Freehold Australian Property Fund

SEPTEMBER 2020 Investment Update

FREEHOLD
Investment Management

OVERVIEW

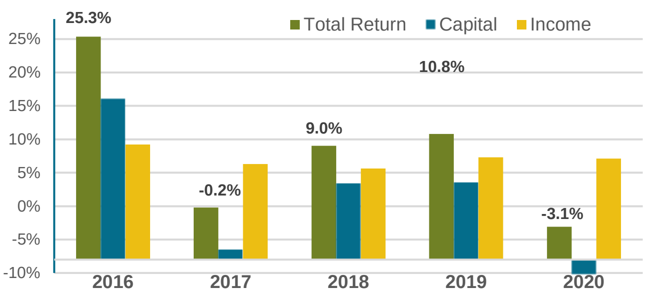
An open-ended fund that provides quarterly tax effective income and long-term capital growth from a portfolio of direct and listed real estate and infrastructure, as well as select value-add and development opportunities.

Investment Performance

	Month	Quarter	1 Year	3 Years	5 Years	Since inception**
Freehold Australian Property Fund (net of fees)	0.5%	0.9%	(3.1%)	5.7%	7.2%	11.1%
A-REITs Index*	(1.1%)	7.4%	(15.8%)	4.1%	6.0%	11.0%
Listed Infrastructure Index*	2.2%	(0.1%)	(7.3%)	7.5%	10.0%	15.3%
Unlisted Property Index*	0.1%	0.5%	(3.4%)	4.5%	7.4%	8.3%

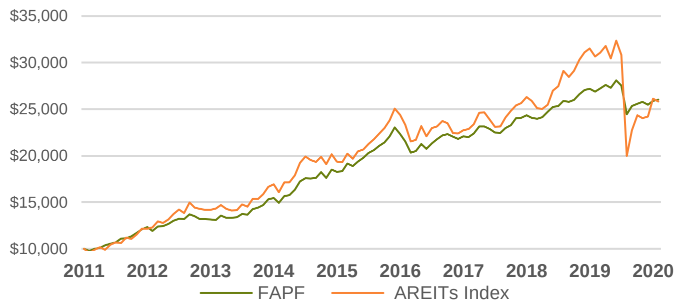
*A-REITs Index is the S&P/ASX 300 AREIT Accumulation index; Listed Infrastructure Index is a subset of S&P/ASX 200 Index infrastructure sub industries, as defined by the Global Industry Classification Standard (GICS); Unlisted Property Index is the Mercer/IPD Australia Core Wholesale Property Fund Index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

Return Split by Financial Years

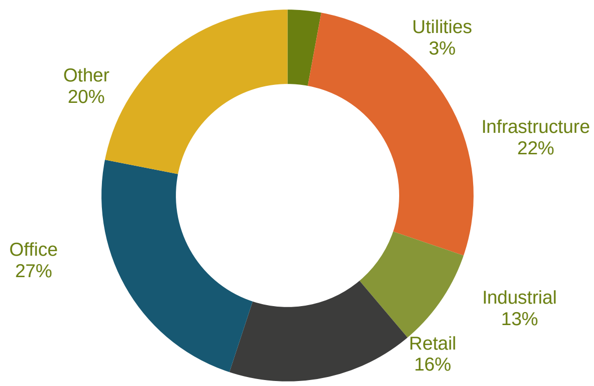


*Income distribution include net realised capital gains

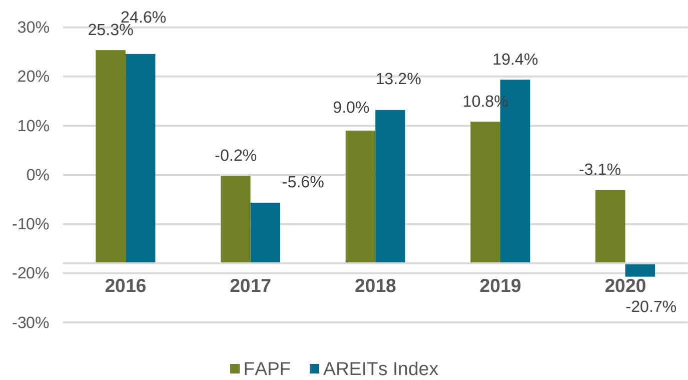
Since Inception Return



Sector Allocation



Financial Year Returns



Level 8, 25 Bligh Street
Sydney NSW 2000

P. +61 2 9228 1400
E. enquiries@freeholdim.com.au

www.freeholdim.com.au

Quarterly Commentary

The Freehold Australian Property Fund increased by 0.5% during the month and has outperformed its benchmark by over 4% over the past twelve months. This can be attributed to the Fund's overweight unlisted asset allocation at the start of the year, which provided protection during the significant market drawdown. We have since rebalanced the Fund to an overweight listed position to take advantage of our assessment of relative valuation and market pricing dislocation.

