# Freehold Australian Property Fund

FREEHOLD
Investment Management

**March 2020 Investment Update**

## OVERVIEW

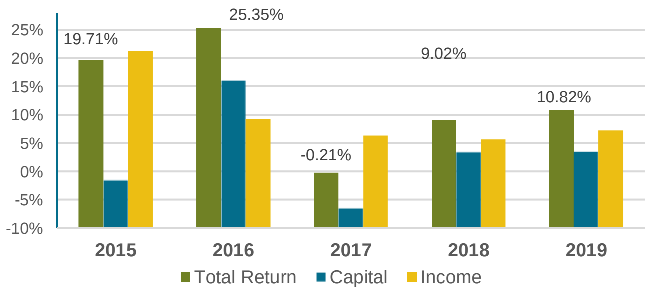
An open-ended fund that provides quarterly tax effective income and long-term capital growth from a portfolio of direct and listed real estate and infrastructure, as well as select value-add and development opportunities.

## Investment Performance

| | Month | Quarter | 1 Year | 3 Years | 5 Years | Since inception** |
|---|---|---|---|---|---|---|
| **Freehold Australian Property Fund (net of fees)** | (11.2%) | (10.4%) | (5.5%) | 4.0% | 6.9% | 11.0% |
| **A-REITs Index*** | (35.2%) | (34.3%) | (31.3%) | (4.8%) | 0.5% | 8.4% |
| **Listed Infrastructure Index*** | (18.4%) | (20.8%) | (8.0%) | 4.5% | 8.4% | 14.7% |
| **Unlisted Property Index*** | (2.0%) | (1.4%) | 3.0% | 7.8% | 9.6% | 9.3% |

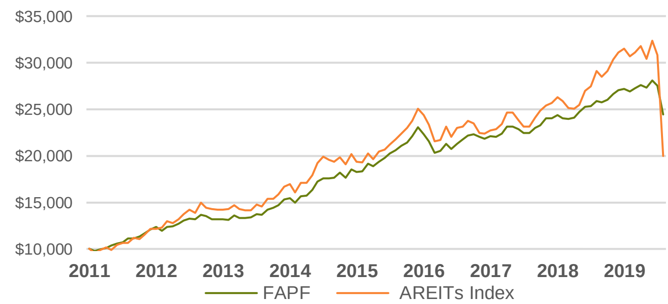
*A-REITs Index is the S&P/ASX 300 AREIT Accumulation index; Listed Infrastructure Index is a subset of S&P/ASX 200 Index infrastructure sub industries, as defined by the Global Industry Classification Standard (GICS); Unlisted Property Index is the Mercer/IPD Australia Core Wholesale Property Fund Index
** Freehold Australian Property inception date – effective 7 November 2011. Performance numbers are NET and assume reinvestment of distributions.

