(1)	(25)
Financing activities			
Increase in borrowings	**150**	100	180
Cash flows from financing activities	**150**	100	180
Net increase in cash and cash equivalents	**251**	370	28
Cash and cash equivalents at beginning of period	**34**	6	6
Cash and cash equivalents at end of period	**285**	376	34

Notes to the interim statement

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1 This interim statement for the six month period to 31 December 2014 is unaudited and was approved by the directors on 31 March 2015. Caledonian Trust PLC (the "Company") is a company domiciled in the United Kingdom. The information set out does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006.

2 Going concern basis

After making enquiries, the Directors have a reasonable expectation that the company and the group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing this interim statement.

3 Accounting policies

Basis of preparation

The consolidated interim financial statements of the Company for the six months ended 31 December 2014 comprise the Company and its subsidiaries, together referred to as the "Group". The financial information set out in this announcement for the year ended 30 June 2014 does not constitute the Group's statutory accounts for that period within the meaning of Section 434 of the Companies Act 2006. Statutory accounts for the year ended 30 June 2014 are available on the Company's website at www.caledoniantrust.com and have been delivered to the Registrar of Companies. These accounts have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union. The auditors have reported on those financial statements; their reports were (i) unqualified, (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their reports, and (iii) did not contain statements under Section 498 (2) or (3) of the Companies Act 2006.

The financial information set out in this announcement has been prepared in accordance with International Financial Reporting Standards as adopted by the European Union ("adopted IFRS"). The financial information is presented in sterling and rounded to the nearest thousand.

The financial information has been prepared applying the accounting policies and presentation that were applied in the preparation of the company's published consolidated financial statements for the year ended 30 June 2014.

In the process of applying the Group's accounting policies, management necessarily makes judgements and estimates that have a significant effect on the amounts recognised in the interim statement. Changes in the assumptions underlying the estimates could result in a significant impact to the financial information. The most critical of these accounting judgement and estimation areas are included in the Group's 2014 consolidated financial statements and the main areas of judgement and estimation are similar to those disclosed in the financial statements for the year ended 30 June 2014.

4 Profit or loss per share

Basic profit or loss per share is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period as follows:

	6 months ended 31 Dec 2014 £000	**6 months ended 31 Dec 2013 £000**	**Year ended 30 June 2014 £000**
(Loss)/profit for financial period	**(187)**	(262)	164
	===	===	===
	No.	No.	No.
Weighted average no. of shares: For basic and diluted profit or loss per share	**11,783,577**	**11,783,577**	11,783,577
	========	**========**	========
Basic (loss)/profit per share	**(1.59p)**	**(2.22p)**	1.39p
Diluted (loss)/profit per share	**(1.59p)**	**(2.22p)**	1.39p

5 Income tax

Taxation for the 6 months ended 31 December 2014 is based on the effective rate of taxation which is estimated to apply to the year ending 30 June 2015. Due to the tax losses incurred there is no tax charge for the period.

In the case of deferred tax in relation to investment property revaluation surpluses, the base cost used is historical book cost and includes allowances or deductions which may be available to reduce the actual tax liability which would crystallise in the event of a disposal of the asset. At 31 December 2014 there is a deferred tax asset which is not recognised in these accounts.

6 Issued share capital

	31 December 2014		31 December 2013		30 June 2014	
	No 000	**£000**	No. 000	£000	No. 000	£000
Issued and fully paid						
Ordinary shares of 20p each	**11,784**	**2,357**	11,784	2,357	11,784	2,357
	=====	**====**	=====	====	=====	====