Freehold Australian Property Fund

FREEHOLD Investment Management

DECEMBER 2020 Investment Update

OVERVIEW

An open-ended fund that provides quarterly tax effective income and long-term capital growth from a portfolio of direct and listed real estate and infrastructure, as well as select value-add and development opportunities.

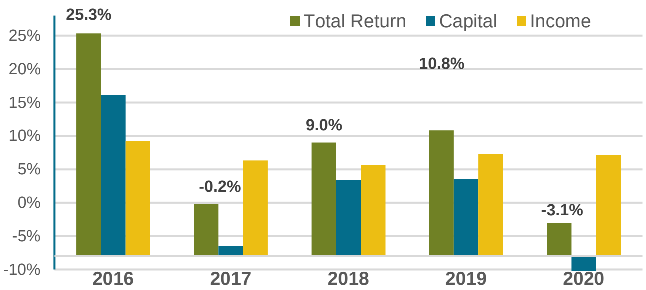
Investment Performance

	Month	Quarter	1 Year	3 Years	5 Years	Since inception**
Freehold Australian Property Fund (net of fees)	0.0%	6.5%	1.6%	6.2%	7.4%	11.5%
A-REITs Index*	0.6%	13.2%	(4.0%)	5.8%	7.4%	12.2%
Listed Infrastructure Index*	(2.3%)	0.9%	(9.8%)	6.1%	8.6%	15.0%
Unlisted Property Index*	1.6%	2.3%	(2.6%)	4.1%	7.2%	8.4%

*A-REITs Index is the S&P/ASX 300 AREIT Accumulation index; Listed Infrastructure Index is a subset of S&P/ASX 200 Index infrastructure sub industries, as defined by the Global Industry Classification Standard (GICS); Unlisted Property Index is the Mercer/IPD Australia Core Wholesale Property Fund Index

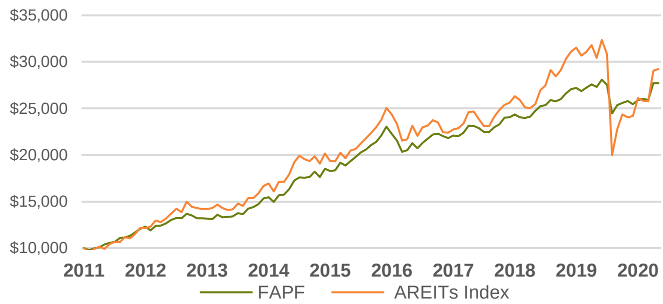
** Freehold Australian Property inception date – effective 7 November 2011. Performance numbers are NET and assume reinvestment of distributions.

