Freehold Australian Property Fund

FREEHOLD Investment Management

March 2021 Investment Update

OVERVIEW

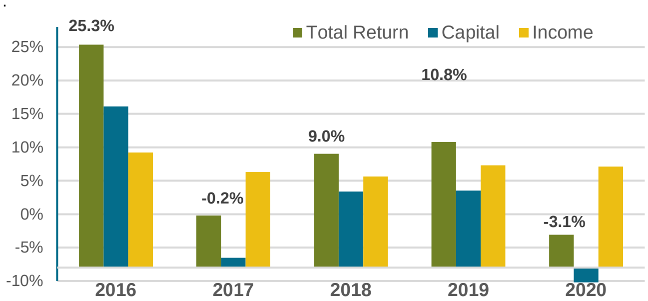
An open-ended fund that provides quarterly tax effective income and long-term capital growth from a portfolio of direct and listed real estate and infrastructure, as well as select value-add and development opportunities.

Investment Performance

	Month	Quarter	1 Year	3 Years	5 Years	Since inception**
Freehold Australian Property Fund (net of fees)	3.0%	1.9%	15.5%	7.9%	6.5%	11.4%
A-REITs Index*	6.3%	(0.6%)	45.4%	7.9%	6.0%	11.8%
Listed Infrastructure Index*	5.7%	(1.6%)	12.1%	7.9%	7.1%	14.4%
Unlisted Property Index*	1.1%	1.9%	0.6%	4.0%	7.0%	8.4%

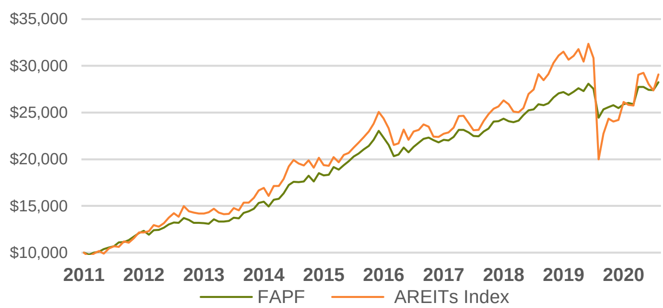
*A-REITs Index is the S&P/ASX 300 AREIT Accumulation index; Listed Infrastructure Index is a subset of S&P/ASX 200 Index infrastructure sub industries, as defined by the Global Industry Classification Standard (GICS); Unlisted Property Index is the Mercer/IPD Australia Core Wholesale Property Fund Index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

Return Split by Financial Years

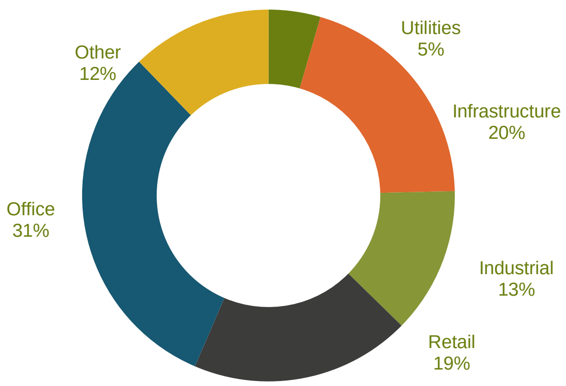


*Income distribution include net realised capital gains

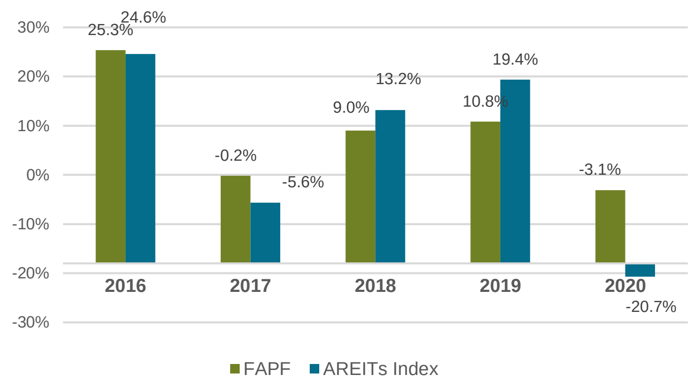
Since Inception Return



Sector Allocation



Financial Year Returns



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Quarterly Commentary

The Freehold Australian Property Fund increased by 1.9% during the quarter, albeit returns were volatile due to significant movements in bond yields, given their high correlation. The bond sell-off was severe, with 10-year bond yields almost doubling from 0.97% at the end of December to 1.79% by the end of March. A faster than expected global recovery was the catalyst, fuelling inflationary fears across the market. This also, in turn, underpinned equity markets, sparking a rotation out of defensive and growth / technology sectors into value and cyclical companies.

