Folkestone

MAXIM A-REIT SECURITIES FUND

FOLKESTONE MAXIM A-REIT SECURITIES FUND

SEPTEMBER 2017 REPORT

MARKET REVIEW

During September, the US Federal Reserve kept interest rates steady but announced it would begin “quantitative tightening”- unwinding the US$4.5 trillion balance sheet it built up in the wake of the Global Financial Crisis. Global bond yields initially fell in September then rose to end the month higher as a result of the prospect of a December rate hike.

In Australia, the Reserve Bank (RBA) left rates unchanged at 1.5% and reaffirmed a neutral bias to policy. The improvement in the outlook for non-mining investment outweighed their concerns around the strength of the Australian dollar and continued low wage growth. On housing, the RBA noted that price growth has eased particularly in Sydney and Melbourne, though housing debt continues to outpace household income growth.

The Australian yield curve steepened in September, with the spread between long-term rates and short-term rates up 2.6 basis points.

Economic data released in Australia during September were mixed with 2Q GDP coming in slightly weaker than expected at 0.8% quarter-on-quarter, though higher than the 0.3% growth recorded in the previous quarter.

The NAB Survey of Business Conditions for August rose 1 point to +15, however confidence levels dropped from +12 to +5. Employment for August grew a much stronger-than-expected 54,000 (consensus: +20,000) and the unemployment rate remained steady at 5.6%. Retail sales were flat, with discretionary spending weak, led by a 3% drop in department store sales.

The S&P/ASX 300 Index was flat over September. Among the sectors, Telecommunications (-4.7%) was the biggest drag to performance followed by Utilities (-4.0%) and Materials (-2.8%). Defensive sectors such as Healthcare (+1.3%), Financials (+0.9%) and REITs (+0.6%) were the only sectors to record positive returns.

Over the month of September, the S&P/ASX 300 A-REIT Accumulation Index returned +0.6%, outperforming the Australian equities market (S&P/ASX 300), which was flat at 0.0%. For the September quarter the equities market returned +0.8% compared to the S&P/ASX 300 A-REIT Accumulation Index at +1.9%. For the rolling 12 months to September 2017, the S&P/ASX 300 A-REIT Accumulation Index underperformed the equities market by 11% (Figure 1).

KEY STATISTICS
as at 30 September 2017

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
HUB24
IOOF
Macquarie Wrap Solutions
Netwealth
Powerwrap
Symetry
uXchange

TOP 5 HOLDINGS
(Active Overweight)
Rural Funds
Carindale Property Trust
Industria REIT
Folkestone Education Trust
Lifestyle Communities

Fund Performance to 30 September 2017

Folkestone Maxim A-REIT Securities Fund	September 2017 %	3 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	+0.07	+2.35	-0.13	+9.96	+8.61	+8.208	-1.13	+1.01
Income Return	+0.91	+0.91	+3.81	+4.98	+6.65	+5.490	+2.40	+3.68
Total Return (After Fees but Before Tax)**	+0.98	+3.26	+3.67	+14.94	+15.26	+13.70	+1.27	+4.69
S&P/ASX 300 A-REIT Accumulation Index	+0.57	+1.94	-1.97	+12.47	+13.21	+12.25	-0.40	+3.20
Value Add	**+0.41**	**+1.32**	**+5.64**	**+2.47**	**+2.05**	**+1.45**	**+1.67**	**+1.49**

*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.

For the September quarter, the Specialised A-REIT sub-sector provided the best performance with a return of +7.9%. The next best sub-sector comprised Industrial A-REITs which returned +4.9%, followed by Health Care A-REITs at +3.6%, Residential A-REITs at +3.5%, Diversified A-REITs at +2.8%, Office A-REITs at +1.3% and Retail A-REITs at +0.3%.

The three best performing securities in the S&P/ASX 300 A-REIT Index for the September quarter were Abacus Property Group (ABP +20.0%), Rural Funds Group (RFF +18.4%) and Iron Mountain (INM +13.4%). The three worst performing securities were Viva Energy REIT (VVR -4.2%), Charter Hall Retail (CQR -2.9%) and Charter Hall Group (CHC -2.4%).

