Real Estate Market Outlook

5 February 2014- HLB Mann Judd Client Breakfast

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A specialist funds manager,
investor and developer
providing real estate wealth solutions

Folkestone Business

Providing Real Estate Wealth Solutions to Private Clients & Select Institutions

Real Estate Investing
Office, Retail, Industrial, Residential & Social Infrastructure

Balance Sheet	Funds Management
■ Value-add & Development ■ Underwriting Funds	■ Income, Value-add & Development Funds ■ Listed and unlisted
■ Development Profits ■ Pref Equity Interest Income ■ Development Mgt Fees	■ Acquisition Fees ■ Management Fees ■ Performance Fees

- Folkestone is listed on the ASX (ASX:FLK)
- FLK has two real estate businesses:
  - funds management – income (listed and unlisted), value-add and development funds for private client and select institutions
  - on-balance sheet “direct” investments – focus on value-add and development investments
- FLK has approximately $700m in FUM
  - two listed funds – Australian Education Trust (ASX Code: AEU) & Australian Social Infrastructure Fund (ASX Code: AZF)
  - four unlisted income funds
  - one wholesale fund (owns police stations and courthouses)
  - two development funds

Market Conditions

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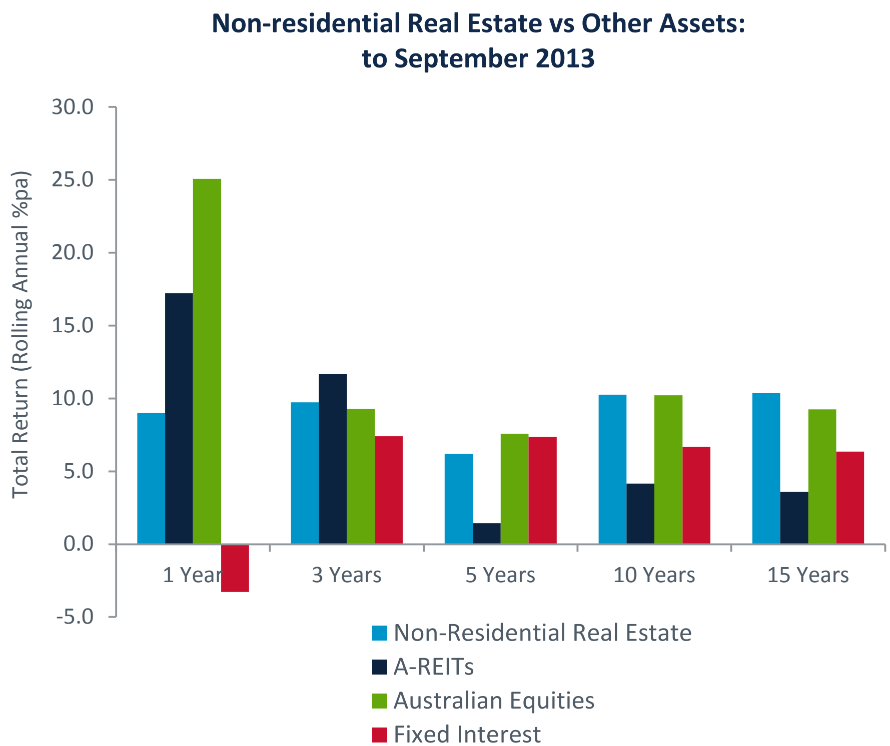
Asset Class Comparisons



- Non residential real estate (direct)
  - provided total return of 9.0% to September 2013
  - outperformed other asset classes over 10 and 15 years
  - long-term performance - circa 10.0% p.a. comprising 7.0% income and 3% capital growth p.a.
- A-REITs (listed real estate)
  - provided total return of 17.2% to September 2013
  - outperformed direct non-residential real estate over 1 and 3 years but significantly underperformed over 5, 10 and 15 years

