

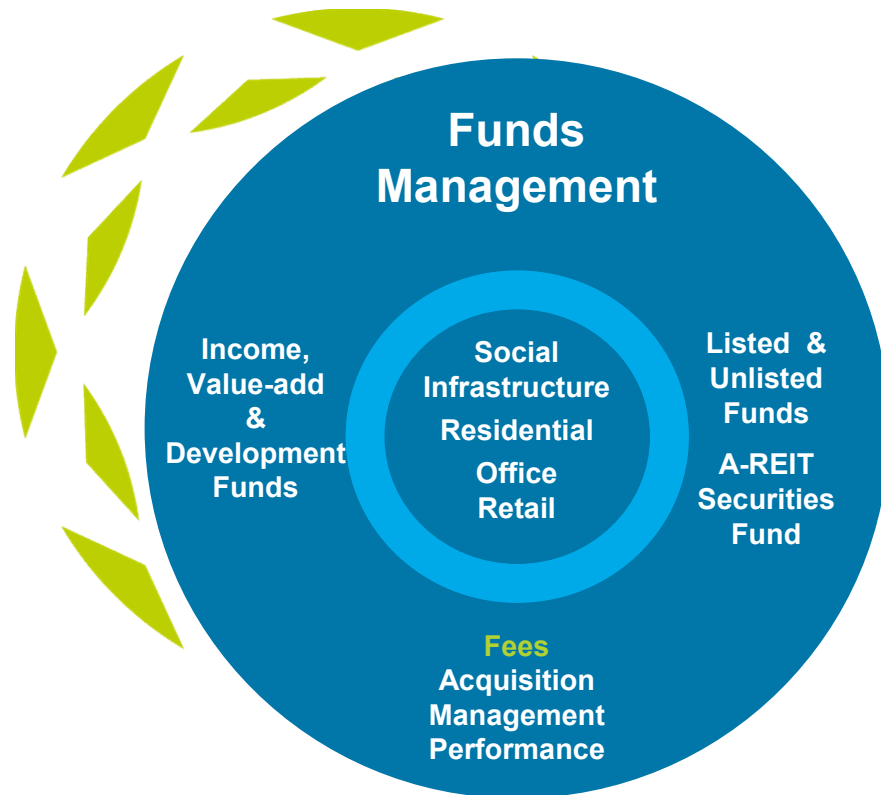
# Real Estate Cycles – Latest Trends and Emerging Opportunities



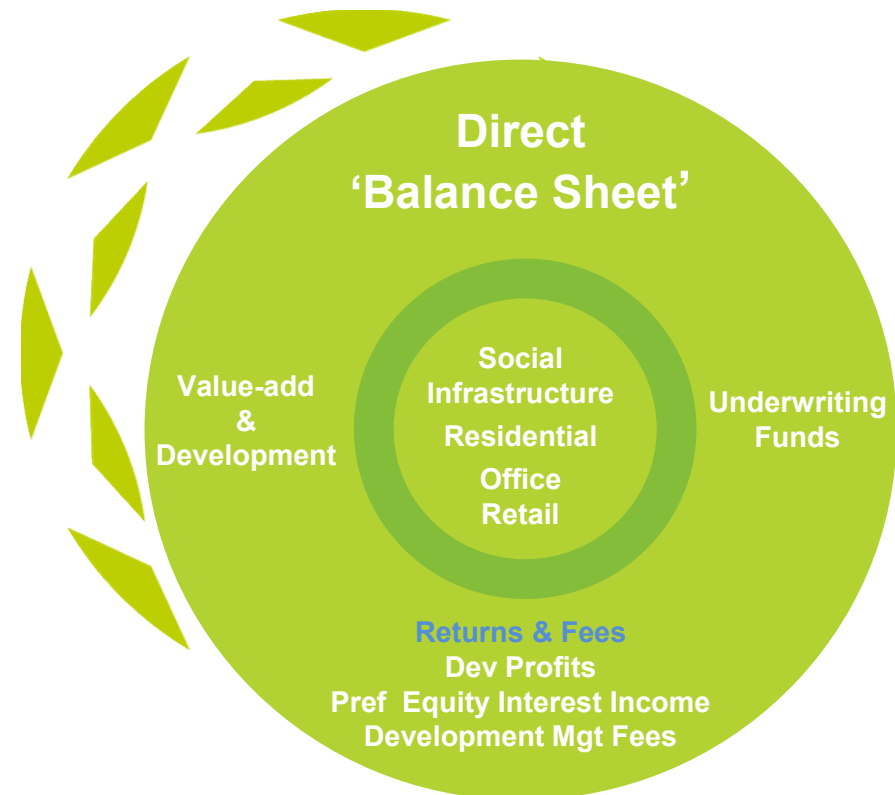
Folkestone

# FOLKESTONE OVERVIEW

AN ASX LISTED REAL ESTATE FUND MANAGER AND DEVELOPER  
PROVIDING REAL ESTATE WEALTH SOLUTIONS FOR  
PRIVATE CLIENTS AND SELECT INSTITUTIONS



Offers listed and unlisted real estate funds to private clients and select institutional investors  
\$1.2 billion in funds under management<sup>1</sup>



On balance sheet activities focus on value-add and opportunistic (development) investments  
Market capitalisation of \$143 million<sup>1</sup>

<sup>1</sup> As at June 2017.

# FUNDS MANAGEMENT



## Public Markets

### Equity (Listed)

#### Listed A-REITs

- Folkestone Education Trust (ASX: FET)

#### A-REIT Securities Funds

- Folkestone Maxim A-REIT Securities Fund & SMA

## \$1.2 BILLION IN FUM AND 7,500 INVESTORS<sup>1</sup>

- A menu of real estate funds across:
  - public (listed) and private (unlisted) markets, debt and equity to meet the various risk/return requirements of our clients
  - sectors - office, retail, residential and social infrastructure
  - private clients and select institutions



## Private Markets

### Equity (Private Funds)

#### Income Funds

- Altona North
- CIB
- Sydney Olympic Park
- Wollongong

#### Development Funds

- Truganina
- Wollert

#### Seniors Living Funds

- Seniors Living No. 1



<sup>1</sup> As at June 2017 and includes Folkestone and all its funds.



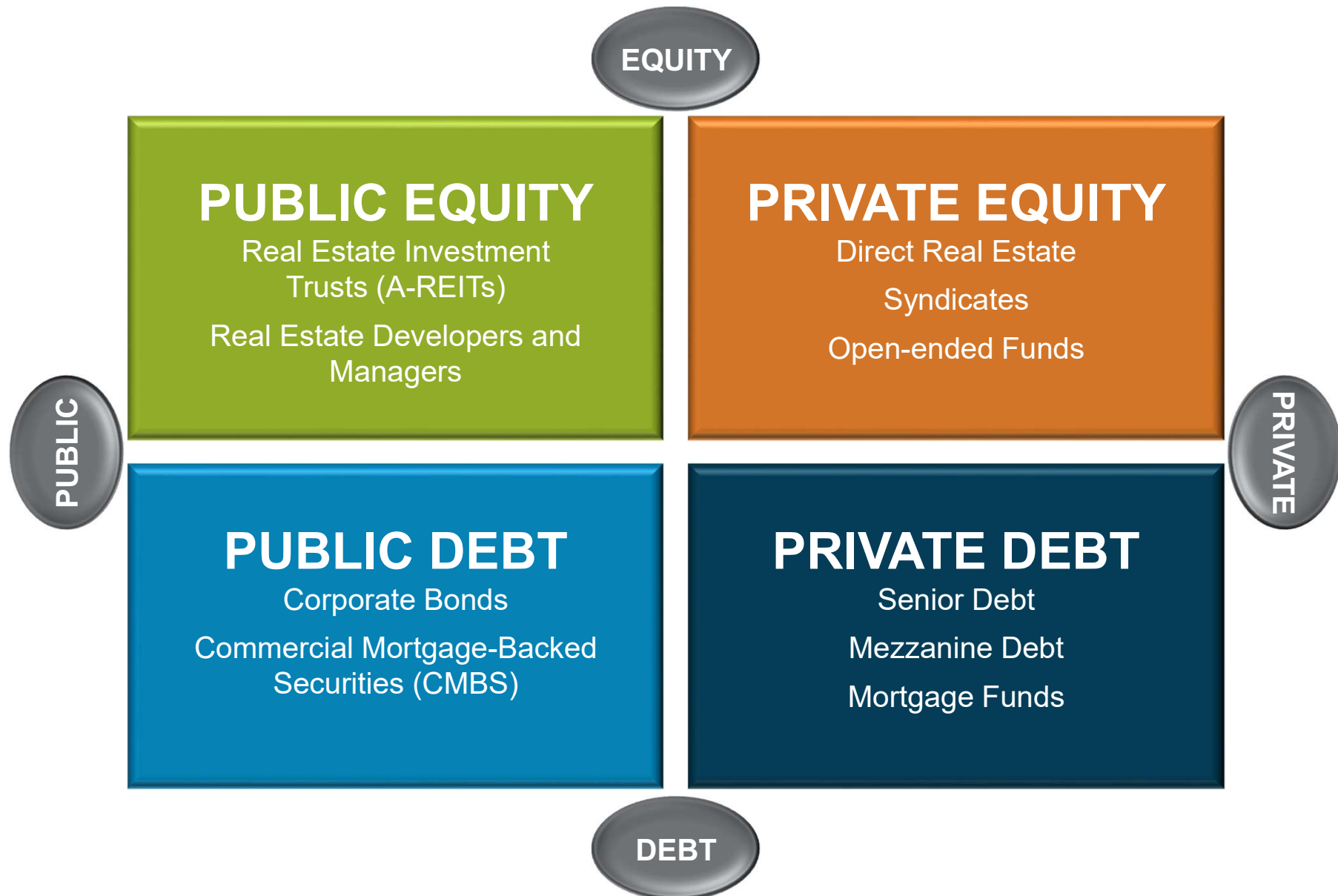
# PROPERTY MARKET OUTLOOK



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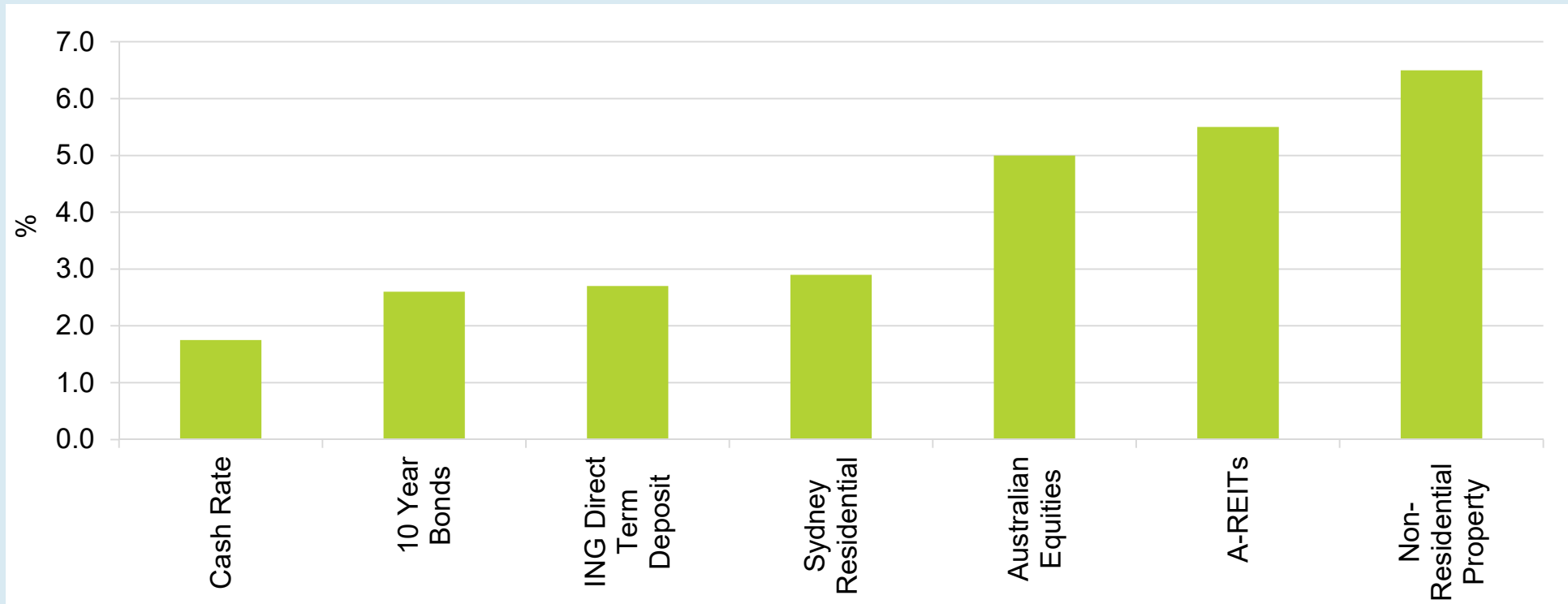
Sydney Olympic Park, NSW – an asset of the Folkestone Real Estate  
Income Fund at Sydney Olympic Park