ACTIVITY

There were several inclusions to the S&P/ASX Index over the month with Charter Hall Group (CHC) into the S&P/ASX 100, Charter Hall Long WALE REIT (CLW) into the S&P/ASX 200 and Centuria Metropolitan REIT (CMA) into the S&P/ASX 300, taking the total number of securities in the A-REIT Index to 31.

Cromwell Group (CMW) announced it withdrew plans to list its European assets on the Singaporean Stock Exchange worth $1.5bn due to insufficient interest, despite securing two cornerstone investors, increasing it's stake and reducing the size of the IPO from $1.5bn to $1.2bn.

Blackstone called off the intended sale of it's portfolio of ten shopping centres valued at $3.0bn, as fears of the arrival of Amazon into the Australian market weighed on buyer sentiment. Blackstone will seek to reposition the assets through redevelopment and will review its retail strategy in the near future.

MERGERS & ACQUISITIONS

During the month, the battle for ownership of Asia Pacific Data Centre (AJD) continued, as 360 Capital Group (TPG) made a unconditional all-cash take-over offer of $1.95 for AJD. NextDC's competing bid of $1.87 lapsed on 18 September 2017. The market awaits NEXTDC's response following its review of TPG's Bidder Statement.

Fund manager Centuria Capital (CNI) and Centuria Industrial REIT (CIP) acquired a combined 17.0% strategic stake in Propertylink (PLG). CNI financed its stake through a $25.0m bond issue and $44.0m capital raise. CNI and CIP subsequently made an unsolicited conditional and non-binding proposal to acquire 100% of PLG's securities for a cash and scrip consideration comprising of $0.055 cash, 0.23 CNI securities and 0.232 CIP units, placing a value of $0.95 per PLG security. The board rejected the proposal on the basis it did not offer a premium for control and would expose PLG security holders to a higher degree of leverage through CNI and CIP scrip.

DEBT AND CAPTIAL MARKETS

There were several debt issuances during the month including Goodman Group (GMG) buying back $1.5bn of bonds and issuing $1.8bn, extending the debt duration from 3.2 years to 8.2 years. Mirvac Group (MGR) issued US$400.0m of notes with a tenor of 9.5 years at 3.63% and GPT Group (GPT) issued US$325m extending its debt maturity to 6.9 years.

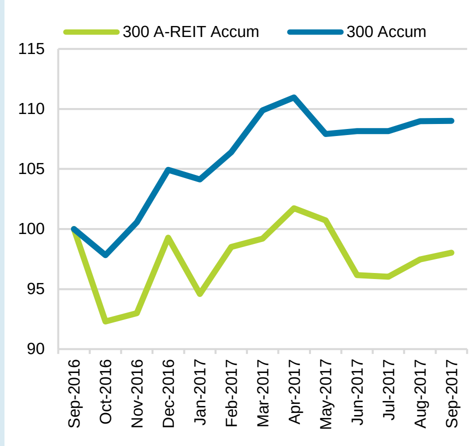
A number of A-REITs now have buy-backs in place as part of their active capital management strategies. Vicinity (VCX) bought $60.0m over the month and has now completed 27.0% of their target, whilst IOF were very active in September after recently turning on their buy-back program, buying back $57.0m of securities, 75.0% of their target.

SECTOR VALUATION

As at the end of September, the A-REIT sector was trading at a FY18 estimated distribution yield of 5.2%, representing a 370 bps premium to the RBA Cash rate and a 238 basis points premium to 10 Year Bonds (Figure 3).