Return Split by Financial Years

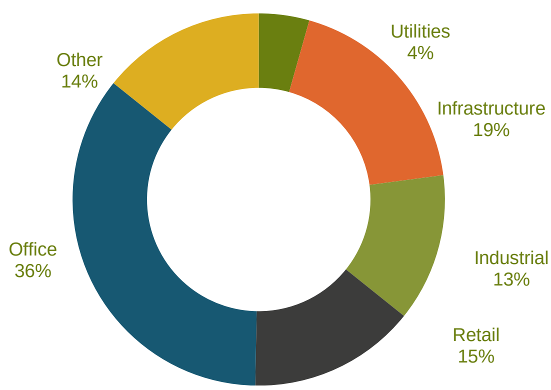


*Income distribution include net realised capital gains

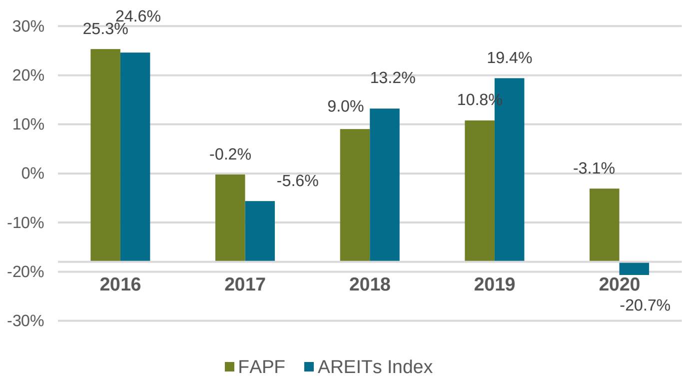
Since Inception Return



Sector Allocation



Financial Year Returns



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Quarterly Commentary

The Freehold Australian Property Fund increased by 6.5% during the quarter, which was in a large part driven by November's stellar monthly performance. Vaccine developments drove upgrades to global GDP forecasts and the first step towards a sustained global recovery. This, in turn, fuelled equity markets and sparked a rotation out of defensive and growth sectors into beaten-up value and cyclical companies. The Fund's focus on quality, defensive cash flows shone through the period and drove outperformance against its benchmark during the period which rewarded 'beaten up' stocks leveraged to the 'reopening trade'.

The December quarter was similarly characterised by AGM Season, where corporates generally reported increases in rent collection, particularly within the retail sector, albeit Melbourne continued to lag due to its recent lockdown measures. Commercial office markets reported their worst year on record, with Sydney and Melbourne vacancy levels sharply increasing. Net effective rents within the major cities declined due to a rise in incentives as landlords increasingly fought to protect their occupancy levels. Despite the deteriorating demand outlook, valuations have held firm as prime yields remain at historic spreads to the long-term bond rate. Several transactions during the December quarter reinforced commercial office valuations, which in our view highlights the current pricing dislocation between private markets and publicly listed REITs. In our view, the publicly listed office REITs look cheap on a comparative basis.

During the same period, listed residential developers have benefited from government stimulus measures and an acceleration in e-commerce demand has underpinned valuation gains and yield compression within the industrial sector. Whilst listed infrastructure companies are temporarily impacted by border closures and stay-at-home orders, we anticipate that their stable, long term cash flows will continue to be highly sought after.

Outlook

As the world inches closer to a coordinated vaccine rollout, the pace and magnitude of the global recovery will continue to drive equity markets. Longer-term structural shifts to employment and consumer spending habits are still playing out, which are critical to how the Team frames its investment decisions. We are closely watching developments abroad, particularly as the United States has handed control of the Senate to the Democrats, and the implications to stimulus for consumers and small businesses. We have already seen in the first week of January that the 'Blue Wave' political scenario in the United States has brought forward global recovery expectations and an associated yield curve steepening. While it may be premature to celebrate the world's 'silver bullet', we're looking towards 2021 with renewed optimism.

Stock in focus – Centuria Office

Centuria Office REIT (COF) is Australia's largest pure play listed office vehicle with a portfolio value of approximately $2bn across 23 assets. We have high regard for the manager, Centuria Capital, which has successfully reduced the Trust's debt burden and enhanced the underlying income profile since it acquired the management rights in January 2017. Approximately 80% of the portfolio's assets are located on the eastern seaboard in affordable metropolitan markets, with a diverse tenancy mix of predominately government, ASX-listed and multi-national corporates. This strong tenant covenant has enabled Centuria to collect over 90% of its rent since the introduction of the National Code of Conduct in April 2020, which compares to the discretionary retail sector, where over half of tenants ceased trading or paying rent during the height of COVID-19.

Despite the portfolio's high occupancy of 98% and strong levels of cash collection, negative sentiment towards office markets amid increasing work-from-home arrangements has seen COF's share price sharply de-rate. This is contrary to the portfolio's high proportion of government tenants, and the location of its assets which may in fact benefit from COVID-19 as companies seek to lower costs via hub and spoke models. Whilst the portfolio has several large tenant leases expiring over the next twelve months to work through, Centuria is in a fortunate position to offset any downtime with a lease surrender payment that it has received from Foxtel at its asset in Robina, Queensland.