The March quarter was dominated by reporting season, where companies provided investors with a snapshot of where their respective businesses are positioned as the economy slowly reopens following the COVID-19 pandemic. The performance of respective asset classes was mixed. The tailwinds underpinning industrial property were evident, demonstrating strong cash collection and unabated investor demand fuelling asset price growth. In contrast, discretionary retail landlords continue to confront the structural challenges confronting the asset class. Anecdotal evidence suggests a resetting of rents within regional malls is playing out to ensure the long-term viability of its tenants.

Commercial office markets are perhaps the most polarising in the market at present, with opinions mixed as to future business accommodation needs. That said, a number of direct market transactions have taken place validating book values and providing confidence in asset valuations. Whilst we can see short-term headwinds such as increasing vacancy rates putting downward pressure on rents, we believe there is a current dislocation between private market pricing and publicly listed REITs. In our view, the publicly listed office REITs screen cheap on a comparative basis and we have positioned the Fund accordingly, which to date has assisted performance.

The listed infrastructure sector was impacted even more severely than listed property due to the bond sell-off. At an operational level, toll road traffic is recovering from COVID-19 impacts and there are green shoots within the airline industry, however a full recovery still appears to be a long way off.

Outlook

Co-ordinated global stimulus continues to support markets and investment outcomes. That said, longer-term structural shifts to employment and consumer spending habits are still playing out, which are crucial to framing our investment decisions going forward. We anticipate our investment landscape could be influenced by corporate activity over the remainder of the calendar year, which may serve to underpin asset valuations and Fund performance.

Stock in focus – Vicinity Centres

Vicinity Centres (VCX.ASX) is one of Australia's largest pure play listed retail property groups with $24bn of assets under management across the full spectrum of retail offerings, albeit with a strong bias towards major regional and CBD centres. Whilst longer term structural issues confronting traditional bricks and mortar retail have been playing out, the onset of COVID-19 proved a significant setback for Vicinity, given its concentrated exposure in Melbourne, high-end and CBD retail; being the three most impacted retail sub-sectors.

During the year, the Vicinity undertook a $1.4bn capital raising to support its balance sheet and offset significant asset write-downs exceeding $2Bn across its portfolio. Whilst gearing at a headline level has been brought down to a manageable 25% level, the threat of further asset write-downs remains. This is because we are yet to see a significant direct market transaction occur, which, when it does will set a new benchmark for asset pricing. We expect price discovery to occur this year and believe the full impact of asset price erosion is yet to be fully reflected in the Group's share price, which is currently trading at a 20% discount to the Group's net tangible asset position.

Just recently, the Group placed three of its Sydney CBD assets on the market. Once highly productive centres, these assets have felt the brunt of COVID-19 impacts and the transaction will be viewed as a true litmus test for this asset class.

Despite a stated occupancy rate of 98%, cash collection over the first 6 months of FY21 stands at just 72% of gross billings. While this has slowly been increasing, the expiry of JobKeeper stimulus measures and the SME Code of Conduct, whereby landlords were enforced to collaboratively 'share the pain' with their tenants has now expired in all states, placing further strain on tenants. The stress on specialty retailers is playing out in declining rents, where new rental agreements are being struck at an average decline of 12.6% versus passing rents.

Despite owning some of the best shopping centres in Australia, we believe the market does not fully grasp the structural headwinds facing the Group's total portfolio. As negotiating power has shifted to favour tenants versus landlords, we anticipate continued pressure on earnings and occupancy and continue to maintain a significant underweight position within the Fund.

Source: Vicinity Direct Property Portfolio Handbook, December 2020

Listed Performance Update

Contributors

CIP (overweight) – Centuria Industrial REIT benefited from very strong revaluation gains in March, reflecting strong investor demand for the industrial asset class.

DXS (overweight) – Dexus continues to move closer to acquiring the management rights of AMP Capital Diversified Property Fund (ADPF) which has over $5Bn of assets under management. The unitholder vote is late April, which, if successful would boost Dexus' funds management fees.

Detractors

COF (overweight) – Despite offering one of the highest dividend yields in the sector, the Centuria Office Fund has a number of lease expiries to manage in challenging market conditions.

AST (not held) – AusNet Services successfully priced a EUR 700m hybrid security issue in the form of non-convertible subordinated notes with a 60-year maturity and 1.625% fixed rate.

Current & Active Weights

Asset Class	Benchmark	Range	Current	Active Weight
A-REITs	35%	20%-100%	40.5%	5.5%
Listed Infrastructure	15%	0%–60%	16.8%	1.8%
Unlisted Property	50%	0%-80%	39.0%	(11.0%)
Cash	0%	0%-20%	3.7%	3.7%

Top 6 Portfolio Positions

Security	Portfolio Weight	Sector
Scentre Group	9.6%	Retail
Transurban Group	9.0%	Infrastructure
Dexus	8.7%	Office
Mentmore Property Unit Trust	6.1%	Office
AMP Capital Wholesale Office Fund	5.9%	Office
Freehold Debt Income Fund	5.4%	Other