## Return Split by Financial Years

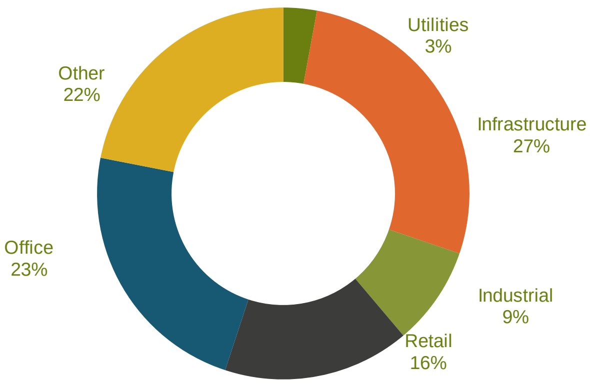



*Income distribution include net realised capital gains

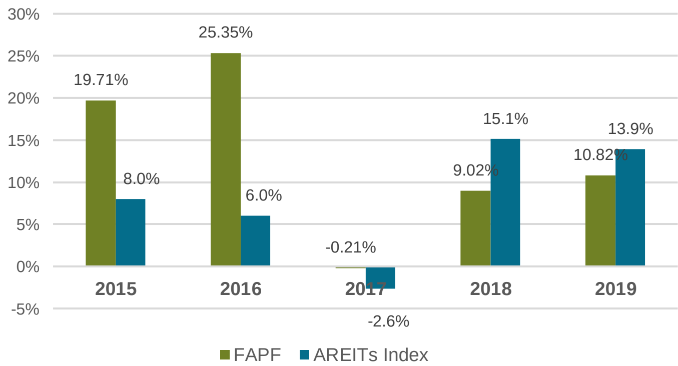
## Since Inception Return




## Sector Allocation




## Financial Year Returns





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# Quarterly Commentary

The Freehold Australian Property Fund (FAPF) declined by 11.2% over the March quarter, with the unlisted part of the portfolio, which we were overweight prior to the pandemic, providing investors with some level of insulation from the significant declines experienced within the listed sector. The Coronavirus (COVID-19) was the catalyst for the extreme selloff late in the quarter, with A-REITs selling off even more than equities. This can largely be attributed to the aggressive selloff of retail landlords – especially those with a high exposure to discretionary spending – given they constitute a significant weight in the Listed Property Benchmark. We have been concerned about the structural changes occurring in the discretionary retail landscape for some time and as a result our significant underweight towards these stocks was a material contributor to the Fund's outperformance.

The extreme selloff in the listed sector has, in our view, thrown up some attractive buying opportunities and we are currently in the process of attempting to rotate out of some unlisted positions – in particular some of the Wholesale unlisted Funds – where there is generally some level of liquidity. These investments have performed well for us, but we are of the view that their unit prices may be at or near their peak and better investment opportunities now appear within the listed sector.

Investors focus was to seek out stocks with high levels of income security and predictability, with an increasing awareness on the counterparty that was paying the rent. The Fund's significant exposure a number of infrastructure names such as Transurban, APA Group, Sydney Airport and Spark Infrastructure Group was the other main driver of the Fund's strong relative performance given they all possess the high quality earnings streams that investors were seeking given the heightened sense of uncertainty.

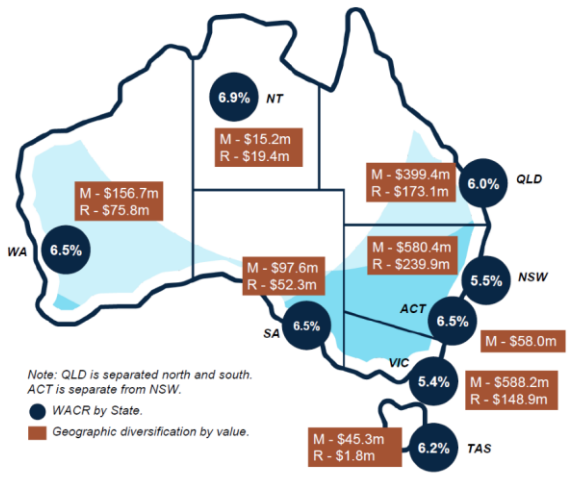
The Federal Government's decision to effectively shut down the economy has had a significant and immediate effects on almost all businesses. As a result, we have seen all but a few A-REITs withdraw their earnings guidance from the market since providing it only a month prior, so has been the magnitude and speed of the impact of the Coronavirus on the economy. It has led to landlords question many of their tenants ability to fulfil their current rental obligations under the terms of their lease, or are under pressure from these tenants to provide either a rental reduction or even an abatement. While the levels of Government intervention to provide support for the economy is unprecedented, this uncertainty has flowed through into a number of downgrades to earnings by many brokers. So what is priced in? That is the $64 dollar question given nobody can honestly say how long this will last. With opinions wide and varied, we expect volatility to continue over the short to medium term and will stick with owning quality stocks given the current backdrop.

### Stock in focus – Viva Energy REIT (VVR.ASX)

Viva Energy REIT owns a portfolio of 469 service station / convenience retail properties underpinned by 2.2m square metres of land. The stock possesses a highly predictable income stream underpinned by a 100% occupancy rate, average lease expiry of greater than 11 years and fixed annual reviews of circa 3%. The security of this income is enhanced by the quality of the majority of the tenant covenant – Viva Energy who possess the sole right to use the Shell brand in Australia for the sale of fuel. Conservatively geared at circa 30% and with the tenant responsible for all additional expenses to the properties the stock provides a high quality defensive and predictable dividend yield in the current environment, which, on current prices and guidance is circa 6.5%.