# FOUR QUADRANT REAL ESTATE INVESTING



# THE SEARCH FOR YIELD

Investment Yields: May 2017



Source: Yield Report, Core Logic, RP Data, Credit Suisse, Folkestone

- Non-residential property and A-REITs provide an attractive yield relative to other investments

# POPULATION – GROWTH BY STATE

## Australian Population Growth by State: December 2016

	Population (m)	Growth in Year ('000)	% Change in Year
VIC	6.2	146.6	2.4
ACT	0.4	6.8	1.7
NSW	7.8	116.4	1.5
QLD	4.9	70.4	1.5
WA	2.6	16.8	0.7
SA	1.7	10.3	0.6
TAS	0.5	3.0	0.6
NT	0.2	0.6	0.3
<b>Australia</b>	<b>24.4</b>	<b>372.8</b>	<b>1.6</b>

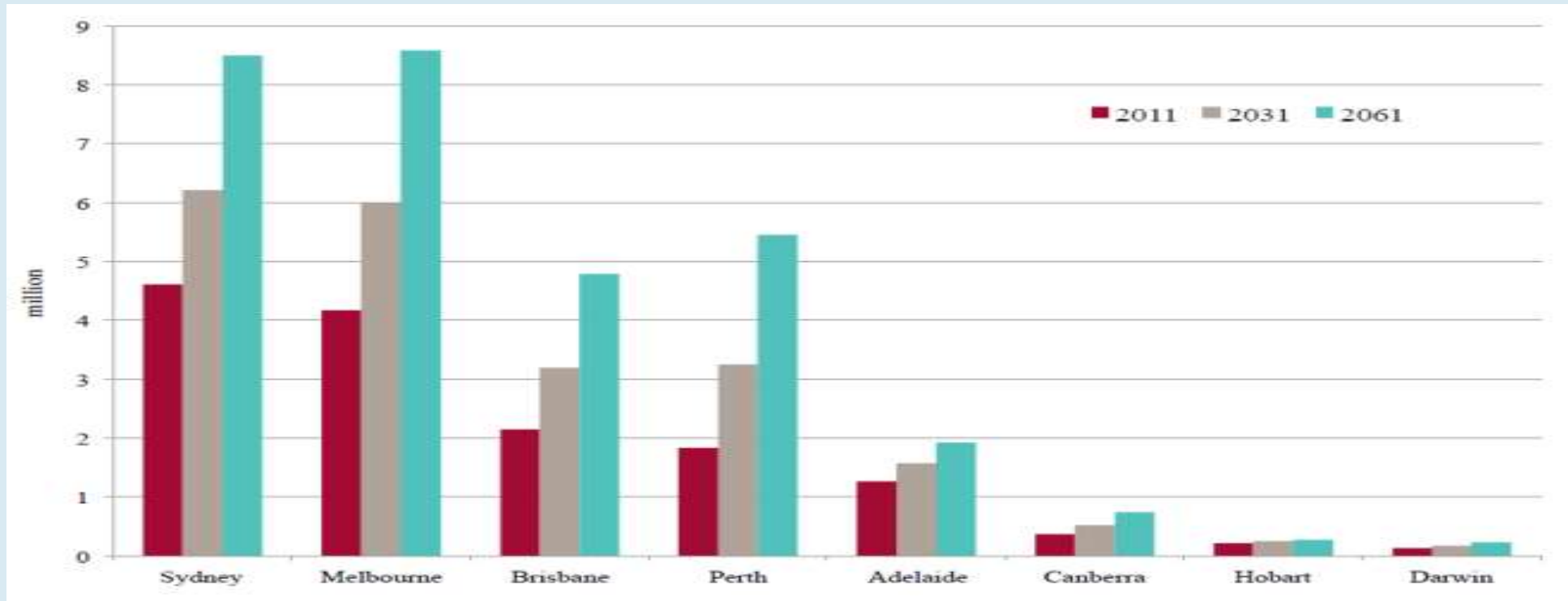
Source: ABS





# POPULATION – SYDNEY AND MELBOURNE TO BENEFIT

Population of Australia's Capital Cities: 2011 and Projected to 2031 and 2061



Source: Infrastructure Australia analysis of Australian Bureau of Statistics, 2013

**The growth of Australia's larger cities over the next two decades is expected to be faster than that of our smaller cities**



# POPULATION – OPPORTUNITIES FOR PROPERTY



&



- **Cities need to redefine themselves**

- the past - city borders forced outwards driven by influx of people and large blocks of land, large houses and backyards
- the future:
  - smaller blocks and houses creating more affordable housing
  - gentrification of inner and middle-ring suburbs
  - growth of inner-city apartment living driven by accessibility, affordability, smaller household sizes
  - retirees downsizing
  - growth of student market and medium density, transport orientated development

- **Regional cities will grow**

- centres close to major cities will prosper as feeder suburbs - Geelong, Bendigo, Wollongong, Newcastle and Gold Coast

- **Non-core real estate becomes core**

- growth in social infrastructure assets – childcare, medical, healthcare and seniors living
- seniors living will stretch from manufactured housing, ILU's to aged care – many of these will be integrated offering ageing in place

# GOVERNMENT CAPITAL – THE SPENDING DILEMMA

## Investing for Today



## Investing for Tomorrow

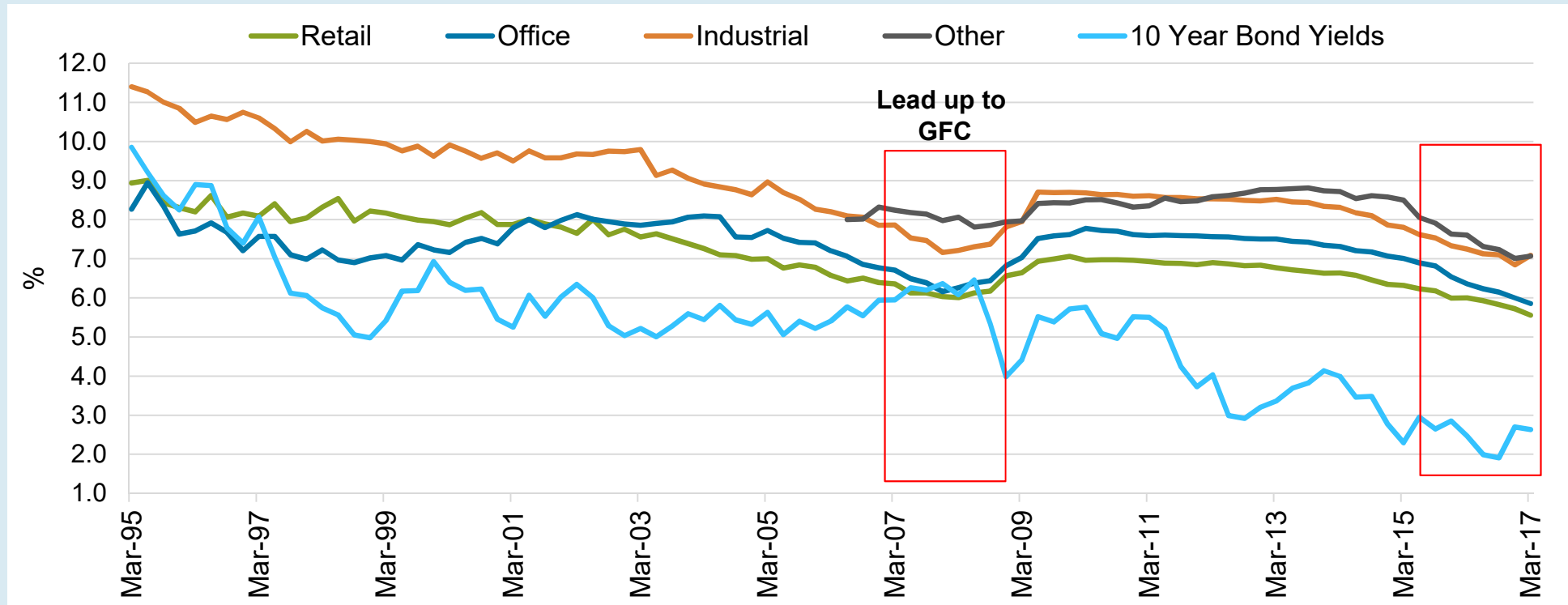


VS



# AUSTRALIAN MARKET CONDITIONS – CAP RATES (YIELDS)

Non-Residential Direct Property Sectors - Weighted Average Cap Rates: 1995 - 2017

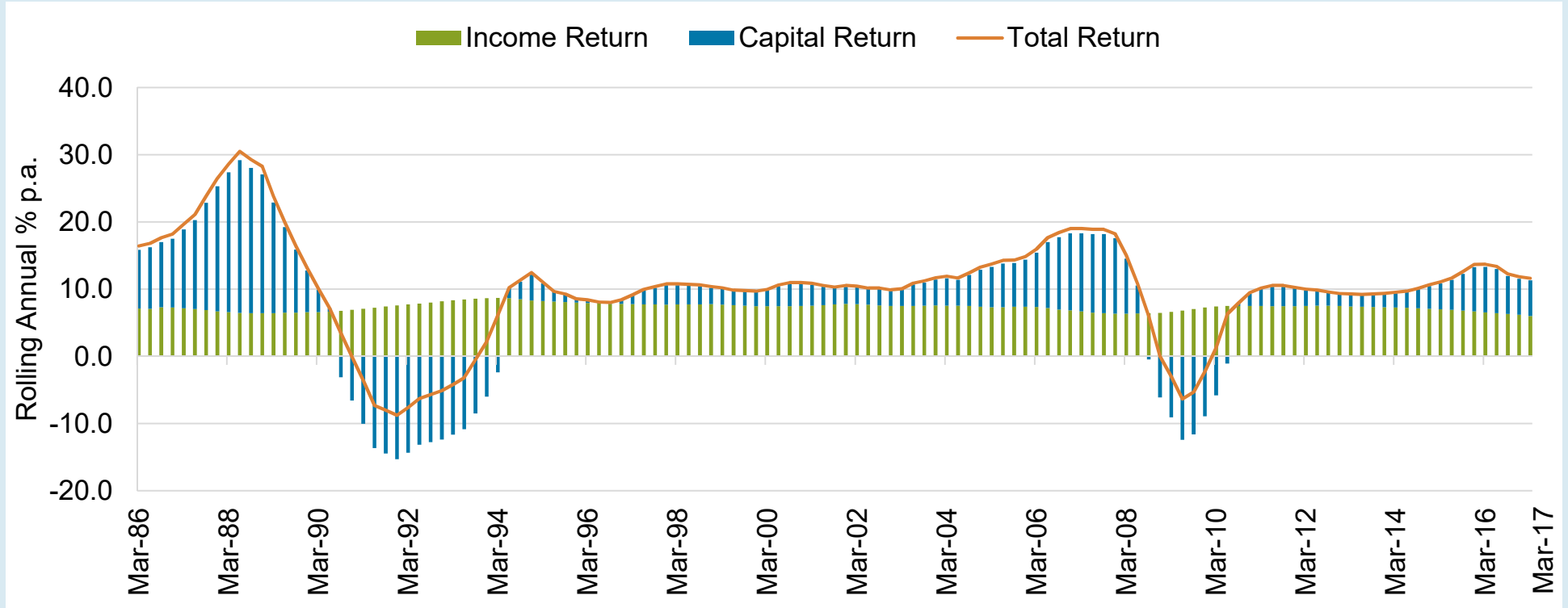


Source: MSCI / IPD

- Cap rates (yields) now lower than pre-GFC lows
- Driven by low interest rates weight of money chasing real estate – capital fundamentals running ahead of physical real estate fundamentals
- The relatively wide yield spread vs 10 year bonds appears attractive compared to 2007 when the yield spread evaporated

