Folkestone
MAXIM A-REIT SECURITIES FUND

FOLKESTONE MAXIM A-REIT SECURITIES FUND

DECEMBER 2016 REPORT

MARKET REVIEW

As generally anticipated, the US Federal Reserve raised the Federal Funds rate target range by 25 basis points in December to 0.50% to 0.75%. Expectations regarding the interest rate outlook now favour three rate rises in 2017, likely driven by declines in the unemployment rate. Markets took the rate rise in their stride with the Dow Jones Index rising 3.3% in December, the S&P 500 moving 1.8% higher and the NASDAQ adding 1.1%. This coupled with the expectant positive outlook for the US economy from a Trump presidency, assisted in moving global markets higher in December. The UK's FTSE rose 5.3%, the Nikkei 225 gained 4.4% and the EURO Stoxx 50 added 7.8%.

Here in Australia, the Reserve Bank (RBA) left rates unchanged at 1.5% following its Board Meeting in December, notwithstanding its acknowledgement of slowing year end GDP growth. Third Quarter GDP contracted 0.5% taking the annual figure to 1.8%, the lowest level since the GFC.

The Australian yield curve flattened, with the spread between long-term rates and short-term rates narrowing 1.9 bps. The Australian 3-year bond yield rose 6.1 bps to 1.96%, while the 10-year bond yield rose 4.2 bps to 2.77%.

The ASX 200 Accumulation Index ended the month 4.1% higher with all the underlying sectors being positive. Utilities was the strongest of the standalone GICS sectors, with Financials and A-REITs also outperforming the Index.

Retail sales in October came in marginally above consensus at 0.5% owing to an increase in non-discretionary spending. Food retailing, cafes and restaurants and 'other' retailing reported gains, while clothing/footwear and department store sales continued to fall.

The ABS house price index rose 1.5% in the quarter to 30 September 2016. Annual house price growth has slowed relative to the double digit growth rates seen this time last year. Positive price growth continued in Sydney and Melbourne, while prices in Perth deteriorated further.

The composition of employment continued to be skewed to full-time workers (+39.3k positions). Both the unemployment rate and the participation rate rose from 5.6% to 5.7% and from 64.4% to 64.6%.

The Mid Year Economic and Fiscal Outlook (MYEFO), saw a slight improvement in the

KEY STATISTICS

as at 31 December 2016

Status	*Open*
Fund Maturity	*Open Ended*
Investments	*Primarily A-REITS*
Investment Horizon	*3-5 years*
Distribution frequency	*Quarterly*
Fund Inception Date	*October 2005*
Pricing	*Daily*
Buy/Sell Spread	*0.25%/0.25%*
Total MER	*0.95% up to $50m Then 0.85% > $50m*
ARSN	*116 193 563*
APIR Code	*COL0001AU*

PLATFORMS

Asgard
BT Wrap
Macquarie Wrap Solutions
Netwealth
Powerwrap
Symetry
HUB24

TOP 5 HOLDINGS

(by Portfolio Weight)
Scentre Group
Westfield Corporation
Goodman Group
Stockland Group
GPT Group

Fund Performance to 31 December 2016

Folkestone Maxim A-REIT Securities Fund	December 2016 %	6 Months %	1 Year % p.a.	3 Years % p.a.	5 Years % p.a.	7 Years % p.a.	10 Years % p.a.	Since Inception % p.a.*
Growth Return	+5.10	-2.85	+9.41	+13.77	+11.97	+8.13	-1.39	+0.86
Income Return	+1.25	+2.76	+4.95	+5.20	+7.11	+5.06	+2.99	+3.79
Total Return (After Fees but Before Tax)**	+6.35	-0.09	+14.36	+18.97	+19.08	+13.19	+1.60	+4.65
S&P/ASX 300 A-REIT Accumulation Index	+6.75	-2.60	+13.18	+17.96	+18.51	+12.53	+0.25	+3.54
Value Add	**-0.40**	**+2.51**	**+1.18**	**+1.01**	**+0.57**	**+0.66**	**+1.35**	**+1.11**

*Fund inception date October 2005. **Please note the Fund's management fee was reduced on 16 May 2014. The Fund's after fees but before tax performance only reflects the new management fee from this date.

2016/17 deficit ($600m to $36.5bn), whilst the trade deficit widened to $1.5bn despite expectations that recent commodity price increases would result in higher exports.

Over the month of December, the S&P/ASX 300 A-REIT Accumulation Index returned +6.8% outperforming the Australian equities market (S&P/ASX 300) which returned +4.3%. For the December quarter the equities market returned +4.9% compared to the S&P/ASX 300 A-REIT which fell 0.7%. Over the 2016 calendar year, the S&P/ASX 300 A-REIT Accumulation Index returned +13.2% outperforming the Australian equities market which rose 11.8% (Figure 1).