Source: IPD

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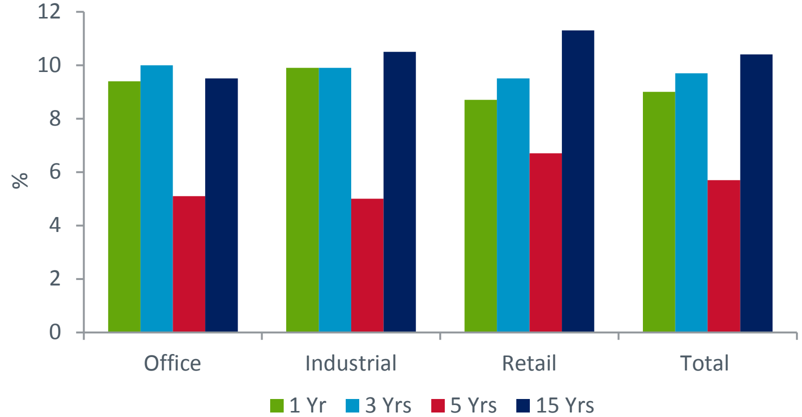
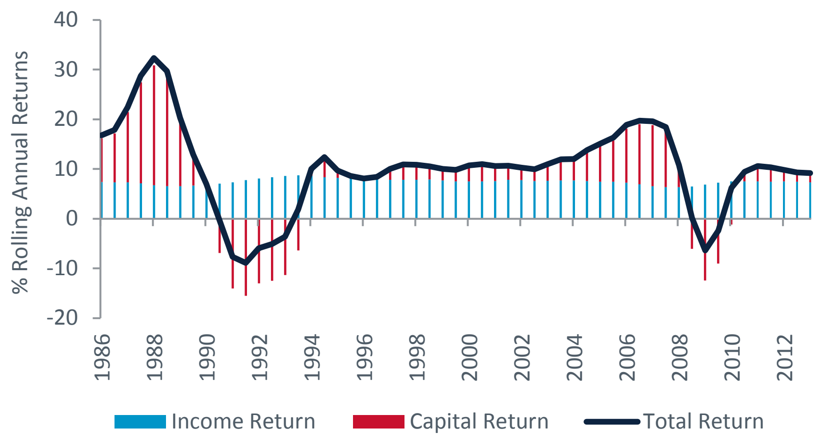
Australian Market Conditions – Non-Residential

Direct Property Total Returns: to September 2013



Direct Property Total Returns: 1985 - 2013



Source: PCA / IPD Australia All Property Index

- Direct property returns have moderated –
  - 9.0% total return in year to September 2013
  - industrial - 9.9% outperformed offices at 9.4% and retail at 8.7%
- Strong investor demand for yield investments is unlikely to abate – "core" real estate well placed to benefit
- Disconnect between capital and leasing markets will continue into 2014 – weaker tenant demand may be offset by cap rate compression from weight of money chasing assets
- Investors with higher risk appetite starting to look at secondary assets which have the potential to be refurbished and repositioned
- Performance across sectors will vary in 2014 – industrial sector should outperform the office and retail sectors
- Active management will continue to be a key driver of performance – investors should focus on the underlying fundamentals of individual assets

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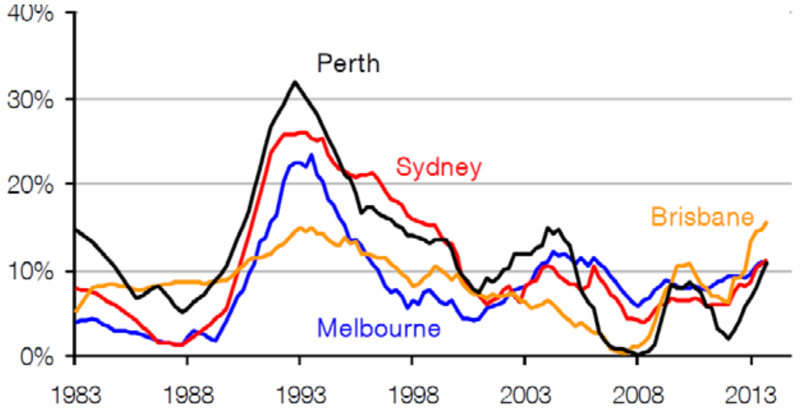
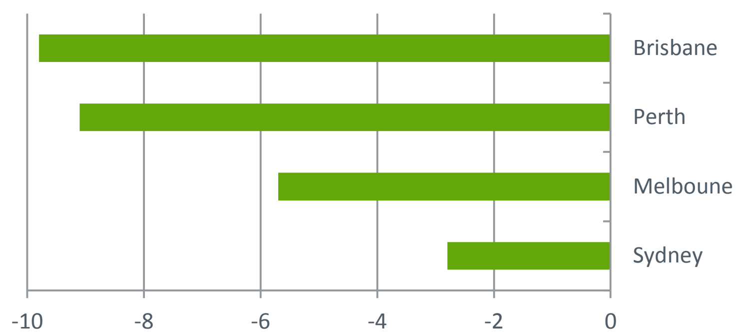
Australian Market Conditions – Office