# NON-RESIDENTIAL REAL ESTATE RETURNS

Non-Residential Direct Property Returns: 1986 - 2017



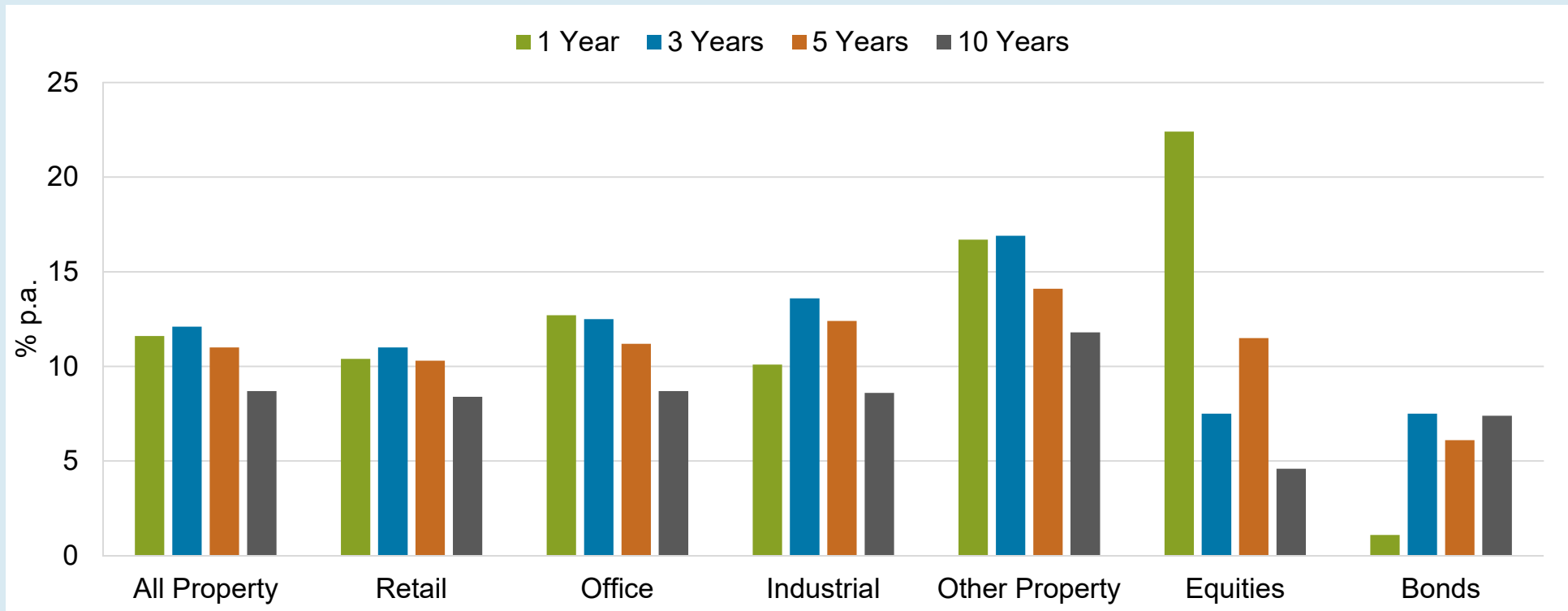
Source: MSCI / IPD

- Non-residential real estate has delivered:
  - relatively stable income returns over the past 25 years
  - a total return of 11.6% in the year to March 2017
  - a capital return of 5.3 year to March 2017 – values have moderated (6.8% in March 2016)



# NON-RESIDENTIAL REAL ESTATE RETURNS

Non Residential Real Estate Sectors vs Equities and Bonds – Total Returns: to March 2017

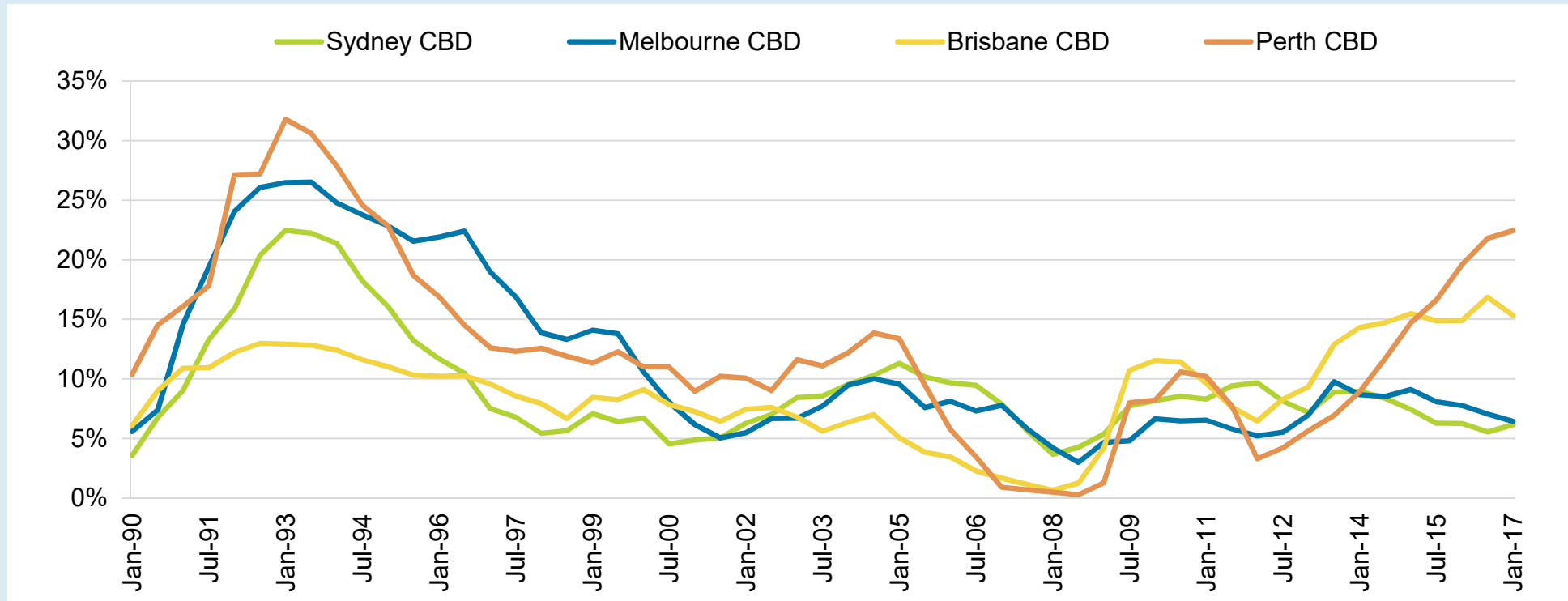


Source: MSCI / IPD

- Non-residential real estate outperformed equities and bonds
- Other property (hotels, healthcare, carparks etc.) was the best performing property sector with a total return of 16.7% for the year to March 2017

# OFFICE MARKET

CBD Total Vacancy: January 1990 to January 2017

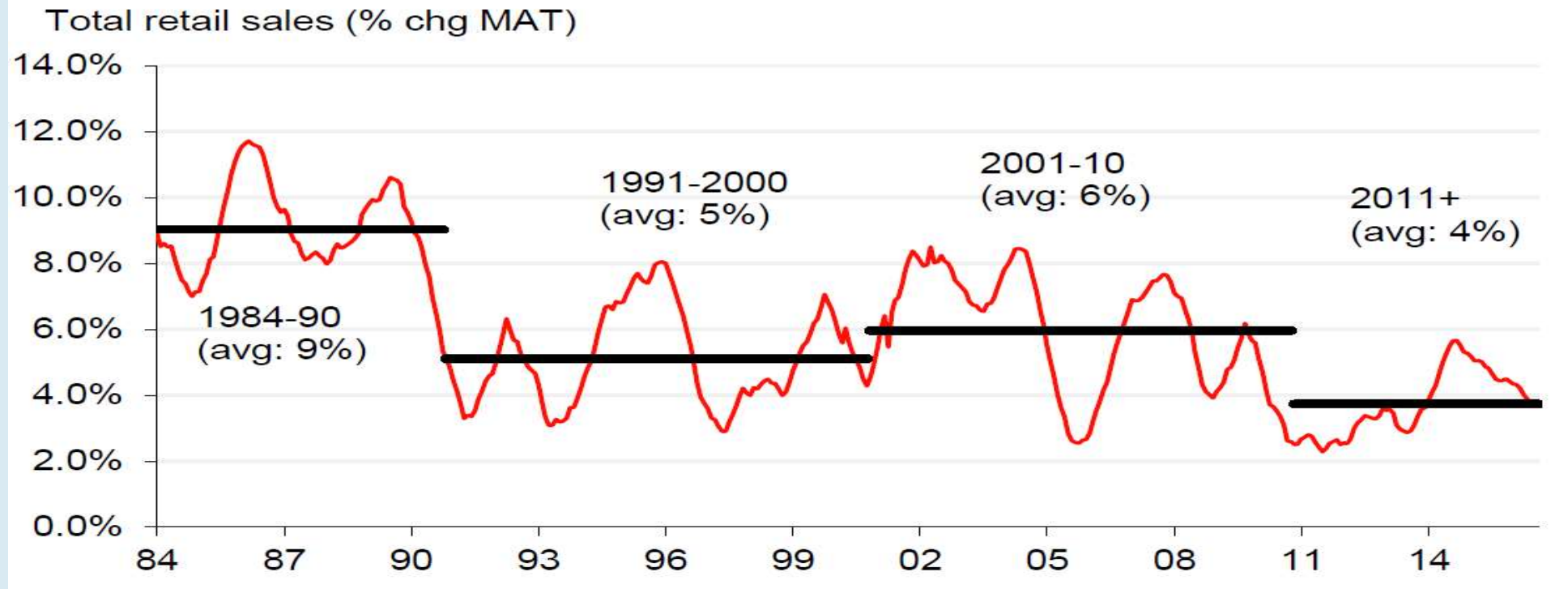


Source: Property Council of Australia

- Wide variation in CBD office vacancy rates between Sydney/Melbourne and Perth/Brisbane
- Not since 1991/1992 recession has there been such a wide variation
- Vacancy rates across most markets to trend down until 2020 driven by limited supply coming on line
- Sydney and Melbourne CBD recorded strong rent growth reflecting low vacancy, solid tenant demand and historically high stock withdrawals in Sydney CBD

# RETAIL MARKET

Retail Sales: 1984 - 2017

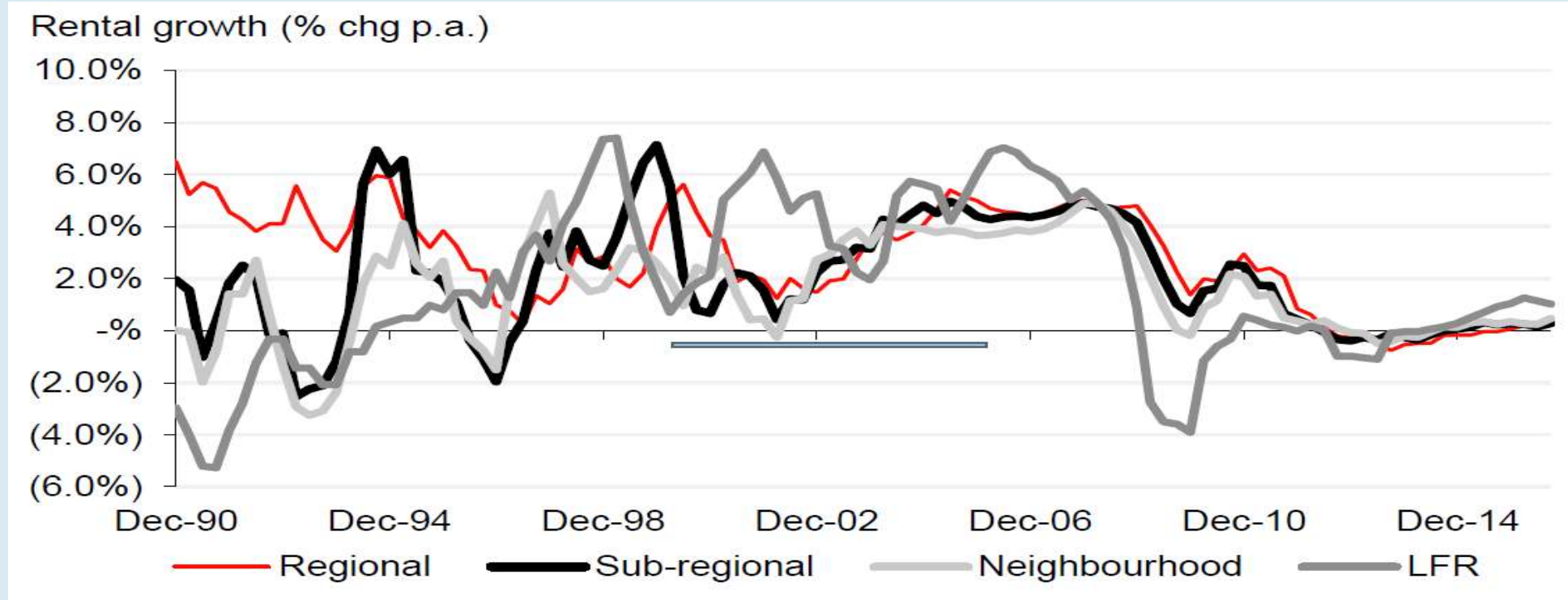


Source: ABS/Macquarie Research

- Retail sales losing momentum
- The retail environment remains highly competitive, with changing trends, more savvy consumers, competition from online shopping, people wanting more entertainment and lifestyle choices, as well as an influx of international retailers (i.e. H&M, Zara, Uniqlo and Top Shop)