Unlisted Property Portfolio

Fund	Portfolio Weight	Sector Weight
Mentmore Property Unit Trust	6.1%	15.6%
AMP Capital Wholesale Office Fund	5.9%	15.2%
Freehold Debt Income Fund	5.4%	13.8%
Dexus Healthcare Wholesale Property Fund	3.6%	9.1%
8 Station Street Property Unit Trust	3.1%	8.0%
Charter Hall Core Plus Industrial Fund	2.9%	7.4%
Freehold Development Trust 2	2.7%	6.9%
AMP Capital Diversified Infrastructure Trust	2.3%	5.9%
Westpac House Investment Trust 1	1.9%	4.8%
Jade Development Fund No.1	1.4%	3.6%
Investa Commercial Property Fund	1.1%	2.9%
Caboolture Retail Trust	1.0%	2.5%
Freehold Development Trust 3	0.7%	1.8%
Alceon UPG No.2 Trust	0.6%	1.5%
Perth Rail Link Property Trust	0.4%	1.0%
Micro Nest Holding Trust	0.0%	0.0%
TOTAL	**39.0%**	**100.0%**

Unlisted Portfolio Update

EPGMA: The Eagle Property Group Mentmore Property Trust was established to hold an asset we acquired as a value-add opportunity. The 5-level office building in South Sydney at 55 Mentmore Avenue, Rosebery was acquired for approximately $30 million from a private investor who had purchased the property after the GFC. The 5,316sqm building is located at the prominent corner of Mentmore Avenue and Morley Avenues and sits on a large 2,931sqm site directly opposite the destinational retail offering, The Cannery. The office space offers a Net Lettable Area of 5,316sqm with 50 basement and 10 on-grade parking spaces. Advanced discussions are progressing with a potential tenant for the whole building as well as continuing with a multi-tenant solution should the current discussions cease.

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 established an Independent Advisory Committee with three members to advise on recommendations to any transaction that impacts management rights or units in AWOF. We expect this to play out in coming months.

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 (98%) 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.

DHWPF: The Dexus Healthcare Fund has finally reached practical completion at its North Shore Health Hub which is exciting for investors. The Fund undertook a capital raising in the March quarter and has grown its assets under management to approximately $1bn.

EPG8SS: The Eagle Property Group, 8 Station St Wollongong asset is 100% leased to the Department of Defense on a 10-year lease until 1 January 2030 with 8.75 years remaining. The development application for the cladding replacement works with a non-combustible material was lodged with council and has now been approved. A section of earth behind one of the car park retaining walls has come down, likely caused by tree roots from a neighbouring tree. A proposal for the repair has been received with works to commence in the near term. An updated valuation will be obtained for the end of the financial year.

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. During the quarter, Charter Hall announced the acquisition of a 50% interest in two Aldi regional distribution centres for $140m, subject to a 7-year triple net sale and leaseback arrangement on a blended passing yield of 4.62%. The acquired assets have sufficient capacity to service Aldi's forecast growth profile in Victoria and Queensland for the next decade.

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. 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. While the DA remains outstanding, we have accepted an offer for the Oakville site which is due to settle in May and will see approximately half of investor capital returned. The Vineyard site has had approximately 60% of land classified as 'open space' meaning the council will purchase this land from us based on agreed rates. This will leave approximately 16 individual sites to develop or to sell in a single line to a developer.

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.

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. The Fund successfully undertook a capital raise via the issuance of Resettable Preference Units (RPUs) to replace an existing bank facility and fund its ongoing capex programme. Leasing is the priority, and the Fund has done a deal with medical technology firm LBT Innovations to lease the Delmont Building (830sqm).

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. The asset continues to perform well with a further term-out expected in calendar year 2021.

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. During the quarter, the Fund sold its 25% interest in 400 George St, Sydney to an existing investor at book value with the proceeds to be used to reduce gearing and potentially satisfy redemption requests.

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 where distributions have recommenced following the initial Covid impact. K-Mart has confirmed they will vacate with several options to replace them currently underway, where lease terms would be superior to those with K-mart. The asset will now be held for a longer period to see through the re-leasing.

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. All lots have been sold except for two basin lots which the council require to be held until their own permanent stormwater basin is completed. Debt has been fully repaid and approximately 15% of investor capital has been returned. We are working towards winding up the Fund within the next quarter, which includes finding a solution for the sale of the basin lots.

AUPG No. 2 Trust: The Trust provides debt finance to a substantially de-risked master-planned residential development project located in Sydney's fast-growing Marsden Park. The project comprises a mix of affordable townhouses, houses and low-rise apartments, and is being delivered by Universal Property Group.

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 continues to be delayed as a result of COVID-19 with a further campaign to offshore buyers likely to occur in calendar year 2021.

MicroNest: The Micronest Holding Trust is being wound up following the sale of the underlying asset in Ashfield. Other than a small residual for wind up costs, all proceeds have now been returned to investors.

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	Weekly
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

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