The Fund introduced COF into its portfolio during August 2020 and is currently offering investors an attractive distribution yield in excess of 8%. The current share price is also trading at a significant discount to the portfolio's net asset valuation. In our view, this implied market pricing is overly pessimistic, given the level of capital market demand for high-quality metropolitan office assets, which offer affordability relative to premium CBD locations.

Source: company data.

Listed Performance Update

Contributors

MGR (overweight) – Mirvac benefited from strong enquiry levels, sales and settlements across its residential portfolio.

BWP (overweight) – No material news flow for the month of December. BWP announced an expected 1H21 dividend of 9.0c.

Detractors

CQE (not held) – Charter Hall Social Infrastructure REIT announced the acquisition of a purpose-built South Australian Emergency Services Command Centre and adjacent multi-deck carpark, which is currently under construction. The purchase price is $103m and reflects a passing yield of 4.8%.

ARF (not held) – Arena REIT announced a fund update which demonstrated a strong rebound in early learning centre attendances post the easing of COVID-19 related restrictions.

Current & Active Weights

Asset Class	Benchmark	Range	Current	Active Weight
A-REITs	35%	20%-100%	34.2%	(0.8%)
Listed Infrastructure	15%	0%–60%	14.5%	(0.5%)
Unlisted Property	50%	0%-80%	48.6%	(1.4%)
Cash	0%	0%-20%	2.7%	2.7%

Top 6 Portfolio Positions

Security	Portfolio Weight	Sector
Mentmore Property Unit Trust	8.3%	Office
AMP Capital Wholesale Office Fund	7.9%	Office
Transurban Group	7.7%	Infrastructure
Dexus	6.4%	Office
Scentre Group	6.4%	Retail
Freehold Debt Income Fund	4.7%	Other

Unlisted Property Portfolio

Fund	Portfolio Weight	Sector Weight
Mentmore Property Unit Trust	8.3%	17.1%
AMP Capital Wholesale Office Fund	7.9%	16.2%
Freehold Debt Income Fund	4.7%	9.6%
8 Station Street Property Unit Trust	4.3%	8.8%
Charter Hall Core Plus Industrial Fund	3.7%	7.6%
Freehold Development Trust 2	3.6%	7.5%
AMP Capital Diversified Infrastructure Trust	3.0%	6.2%
Dexus Healthcare Wholesale Property Fund	2.9%	5.9%
Westpac House Investment Trust 1	2.5%	5.1%
Jade Development Fund No.1	1.9%	3.9%
Investa Commercial Property Fund	1.5%	3.2%
Caboolture Retail Trust	1.3%	2.7%
Freehold Development Trust 3	1.1%	2.3%
Alceon UPG No.2 Trust	0.8%	1.7%
Perth Rail Link Property Trust	0.6%	1.1%
Alceon UPG Trust	0.4%	0.8%
MicroNest Holding Trust	0.1%	0.1%
Bolton Street Property Unit Trust	0.0%	0.0%
TOTAL	**48.6%**	**100.0%**

Unlisted Portfolio Update

EPGMA: The Eagle Property Group Mentmore Property Trust was established to hold an asset we acquired as a value-add opportunity. The 5-level office building in South Sydney at 55 Mentmore Avenue, Rosebery was acquired for about $30 million from a private investor who had purchased the property after the GFC. The 5,316sqm building is located at the prominent corner of Mentmore Avenue and Morley Avenues and sits on a large 2,931sqm site directly opposite the destinational retail offering, The Cannery. The office space offers a Net Lettable Area of 5,316sqm with 50 basement and 10 on-grade parking spaces. Discussions have commenced with potential tenants for the building as either a repositioning strategy across multiple tenants, or,a single tenant strategy in a key sector.

AWOF: The Fund holds a 13-asset portfolio of prime and A-grade office buildings focused on the eastern seaboard, with 59% of the portfolio in Sydney and 39% in Melbourne. The AMP Wholesale Office Fund delivered a return of 2.1% for the quarter, benefitting from a significant uplift in its Quay Quarter development following the successful leasing deal with legal firm Coors Chambers. The Fund also acquired some additional units in the Fund during the quarter at a discount of over 5% to NAV, which, coupled with the valuation gains has provided investors with a strong return for the period.