The period's much-anticipated reporting season quantified the impact brought upon by COVID-19 and its associated restrictions on the movement of people. Pleasingly, corporate results beat cautious expectations and cash collection held up strongly across office (>90% on average) and industrial (>95%) sectors. Conversely, discretionary malls experienced significant cash collection shortfalls from tenants, which is unsurprising given broader economic shutdowns.

In our view, the onset of COVID-19 has resulted in the acceleration of several structural changes. Greater e-commerce penetration and technological automation are impacting supply chains and operational structures. We believe that these long-term trends are already being priced into asset valuations, whilst ongoing uncertainty and market volatility requires price discovery to better understand what these assets are worth.

Scentre Group is a case in point, which booked low levels of cash collection during the period. In the absence of direct market transactional evidence, the Group undertook a USD$3bn subordinated hybrid issue to address its rising debt burden. Whilst this alleviates pressure on the Group's credit metrics, in our view Scentre's balance sheet remains stretched when considered from the perspective of an equity investor.

Within commercial office markets, there are positive signals emerging with direct market transactions expected to change hands at or near book value, which should support the share prices of listed commercial office landlords that are currently trading at significant discounts to their net asset position. Listed infrastructure securities reported mixed performance over the quarter. Despite Australia's international borders remaining closed, the 'reopening trade' has underpinned Sydney Airport's price recovery as investors start to price in the potential of increasing flight movements. In contrast, APA Group's result caught the market on the hop by reporting declines in its variable gas transportation volumes and the postponement of large customer-led growth projects.

So where to from here? There are many unknowns that will have a long-term impact on markets. Some of these include the timing of a COVID-19 vaccine, if at all; the upcoming US election, and government policy to support individuals and businesses. We believe volatility will remain prevalent and we anticipate interest rates will remain low around the globe, which will be supportive of real asset values, provided income levels remain stable.

While the economy slowly reopens, for us the real question is what will 'the new normal' look like? There is no question that both individuals and businesses are re-evaluating the same thing. Will their jobs be safe? What happens to the housing market once government stimulus is wound back? Will employees continue to work from home? How will consumer shopping habits change? Many of these questions remain unanswered and will play out over time. Despite the unprecedented level of uncertainty facing investors, we believe that the market is currently pricing overly pessimistic outcomes and is offering attractive value for patient investors.

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Stock in focus – Centuria Industrial

Centuria Industrial REIT (CIP) is Australia's largest pure play listed industrial vehicle with a portfolio value of approximately $2bn across 53 assets. We have a high regard for the manager Centuria Capital, which has successfully reduced the Trust's debt burden and enhanced the underlying income profile since it acquired the management rights in January 2017.

It is no secret that industrial and logistics assets are currently in high demand as businesses look to optimise supply chains with strategic warehouse sites. This trend has accelerated since the GFC in 2008 with e-commerce now accounting for over $35bn in sales within Australia, representing a growth rate exceeding 20% per annum. The advent of COVID-19 has only served to accelerate this rapid growth. As a result, industrial asset values across the eastern seaboard have witnessed strong price growth and yields have compressed considerably. Once deemed 'the ugly duckling' behind both office and retail, industrial has fast become the most sought-after sector with many large institutions looking to rotate portfolio exposures into this newly favoured asset class.

In August, the manager announced a transformational acquisition and undertook a $340m capital raise to purchase a Telstra Data Centre complex in Clayton. This asset was acquired on a very tight 4.25% capitalisation rate, due to its 30-year sale and leaseback to Telstra. The asset represents a crucial plank in Telstra's data storage and connectivity with its clients and has significant infrastructure invested. This large acquisition strengthens the portfolio's overall security of income underpinned by strong industry thematics.

Centuria Industrial REIT is conservatively geared with high levels of occupancy and a long lease expiry profile. We believe this provides a steady path to distribution growth, coupled with the prospect of further asset price appreciation as the current low interest rate environment drives continued investor appetite

Source: Telstra, Centuria

Listed Performance Update

Contributors

GMG (overweight) – Goodman Group reported a high-quality result that has been a key beneficiary of the booming e-commerce thematic. The Group's development pipeline is also growing considerably due to increasing demand.

GPT (underweight) – We believe GPT Group lacks any clear strategy and has significant exposure to the discretionary retail mall asset class, which is facing major headwinds at present.