For the December quarter, the Commercial A-REIT sector provided the sole positive contribution, returning +7.1%. The next best sub-sector comprised the Industrial A-REITs which returned -0.5%, followed by the Diversified, which fell 0.8%, Retail -2.2%, Health Care -2.9% and Specialised -4.1%.

The three best performing securities in the S&P/ASX 300 A-REIT Index for the December quarter were Rural Funds Group (RFF +7.9%), GDI Property Group (GDI +7.8%) and Dexus Property Group (DXS +7.5%). The three worst performing securities were Iron Mountain (INM -8.1%), Charter Hall Group (CHC -4.4%) and Ingenia Communities (INA -4.3%).

ACTIVITY

At a very similar time that Cromwell Group (CMW) looked to acquire Investa Office Fund (IOF), ICPF agreed to acquire Morgan Stanley's 8.9% stake in IOF at a cost of $232m. In other news, IOF announced having secured three new leases in Perth which resulted in extending IOF's Perth portfolio WALE from 2.9 years to 7.7 years and occupancy increasing by 4% to 83%.

Charter Hall Group (CHC) listed a new real estate trust, the Charter Hall Long WALE REIT on the ASX, whilst joint-CEO and MD David Southon left the business in December following the Board's decision in February 2016 to appoint David Harrison as sole CEO and MD.

Growthpoint Properties Australia (GOZ) successfully completed its takeover of the GPT Metropolitan Fund (GMF) whilst the GPT Group (GPT) agreed to purchase 164.2m securities in the GPT Wholesale Shopping Centre Fund at a cost of $157m.

MERGERS & ACQUISITIONS

On 30 November 2016, Cromwell Property Group (CMW) announced that it had submitted a proposal on 14 November 2016 to the Board of Investa Listed Funds Management Limited (ILFML) in its capacity as responsible entity of IOF, to make a fully funded cash offer to privatise IOF at $4.45 per IOF unit. The IOF Board of Directors turned down the proposal on the basis of a "lack of certainty in funding" and the premium to NTA being too low.

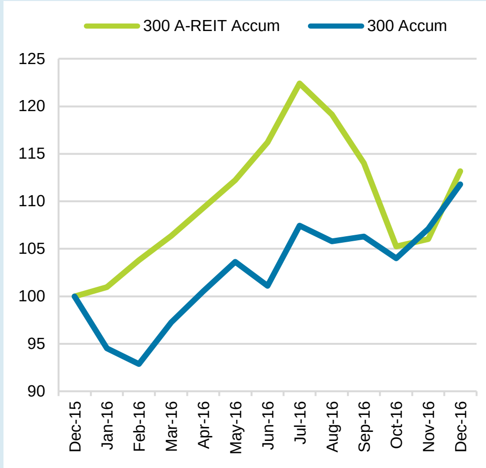
Centuria Capital Limited (CNI) announced that it had reached an agreement to acquire the majority of 360 Capital Group's real estate funds management platform including co-investment interests in listed funds for a total of $217m. In November a total of $150m was raised by CNI to assist in funding the acquisition by way of a Placement, a Conditional Placement and an accelerated non-renounceable Entitlement Offer.

DEBT AND CAPTIAL MARKETS

In December, Hotel Property Investments (HPI) re-negotiated their debt facilities totaling $285m with their bankers, as did Cromwell (CWP) for an amount of $100m. Over the 2016 calendar year, a total of $4.9bn of debt issuance was announced by the A-REITs at an average term of 8.3 years and margin of 207 basis points. This amount represents 50% of 2015's total debt issuance of $9.8bn, much of which related to re-issuance of debt facilities by Westfield Corporate and Scentre Group following their 2015 re-structure.

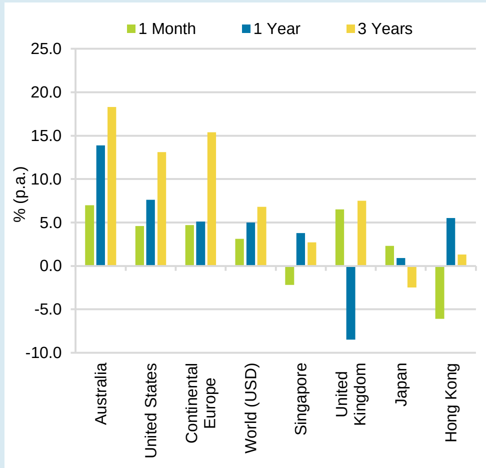
Whilst there were 5 (new) IPO offerings in 2016, namely Australian Unity Office (AOF), Viva Energy (VVR), Propertylink Group (PLG), Charter Hall Long Wale REIT (CLW) and Elanor Retail Property Fund (ERF), there were no capital raisings in December by any A-REIT in the S&P/ASX 200 A-REIT Index. However, over the course of 2016 a total of $386m of equity was raised in the secondary market. In July National Storage (NSR) raised $260m through an institutional placement of $101m, as well as a $159m 3 for 10 entitlement issue at a price of $1.58 per