# RETAIL MARKET

Specialty Rental Growth: 1990 – 2017



Source: ABS/Macquarie Research

- Speciality rental growth across all forms of retailing has slowed except in the large format retail sector which is being boosted by the residential building boom driving household goods spending



# TECHNOLOGY – CHANGING FACE OF RETAIL

*"Amazon in Australia, it is not going to be as easy as the US ... Most of the retailers there rolled over but they won't here."*  
– Gerry Harvey: Harvey Norman  
News.com.au 26/04/17

*"We have been expecting this for a long time. We have a healthy sense of paranoia. We are not complacent around the competitive risks."*  
– Rob Scott: Next CEO of Wesfamers,  
SMH 20/04/17

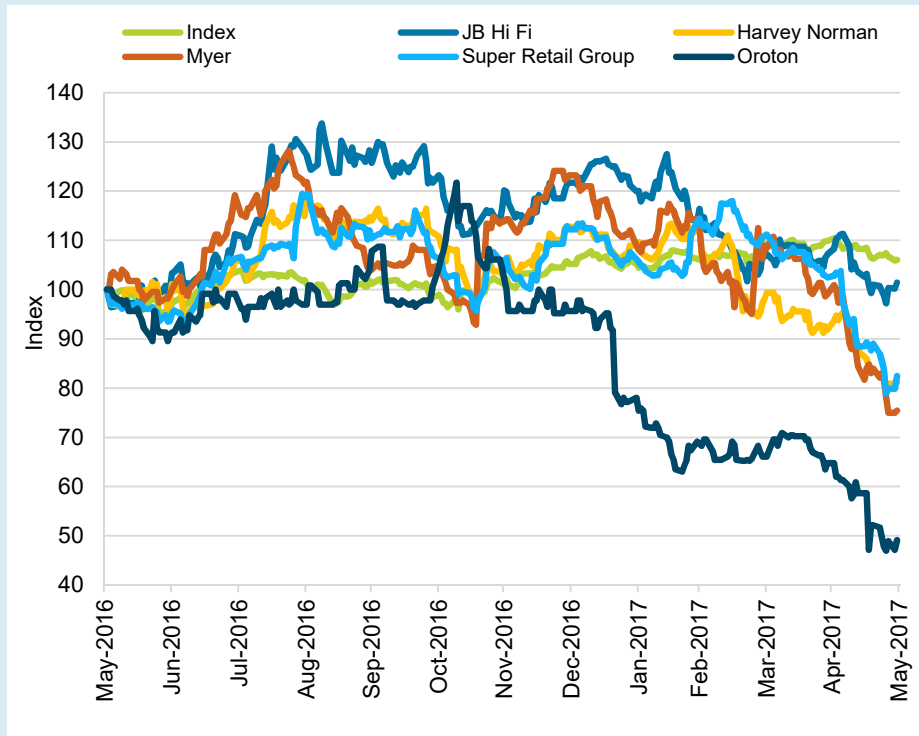
**Shopping centres need not be just a place of selling, but a place where the retail space is complemented by entertainment, cultural and community services. They need to become a community gathering place where people can shop, play and even work and live. In other words a community centre.**

**amazon.com<sup>®</sup>**



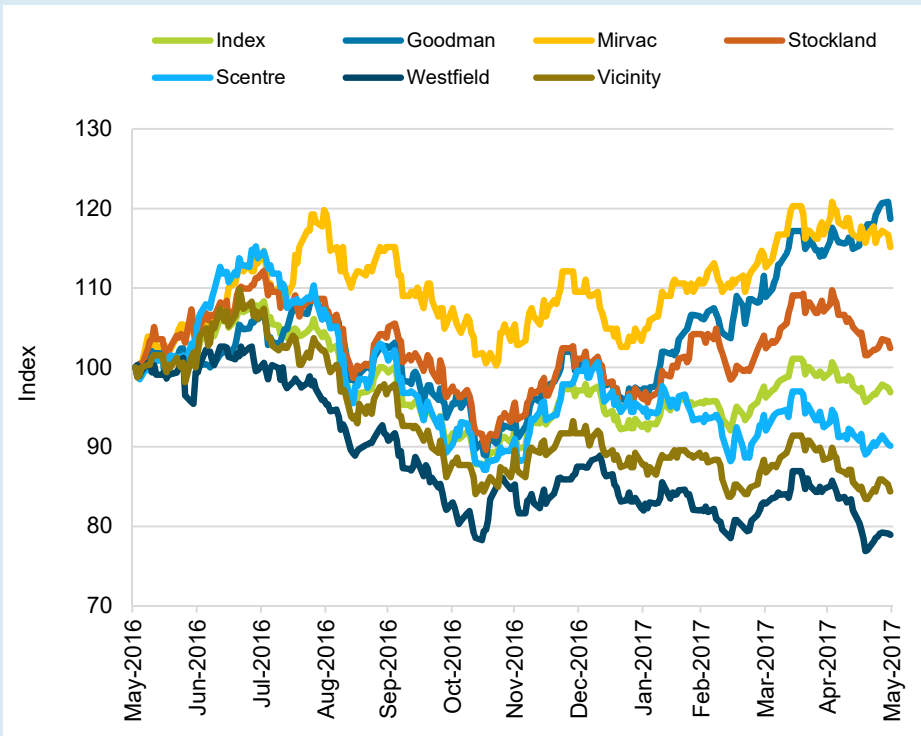
# TECHNOLOGY – CHANGING FACE OF RETAIL: LISTED RETAILERS AND RETAIL A-REITS

Performance of Listed Retailers:  
12 Months to 31 May 2017



Source: IRESS

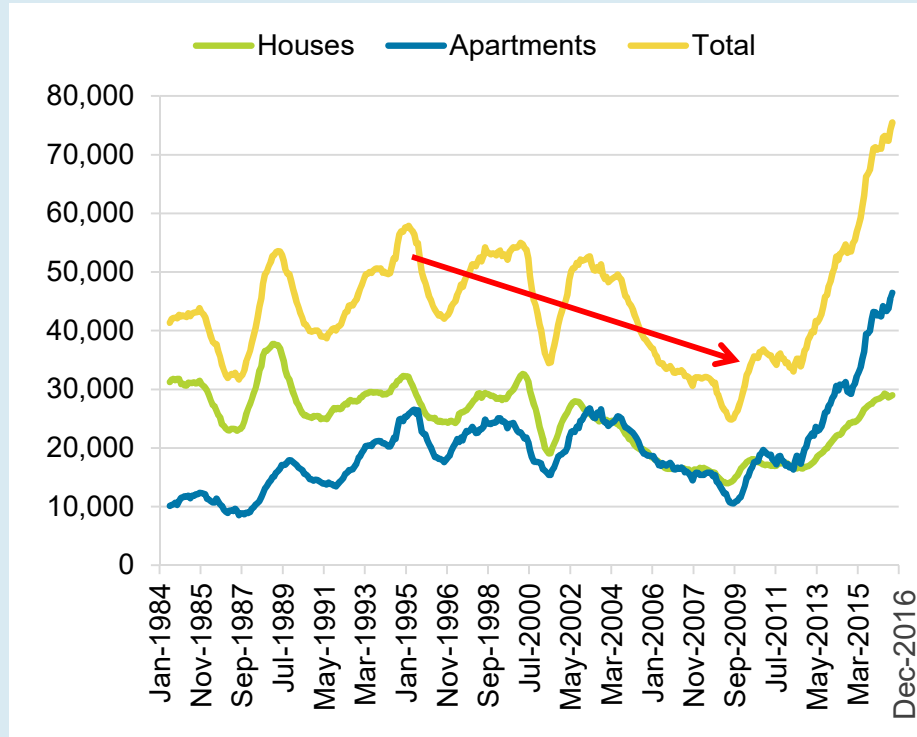
Performance of Listed A-REITs:  
12 Months to 31 May 2017



- Retailers and the listed retail A-REITs underperforming, as investors become increasingly concerned about how both components of the retail marketplace respond to the significant headwinds
- Given retail assets comprise more than 55% of the listed A-REIT sector, it is not surprising that the relative performance of the A-REIT sector has been impacted. Westfield, Vicinity and Scentre, the three largest retail A-REITs, have all significantly underperformed the Index in the past year
- Not all retailers and centres will survive the onslaught of Amazon, other online retailers and shifts in consumer preferences. The gap between the winners and losers will widen and picking winners will be lot more difficult

