Folkestone
MAXIM A-REIT SECURITIES FUND


# FOLKESTONE MAXIM A-REIT SECURITIES FUND

## SEPTEMBER 2016 REPORT

### MARKET REVIEW

Despite a number of issues bearing down on financial markets, including speculation that central banks would raise rates, ongoing concerns relating to issues with the future of Deutsche Bank, oil price volatility as well as the uncertainty of the outcome of the US presidential election, most of the equity markets around the globe shrugged off early-month bond-led wobbles to post gains through the month of September. In Australia, the broader equities market as measured by the S&P/ASX300 Accumulation index rose marginally, up +0.5% for the month. This was driven by Materials (+5.7%), Staples (+1.6%) and IT (+1.5%). Conversely, defensive sectors such as A-REITS (-4.0%) and Utilities (-3.2%) were down as the market reacted to rising bond yields.

The US Fed left rates unchanged at 0.25-0.50%, delivering a more hawkish than expected hold decision, but stated that “the case for an increase in the federal funds rates has strengthened” and the appropriate rate should be higher by the end of the year. The Bank of England’s monetary policy committee decided to leave the Bank Rate unchanged at 0.25%. Likewise, the ECB left the key policy rates unchanged whilst in Japan, the Bank of Japan announced a shift away from QE towards yield targeting.

At its September monthly Board Meeting, the Reserve Bank of Australia (RBA) left rates unchanged at 1.50% after cutting rates by 25 basis points in August. Their accompanying statement offered no new information, reiterating that inflation remains “quite low” and labour market indicators appear mixed. Following two interest rate cuts this year, the RBA is widely expected to leave interest rates on hold for the remainder of 2016.

Economic data releases in Australia during the month of September were generally positive with 2Q GDP rising 3.3% - the strongest in four years overshadowing a soft employment reading for the month. Australia’s 2Q business indicators came in more positive than expected. Company profits increased 6.9% over the quarter, led by gains in mining profits (+14%). Employment fell by 3.9k positions below the markets expectation of 15k in August 2016. The composition of employment was skewed to full-time workers (+11.5k positions). Part-time employment fell (-15.4k positions). However, on a year-on-year basis, part-time employment remained the main driver of employment growth (148.6k compared to 31.9k fulltime jobs created). The unemployment rate fell from 5.7% to 5.6% given the pullback in the

### KEY STATISTICS
**as at 30 September 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
Stockland Group
GPT Group

**Fund Performance to 30 September 2016**

| Folkestone Maxim A-REIT Securities Fund | September 2016 % | 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 | -5.19 | -1.51 | +19.44 | +13.45 | +13.78 | +7.97 | -0.46 | +0.96 |
| Income Return | +1.54 | +1.61 | +5.44 | +5.28 | +6.25 | +4.78 | +3.34 | +3.82 |
| Total Return (After Fees but Before Tax)** | -3.65 | +0.10 | +24.88 | +18.73 | +20.03 | +12.75 | +2.88 | +4.78 |
| S&P/ASX 300 A-REIT Accumulation Index | -4.31 | -1.88 | +20.88 | +17.68 | +19.58 | +11.83 | +1.65 | +4.14 |
| **Value Add** | **+0.66** | **+1.98** | **+4.00** | **+1.05** | **+0.45** | **+0.92** | **+1.23** | **+0.64** |

*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.

participation rate from 64.9% to 64.7%.

Seasonally adjusted retail sales were flat for the second time this year. The trend estimate rose 0.1% during the month of August. Among the sectors, clothing, footwear and personal accessory retailing rose +0.6% and cafes, restaurants and takeaway food services were up +0.5%. Household goods retailing (-0.4%) and department stores (-0.9%) posted declines.

Monthly readings of inflation continued to show that price pressures remain subdued whilst A$ firmed over the month alongside a rise in commodity prices as the Fed and Bank of Japan (BoJ) retained their accommodative stance to monetary policy.

The S&P/ASX300 A-REIT Accumulation Index returned -4.3% over the month of September 2016 underperforming the Australian equities market, as measured by the S&P/ASX300 Accumulation Index which rose 0.5%. For the September quarter the equities market returned 5.2% compared to the S&P/ASX300 A-REIT which fell -1.9%. For the year to September 2016, the S&P/ASX300 A-REIT Accumulation Index returned 20.9% outperforming the Australian equities market which rose 13.5% (Figure 1).