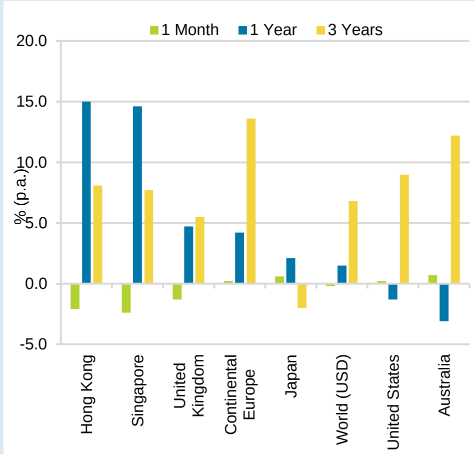
The sector's look-through gearing currently stands at an acceptable 29.0%, whilst it is trading at a premium to NTA of 17.0% compared to the 25 year average of 15.0%, although there is wide disparity between individual securities, with a few securities now trading below NTA – Vicinity Centres (VCX), Charter Hall Retail (CQR) and Investa Office Fund (IOF).

Figure 1: A-REIT vs. Equity Performance: 12 months to 30 September 2017



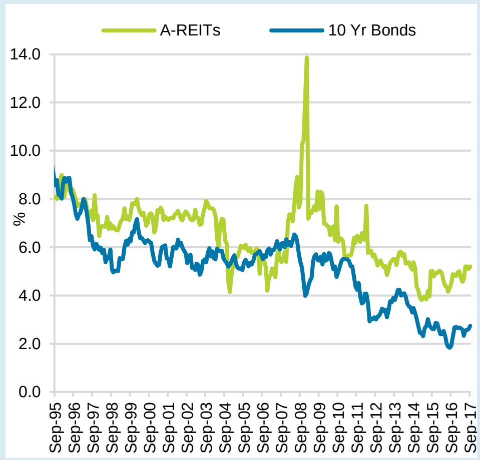
Source: IRESS

Figure 2: Global REIT Performance: to 30 September 2017



Source: UBS, returns in local currencies

Figure 3: A-REIT Sector EPS and DPS Yields vs. 10 Year Bonds Yields: 1995 – 2017



Source: IRESS

PERFORMANCE REPORT

September 2017

For the month of September 2017, the Fund returned +0.98% (on After Fees but Before Tax), outperforming the Fund's Benchmark

Positive contributions to returns in September 2017 came from the Fund's overweight holdings in Lifestyle Communities (LIC +4.6%), Industria REIT (IDR +2.9%) and Asia Pacific Data Centre (AJD +3.7%) and a zero holding in Stockland Group (SGP -2.9%).

Detracting from returns, included an overweight holding in Eureka Group (EGH -5.7%), Kangaroo Island Plantation (KPT -3.1%) and Carindale Property Trust (CDP -1.4%).

September Quarter 2017

Over the September 2017 Quarter, the Fund returned +3.26% (on After Fees but Before Tax), compared to the S&P/ASX 300 Accumulation Index of +1.94%.

Positive contributions to returns in the September Quarter came from the Fund's exposure to Rural Funds Group (RFF +18.4%), Industria REIT (IDR +11.4%) and Asia Pacific Data Centre (AJD +11.1%).

Detracting from returns can be attributed to a zero exposure to Goodman Group (GMG +4.7%) and an overweight holding in Eureka Group Holdings (EGH -10.8%).

Year to September 2017

For the 12 months to September 2017, the Fund returned +3.67% (on After Fees but Before Tax), outperforming its benchmark by 5.64%.

The table below highlights our key active positions which have contributed most to the Fund's outperformance over the year to September 2017.

Contributions to Returns: 12 Months to 30 September 2017	
Rural Funds Group (RFF)	Over weight
Industria REIT (IDR)	Over weight
Folkestone Education Trust (FET)	Over weight

At the end of September 2017, the Fund's investments comprised 18 ASX listed securities totaling 99.8% of the portfolio, 10 of these securities were constituents of the S&P/ASX 300 A-REIT Index, whilst the remaining 8 securities were Ex-Index securities. Unlisted securities comprised 0.1% of the portfolio and the remaining 0.1% was held in cash/liquid investments.

A September 2017 Quarter distribution of 0.7728 cents per Unit (paid to investors in early October 2017), took total distributions for the year ended 30 September 2017 to 3.29 cents per Unit.

OUTLOOK

As the 2017 reporting season wraps up, the market is focusing on the outlook of each sector and the company's guidance.