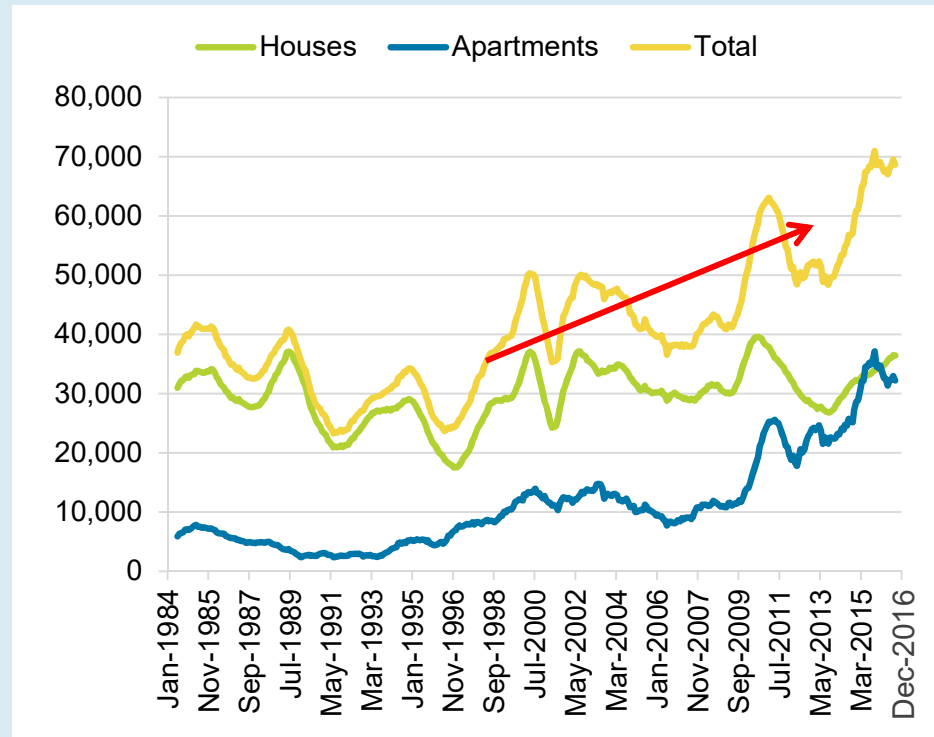
# RESIDENTIAL MARKET - APPROVALS

House and Apartment Approvals –  
NSW: 1984 – 2016



Source: ABS

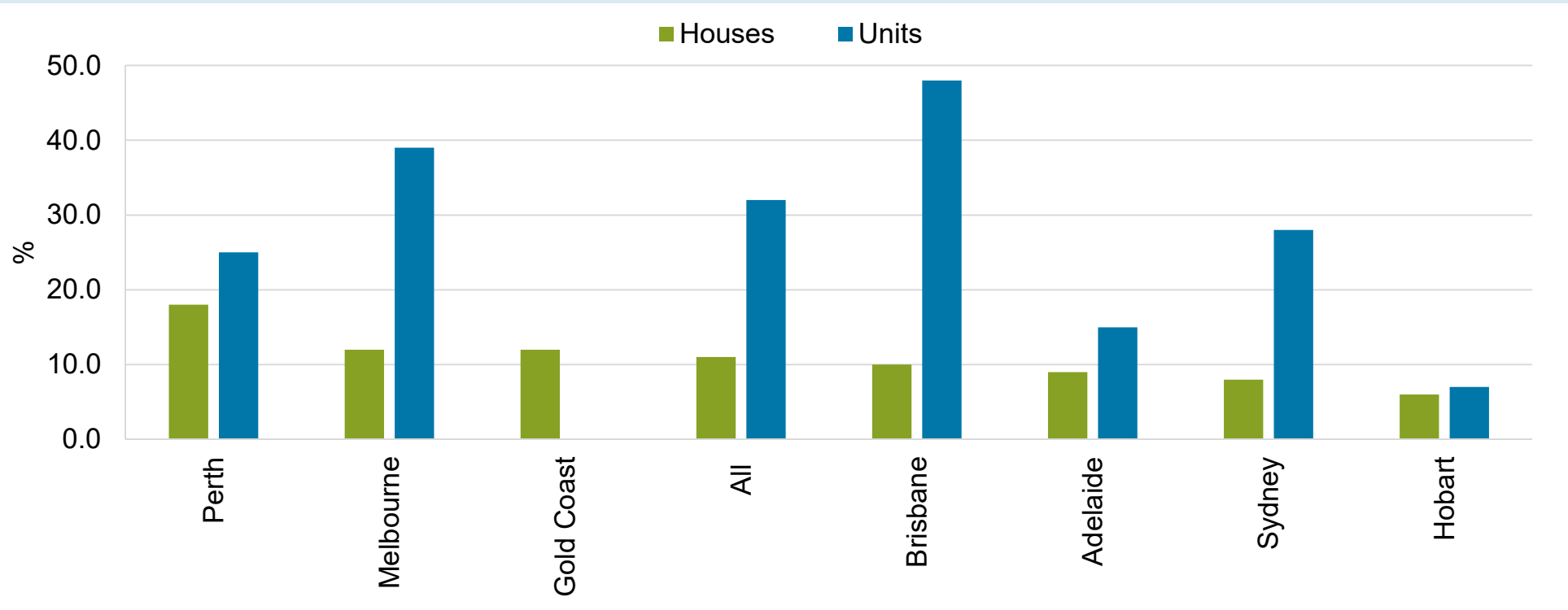
House and Apartment Approvals –  
Victoria: 1984 – 2016



- NSW approvals declined significantly between 2003 and 2008, but significantly picked up in past 4 years
- VIC approvals continue to run ahead of long-term average and also ahead of NSW – more efficient planning system
- Declining affordability, macro prudential controls on investor lending, concerns of oversupply in some sub-markets (Inner Melbourne, South Sydney), supply bottlenecks (Sydney planning) will see supply taper off into 2018, as approvals decline
- More even split between houses and apartments in VIC vs NSW, which continues to be slow in releasing land for houses

# RESIDENTIAL MARKET - APPROVALS

Building Approvals Over the Past Five Years as a % of the Housing Stock in 2017



Source: ABS, ANZ Research

- Recent boom in construction has added significantly to the supply of dwellings
- Strong growth in units/apartments – especially those in Melbourne and Brisbane, where over the past 5 years close to another 40% and 50% of the stock of units/apartments in 2011 has been approved
- Sydney's houses – small % of houses being built (a key reason that low supply in past 5 years has driven house prices up)



# RESIDENTIAL MARKET – HOUSING FINANCE

Housing Finance: 1992 - 2017



Source: ABS, ANZ Research

- APRA's macro prudential tightening announced in late March - measures and associated mortgage interest rate increases are likely to weigh more heavily on investor loans
- First home buyers continue to struggle – state and Federal Governments have announced housing affordability packages to assist first home buyers



# SOCIAL INFRASTRUCTURE



Folkestone



# REAL ESTATE SOCIAL INFRASTRUCTURE GOES CORE

- **Types of real estate social infrastructure**
  - education – early learning, schools, tertiary/vocational, student accommodation
  - health – medical, hospitals, specialist centres
  - seniors living – manufactured housing, retirement villages, aged care
  - social housing
  - transport – bus & train stations, park & rides, car parks
  - government accommodation – police stations, court houses, prisons, etc.
- **Benefits of real estate social infrastructure include**
  - longer leases than traditional real estate assets
  - net or triple net leases (operator/tenant pays outgoings)
  - secure (often government backed) cashflows
  - low correlation to other real estate and non-real estate assets
- **Drivers of demand for real estate social infrastructure**
  - demographic and social changes
  - governments looking to private sector funding
  - yields tend to be higher (although gap is narrowing)
  - some sectors have undersupply and/or existing stock is obsolete – opportunities to manufacture new product



# WHY RETIREMENT LIVING

## Demand

- Australia's population is ageing
- Affordability for some – frees up capital via downsizing
- Independent living in smaller facilities – easier and cost efficient to maintain
- Cultural shift with focus on lifestyle and community and social engagement
- Desire to age-in-place

## Supply

- Fragmented market
- Low penetration rate – supply to respond to growing penetration of retirement living communities as an acceptable seniors living product
- Quality of stock differs – opportunity to create modern facilities with a strong service offering – more than just a residential play





# FUTURE TRENDS - INDUSTRY

- **Retirement Village Trends**

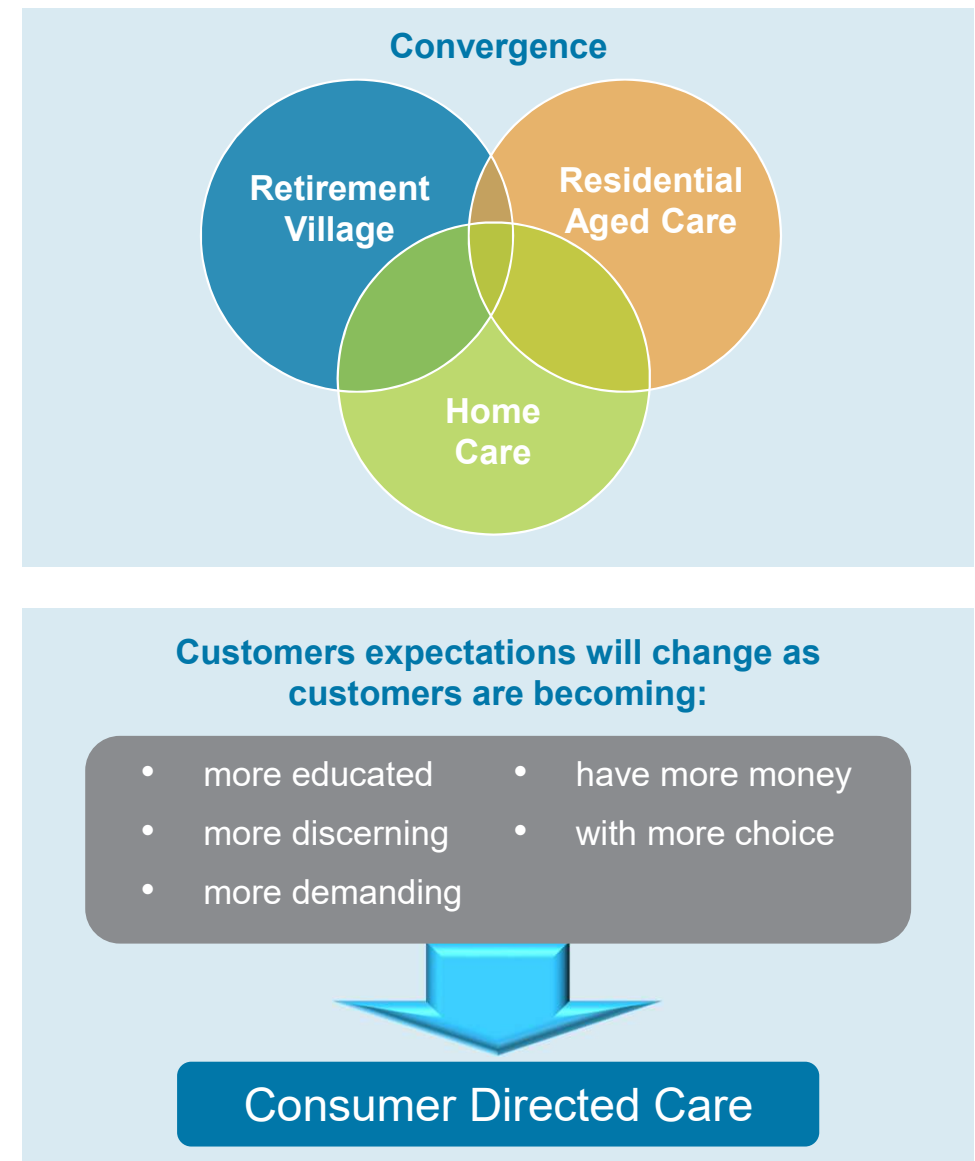
- sector consolidation – both for-profit and not-for-profit
- larger apartments and villas and larger developments
- more lifestyle facilities – pools, gyms, cafes and restaurants  
cinemas, day spas, mens sheds
- more vertical developments
- growth of the Manufactured Home Estate (MHE) sector
- increasing/harmonising State government regulation
- greater organisation and voice of consumer/resident lobby

- **Aged Care Trends**

- consolidation by well capitalised for-profit operators
- greater emphasis and funding on home care vs residential care
- move to CDC (Consumer Directed Care)
- Federal budget constraints putting more pressure on “user-pays”
- responding to emerging dementia epidemic
- greater focus on managing revenues and costs in a highly regulated sector

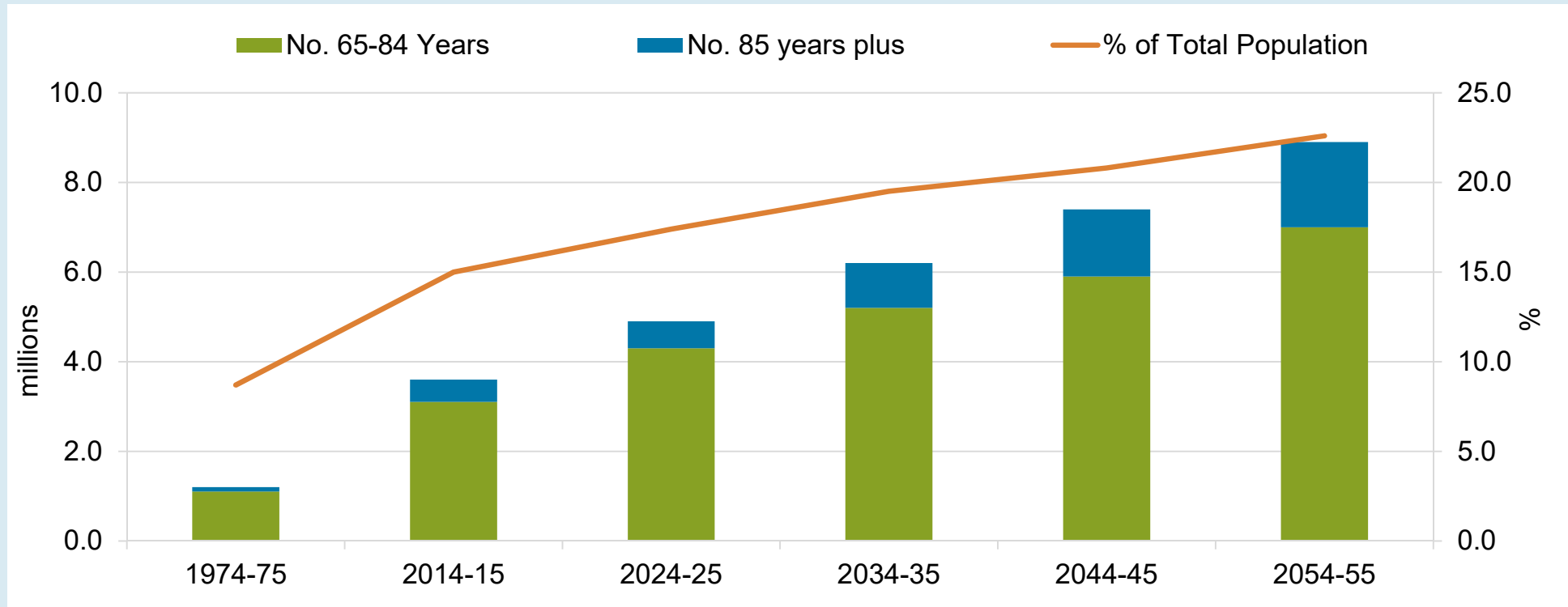
- **Convergence – Co-Location**

- greater focus on co-location of retirement villages and aged care and sharing of services
- supports the governments push for ageing in place
- delivery hubs for co-located community and providing services through home care to wider local community