FDIF: The Freehold Debt Income Fund's objective is to provide investors with a total annualised return of between 7 - 8% p.a. derived from a diversified pool of loans originated by Alceon, a leading non-bank corporate lender and investment firm. The underlying portfolio of loans is primarily secured by registered first ranking mortgages held over Australian property and primarily finances real estate development, construction and ownership across the east coast of Australia. The Fund has negotiated a fee structure for its capital that materially enhances the return relative to FDIF's target.

EPG8SS: The Eagle Property Group, 8 Station St Wollongong asset is 100% leased to the Department of Defense on a 10-year lease. The design work to undertake the cladding replacement works with a non-combustible material has been completed and a development application is being prepared to go to council. With the value of a long-term government tenant now at a premium, where they continue to meet 100% of their contracted lease obligations through the crisis, we will continue to benefit from this income stream and may consider realising some of the value uplift by divesting a minority stake in the asset.

CPIF: The Charter Hall Prime Industrial Fund (CPIF) owns 64 prime grade industrial assets located across Australia with 34% in NSW; 32% in Victoria and 19% in QLD. Approximately 70% of assets are distribution/logistics centres and a further 17% are industrial estates. Sector tailwinds are strengthening, whilst market yields have firmed during the COVID outbreak. During the quarter, Charter Hall announced the acquisition of a 50% interest in two Aldi regional distribution centres for $140m, subject to a 7-year triple net sale and leaseback arrangement on a blended passing yield of 4.62%. The acquired assets have sufficient capacity to service Aldi's forecast growth profile in Victoria and Queensland for the next decade.

FDT2: The Fund comprises the subdivision of two parcels of residential land in the Western Sydney suburbs of Oakville and Vineyard for the owner occupier market. The Development Applications for both sites remain contingent on the State government department IPART (Independent Pricing and Regulatory Tribunal) setting the infrastructure contributions for the region before Hawkesbury Council can issue the DA. . The best estimate for receiving the DA is in Q1 of 2021. An expression of interest has been received for the Harkness Rd site subject to the DA. We will be assessing this as an alternative to developing the site.

ADIT: The AMP Diversified Infrastructure Trust provides exposure to airports, electricity and gas distribution, roads, rail rolling stock and student housing. The major asset in the portfolio is a minority ownership of Australia Pacific Airports Corporation (APAC), which owns Melbourne Airport. The manager has successfully secured financial covenant waivers across Melbourne Airport to June 2021 and has sufficient liquidity above its lockup/default thresholds whilst the city is facing lockdown measures.

Dexus Healthcare: The Fund delivered a strong return during the December quarter of over 6%, continuing to benefit from cap rate compression as the market increasingly understands the security of cashflows this asset class provides. The Fund currently owns three high quality assets at various stages in their development. The largest asset is Calvary Adelaide Hospital, which reached practical completion in September 2019 and is leased to Calvary for a term of 15 years. More recently, the Fund acquired a 50% share of SAHMRI2, which is a substantial asset leased to the South Australian Government. The third asset is the North Shore Health Hub, which is in a prime location adjacent to Royal North Shore Hospital and is currently being leased up.

IWEST: The ICAM Westpac House Investment Trust owns the Westpac House commercial office in Adelaide. The single asset fund is currently focused on re-letting space that was vacated by the State Government. Phase 1 of the repositioning strategy to address the ground floor lobby is now complete. The Fund is highly geared at circa 60% and is undertaking a capital raise via the issuance of Resettable Preference Units (RPUs) to replace an existing bank facility and fund its ongoing capex. The Fund has elected not to participate in this raising.