In our view, VVR.ASX will be one of the few stocks in the A-REIT sector not impacted by the current COVID-19 crisis given their tenants are well capitalised, continuing to trade and make money in the current environment while being secured by long term leases. It is a simple story but one which should provide investors with a stable and secure dividend going forward, with steady growth which is rare given the current macroeconomic backdrop.

**WACR and metro/regional split by state/territory:** as at 31 December 2019




### Outlook

The current COVID-19 situation has played havoc with the stock market, resulting in some dramatic price declines amongst stocks. The Freehold A-REIT and Listed Property Fund has significantly outperformed both it's Benchmark and the broader A-REIT universe over this period, reinforcing the Fund's underlying investment principles of investing in high quality stocks that offer highly predictable earnings streams supported by either long term contracts or leases.

Despite the sector possessing strong balance sheets and debt metrics before the impact of COVID-19 was unleashed, the devastation to the broader economy has put enormous uncertainty over the potential income streams of many A-REITs. This has also led to massive uncertainty over underlying asset values, causing transaction markets to freeze.

So where to from here?

There remains so much uncertainty as to how long the current economic landscape will remain in place and as a result there are very few companies that can provide any real certainty as to where their earnings will fall at their next result.

While balance sheets were broadly in pretty good shape entering this period, we would not discount the potential for some capital raisings to occur as corporates look to make their balance sheets bullet proof and not be reliant on debt markets for capital going forward. We also expect some asset values to 'rebase' from here, with investors putting a premium on the counterparty with significant evaluation regarding the long-term viability of some tenants.

We remain in unchartered waters and while we believe the initial sell off has thrown up some excellent investment opportunities, we also remain relatively cautious on the short to medium term outlook and will continue to have a bias I the portfolio towards quality.

# Listed Performance Update

### Contributors

**Vicinity Centres** (not held): the 'social distancing' and extreme measures put in place to combat COVID-19 will hit retail landlords harder than most. The VCX portfolio has a high level of exposure to discretionary and luxury retail which is likely to have a material impact to earnings going forward.

**Viva Energy REIT (OW)**: Has exposure to a high-quality counterparty and a long term lease expiry profile meaning the REIT should be immune from any impact arising from COVID-19.

**APA Group (OW):** Another business with a high-quality counterparties where their revenue streams derived from owning a large east coast gas pipeline predominantly should be relatively immune from the current environment.

### Detractors

**Ausnet (not held)**: was the beneficiary of its regulated revenue streams that should not be impacted by the current economic backdrop. The Fund offset this by owing Spark Infrastructure which also are exposed to regulated cashflows.

# Current & Active Weights

| Asset Class | Benchmark | Range | Current | Active Weight |
|---|---|---|---|---|
| **A-REITs** | 35% | 20%-100% | 21.8% | (13.2%) |
| **Listed Infrastructure** | 15% | 0–60% | 14.2% | (0.8%) |
| **Unlisted Property** | 50% | 0%-80% | 60.6% | 10.6% |
| **Cash** | 0% | 0%-20% | 3.4% | 3.4% |

# Top 6 Active Positions

| Security | Portfolio Weight | Active Weight* |
|---|---|---|
| **Charter Hall Core Plus Industrial** | 9.0% | Charter Hall Core Plus Industrial |
| **Transurban Group** | 7.0% | Transurban Group |
| **Dexus Property Group** | 6.9% | Dexus Property Group |
| **Freehold Debt Income Fund** | 5.7% | Freehold Debt Income Fund |
| **AMP Capital Wholesale Office Fund – Class A units** | 5.3% | AMP Capital Wholesale Office Fund – Class A units |
| **8 Station Street Property Unit Trust** | 5.2% | 8 Station Street Property Unit Trust |