# SOCIAL INFRASTRUCTURE – SENIORS LIVING

Australian Population >65 Years: 1975 - 2055



Source: ABS and Treasury Projections

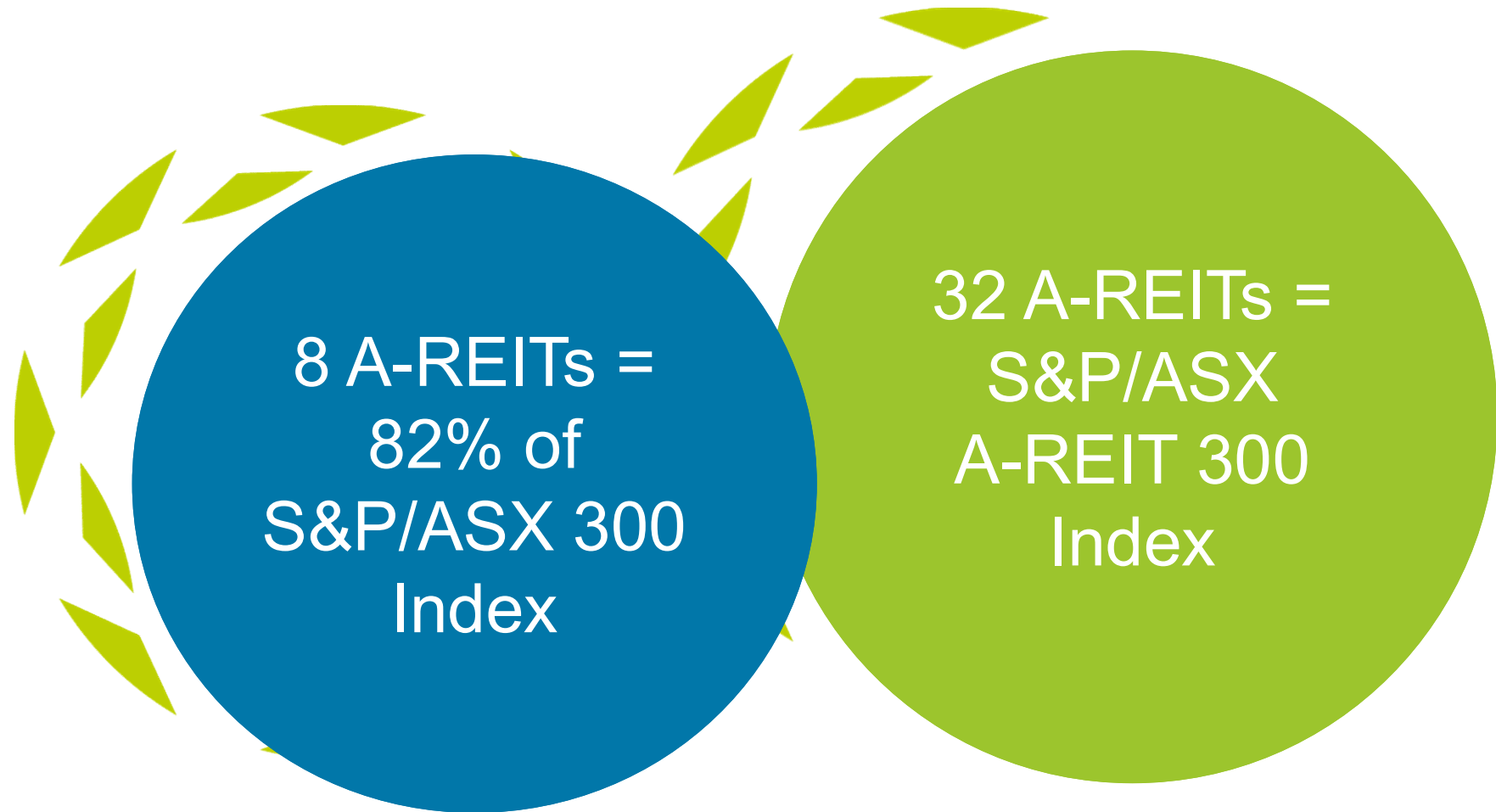
- Seniors living becoming key investment sector
- Strong demographics driving the demand for seniors living
- Sector undergoing significant transformation:
  - boutique, cottage industry to one of scale through consolidation
  - a shortage of quality accommodation driving innovation in product
  - recognition by institutional investors as a legitimate investment opportunity

# A-REIT SECTOR OUTLOOK



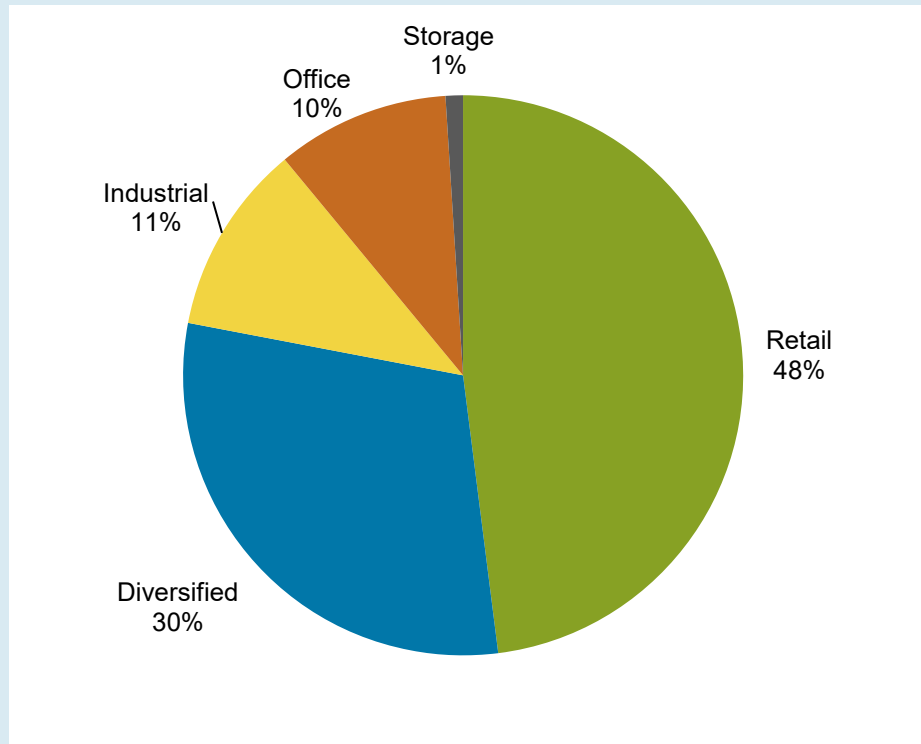
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# A-REIT INDEX - A HIGHLY CONCENTRATED BENCHMARK



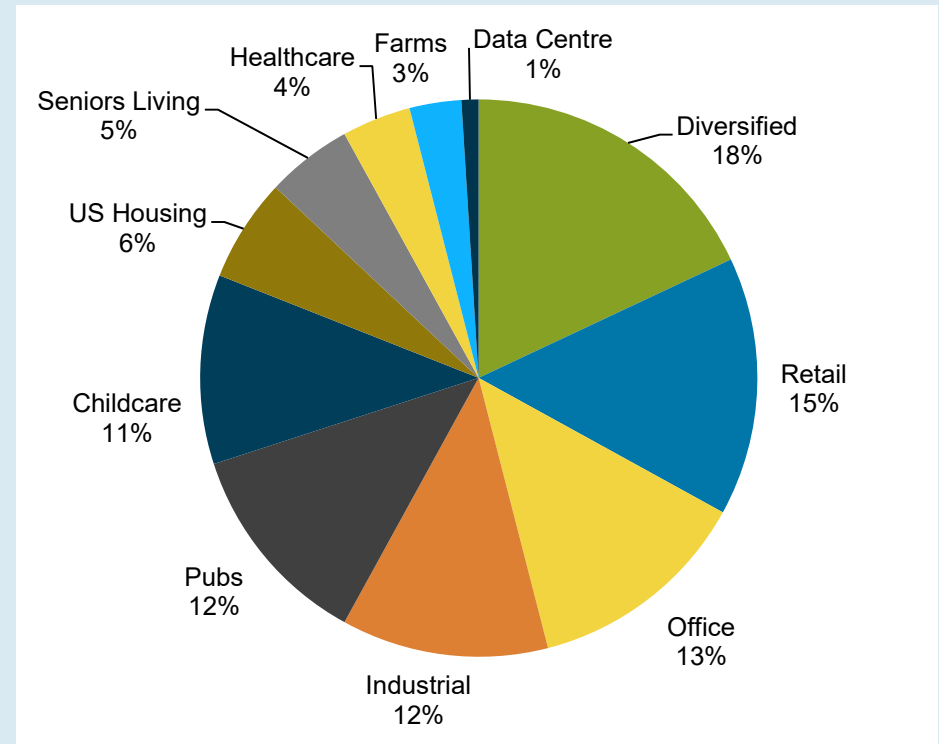
# A-REIT - SECTOR COMPOSITION

Composition of S&P/ASX 200 Index A-REITs:  
30 April 2017



Source: Petra Capital

Composition of Non S&P/ASX 200 Index A-REITs:  
30 April 2017



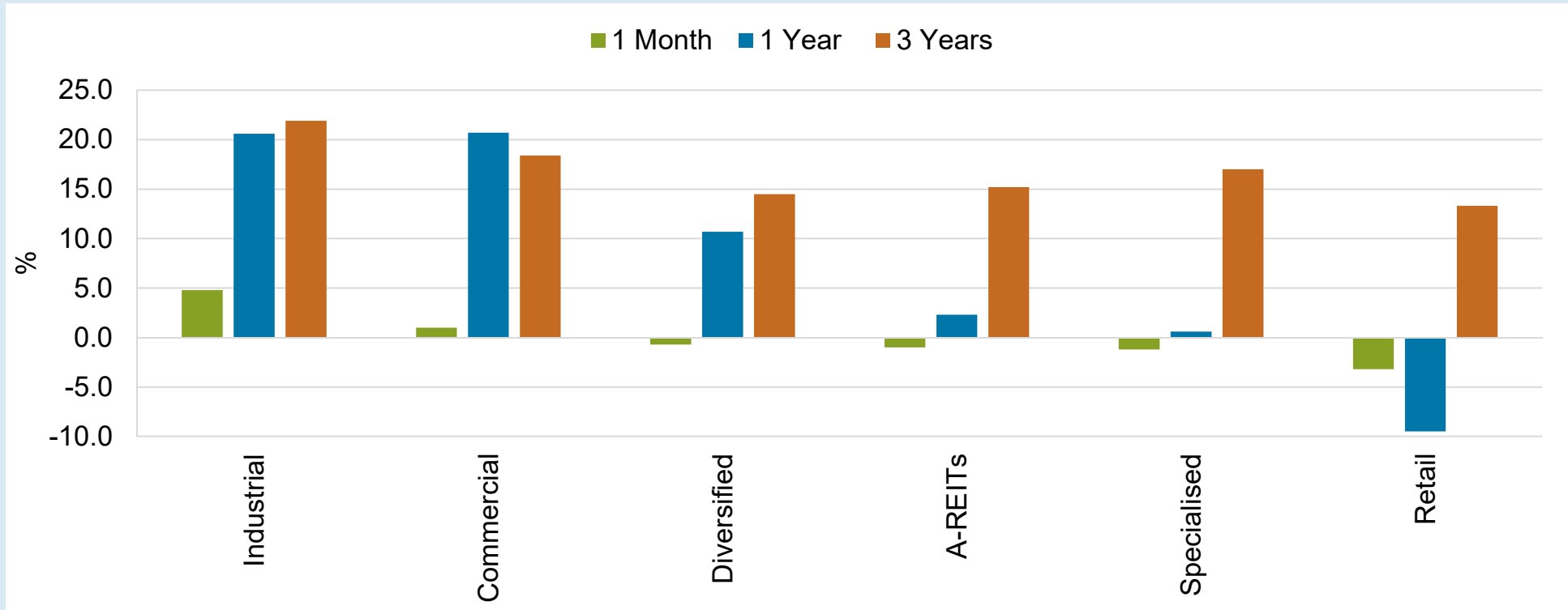
Source: Petra Capital

- Traditionally, the A-REIT sector has focused on core sectors – office, retail and industrial which comprise 90% plus of the sector's market cap
- Broader sector diversity and more non-core sectors outside of the S&P/ASX 200 Index