Australian CBD Office Vacancy Rates: 1983 - 2013



Australian Prime CBD Office Rental Change: Year to December 2013



Source: Jones Lang LaSalle

- Vacancy rates have increased in all major markets
  - Brisbane CBD up from 9.9% to 15.5% in 2013 – the highest on record
- Demand varies across CBD markets
  - across Australia CBD office demand contracted by 253,000 sqm in 2013 – the largest annual contraction on record
  - driven by Brisbane (-106,000 sqm) and Perth (-81,000) CBD's
- Rents lower and higher incentives (already pushing 25% - 30% along the eastern seaboard) expected in 2014
- Supply levels are low in most CBD markets (Melbourne excluded) before next wave of supply hits in 2015/16 particularly in Sydney (Barrangaroo) and Perth
- Office assets with high occupancy, superior tenant quality and location will continue to be well sought after by investors
- Some secondary assets will continue to be under pricing pressure – unless there is an opportunity to refurbish, re-let or re-position

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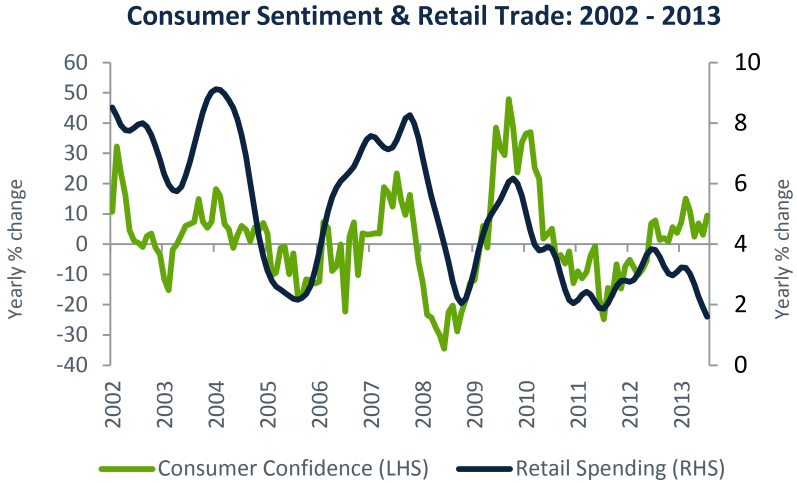
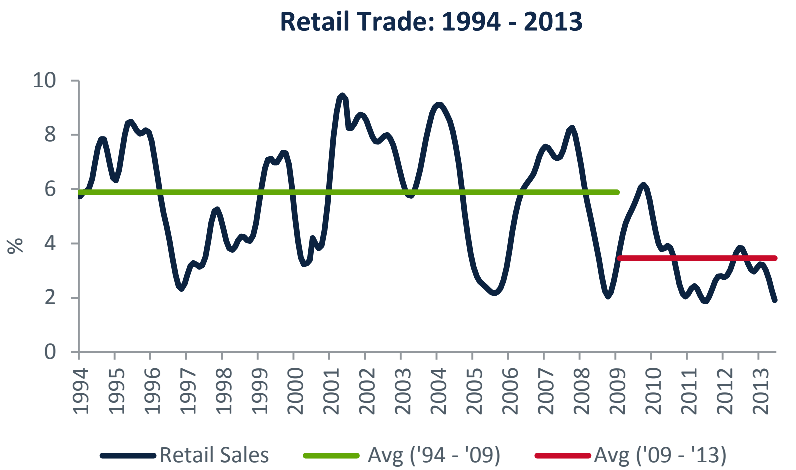
Australian Market Conditions – Retail