Detractors

CLW (not held) – Charter Hall Long WALE REIT regained some of its recent underperformance. The Group undertook a capital raising last month to acquire a 50% interest in a portfolio of BP service stations in New Zealand.

DXS (overweight) – Dexus was impacted by negative sentiment towards office markets, due to changing work patterns during lockdown. The question remains whether COVID-19 has brought about a prolonged structural shift to remote workplace behaviour.

Current & Active Weights

Asset Class	Benchmark	Range	Current	Active Weight
A-REITs	35%	20%-100%	36.7%	1.7%
Listed Infrastructure	15%	0%–60%	16.0%	1.0%
Unlisted Property	50%	0%-80%	45.8%	(4.2%)
Cash	0%	0%-20%	1.4%	1.4%

Top 6 Portfolio Positions

Security	Portfolio Weight	Sector
Dexus	8.4%	Office
Transurban Group	8.3%	Infrastructure
Scentre Group	6.7%	Retail
Freehold Debt Income Fund	6.1%	Other
8 Station Street Property Unit Trust	5.1%	Office
GPT Group	5.0%	Diversified

Unlisted Property Portfolio

Fund	Portfolio Weight	Sector Weight
Freehold Debt Income Fund	6.1%	13.2%
8 Station Street Property Unit Trust	5.1%	11.1%
Charter Hall Prime Industrial Fund	4.5%	9.7%
AMP Capital Wholesale Office Fund	4.4%	9.7%
Freehold Development Trust 2	4.4%	9.6%
Jade Development Fund No.1	3.8%	8.2%
AMP Capital Diversified Infrastructure Trust	3.6%	7.9%
Dexus Healthcare Wholesale Property Fund	3.3%	7.1%
Westpac House Investment Trust	3.0%	6.6%
Investa Commercial Property Fund	1.8%	4.0%
Caboolture Retail Trust	1.6%	3.5%
Freehold Development Trust 3	1.4%	3.0%
Alceon UPG Trust	1.3%	2.8%
Micro Nest Holding Trust	1.0%	2.2%
Perth Rail Link Property Trust	0.7%	1.5%
Bolton Street Property Unit Trust	0.0%	0.0%
TOTAL	**45.8%**	**100.0%**

Unlisted Portfolio Update

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.

EPG8SS: The Eagle Property Group, 8 Station St Wollongong asset is 100% leased to the Department of Defense on a 10-year lease. The tender process to undertake the cladding replacement works with a non-combustible material has been completed and a contract awarded. A valuation took place during the June quarter which saw a strong uplift which is now reflected in the unit price. Refinancing of the debt facility has been completed which will provide the capital necessary to complete the works. With the value of a long term government tenant now at a premium, where they continue to meet 100% of their contracted lease obligations through the crisis, we will continue to benefit from this income stream and may consider realising some of the value uplift by divesting a minority stake in the asset.

CPIF: The Charter Hall Prime Industrial Fund (CPIF) owns 64 prime grade industrial assets located across Australia with 34% in NSW; 32% in Victoria and 19% in QLD. Approximately 70% of assets are distribution/logistics centres and a further 17% are industrial estates. Sector tailwinds are strengthening, whilst market yields have firmed during the COVID outbreak. This strong performance has been captured in recent CPIF returns and as such, the Fund redeemed half of its holding in CPIF via a secondary market sale to take advantage of relative mispricing within listed equities. Charter Hall recently announced a $1.2bn equity raise and during the quarter increased this by a further $700m to take advantage of strong investor appetite in the industrial asset class.

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. The AMP Wholesale Office Fund has remained relatively flat for the September quarter with slight valuation declines within the stabilised portfolio being offset by some modest valuation gains within its development assets. The development of Quay Quarter, Sydney saw the greatest gain, while the completion of South Everleigh (building 2) was another beneficiary. Owning arguably one of Australia's highest quality office portfolios, AMP continues to manage the portfolio conservatively to cushion it from the current COVID-19 headwinds.

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 Development Applications for both sites remain contingent on the State government department IPART (Independent Pricing and Regulatory Tribunal) setting the infrastructure contributions for the region before Hawkesbury Council can issue the DA. Following historical conflicts of interest between developers and elected officials, there are limited avenues to lobby to expedite this process. Given the delay, additional equity was raised at a 34% discount, in lieu of introducing debt to settle the Harkness Rd site in June 2020. While a sale of the sites following receipt of the DAs has been contemplated and the market soft sounded, due to Covid-19 there is very little market depth and so plans to continue through to construction continue. The best estimate for receiving the DA is in Q1 of 2021.

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. There was a term out after quarter end which will allow for a partial return of capital to the fund in Q4, CY2020.