# A-REIT – VARIATION OF PERFORMANCE ACROSS SECTORS

A-REIT Sectors - Total Returns: To 30 May 2017

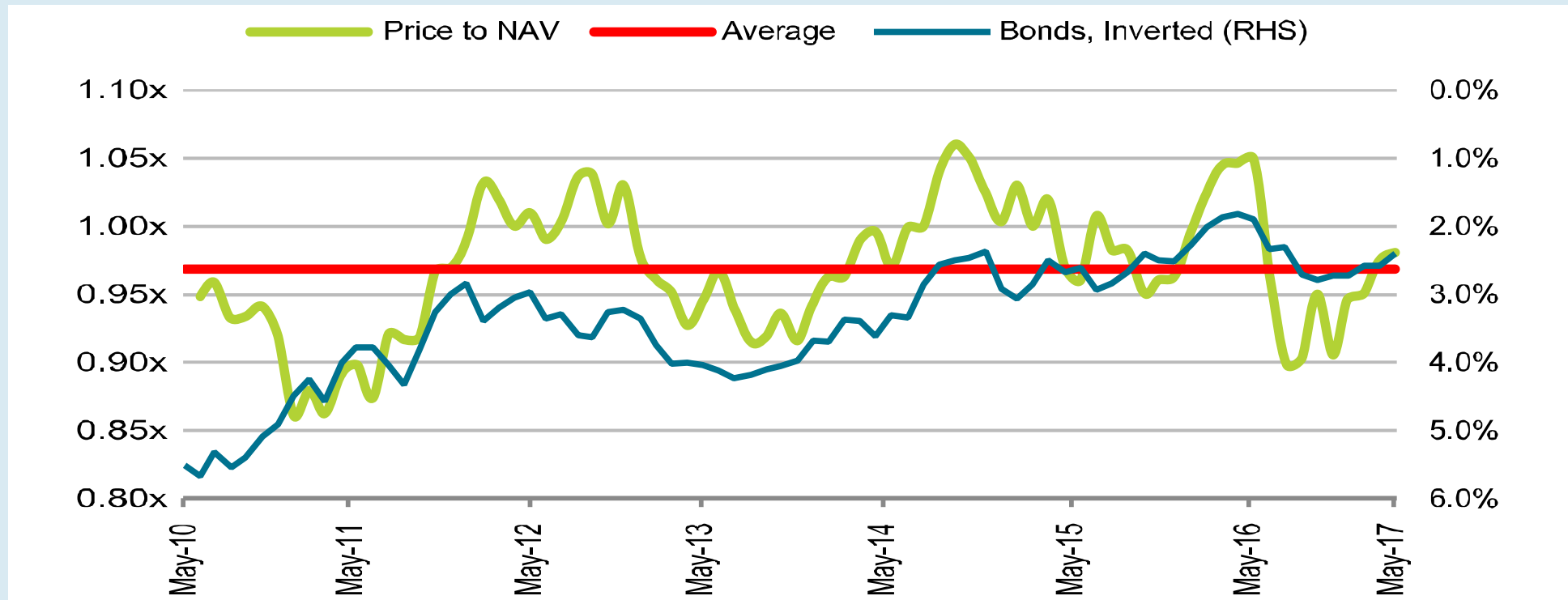


Source: ABS

- A-REIT sub-sector performance shows variation over different timeframes
- Commercial and Industrial were the best performers in the past year – driven by high office exposure of Dexu and IOF to the improving Sydney and Melbourne CBDs and Goodman to the distribution / e-commerce market
- Retail has significantly underperformed due to concerns about the challenging retail environment

# A-REIT - VALUATIONS

A-REIT Price to NAV vs. 10y Bonds: 31 May 2017

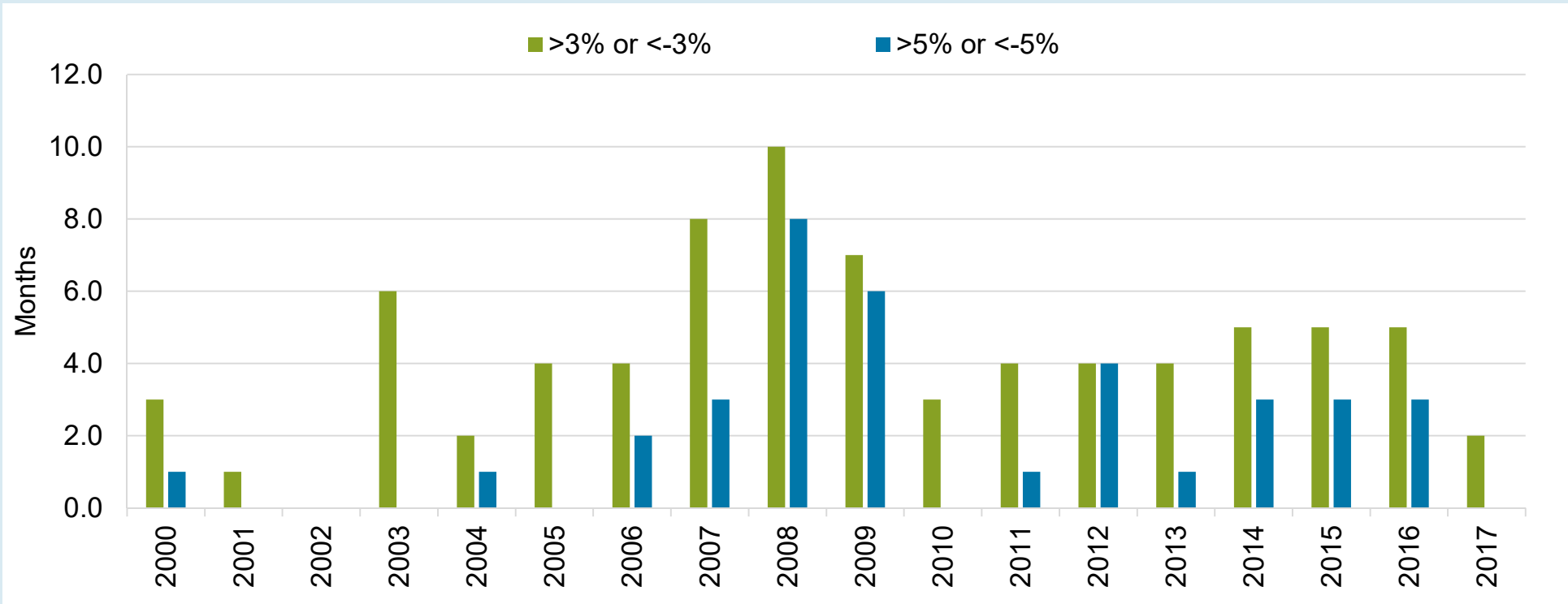


Source: Credit Suisse

- A-REIT pricing is fair at present
- A-REITs currently trading on:
  - circa 27% premium to NTA versus 16% premium historically
  - circa 3% discount to NAV versus 3% discount historically

# A-REIT - RETURN VOLATILITY

A-REIT Return Volatility: 2000 – 2017

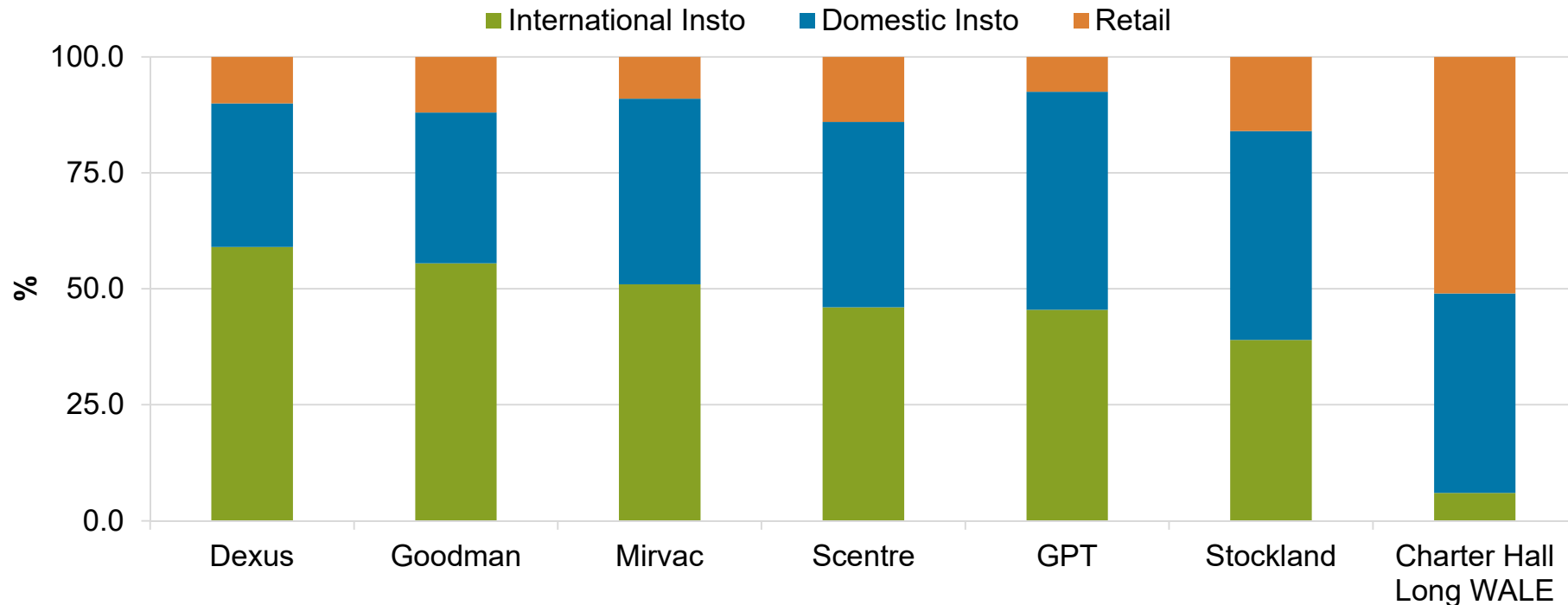


Source: IRESS

- the A-REIT sector's volatility has increased recently, but not back to the heightened levels of the GFC
- A-REITs investor base now more diversified - have different returns and time frame outlooks creating short term volatility:
  - A-REIT securities funds and global REIT securities funds
  - general equities
  - hedge funds (including shorters)
  - "mum and dad" investors