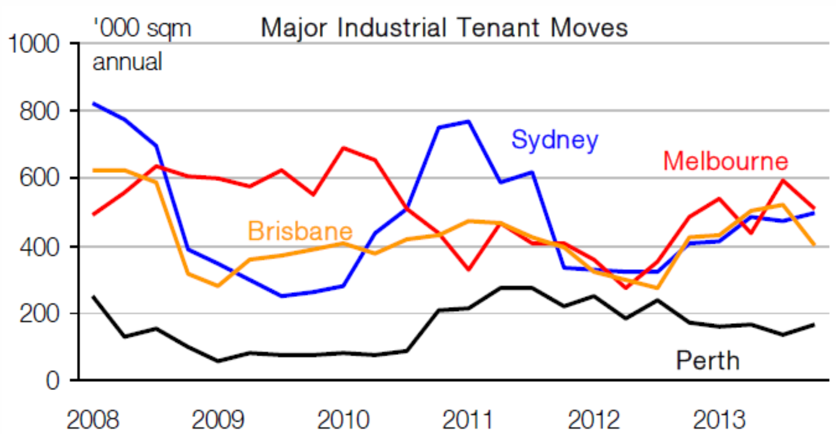


Source: Westpac/Melbourne Institute, ABS

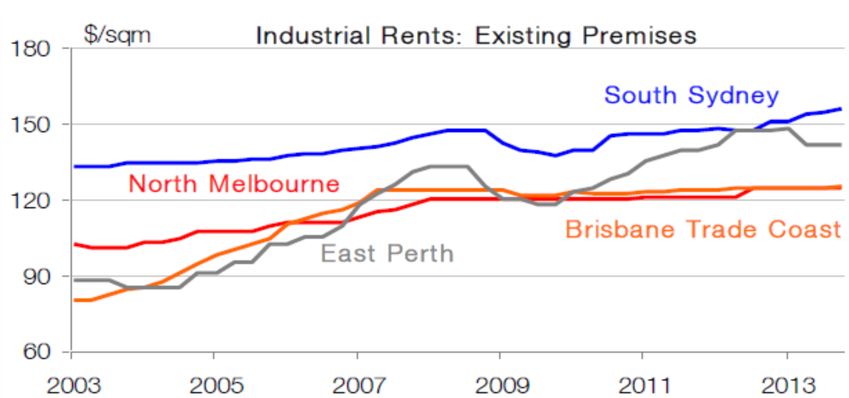
- Retail environment remains challenging
- Low consumer confidence keeping retail spending below trend especially in the discretionary retail sector
- Driven by:
  - **cyclical** factors - price discounting, low consumer sentiment and continued high savings levels
  - **structural** factors – on-line and changing retail formats
- Rental growth has slowed, incentives are increasing and vacancy rates are rising especially in secondary centres
- Competition between centres will continue to drive defensive investment by owners to improve amenity, maintain occupancy and drive foot traffic
- Grocery anchored 'neighbourhood centres' and super regional destination centres should perform better than other types of retail centres
- Sub-regional centres and secondary centres in poor locations or with poor tenancy mixes are more likely to be impacted by the cyclical and structural changes impacting the retail sector

Australian Market Conditions – Industrial

Major Tenant Moves: 2003 - 2013



Industrial Rents: Exiting Premises: 2003 - 2013



Source: Jones Lang LaSalle, Macquarie Research

- Two tier market - prime assets in strong demand from tenants and investors whilst secondary assets not as well supported
- Industrial currently attracting significant investor interest
  - Strong demand from A-REITs (Goodman, Mirvac, GPT, Dexus) and private investors
  - Fife Capital industrial REIT IPO in November well supported
- Industrial attractive to investors for a number of reasons
  - positive yield spread to bonds - prime grade Brisbane industrial yields range between 7.25% and 8.25%[1]
  - typically long term leasing structures with fixed increases
  - changes to the structure economy (decline of local manufacturing, growing online retailing and improved infrastructure) driving increased demand for distribution and logistic centres
- Rental growth for expected to pick-up, although uneven across markets
- According to IPD, Brisbane industrial has performed relatively well compared to Sydney, Melbourne and Perth
  - 1 yr – 9.9% (2nd behind Melbourne)
  - 5 years – 6.6% p.a. (2nd behind Perth)
  - 10 years – 12.4% p.a. (1st)

[1] Savills 2014

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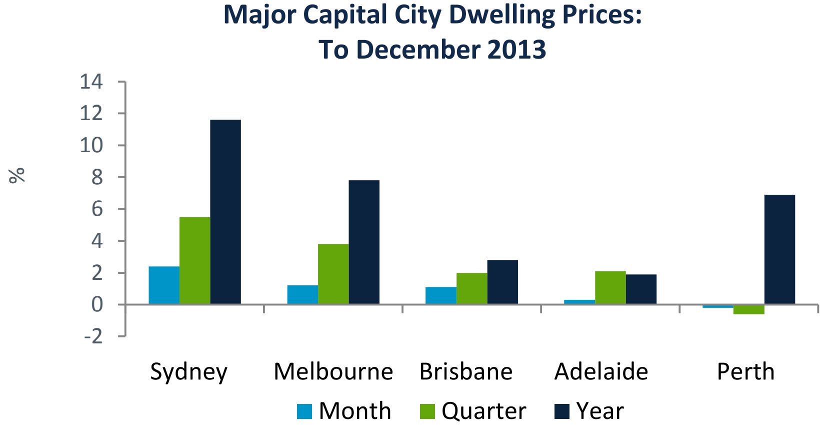
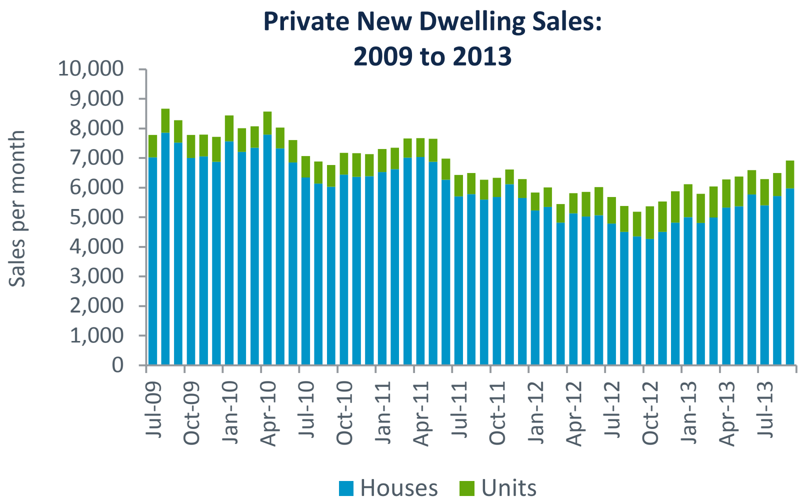
Australian Market Conditions – Residential