# Unlisted Property Portfolio

| Fund | Portfolio Weight | Sector Weight |
|---|---|---|
| Charter Hall Core Plus Industrial Fund | 8.9% | 14.8% |
| Freehold Debt Income Fund | 5.6% | 9.4% |
| AMP Capital Wholesale Office Fund - Class A units | 5.2% | 8.7% |
| 8 Station Street Property Unit Trust | 5.1% | 8.5% |
| AMP Capital Diversified Infrastructure Trust | 4.2% | 7.7% |
| Jade Development Fund No.1 | 4.4% | 7.3% |
| Freehold Development Trust 2 | 4.0% | 6.6% |
| Palisade's Renewable Energy Fund | 2.5% | 6.4% |
| Dexus Healthcare Wholesale Property Fund | 3.9% | 6.5% |
| Westpac House Investment Trust | 3.2% | 5.4% |
| Investa Commercial Property Fund | 2.2% | 3.6% |
| Caboolture Retail Trust | 1.8% | 2.9% |
| Freehold Development Trust 3 | 1.6% | 2.6% |
| Micro Nest Holding Trust | 1.6% | 2.7% |
| Alceon UPG Trust | 1.4% | 2.3% |
| Bolton Street Property Unit Trust | 1.5% | 2.4% |
| Alceon Apartment Finance Trust | 0.3% | 0.5% |
| Perth Rail Link Property Trust | 0.9% | 1.5% |
| **TOTAL** | **58.4%** | **100.0%** |

# Unlisted Portfolio Update

**CPIF:** The Charter Hall Prime Industrial Fund owns 65 prime grade industrial assets located across Australia. Approximately 70% of assets are distribution/logistics centres with a significant weighting to consumables and essential services. The portfolio has a resilient weighted average lease expiry of 10.7 years, weighted 89% by value in the key land constrained Eastern Seaboard markets of Sydney, Melbourne and Brisbane. During the quarter, the Fund announced a $900m capital raising targeting identified off-market acquisitions currently under exclusive due diligence, as well as the build out of its committed development pipeline.

**EPGBS:** Following the execution of the new 15 year lease to the Family Courts, a valuation was undertaken for the Bolton St, Wollongong asset and the debt refinanced. The increase in valuation and an increase in the gearing to 50% allowed a substantial return of capital to investors. Several off market offers were received with one party going into exclusive due diligence, however, they have now declined to proceed as a result of the Covid-19 pandemic and Eagle now intends to sit and hold the asset for a further period with strong income until the market recovers to take the asset to market.

**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. Eight of the Funds assets were revalued in March, prior to the COVID-19 taking effect resulting in a 2.4% increase driven primarily by capital works in Bourke Place and Collins Place in Melbourne. Going forward, the Fund has announced a new monthly revaluation policy to deal with the increasingly volatile markets where we are expecting some small valation declines in the interim.

**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. We expect a series of partial term-outs over the next 12 – 24 months that will allow for return of capital.

**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. During the quarter, the Manager engaged an external valuer to consider the valuation of all assets, given the rapidly changing environment and associated uncertainty. As a result, the Manager prudently reduced the carrying values of Melbourne Airport, Port Headland Airport and the ANU Student Accommodation, resulting in an -8.2% reduction to the Fund's unit price as at 31 December 2019.

**PREF:** The Palisade Renewable Energy Fund's assets include wind farm assets in Waterloo and Hallett, South Australia and Granville Harbour, Tasmania, and Ross River Solar Farm in QLD. The Australian energy market continues to transition to a generation mix dominated by wind, solar and other forms of sustainable energy. Recent bushfires may serve to hasten policy initiatives. During the period, most renewables assets have not been materially impacted by COVID-19 given long term offtake agreements. Granville Harbour is currently in construction phase and broader travel restrictions are impacting FIFO workers in Tasmania. The Manager is working with lenders, Hydro Tasmania and the Tasmanian Government to minimize the impact of any construction delays.

**IWEST:** The ICAM Westpac House Investment Trust is a single asset fund holding Westpac House in Adelaide. The Fund continues to focus on re-letting the space that was vacated by the State Government at the end of December which, while impacting short term cashflows will provide the manager the opportunity to upgrade and reposition the asset. This is still ongoing, with lobby works currently being carried out. The Group has also secured a new bridge funding facility to facilitate these works, however needs to reduce their gearing, in our view given the uncertain backdrop.