Office fundamentals continue to improve, for Sydney and Melbourne with limited supply and stock withdrawals (particularly in Sydney) pushing vacancies to below 5.0%. Brisbane and Perth however, continue to experience weakness due to the on-going effects of the mining downturn.

The retail operating environment remains challenging, with weak earnings sentiment, due to increased competition from on-line retailing and foreign retailers, increased utility costs and a rise in the number of retailers going into administration. This is expected to continue for the remainder of 2017 and throughout 2018.

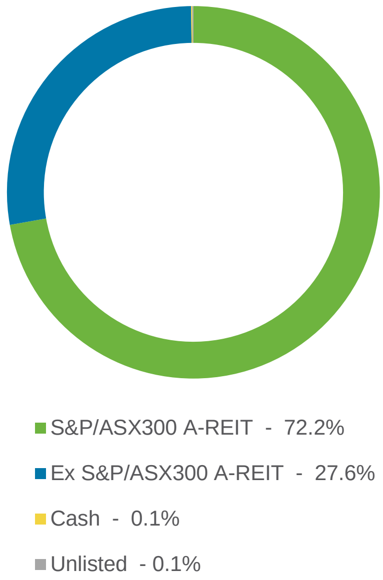
Industrial sector remains strong, especially in metropolitan locations, that could potentially service the growing online sector.

The weight of money chasing quality assets continues to see cap rates across most sectors and locations at record yields. The question is how much further can cap rates tighten. We believe we are entering the closing stages of the cap rate firming cycle, and therefore, the strong increases in values over the past few years will moderate, but still remain positive, with growth in single digits.

In the absence of corporate activity, we are forecasting a total return range of 7.0% to 9.0% for the A-REIT sector for the 2018 year. Should M&A activity become a feature, returns in excess of 10.0% could possibly be achieved.

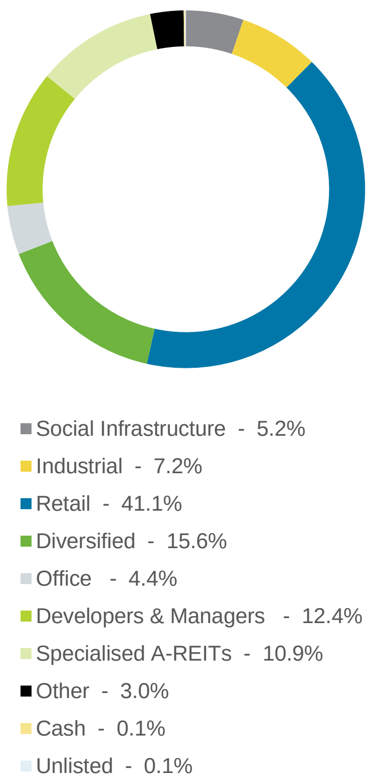
ASSET ALLOCATION

As at 30 September 2017



SECTOR SPLIT

As at 30 September 2017



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

However, the wildcard is bond yields. As we saw between August and November last year, the sudden uptick in bond yields drove an A-REIT sell off, and any further upward movement in bond yields could see further short-term pressure on A-REIT pricing.

The earnings outlook remains robust with consensus forecasts showing growth of circa 4.6% in FY18. The positive outlook is being driven by the office A-REITs which are benefiting from the strong Sydney and Melbourne office markets. The active A-REITs who have strong development pipelines (Goodman, Mirvac) or funds management platforms (APD, GPT, Charter Hall, Goodman) and social infrastructure A-REITs (Folkestone Education Trust and Lifestyle Communities) are benefiting from demographic and social changes.

Gearing levels remain acceptable, with few A-REITs looking to gear-up given the low cost. The balance sheet of A-REITs have clearly benefited from cap rate compression (pushing values higher), asset sales and more conservative payout ratios. Gearing levels could be at risk if cap rates increase (values fall), but we don't foresee any material upward movement in cap rates just yet; the weight of money from both domestic and offshore investors chasing assets should continue in the next year.

We continue to favour those A-REITs with exposure to the industrial and social infrastructure property sub-sectors, real estate developers/managers 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.

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