- Housing recovery strongest in Sydney and Melbourne, Brisbane lagging behind
- Buyer activity varies
  - first home buyers subdued - 12.3% of the loan market in November 2013 (down from 31.9% in May 2009 and below 20yr average of 19.9%)
  - investor activity is increasing - loans to investors 39% of total loans in November 2013, above 20 year average of 32%
- New home sales up and auction clearance rates improving
  - sales activity up in 2013
  - Sydney and Melbourne averaging above 60% in recent months with Sydney topping 80% in November
- Rental growth remains strong as vacancies remain low
- Sydney should continue to lead the recovery given limited price growth over past decade but Brisbane will pick-up during 2014

Source: RP Data – Rismark Index, HIA

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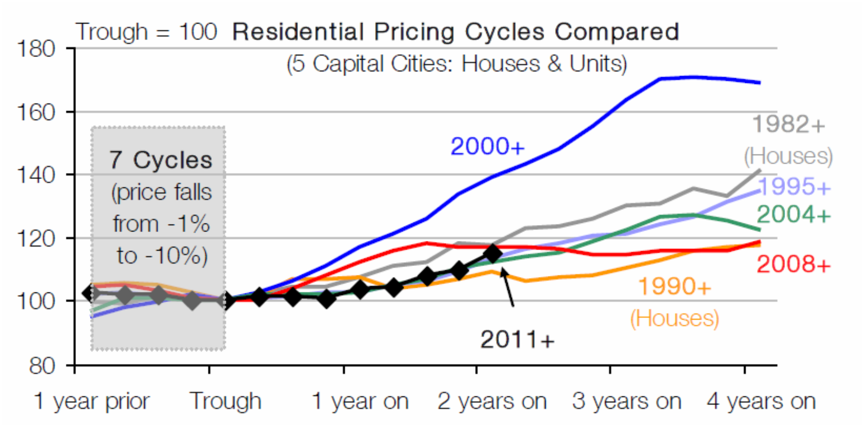
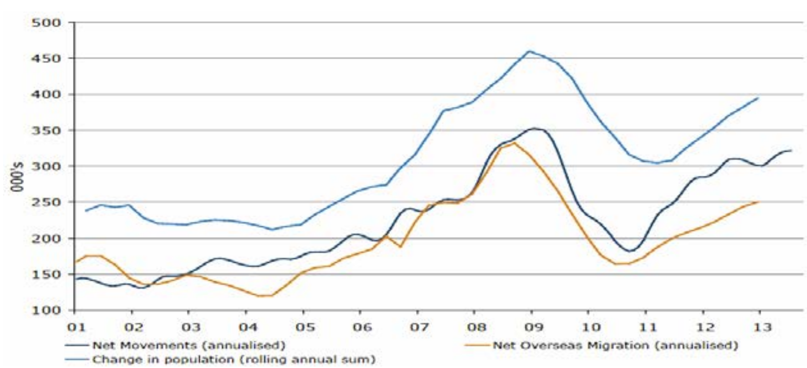
Australian Market Conditions – Residential

Residential Pricing Cycles Compared



Australian Population Growth: 2001 - 2013



Source: ANZ, ABS

- Dwelling construction recovery subdued compared to previous easing interest rate cycles
- Approvals process in many areas remains difficult and government levies makes supply of land expensive
- Australia's population growth strong
  - strong immigration driven by favourable economic conditions, supportive gov't policy and demand for skilled labour
  - fewer Australia's going offshore due to weaker job prospects overseas
- Medium term outlook positive – high population growth, demographic changes, undersupply of dwellings and growing acceptance of medium density accommodation forcing developers to rethink what consumers want