Figure 1: A-REIT vs. Equity Performance –12 months to 31 December 2016



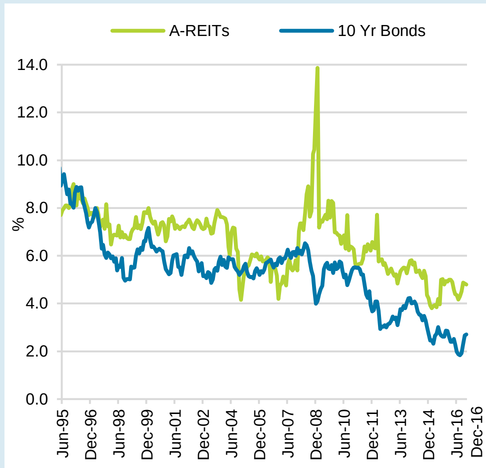
Source: IRESS

Figure 2: Global REIT Performance – To December 2016



Source: UBS, returns in local currencies

Figure 3: A-REIT Sector EPS and DPS Yields vs. 10 Year Bonds Yields – 1995-2016



Source: IRESS

security. In August, the Aveo Group (AOG) undertook a fully underwritten institutional placement of new securities at a price of $3.40 per new security.

SECTOR VALUATION

The A-REIT sector ended the year trading at a FY17 estimated distribution yield of 4.8%, representing a 330 bps premium to the RBA Cash rate and a 208 bps premium to 10 Year Bonds (Figure 3).

The sector's look-through gearing is a generally acceptable 30.0%, whilst it is trading at a premium to NTA of 28.9% compared to the 25 year average of 13.9%.

PERFORMANCE REPORT

For the month of December 2016, the Fund returned +6.35% (on an After Fee but Before Tax basis), underperforming the Fund's Benchmark (S&P/ASX 300 A-REIT Accumulation Index) by 0.40%.

Positive contributions to returns in December 2016 came from the Fund's overweight holding in Rural Funds Group (RFF +10.6%), Folkestone Education Trust (FET +4.3%) and Asia Pacific Data Centre (AJD +9.8%).

Detracting from returns, included zero holdings in Dexus Property Group (DXS +7.9%) and Vicinity Centres (VCX +5.4%) and an underweight holding in Scentre Group (SCG +9.4%).

Over the December 2016 Quarter, the Fund returned -0.19% (on an After Fee but Before Tax basis), outperforming its Benchmark by 0.54%.

Positive contributions to returns in the December Quarter came from the Fund's exposure to Rural Funds Group (RFF +7.9%) and zero exposure to Vicinity Centres (VCX -2.9%). Detracting from returns can be attributed to a zero exposure to Dexus Group (DXS +7.5%) and an overweight position in APN Property Group (APD -4.6%).

For the 12 months to December 2016, the Fund returned +14.36% (after Fees but Before Tax), outperforming its benchmark by 1.18%.

At the end of December 2016, the Fund's investments comprised 17 ASX listed securities totaling 97.7% of the portfolio, 12 of these securities were constituents of the S&P/ASX 300 A-REIT Index whilst the remaining 5 securities were Ex-Index securities, Unlisted securities comprised 0.5% of the portfolio and the remaining 1.8% was held in cash/liquid investments.

A December 2016 Quarter distribution of 1.0000 cents per Unit (paid to investors early in January 2017), took total distributions for the year ended 31 December 2016 to 3.8049 cents per Unit.

OUTLOOK

US equity markets have risen around 9% over the last two months on positive election implications and improving economic indicators. Investors however, will now be looking for companies to confirm the expected pick-up in growth during the upcoming earnings season. Should management's tone turn out to be more cautious (i.e. focusing on USD strength, rising borrowing costs, unfavorable trade policies) disappointment with the outlook is likely to occur.

The Trump presidency raises uncertainty. The impact to REITs and real estate assets more broadly will likely initially be felt through short-term US Federal policy reaction, causing a flow-on effect to long bond rates around the world.

In the short-term, uncertainty and market volatility will likely be high, as President Trump provides a greater insight into how he plans to govern, and whether campaign rhetoric will translate to policy.

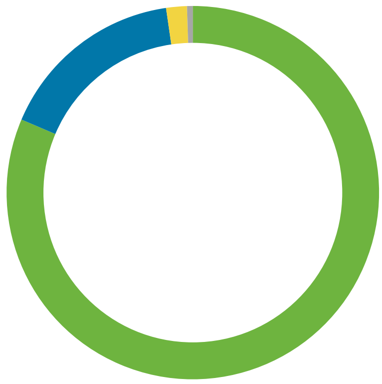
While the A-REITs will be vulnerable to higher bond yields, the sector has already corrected 17% from its 1 August 2016 peak. At current pricing, the A REIT sector appears to be pricing in a 10-year Australian Government bond yield of ~3.3% (up from 2.7%).