**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 DA's are expected to be formally issued at the beginning of Q3 2020. While some efforts were made to divest the site over the past quarter, in the current climate there is little liquidity available for englobo land parcels and so we will continue with the development. A partnership with a house builder is being explored with the expectation we can commence construction in Q3 and run a parallel sales campaign of house and land as the economy improves.

**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. The portfolio is s currently 96.4% occupied by area with a weighted average lease expiry of 5.3 years. The portfolio valuation increased by 1.7% over the March quarter however we expect that we are near the peak of the valuation cycle given the impact COVID-19 will have on tenant demand.

**AAFT:** The Alceon Apartment Finance Trust provides debt finance to residential developers on a first mortgage basis to finance completed apartments which haven't been sold prior to completion. The Fund is performing well and is on track to deliver a forecast 11.0% p.a. IRR. About 91% of the original capital commitment has been returned and the remainder remains well secured against completed apartments with a blended LVR of 50%. Full repayment of capital is expected in Q1 – Q2, 2020.

**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 strategy was to acquire at well below replacement cost and lease up the vacant space before putting back on the market. The asset is now nearly fully leased but before a sale, negotiations with one anchor tenant need to be finalised. These are expected to be concluded between Q3 – Q4, 2020. We hold this as a value add asset.

**Micronest:** The Micronest Holding Trust is a fund set up to participate in the build to rent sector, initially through a Co-Living strategy. The property in Ashfield is being redeveloped into 29 units. There will be an initial development phase followed by a longer-term hold during which the targeted cash flow yield will be in the order of 6%pa. Recent events have resulted in debt been generally unavailable for any new project in the market and where a lender can be found, interest rates are more than double those achievable only a short time ago. In addition the theme of co-living will take some time to re-emerge following the social distancing requirements put in place around Covid-19. We have agreed to support the project until the end of Q2 2020 however should the situation not improve then we expect to divest this position and redeploy capital into assets where we expect to achieve better outcomes in the period ahead.

**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. Construction works are now complete and practical completion achieved. Sales had been progressing towards debt cover achieving strong pricing prior to Covid-19 pandemic. Restrictions on display village attendance has resulted in a significant drop in demand playing out across the market generally. To protect the downside we have engaged with a house builder to put sufficient stock into the market to meet debt cover in the short term and will then assess the remainder of the project without the burden of interest cost being a factor.

**EPG8SS:** The Eagle Property Group, 8 Station St Wollongong asset is 100% leased to the Department of Defense. Following the completion of building works a new lease was agreed for a further 10 year period with 2x5 year options on strong terms which has now been executed. Costs for the buildings cladding will be received in coming days including replacement of the existing cladding with non-combustible material, compliant with current BCA requirements and will include upgrades to the exposed brickwork, steel elements and sunshades. A valuation has been undertaken on the building with only the finalisation of the cladding costs required before its formal release.

**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 c.70% drawn with a coupon of 14% and is currently delivering its target returns. It is anticipated that the facility will be fully drawn in Q3 2020.

**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. Following the unsuccessful sales campaign during 2019, an offer to acquire one of two sites was received during the quarter, however, this has since been held over while the potential purchaser assesses the general market.

**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.

**Dexus**: The Dexus Healthcare Wholesale Property Fund (HWPF) represents a new investment made by the Fund in December. The major assets are the North Shore Health Hub which is located in St Leonards and adjacent to North Shore Private hospital with an 'as complete' asset value of $225m. The other major asset is the recently completed Calvary Adelaide Hospital with 343 overnight beds and 60-day surgery beds leased to Calvary for 30 years on a triple net basis. We believe this asset class will continue to gain institutional recognition and remain confident of the long-term prospects for the Group.

| **Fund Details** | |
|---|---|
| **Fund Inception Date** | Model Portfolio – 7th Nov 2011<br>Fund – 15th Feb 2015 |
| **Objective** | Outperform the Benchmark on a rolling 3-year basis |
| **Benchmark** | Derived as the A-REITs and Listed Infrastructure Customised Index and the Unlisted Property and Infrastructure Customised Index, combined on a 50/50 basis. |
| **Investment Timeframe** | 3-5 Years |
| **Minimum Investment** | $10,000 |
| **Income Distribution** | Quarterly |
| **Unit Pricing** | Daily |
| **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 |

# Important Notice

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