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A-REITs

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A-REIT Sector

A-REIT Relative Price Performance v 10 Year Bond Yields: 1989 – 2013

Source: Morgan Stanley, Thomson Reuters

- A-REITs were hit hard during the GFC
  - fell more than 70% from peak to trough[1]
- A-REITs recovered strongly in 2012 outperforming equities as interest rates fell and real estate markets improved
  - A-REITs up 33.0% and equities up 20% in year to December 2012[1]
- However, AREITs have underperformed equities since global bond yields started rising in May 2013
  - equities up 3.4% and A-REITs down 1.3% in six months to December 2013
- Despite recent underperformance the sector is in good health
  - manageable gearing (currently circa 29%)
  - more sustainable payout ratios – currently average 83%
  - focus on core activities
  - strong focus on capital management – refinancing debt, buy backs
- Sector currently trading at[1]:
  - 18.4% premium to NTA although skewed by WDC, GMG, CHC
  - Sector offering a distribution yield of 5.8% - a 320 bps premium to 90 day bank bills and 160bps to 10 year bonds

[1] UBS

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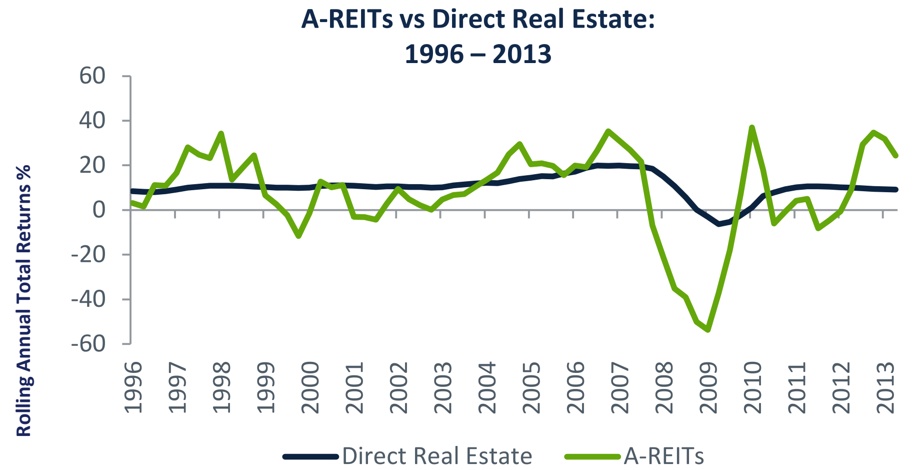
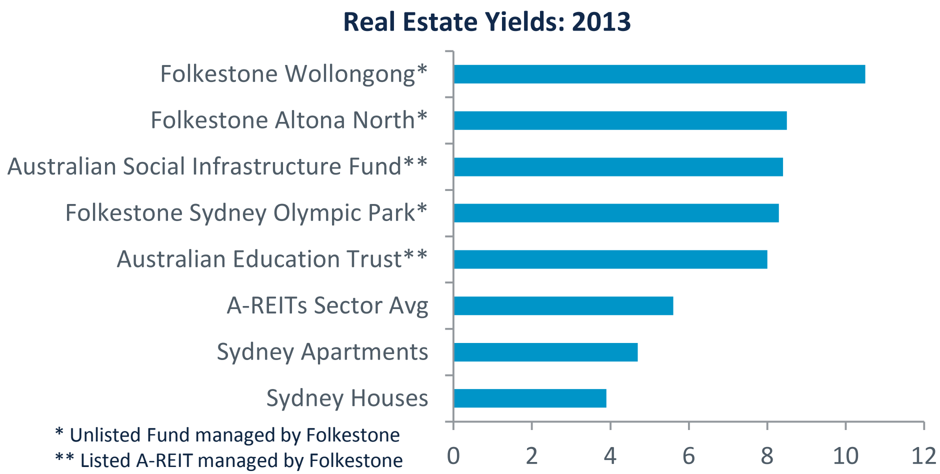
Direct & Listed Real Estate



Source: IPD and MSCI



* Unlisted Fund managed by Folkestone
** Listed A-REIT managed by Folkestone

Source: Folkestone, RP Data, UBS

- Real estate – yield or growth?
- Prices between public and private markets diverges in short term but converges in the long term
- A-REIT pricing driven by short-term factors not related to real estate fundamentals
  - equity movements
  - hedge fund trading
  - liquidity
- Short-term pricing arbitrage between REITs and direct real estate will continue – driven by lag in direct property valuations
- A-REIT market focus on EPS and DPS but NTA is still a valuable measure
- Unlisted typically higher yield than listed real estate
  - spread 150bps - 250bps
  - compensation for illiquidity and lack of diversification
- Residential real estate – focus on growth and tax benefits of negative gearing