Office rents appear to be rising, albeit slowly, in Sydney and Melbourne, reducing the risk of lower asset values in those markets. Other supporting factors include valuations (10.9% discount to NAV, FY17 estimated earnings yield at 6.6% and dividend yield at 5.3%), GDP growth at ~3% in 2017, and increased infrastructure spend which is supporting employment.

The appetite for assets continues to be strong particularly from sovereign/pension

ASSET ALLOCATION

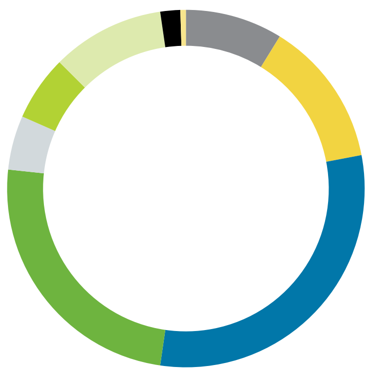
As at 31 December 2016



- S&P/ASX300 A-REIT - 81.4%
- Ex S&P/ASX300 A-REIT - 16.3%
- Cash - 1.8%
- Unlisted - 0.5%

SECTOR SPLIT

As at 31 December 2016



- Social Infrastructure - 8.8%
- Industrial - 13.2%
- Retail - 30.3%
- Diversified - 24.4%
- Office - 4.9%
- Developers & Managers - 5.9%
- Specialised A-REITs - 10.2%
- Cash - 1.8%
- Unlisted - 0.5%

Please note: Numbers in the graphs may not add up to 100 due to rounding.

funds, insurance companies and high-net worth investors as well as private equity funds. At the same time, and notwithstanding a rising interest rate environment, real estate financing is not only currently cheap but is also readily available. Property yields are attractive relative to funding costs which augurs well for asset price levels to be supported.

In the absence of corporate activity, we are forecasting a total return range of 7% to 9% for the A-REIT sector for the 2017 year. Should M&A activity become a feature, a range of 10% to 15% could possibly be achieved.

We continue to favour those A-REITs with exposure to the industrial and social infrastructure property sub-sectors, and those securities with quality management and relative attractive yields that have the ability to actively manage their portfolios to drive income growth in the year ahead.

Superior SQM research

MORNINGSTAR ★★★★★

Recommended Lonsec Research

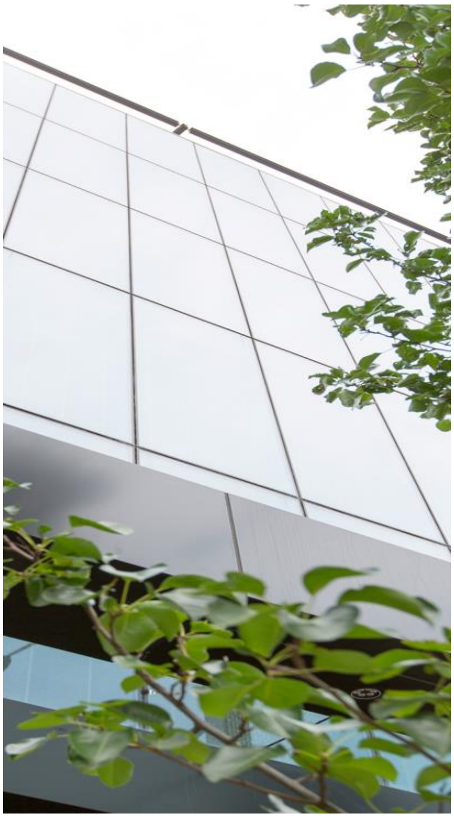
ATCHISON CONSULTANTS RECOMMENDED

CONTACT US:

Winston Sammut
Managing Director
Folkestone Maxim Asset Management
e: wsammut@folkestone.com.au
t: + 61 2 8667 2825

Lula Liossi
Investor Relations Manager
e: lliossi@folkestone.com.au
t: + 61 3 9046 9946

Harry Horwitz-Rourke
Distribution Manager
e: hhorwitz@folkestone.com.au
t: + 61 2 8667 2830



Folkestone Maxim Asset Management Ltd
ACN 104 512 978 AFSL 238349

e: office@folkestone.com.au
www.folkestone.com.au

Sydney Office
Level 10, 60 Carrington Street
Sydney NSW 2000

t: +61 2 8667 2800
f: +61 2 8667 2880

Melbourne Office
Level 14, 357 Collins Street
Melbourne VIC 3000

t: +61 3 9046 9900
f: +61 3 9046 9999

Folkestone
MAXIM A-REIT SECURITIES FUND