For the September 2016 Quarter, the Commercial A-REIT sector returned 2.0%, followed by Diversified 1.0%, Industrials 0.4%, Healthcare -3.6%, Specialised A-REIT -4.0% and Retail at -4.8%.

The three best performing securities in the S&P/ASX300 A-REIT Index in the September Quarter were Mirvac Group (+10.9%), Growthpoint Properties (+8.9%) and Rural Funds Group (+8.6%) whilst the three worst performing securities were BWP Trust (-11.8%), Charter Hall Retail (-11.1%) and Generation Healthcare REIT (-9.1%).

## ACTIVITY

During the quarter, GPT Group (GPT) increased its interest in the GPT Wholesale Shopping Centre Fund from 20.2% to 25.3%. Similarly, GPT also increased its equity interest in the GPT Wholesale Office Fund from 20.4% to 24.5%.

Scentre Group (SCG) undertook an analyst's/investors tour of Miranda Fair Shopping Centre, at which time it outlined details of four new developments (Carousel, Coomera, Newmarket and Innaloo). SCG will contribute ~$1.5bn of the ~$2.0bn of expected capex. SCG also flagged a potential $500m redevelopment at Doncaster in Victoria.

Charter Hall Group's (CHC) largest investor, the Gandel Group, announced the block sale of 19.2% of CHC's shares to third party investors. The block trade was completed at $5.00 per share representing a 7% discount to the previous day closing price. Similarly, Gandel Group also sold out of its 5.7% interest in Charter Hall Retail to third party investors.

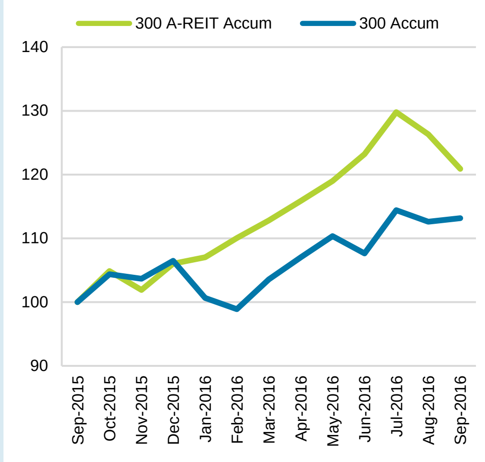
Charter Hall also created a new wholesale property partnership for retail shopping centre assets, to be known as the Charter Hall Prime Retail Fund (CPRF), by co-investing with MTAA Super to acquire Campbelltown Mall in an off-market transaction for $197m, reflecting a market capitalisation rate of 6.0%. The property is the seed asset for the Charter Hall Prime Retail Fund.

Vicinity Centres (VCX) announced the appointment of former CEO of the Grocon group, Carolyn Viney to the position of Executive General Manager (EGM) Development. Ms. Viney will be a member of VCX's Executive Committee and will commence with VCX in October 2016.

VCX also announced it had entered into a contract with TTCT Investments for the sale of its 50% interest in Tuggeranong Hyperdome in the ACT for $120m. The sale reflects the current book value of VCX's interest in the trust which owns the asset. As at 30 June 2016, on a direct holding basis, a 50% interest in Tuggeranong was valued at $140m. VCX have now agreed to the sale of $1.4bn of assets across 12 shopping centres as part of their divestment program of approximately $1.5bn.

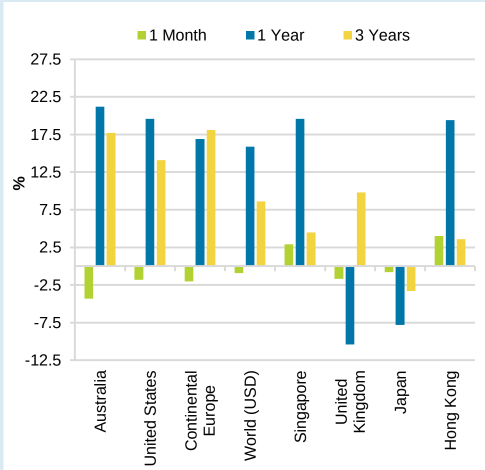
Abacus Property Group (ABP) – announced the sale of a residential development site at 548-568 Canterbury Road, Campsie, NSW for $49.5m and 31-49 Browns Road, Clayton for $51.5m. ABP also advised of the commencement of settlements of 138 land lots representing Stage One and Two of a land sub-division at French Street, Werrington, with funds so far repaying senior lenders and $13.4m of ABP's $17.2m loan. The final two stages