SMSF's and Real Estate

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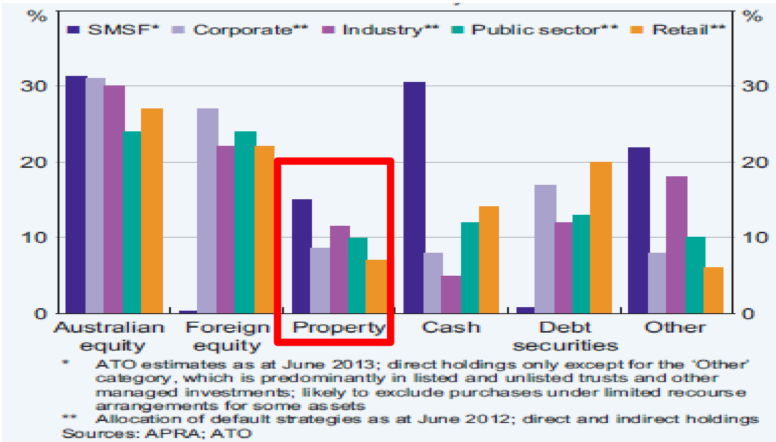
SMSF's and Real Estate

Superannuation Assets by Fund Type: June 2013



SMF Direct Real Estate Holdings: 2004 - 2013

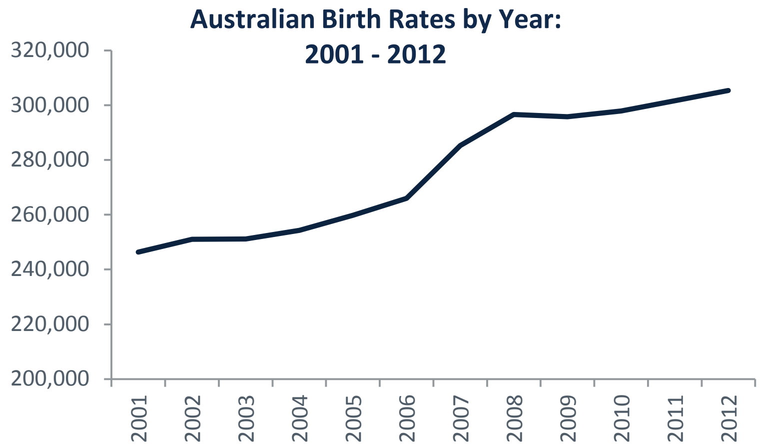
- SMSF's hold more real estate than other types of super funds – around 15% compared to 11% for industry funds and 8% for retail funds
- Real estate held by SMSF's has increased from less than $20bn in 2004 to almost $80bn in 2013 due to:
  - growth in SMSF's in general
  - many SMSF's prefer to invest directly
  - incentives for small businesses to hold their premises in SMSF's
  - gearing now allowed in SMSF's
- SMSF's have a high exposure to commercial property (77%) compared to residential (23%)
- Real estate in SMSF a legitimate investment subject to considerations
  - risk tolerance of members
  - overall Size of SMSF
  - diversification within SMSF
  - liquidation needs of members

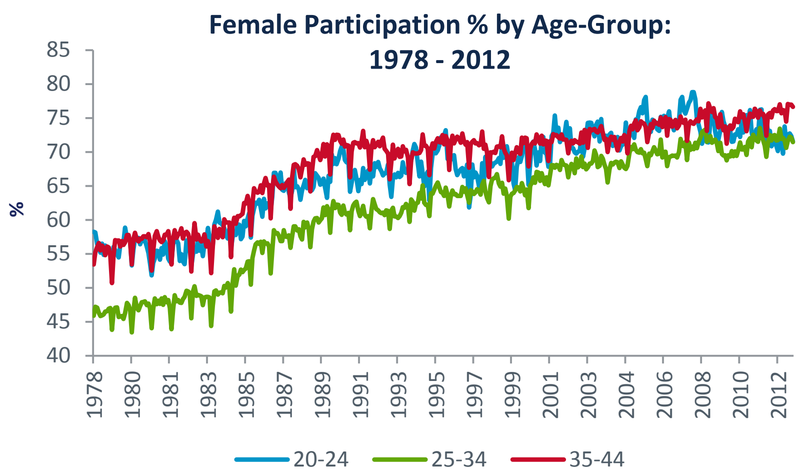
Emerging Real Estate Sectors

Social Infrastructure Assets

- Real estate assets that provide accommodation for fundamental community services including:
  - education - early learning (childcare) centres, schools, tertiary facilities, student accommodation
  - health - medical centres, hospitals, specialist facilities
  - retirement/aged care
  - social housing
  - transport – bus & train stations, park & rides, carparks
  - government accommodation (i.e. police stations, courthouses, prisons, defence housing)
- Benefits of investing in social infrastructure typically include:
  - longer leases than traditional real estate assets
  - net or triple net leases (operator/tenant pays outgoings)
  - secure (often government backed) cashflows
  - low correlation to other real estate and non-real estate assets
- Growth in social infrastructure real estate opportunities driven by:
  - demographic and social changes
  - government financing/budget constraints
  - allows agencies (operators) to focus on core business – managing and delivering core services to the community - rather than the provision, ownership and management of the underlying real estate assets