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. The manager has successfully secured financial covenant waivers across Melbourne Airport to June 2021 and has sufficient liquidity above its lockup/default thresholds whilst the city is facing lockdown measures.

Dexus Healthcare: The Fund is still in its relatively early days, with the asset class increasingly becoming institutionalized. The Fund currently owns three high quality assets at various stages in their development. The largest asset is Calvary Adelaide Hospital, which reached practical completion in September 2019 and is leased to Calvary for a term of 15 years. More recently, the Fund is progressing on the acquisition of a 50% share of SAHMRI2, which is a substantial asset leased to the South Australian Government. The third asset is the North Shore Health Hub, which is in a prime location adjacent to Royal North Shore Hospital and is currently being leased up.

IWEST: The ICAM Westpac House Investment Trust owns the Westpac House commercial office in Adelaide. The single asset fund is currently focused on re-letting space that was vacated by the State Government. Phase 1 of the repositioning strategy to address the ground floor lobby is now complete. The Fund is highly geared at circa 60% and is currently looking to replace its existing short-term debt facility with an alternative structure. As a significant investor within the Fund, we continue to regularly engage with the manager to address the capital position and subsequent capex programme.

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. Despite the deteriorating leasing environment due to COVID-19, the Fund continues to maintain high occupancy levels and a weighted average lease expiry of 4.8 years. The Fund is conservatively geared at 15.9% and there is media speculation that the Group is looking to test the market's depth by divesting a portion of its portfolio.

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 initial strategy was to acquire at well-below replacement cost and lease up the vacant space before putting the asset back on the market. Distributions were held over during the March quarter due to uncertainty over COVID-19 but have now resumed after limited impact on rental income. The K-Mart tenancy has been converted into a regional distribution centre, which has proved to be a success. The timing of the asset sale is being considered in the broader market context to maximise certainty and value. We continue to hold this as a value-add asset.

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. Following practical completion, registration of the main land element comprising 43 lots took place on 7th September and all purchasers of the 27 sold lots were provided notification for settlement. Since then, the first lots have settled which commenced on 18th September. A further lot has sold taking the total to 28 for the primary land area. With respect to the land swaps with the adjoining owners, these are now finalised and registration will likely occur in December or be pushed into January 2021 to save on land tax, which becomes payable following registration. Of the additional 16 land swap lots, a further three have been sold ahead of registration, where the Fund receives its pro-rata share based on the area that sits within our boundary. The total sales value has resulted in the Fund achieving debt cover and we are currently exploring whether further lot settlements can be expedited to save on interest expense and hence enhance the return. The residual land swaps are being jointly marketed with Clarendon and Domaine who are the adjoining landowner via their display village, which provides an enhanced sales channel. The two lots within the original 43 which are designated as basin lots for the site's water retention should soon be released by council to be sold.

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.80% drawn with a coupon of 14% and is currently delivering its target returns. It is anticipated that the underlying assets will be refinanced and capital returned around Q4, CY2020.

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 Ashfield property received its Development Application and Construction Certificate tenders for construction. The construction costs were well in excess of the budget from an independent quantity surveyor. COVID-19 has had a material impact on the strategy of this Fund, which was to own many 'micro' apartments with common areas to create a community, which is not conducive to social distancing. As a result, we decided to withdraw support for the manager to proceed with the development and instructed the sale of the asset. An off-market offer was made prior to the formal campaign and we have negotiated an agreed sale price at an acceptable level. The asset has now exchanged and is expected to settle at the end of October.

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. The divestment of this position has been delayed as a result of COVID-19 with a further campaign to offshore buyers likely to be pushed into the early part of 2021.

EPGBS: Following the new 15-year lease to the Family Courts and other capital works undertaken, the Fund was refinanced in March 2020 at a 50% LVR on the back of an updated valuation of $33.5m. After off-market interest early in the year, which was withdrawn following Covid-19, enquiries were renewed after the easing of the first lockdown due to strength of the government tenant covenant. A private purchaser entered exclusive due diligence and went unconditional on the 22nd July. The asset has now been sold and settled on 4th September 2020 for $35.5m delivering approximately 17.5% IRR after all fees and costs. A conservative residual amount is being held in the trust to fund wind up costs and this will be distributed before the end of the financial year reflecting ~$0.01 to $0.03 per unit.

Fund Details	
Fund Inception Date	Model Portfolio – 7th Nov 2011 Fund – 15th Feb 2015
Objective	Outperform the Benchmark on a rolling 3-year basis
Benchmark	Australian Real Assets Index which is derived from a 50/50 combination of the Australian Listed Real Assets Index and the Australian Unlisted Real Assets Index.
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