**Figure 1:** A-REIT vs. Equity Performance –12 months to 30 September 2016



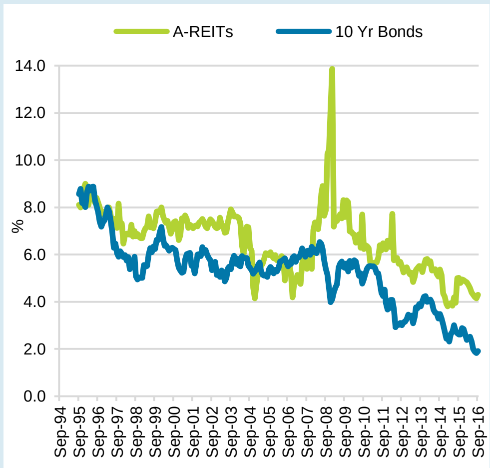

*Source: IRESS*

**Figure 2:** Global REIT Performance – To September 2016




*Source: UBS, returns in local currencies*

**Figure 3:** A-REIT Sector EPS and DPS Yields vs. 10 Year bonds Yields – 1994-2016




*Source: IRESS*

represent a total of 232 land lots for sale, with settlement anticipated in FY18.

Goodman Group (GMG) is transitioning the leadership of its US business from Brandon Birtcher to Anthony Rozic, Goodman's Group COO and Executive Board member. GMG acquired the US business Birtcher in 2012 and rebranded it Goodman Birtcher. It is likely the business will be rebranded to just Goodman. The U.S. business has been a good success story for GMG in the past two years.

Investa Office Fund (IOF) announced the conditional agreement to sell its 50% share of 800 Toorak Road, Melbourne to Charter Hall Group for $140.5m reflecting a 10.5% premium to book value and an aggressive 5.5% yield given it is in a suburban location.

## MERGERS & ACQUISITIONS

The September quarter was relatively quiet on the M&A front, with the market focused on IPOs. Growthpoint (GOZ) completed its takeover of GPT Metro Office Fund (GMF) in September as it received greater than 90% acceptance of GMF units (this includes acceptance from Centuria) and exercised its rights for compulsory acquisition of any outstanding units. GOZ estimates that the transaction will be 4.9% accretive to FY17 earnings.

## DEBT AND CAPTIAL MARKETS

In September, National Storage (NSR) refinanced part of its existing debt portfolio via an institutional term loan with Australian Super. The $100m bi-lateral facility agreement has two $50m tranches with terms of 8 and 10 years. The institutional term loan will marginally increase NSR's all-in cost of debt and extends NSR's average weighted debt maturity to 5.9 years.

Over the past 12 months, S&P/ASX200 A-REIT debt issuance totals A$5.2bn, with a weighted-average term of 7.9 years and an average spread of BBSW of +194bps.

The September quarter saw a number of large IPOs coming to market, including Viva Energy REIT (VVR) with an initial market capitalisation of $911m based on its $2.20 issue price. VVR was keenly sought pre-IPO and ended the quarter at $2.40, representing a 9.0% premium to its issue price.

Propertylink (PLG), an owner and fund manager specialising in industrial and logistics properties, came to the market at the end of August with an initial market capitalisation of $497m based on its $0.89 issue price. PLG closed at the end of September at $0.725 representing an 18.5% discount to issue price.

Charter Hall Long WALE A-REIT launched an IPO, which comprises of a diversified portfolio totaling 66 assets of industrial, office and hospitality assets worth in excess of $1bn and a weighted average lease expiry (WALE) in excess of 12 years. The initial IPO price is $4.00 and is expected to list on the 19 October 2016. The yield on offer is considered to be a tight 5.3%.

## SECTOR VALUATION

The A-REIT sector was trading at a FY17 estimated distribution yield of 4.6%, representing a 288 bps premium to the RBA Cash rate and a 272 bps premium to 10 Year Bonds (Figure 3).

The sector's look-through gearing currently stands at an acceptable 31.0%. The A-REIT sector was trading at a premium to NTA of 32.1% (24.3% ex WFD and GMG) compared to the long-term average of 11.0%.

## PERFORMANCE REPORT

For the month of September 2016, the Fund returned -3.65% (on an After Fee but Before Tax basis), outperforming the Fund's Benchmark (S&P/ASX300 A-REIT Accumulation Index) by 0.66%.