# A-REIT – OWNERSHIP

A-REIT Ownership (Register Split): December 2016

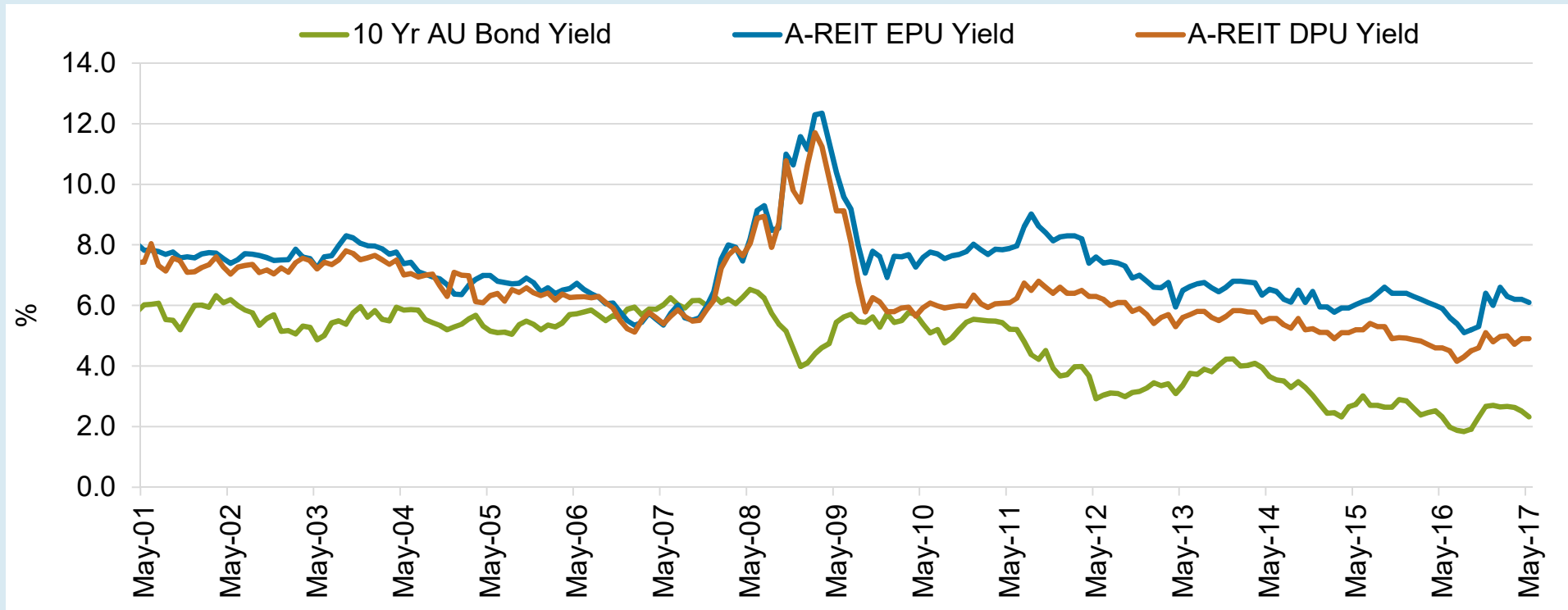


Source: Petra Capital

- On-going diversity of investor base – global institutions, hedge funds, pure equity funds which invest in the sector for different reasons and typically have shorter investment horizons than A-REIT securities funds creating mis-pricing opportunities
- Dexus and Goodman has the highest proportion of offshore institutional investors
- Charter Hall Long WALE REIT has the largest proportion of retail investors

# A-REIT VS BOND YIELDS

A-REIT Sector EPS and DPS Yields Vs. 10 Year Australian Bond Yields: May 2001 – May 2017



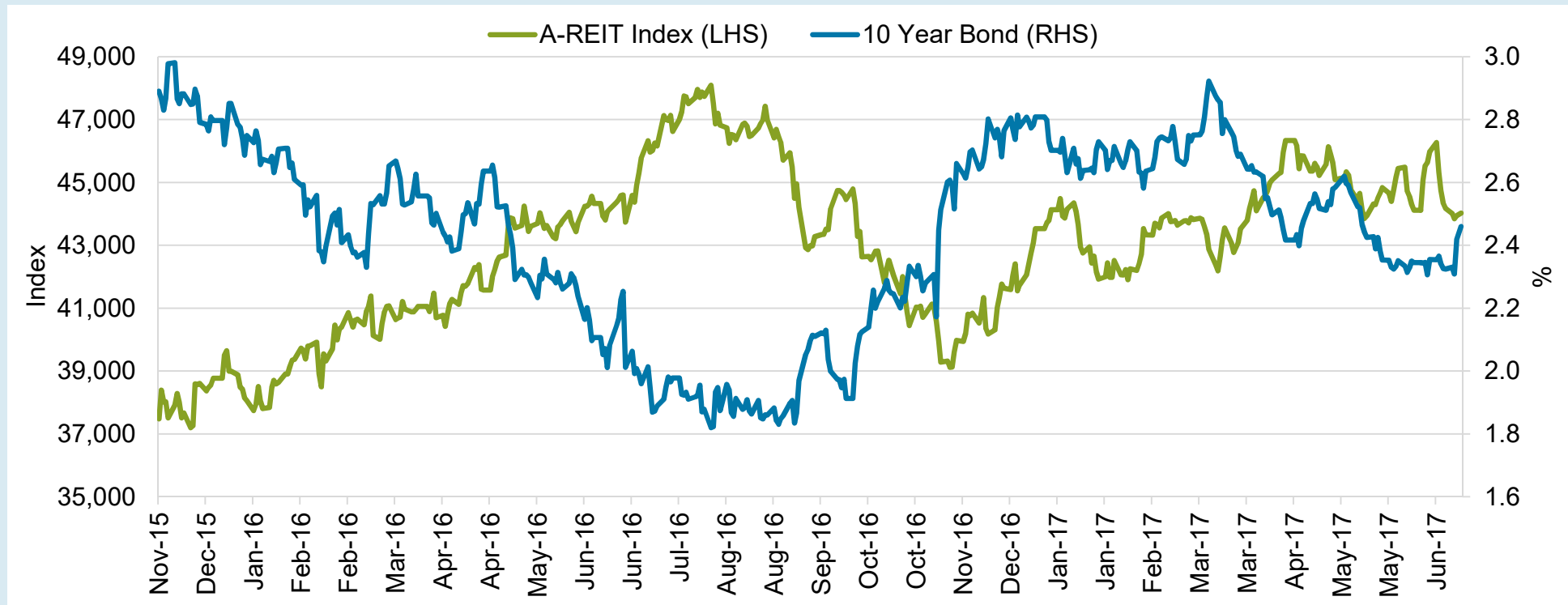
Source: Bloomberg

- A-REITs yield has fallen in recent years as bond yields have fallen
- still wide spread between average A-REIT EPU (362 bps) and DPU (230 bps) and 10 year bonds yield



# A-REIT VS BOND YIELDS

10 Year Bond Yields & A-REIT Sector Total Return: November 2015 to June 2017



Source: IRESS

- A-REITs have strong negative correlation to 10 year bond yields in recent years
- A-REIT prices have been driven more by bond yield movements than other factors in past two years



# OUTLOOK

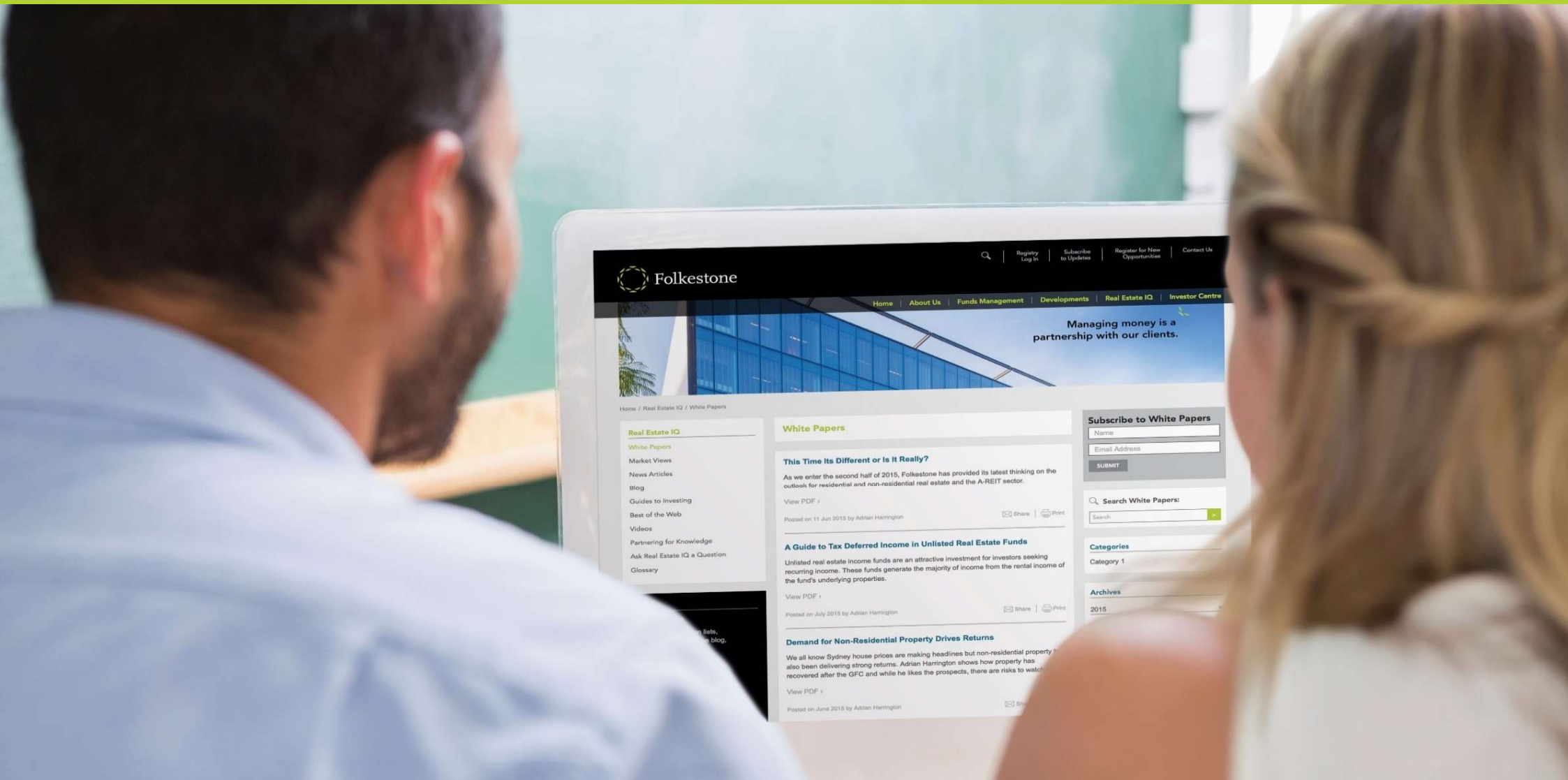


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# SUMMARY

- Divergence in performance between mining and non-mining states to widen
- 2017/2018 will be a challenging year to deploy capital
- Investors should focus on quality non-residential assets with secure income
- Residential property markets to cool but no major downturn anticipated except in certain sub-markets like inner Brisbane and Melbourne apartments and some regional towns
- Real estate social infrastructure assets will continue to be in demand
- A-REITs will continue to prove popular as a safe haven in the equities markets but we expect short-term pricing volatility to continue

# REAL ESTATE IQ



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Visit: [www.folkestone.com.au/real-estate-iq/](http://www.folkestone.com.au/real-estate-iq/)



# DIRECTORY

## FOLKESTONE

ASX Code: FLK

Website: [www.folkestone.com.au](http://www.folkestone.com.au)

ABN: 21 004 715 226

Level 14, 357 Collins Street  
Melbourne VIC 3000  
T: +61 3 9046 9900

Level 10, 60 Carrington Street  
Sydney, NSW 2000  
T: +61 2 8667 2800

## INDEPENDENT BOARD OF DIRECTORS

Garry Sladden  
Non-Executive Chairman

Mark Baillie  
Non-Executive Deputy Chairman

Greg Paramor AO  
Managing Director

Ross Strang  
Non-Executive Director

## COMPANY SECRETARY

Scott Martin  
Telephone: +61 3 9046 9910

## INVESTOR RELATIONS

Lula Liossi  
Telephone: +61 3 9046 9946  
[liossi@folkestone.com.au](mailto:liossi@folkestone.com.au)

## REGISTRY

Boardroom Pty Limited  
P.O. Box R67, Royal Exchange NSW 1223

Telephone: 1300 737 760 or +61 2 9290 9600  
[enquiries@boardroomlimited.com.au](mailto:enquiries@boardroomlimited.com.au)  
[www.boardroomlimited.com.au](http://www.boardroomlimited.com.au)

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