JDF1: The Jade Development Fund principally invests in Junior Notes issued by the Securitisation Trust in respect of a Funding Warehouse Series, which holds a pool of insured and uninsured mortgages. The notes are intended to be held by the fund to maturity. There was a partial term out during the quarter which allowed for a partial return of capital to the fund.

ICPF: Investa Commercial Property Fund and ICPF Holdings are a stapled entity comprising a portfolio of 15 prime and A-Grade office assets plus the operating platform. During the quarter, the Fund acquired a 50% interest of 39 Martin Place with joint venture partner Manlife which will have direct access to the new Martin Place Metro station. This will result in gearing increasing from 13% to 18%.

ACRT: The Alceon Caboolture Retail Trust is a single asset fund holding the Caboolture Square shopping centre in Brisbane. The fund is delivering a ~7.0% yield and the target return of 17% IRR is still anticipated to be achieved. The initial strategy was to acquire at well-below replacement cost and lease up the vacant space before putting the asset back on the market. Distributions have recommenced and the K-Mart tenancy that was converted into a regional distribution centre, continues to be a success. The timing of the asset sale is being considered in the broader market context to maximise certainty and value. We continue to hold this as a value-add asset.

FDT3: The Fund comprises the subdivision of a parcel of residential land in the Western Sydney suburb of Box Hill for the owner occupier market. Sales were strong in the month leading up to Christmas with 45 of the total of 57 lots now sold. Debt cover has reached 154% meaning that once all of the lots that have been sold have settled, there is sufficient funds to repay the debt plus commence returning capital to investors. A put and call option has been entered into with the two larger rural lots which will see these both settled prior to 30 June 2021. The two lots which are designated as basin lots for the site's water retention are contingent on council releasing these before a house can be built however it is still possible these can be sold prior to this. We are working towards winding up the trust on or around 30 June. 2021.

AUPG No. 2 Trust: During the quarter, the fund committed to the Alceon Universal Property Group No. 2 Trust. The Trust provides debt finance to a substantially de-risked master-planned residential development project located in Marsden Park, in Sydney's fast-growing North West. The project comprises a mix of affordable townhouses, houses and low-rise apartments, and is being delivered by Universal Property Group.

EGPRL: The units in the EG Funds Management Perth Rail Link Trust were acquired at a 15% discount to valuation. There are two remaining assets in the Fund sitting close to the Burswood Casino in Perth and next to the local train station. The divestment of this position has been delayed as a result of COVID-19 with a further campaign to offshore buyers likely to be pushed into the first half of 2021.

AUPG: The Alceon Universal Property Group debt fund provides debt finance to a residential developer on a first mortgage basis, stepping into the gap left by the major banks who have withdrawn from this area of the market. The AUPG junior debt trust is now 30.9% drawn with 53% of the original commitment being returned in December. The last remaining asset in the trust is anticipated to achieve practical completion in January 2021 and all capital returned by end of Q1, 2021.

MicroNest: The Micronest Holding Trust is being wound up following the sale of the underlying asset in Ashfield. Other than a small residual for wind up costs, all proceeds have now been returned to investors.

EPGBS: Following the sale of the asset, all proceeds have now been returned to investors other than a small residual amount for wind up costs.

Fund Details	
Fund Inception Date	Model Portfolio – 7th Nov 2011 Fund – 15th Feb 2015
Objective	Outperform the Benchmark on a rolling 3-year basis
Benchmark	Australian Real Assets Index which is derived from a 50/50 combination of the Australian Listed Real Assets Index and the Australian Unlisted Real Assets Index.
Investment Timeframe	3-5 Years
Minimum Investment	$10,000
Income Distribution	Quarterly
Unit Pricing	Weekly
Management Costs	0.165% to 1.015% p.a. (incl. GST)
Buy / Sell Spread	0.25% / 0.25%
Responsible Entity	Responsible Entity Partners Ltd
ARSN	164 098 855
APIR Code	LAM0044AU
Platforms	BT Wrap, Asgard eWrap, Asgard Infinity Wrap, Netwealth

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