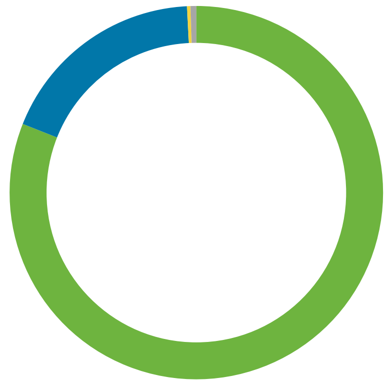
Positive contributions to returns in September 2016 came from the Fund's zero weighting to Dexus Group (-5.9%) and Vicinity Centres (-4.2%) and an underweighting to Scentre Group (-5.4%). Detracting from returns, included overweight positions in Folkestone Education Trust (-6.6%), Gateway Lifestyle (-8.6%) and APN Property Group (-3.9%).

Over the September 2016 Quarter, the Fund returned +0.10% (on an After Fee but Before Tax basis), substantially outperforming its Benchmark by 1.98%.

Positive contributions to returns in the September Quarter came from the Fund's exposure to Elanor Investor Group (+15.2%), APN Property Group (+7.7%) and zero exposure to Vicinity Centres (-4.5%). Detracting from returns included the overweighting to Gateway Lifestyle

## ASSET ALLOCATION

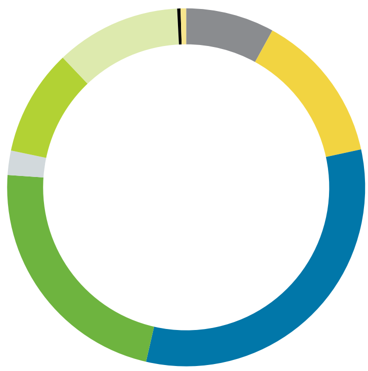
As at 30 September 2016



- S&P/ASX300 A-REIT - 81.0%
- Ex S&P/ASX300 A-REIT - 18.2%
- Cash - 0.3%
- Unlisted - 0.5%

## SECTOR SPLIT

As at 30 September 2016



- Social Infrastructure - 8.0%
- Industrial - 13.6%
- Retail - 32.0%
- Diversified - 22.5%
- Office - 2.2%
- Developers & Managers - 9.6%
- Specialised REITs - 11.3%
- Cash - 0.3%
- Unlisted - 0.5%

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

(-25.4%) and Carindale Property Trust (-9.0%) and a zero weighting to Dexus Property Group (+1.4%).

For the 12 months to September 2016, the Fund returned +24.88% (after Fees but Before Tax), outperforming its benchmark by a substantial +4.00%.

At the end of September 2016, the Fund's investments comprised 17 ASX listed securities totaling 99.2% of the portfolio. 11 of these securities were constituents of the S&P/ASX300 A-REIT Index whilst the remaining 6 securities were Ex-Index securities. Unlisted securities comprised 0.5% of the portfolio and the remaining 0.3% was held in Cash/Liquid investments.

A September 2016 Quarter distribution of 1.3858 cents per Unit (paid to investors in early October 2016), took total distributions for the year ended 30 September 2016 to 3.9037 cents per Unit.

## OUTLOOK

The FY16 A-REIT reporting season confirmed the earnings certainty of the sector, with the majority of the A-REITs meeting their earnings forecast. This fares well when compared to the mixed results from the broader equities market.

The interest rate cut in early August maintained the A-REIT sector's attraction to investors, having regard to the margin above a very low 10 year bond yield which is around 2%. However, the uptick in bond yields during September and expectations of a potential US interest rate hike strengthened saw investors rotate out of defensive sectors including A-REITs. We expect that the sector will be captive in the short-term to bond yield movements.

Growing uncertainty regarding the Central Banks' next move on rates, concerns about Deutsche Bank which may have a flow on affect to the European financial sector and the up and coming US presidential election will likely result in more market volatility.

Overall, the A-REIT sector remains in good shape, with strong balance sheets generated from proceeds of asset sales to lower gearing, or to fund higher yielding acquisitions/development.

The weight of money chasing assets is expected to continue ensuring cap rates for quality assets will remain firm. 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. As a result, there is still upside to NTA growth of A-REITs.

However, the underlying real estate fundamentals are considered to be mixed, with retail sales growth slowing while demand will continue to provide support for both the Sydney and Melbourne office markets whilst Brisbane and Perth will likely remain weak for some time.

We are forecasting a circa 10% total return for A-REITs in 2016 as the fundamentals drive modest earnings growth over the year. 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



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