Early Learning Sector





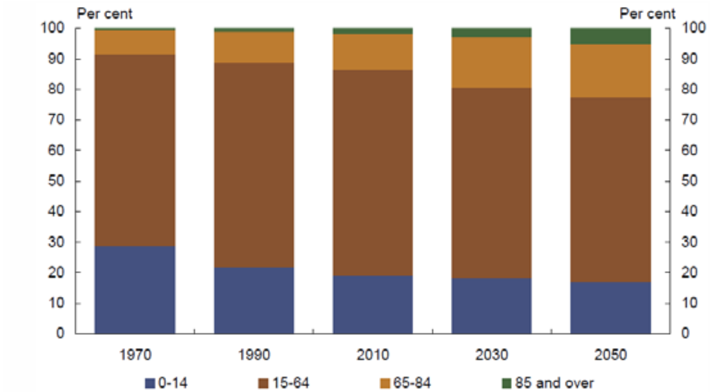
Graph Source: ABS

[1] Department of Education, Employment and Workplace Relations – Childcare in Australia - August 2013

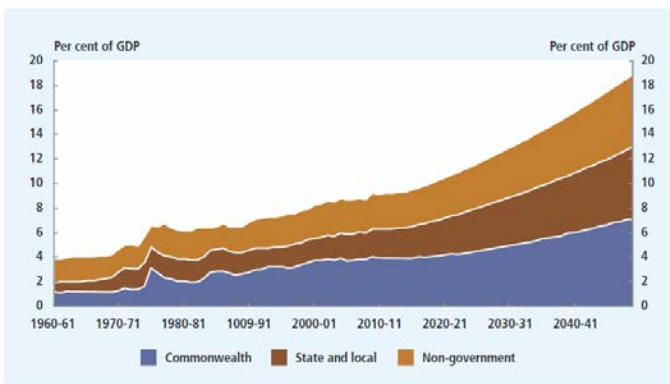
- The key drivers of the early learning sector:
  - demand for childcare services remain strong
  - birth rates has grown steadily - 2012 birth rate at an all time high
  - increased female participation rate in the labour force, supporting demand for long day care
  - recognition of social and educational benefits of early learning in children aged 1-5 years
  - government assisting with access to childcare, largely through Child Care Benefit and Child Care Rebate schemes, with the government forecast to spend $22bn to 2016-17[1]
  - population of children less than 5 years in the catchment area of a centre drives occupancy and profitability
- State of the market:
  - there are 6,192 long day care centres in Australia, an increase of 1,635 centres or 35.9% since 2004[1]
  - since 2004, the number of children using long day care centres has increased by 39.5 per cent to 615,630 children[1]
  - 49.2% of 3 to 5 year olds used childcare in 2012, up from 43.0% in 2006. In the 0-2 years age cohort, 31.4% used childcare compared to 26.9% in 2006[1]
  - there continues to be unmet demand, as evidenced by healthy waiting lists, in many areas across Australia.

Aged Care and Health Care

Proportion of the Australian Population by Age Cohort – Aging Population: 1970 - 2050



Projected Health Expenditure in Australia – Demand for Health to Increase: 1960 - 2050



Source: Treasury projections based on data from the Australian Institute of Health and Welfare. Based on current arrangements.

Source: Australian Treasury

- Demographics – aging population requires increased aged care and health care services
- Government's looking to private sector to deliver aged care and health care services – partners rather than competitors
- Relatively inelastic nature of aged care and health care services
- Real estate/facilities key part of the provision of aged care and health care services

Outlook

Outlook

- Weight of capital to support values despite weaker non-residential real estate fundamentals
- Mixed fortunes across the non-residential real estate sectors
  - Office – subdued demand and future supply increases to limit upside
  - Retail – difficult trading conditions and structural changes to continue- focus on non-discretionary spending i.e food based neighbourhood centres
  - Industrial – currently favourite asset class
- Residential market recovery underway but not yet a bubble
- Higher global bond yields will provide a challenge across all sectors
- Development of niche 'social infrastructure' real estate sectors to continue
- Longer term trends supportive of continued investment into real estate from both
  - domestic and global institutions
  - private client investors especially SMSF's

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